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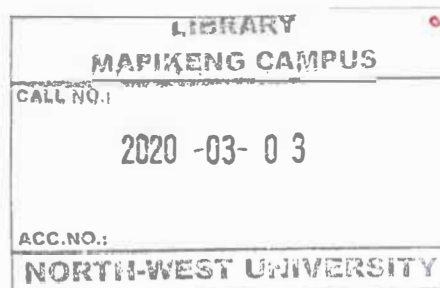
**The reliance on customer due diligence to enhance the  
combating of money laundering under the *Financial  
Intelligence Centre Amendment Act 1 of 2017***

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Dissertation submitted in fulfilment of the  
requirements for the degree  
Master of Laws in Mercantile Law  
at the North-West University

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Graduation ceremony: April 2019  
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### **SOLEMN DECLARATION**

I **Sharon Munedzi**, hereby declare that the Dissertation, entitled:**The Reliance on Customer Due Diligence to Enhance the Combating of Money Laundering under the Financial Intelligence Centre Amendment Act 1 of 2017**, is submitted in fulfillment of the requirements for the Master of Laws (LLM) degree is the product of my research and opinion with the exception of references of the sources acknowledged herein and that I have not at any prior time submitted it to any university or by any person for any qualification.

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Signed at NWU Mafikeng on this 30<sup>th</sup> day of November 2018

Declared before me on this 30<sup>th</sup> day of November 2018

Signature of Supervisor.....

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Special thanks to Reginald Tshepo for the moral support, prayers and believing in me. Thank you for me telling I could do this.

To my brother Asante Takunda who looks up to me, friends and family, thank you for the prayers and support.

## **DEDICATION**

To my brother, Asante Takunda

## ABSTRACT

Customer due diligence is a means of ensuring that financial institutions know their customers and customers are risk assessed before concluding any transactions with them. Customer due diligence measures include identification and verification of customer identity, keeping records of transactions concluded between a customer and the financial institution, ongoing monitoring of customer account activities, reporting unusual and suspicious transactions and risk assessment programmes. The regulation of anti-money laundering measures is crucial to the economic growth of many countries, including South Africa. However, there have been many challenges in the reliance on customer due diligence measures to combat money laundering in South Africa. The challenges include the failure to meet the identification and verification requirements by some South African citizens such that they are denied access to the formal financial sector and a lack of express provisions to regulate the informal financial sector by the *Financial Intelligence Centre Act* as amended. Accordingly, this research provides that South Africa should design measures that regulate the informal financial sector and context-sensitive customer due diligence measures that are applicable in South Africa without challenges. This approach could enable consistency in the application of customer due diligence measures in South Africa. In this regard, the researcher discusses the importance of consistently applying anti-money laundering laws to combat money laundering in South Africa.

**Keywords:** anti-money laundering; customer due diligence measures; high-risk customers; low-risk customers; financial institutions.

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## CHAPTER ONE

### RESEARCH OUTLINE

#### 1.1 Introduction

The *Financial Intelligence Centre Amendment Act*<sup>1</sup> regulates the duty to identify and verify the identity of customers before any transactions or business relationships may be concluded.<sup>2</sup> This duty came into effect on 30 June 2003<sup>3</sup> and has been put upon all financial institutions listed in the *Amendment Act*.<sup>4</sup> The duty to establish customer identification and verification of identity falls within the measures to combat money laundering in South Africa.<sup>5</sup>

Money laundering<sup>6</sup> can be defined as an activity which has or is likely to have the effect of concealing or disguising the nature, source, location, disposition or movement of the proceeds of unlawful activities or any interest which anyone has in such proceeds.<sup>7</sup> It includes any activity which constitutes an offence in terms of the *Amendment Act*<sup>8</sup> and the *Prevention of Organised Crime Act*.<sup>9</sup> For the purposes of this research, financial institution refers to a natural or legal person who as a business conducts, *inter alia*, deposit taking, money lending, money transfer service, issuing and managing means of payment, portfolio management and money and currency changing on behalf of a customer.<sup>10</sup> Customer due diligence is a means of ensuring that customers are risk assessed before conducting any transactions with them.<sup>11</sup> Customer due diligence and know your customer policy are the cornerstone of anti-money laundering programs in South Africa.<sup>12</sup> They are used by financial

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<sup>1</sup> 1 of 2017 (*Amendment Act*), sections 20A-21H.

<sup>2</sup> Sharrock R *Law of Banking and Payment in South Africa* (Juta Cape Town 2016) 101.

<sup>3</sup> De Koker L "Client Identification and Money Laundering Control: Perspectives on the Financial Intelligence Centre Act 38 of 2001" 2004 *TSAR* 715, 716.

<sup>4</sup> Schedule 1 of the *Amendment Act*.

<sup>5</sup> De Koker 2004 *TSAR* 716.

<sup>6</sup> Section 1 of the *Amendment Act*.

<sup>7</sup> Goredema C and Madzima J "An Assessment of the Links Between Corruption and the Implementation of Anti-Money Laundering Strategies and Measures in the ESAAMLG Region" *ESAAMLG Group* (18 May 2009) 8.

<sup>8</sup> Section 64 of the *Amendment Act*.

<sup>9</sup> Sections 4-6 of the *POCA*.

<sup>10</sup> Financial Action Task Force (FATF) "International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation" *FATF Recommendations* (February 2018) 115.

<sup>11</sup> Njotini MN *The Verification and Exchange of Customer Due Diligence (CDD) Data in Terms of the Financial Intelligence Centre Act 38 of 2001* (LLM – Dissertation University of South Africa 2009) 49.

<sup>12</sup> Njotini *Customer Due Diligence Data in Terms of the FICA* 49.

institutions to conduct background checks on customers before forming business relationships.<sup>13</sup>

South Africa is more susceptible to money laundering pressures because of its cash-based economy, characterised by corruption and fraud as the main proceeds-generating crimes.<sup>14</sup> By so doing, an effective anti-money laundering framework is not only a necessity but also a need to foster the combating of money laundering in South Africa. This need exacerbated post-apartheid when South Africa entered the international business community in 1994.<sup>15</sup> The increasing need was due to the pressure on South Africa to implement its anti-money laundering legislation in line with international standards such as the FATF recommendations.<sup>16</sup> Customer due diligence is one of the measures that have been implemented to combat money laundering in South Africa. However, it remains questionable whether the reliance on customer due diligence is what South Africa needs to curb money laundering.

The influence of international bodies such as the FATF and the Basel Committee enabled the adoption of anti-money laundering measures in South Africa.<sup>17</sup> The introduction and implementation of customer due diligence measures in South Africa also acknowledges the significance of the influence of the anti-money laundering laws of the United Kingdom (UK).<sup>18</sup> The challenges of relying on customer due diligence to combat money laundering in South Africa, the researcher concedes, can be identified by a comparative analysis of the UK anti-money laundering laws and the regulation of customer due diligence measures in South Africa.<sup>19</sup>

## **1.2 Background of the study**

Money laundering is mainly regulated in the *POCA*<sup>20</sup> and the *Financial Intelligence Centre Act*.<sup>21</sup> The *POCA*<sup>22</sup> was the first statute to provide a definition of money

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<sup>13</sup> De Koker 2004 *TSAR* 717.

<sup>14</sup> Sujee ZJ *A Study of the Anti-Money Laundering Framework in South Africa and the UK* (LLM-dissertation University of Pretoria 2016) 4.

<sup>15</sup> De Koker 2004 *TSAR* 720.

<sup>16</sup> Srivastava A, Simpson M and Moffat N *International Guide to Money Laundering Law and Practice* 5<sup>th</sup> ed (Bloomsbury Professional 2018) 1179.

<sup>17</sup> Shepherd KL "Guardians at the Gate: The Gatekeeper Initiative and the Risk-Based Approach for Transnational Laws" 2009 *Real Property, Trust and Estate Law Journal* 623, 625.

<sup>18</sup> Njotini *Customer Due Diligence Data in Terms of the FICA* 20.

<sup>19</sup> Shepherd 2009 *Real Property, Trust and Estate Law Journal* 623.

<sup>20</sup> 121 of 1998 (*POCA*), sections 4-6.

laundering offences. On the other hand, the *FICA*<sup>23</sup> established the Financial Intelligence Centre which became the leading structure in providing detailed money laundering control obligations for financial institutions. For the purposes of this research, the background of the reliance on customer due diligence to combat money laundering in South Africa is traced from 1992 to date.<sup>24</sup>

The *Drugs and Drug Trafficking Act*<sup>25</sup> was the first legislation to regulate money laundering in South Africa.<sup>26</sup> This Act was enacted in a bid to combat illicit financial crimes such as money laundering in South Africa. The *Drugs Act* regulated money laundering practices but its success was limited because it was more focused on drug-related crimes in South Africa.<sup>27</sup> In 1996, the *Proceeds of Crime Act*<sup>28</sup> was enacted and specified that money laundering arose from any gains from crime. This Act extended money laundering crimes to include proceeds of all crimes and regulated the confiscation of the proceeds on conviction.<sup>29</sup> The *Drugs Act* and the *Proceeds of Crimes Act* were repealed by the *POCA* in 1998, which combined all money laundering crimes into one Act.<sup>30</sup> The *POCA* contains provisions that criminalise money laundering.<sup>31</sup>

Until 2001 when the *FICA* was promulgated, there was no statutory regulation on the concept of customer due diligence in South Africa. Enactment of the *FICA* can be traced back to August 1996<sup>32</sup> when a Money Laundering Control Bill was published by the South African Law Commission.<sup>33</sup> The Bill had regulations and mechanisms

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<sup>21</sup> 38 of 2001 (*FICA*) as amended by the *Financial Intelligence Centre Amendment Act* 1 of 2017, section 21.

<sup>22</sup> Section 4 of the *POCA* provides, "Any person who knows or ought to have reasonably known that property forms part of proceeds from an unlawful activity but however engages, enters into an agreement or performs any act with such property in a manner that conceals the nature, source or location of the property shall be guilty of money laundering."

<sup>23</sup> Section 2 of the *FICA*.

<sup>24</sup> Ahlers C *The South African Anti-Money Laundering Regulatory Framework Relevant to Politically Exposed Persons* (MPhil in Fraud Risk Management-dissertation University of Pretoria 2013) 48.

<sup>25</sup> 140 of 1992 (*Drugs Act*), section 14.

<sup>26</sup> SujeeA *Study of the Anti-Money Laundering Framework in South Africa and the UK* 5.

<sup>27</sup> De Koker L "Money laundering: the South African Model" 2003 *Journal of Money Laundering Control* 166, 168.

<sup>28</sup> 76 of 1996, section 28.

<sup>29</sup> Sections 8-14 of the *Proceeds of Crime Act*.

<sup>30</sup> De Koker 2003 *Journal of Money Laundering Control* 166.

<sup>31</sup> Sections 4(a)-(b) of the *POCA*.

<sup>32</sup> De Koker 2003 *Journal of Money Laundering Control* 168.

<sup>33</sup> South African Law Commission "Money Laundering and Related Matters" *Discussion Paper* 64(08 July 1996).

of controlling money laundering but the government failed to take immediate action on it.<sup>34</sup> The *FICA* was enacted in 2001 and was used simultaneously with the *POCA* to combat money laundering in South Africa. Among other things, the anti-money laundering provisions obliged financial institutions to identify and verify customers whom they conducted business with.<sup>35</sup> Financial institutions were further required to keep records, client profiles and report any suspicious accounts.<sup>36</sup> This marked the first steps towards the reliance on customer due diligence to combat money laundering in South Africa.

The *FICA* stipulates that financial institutions may not enter or conclude business relationships unless the customer's identity has been established and verified.<sup>37</sup> This requirement applies even when a person is acting on behalf of another, both parties should be identified.<sup>38</sup> The duty to identify extends to the monitoring of the customer's source of funds to determine the consistency of the customer's transactions.<sup>39</sup> This helps financial institutions when grouping customers according to the money laundering risk they are likely to cause. To date, the *Amendment Act*<sup>40</sup> is the major statutory regulation tool that provides guidelines on how customer due diligence should be applied in the fight against money laundering. It also regulates how the reliance on customer due diligence can achieve the combating of money laundering in South Africa.

### **1.3 Statement of the problem**

Several countries have implemented statutory provisions that regulate money laundering.<sup>41</sup> In the past years, United Kingdom and South Africa have been designing laws to cultivate universal participation against money laundering.<sup>42</sup> On the same note, South Africa has adopted anti-money laundering laws and regulations influenced by international standards such as the Financial Action Task

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<sup>34</sup> De Koker 2003 *Journal of Money Laundering Control* 169.

<sup>35</sup> Section 21 of the *FICA*.

<sup>36</sup> Section 22A of the *Amendment Act*.

<sup>37</sup> Section 21 of the *FICA*.

<sup>38</sup> Sections 21(b)(i)-(ii) of the *FICA*.

<sup>39</sup> Section 21C(a)(i) of the *Amendment Act*.

<sup>40</sup> Section 21 of the *Amendment Act*.

<sup>41</sup> Mugarura N "Customer Due Diligence (CDD) Mandate and the Propensity of its Application as A Global AML Paradigm" 2014 *Journal of Money Laundering Control* 77, 79.

<sup>42</sup> Mugarura 2014 *Journal of Money Laundering Control* 79.

Force (FATF) recommendations in combating money laundering.<sup>43</sup> Nonetheless, various challenges could ensue when customer due diligence measures and/or the adopted international standards are incompatible or poorly transposed into the South African anti-money laundering laws on an extra-territorial basis.<sup>44</sup> This could restrict the South African enforcement authorities' reliance on customer due diligence to detect and curb money laundering activities that are perpetrated in South Africa or elsewhere by offenders in other jurisdictions where no such extra-territorial application exists.<sup>45</sup> This could give rise to the poor enforcement of customer due diligence measures to prevent money laundering practices.

The concept of customer due diligence was developed to ensure that financial institutions get to know their customers.<sup>46</sup> However, there is little evidence to show that this concept is designed to achieve its purpose effectively. This follows the fact that the FATF standards that were used to design the customer due diligence under the *Financial Intelligence Centre Act*<sup>47</sup> have been vague on their identification and verification practices.<sup>48</sup> There have been no instructions to consistently consider and assess the adequacy of the verification measures being used.<sup>49</sup> As a result, customer due diligence becomes insufficiently robust to prevent identity fraud hence posing a higher money laundering and terrorist financing risk.<sup>50</sup>

The requirements for the identification and verification processes of financial customers by financial institutions could make customer due diligence an expensive measure of combating money laundering in South Africa.<sup>51</sup> For instance, financial institutions require sufficient people with relevant expertise and sophisticated machinery to conduct identification and verification of financial customers in South Africa.<sup>52</sup> Stringent requirements for the identification and verification processes of

<sup>43</sup> Mugarura 2014 *Journal of Money Laundering Control* 80.

<sup>44</sup> Goredema C and Monsti F "Towards Effective Control of Money Laundering in Southern Africa-Some Practical Dilemmas" 2002 *African Security Review* 2, 3.

<sup>45</sup> De Koker L "The FATF's Customer Identification Framework: Fit for Purpose?" 2014 *Journal of Money Laundering Control* 281, 290.

<sup>46</sup> De Koker 2014 *Journal of Money Laundering Control* 283.

<sup>47</sup> Section 21 of the *FICA*.

<sup>48</sup> De Koker 2014 *Journal of Money Laundering Control* 283.

<sup>49</sup> Goredema and Monsti 2002 *African Security Review* 8.

<sup>50</sup> De Koker 2014 *Journal of Money Laundering Control* 284.

<sup>51</sup> See Sander C "Capturing a Market Share?: Migrant Remittance Transfers and Commercialisation of Microfinance in Africa" *Current Issues in Microfinance Conference* (12-14 August 2003 Johannesburg) 6; Mugarura 2014 *Journal of Money Laundering Control* 90.

<sup>52</sup> Mugarura 2014 *Journal of Money Laundering Control* 90.

financial customers by financial institutions could form barriers that prevent low-income earners and the people from marginalised areas from accessing financial services such as bank accounts in South Africa.<sup>53</sup> This undermines financial inclusion. When anti-money laundering measures undermine financial inclusion, the risk of money laundering increases.<sup>54</sup> The risk increases because significant numbers of people will continue using non-transparent and informal financial sectors.<sup>55</sup> This way, anti-money laundering measures increase the risks that the *Amendment Act* attempts to mitigate.

## **1.4 Aims and Objectives**

### **1.4.1 Aims**

For the purposes of this research, aims include the main overall goals or targets that are generally expected to be achieved by the researcher at the end of the research. In this regard, this research seeks to:

- a) examine whether the customer due diligence provisions provided in the *Amendment Act*<sup>56</sup> will be successfully utilised by the relevant authorities to curb money laundering in South Africa.
- b) evaluate whether the risk management and compliance programme<sup>57</sup> which has been employed in the *FICA* is robust enough to prevent the risks associated with illicit practices such as money laundering in the South African financial markets. In this regard, the research examines the scope and application of the relevant provisions of the *FICA* for the purposes of preventing money laundering in South Africa. Moreover, the researcher discusses the role of selected South African anti-money laundering regulatory and enforcement authorities in order to assess whether they are conducting their functions optimally.

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<sup>53</sup> De Koker L "Money Laundering Control and Suppression of Financing of Terrorism: Some Thoughts on the Impact of Customer Due Diligence Measures on Financial Exclusion" 2006 *Journal of Financial Crime* 26, 27.

<sup>54</sup> De Koker 2006 *Journal of Financial Crime* 28.

<sup>55</sup> De Koker 2006 *Journal of Financial Crime* 28.

<sup>56</sup> Sections 20A-21H of the *Amendment Act*.

<sup>57</sup> Section 42 of the *Amendment Act*.

- c) investigate the flaws in the current customer due diligence statutory regulatory framework in order to recommend possible measures to enhance the enforcement of the South African anti-money laundering laws.

#### **1.4.2 Objectives**

For the purposes of this research, the objectives include any measures or specific stages that are undertaken by the researcher to achieve the overall goals and aims of the research. In order to achieve the aforesaid aims, the research:

- a) examines whether customer due diligence provisions contained in the *Amendment Act*<sup>58</sup> is consistently enforced by courts and other relevant authorities to combat money laundering in South Africa;
- b) discusses the role of the South African anti-money laundering regulatory and enforcement authorities. This is done to investigate whether these authorities are performing their functions effectively to discourage money laundering activities in South Africa; and
- c) recommends other measures that can be utilised by the relevant authorities to combat money laundering in South Africa.

#### **1.5 Research question**

This research seeks to address the following question:

- a) is the current legal framework for customer due diligence consistently enforced by the relevant authorities to combat money laundering in South Africa?

#### **1.6 Rationale of the Study**

The *Amendment Act* rests on the premise that criminalisation and prosecution of money laundering crimes is not enough to curb money laundering in South Africa.<sup>59</sup> The Act brings to light the importance of employing administrative measures towards

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<sup>58</sup> Sections 20A-21H of the *Amendment Act*.

<sup>59</sup> De Koker L and Henning JJ *Money Laundering Control in South Africa* (UOVS/UOFS Bloemfontein 1998) 3.

the combating of money laundering.<sup>60</sup> These measures, *inter alia*, customer due diligence, assist financial institutions to know their customers and who they are doing business with.<sup>61</sup> As a result, the control measures assist financial institutions to prevent, detect and prosecute any money laundering cases.<sup>62</sup>

The *Amendment Act*<sup>63</sup> regulates anti-money laundering measures used in the combating of money laundering in South Africa. Therefore, this research examines whether the measures implemented by the *Amendment Act*,<sup>64</sup> specifically customer due diligence are adequate to combat money laundering in South Africa. This research discusses the shortcomings of customer due diligence as regulated by the *Amendment Act*.<sup>65</sup> Proposed recommendations to enhance the combating of money laundering in South Africa are discussed. Ultimately, the researcher determines whether reliance on customer due diligence is adequate in the fight against money laundering. This is done through a detailed analysis of customer due diligence as an anti-money laundering measure.

### **1.7 Justification for Comparative Study**

The regulation of customer due diligence measures in South Africa is not flawless. For example, stringent requirements for the identification and verification processes of financial customers by financial institutions have formed barriers that prevent low-income earners and the people from marginalised areas from accessing financial services such as bank accounts in South Africa.<sup>66</sup> In this regard, it is necessary to examine the regulation of customer due diligence measures in the United Kingdom (UK) to isolate possible measures that can be adopted from the UK regulatory framework to enhance the combating of money laundering in South Africa. The UK has been chosen as a comparative jurisdiction because it is regarded as having one of the best regulations of customer due diligence measures.<sup>67</sup> In addition, the UK

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<sup>60</sup> Havenga P *et al* *General Principles of Commercial Law* 6th ed (Juta Cape Town 2007) 381-382.

<sup>61</sup> Havenga *et al* *General Principles of Commercial Law* 382.

<sup>62</sup> Njotini *Customer Due Diligence Data in Terms of Financial Intelligence Centre Act* 10.

<sup>63</sup> Chapter 3 of the *Amendment Act*.

<sup>64</sup> Section 21 of the *Amendment Act*.

<sup>65</sup> Sections 20A-21H of the *Amendment Act*.

<sup>66</sup> De Koker 2006 *Journal of Financial Crime* 27.

<sup>67</sup> Commonwealth Secretariat *Combating Money Laundering and Terrorist Financing: A Model of Best Practice for the Financial Sector, the Professions and other Designated Businesses* 2<sup>nd</sup> ed (Commonwealth Secretariat 2006) 138.

has established a relatively adequate and effective regulatory framework on customer due diligence measures.<sup>68</sup>

The South African customer due diligence measures regulations are relatively related to the UK customer due diligence measures because they both stem from the FATF recommendations.<sup>69</sup> In this regard, South Africa and the UK share a common basis of customer due diligence measures.<sup>70</sup> It is hoped that the South African anti-money laundering enforcement authorities will adopt relevant enforcement approaches from the UK to enhance the combating of money laundering in South Africa.

### 1.8 Literature Review

The concept of customer due diligence has always had different views on an academic perspective. Several views have been brought forward regarding the adequacy of customer due diligence in the fight against money laundering in South Africa. It remains a question to be answered whether the regulation of customer due diligence by the *Amendment Act* is adequate to combat money laundering in South Africa.

Njotini recommends that the South African anti-money laundering regulatory framework should be designed and implemented in conformity with international norms like the FATF recommendations.<sup>71</sup> However, Mugarura<sup>72</sup> argues that the implementation of customer due diligence as a global paradigm is with consequences especially on developing economies like South Africa. It has been reported that the incorporation and implementation of an internationally designed customer due diligence model in South Africa causes severe consequences like financial exclusion.<sup>73</sup> Contrary to Njotini's argument,<sup>74</sup> the researcher argues that

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<sup>68</sup> Ahlosani W *Anti-Money Laundering: A Comparative and Critical Analysis of the United Kingdom and the UAE's Financial Intelligence Units* (Palgrave Macmillan London 2016) 241.

<sup>69</sup> Henning JJ and Ebersohn GJ "Insider Trading, Money Laundering and Computer Crime" 2001 *Transactions of the Centre for Business Law: Combating Economic Crime* 105, 108.

<sup>70</sup> Van Jaarsveld IL "Mimicking Sisypheus? An Evaluation of the Know-Your-Customer Policy" 2006 *Obiter* 228, 235.

<sup>71</sup> Njotini MN "The Transaction Or Activity Monitoring Process: An Analysis of the Customer Due Diligence Systems of the United Kingdom and South Africa" 2000 *Obiter* 556, 560.

<sup>72</sup> Mugarura 2014 *Journal of Money Laundering Control* 79.

<sup>73</sup> De Koker L "Aligning Anti-Money Laundering, Combating of Financing of Terror and Financial Inclusion" 2011 *Journal of Financial Crime* 361, 365.

<sup>74</sup> Njotini 2000 *Obiter* 560.

customer due diligence under the *Amendment Act* should be designed and implemented on a South African context-sensitive basis and not international standards. The verification requirements of customer due diligence as designed internationally are too rigid to the extent that the marginalised population of the country remains financially excluded.

A case study was conducted on South Africa to reflect on the impact of the FATF anti-money laundering international standards.<sup>75</sup> It was reported that compliance with the requirements of the international practice of customer due diligence as regulated by the *Amendment Act* is considerably responsible for causing money laundering in South Africa.<sup>76</sup> This follows the fact that South Africa is a developing country and a third of its population still lives in informal dwellings without formal residential addresses.<sup>77</sup> Half of the population lacks the documents required for identification and verification.<sup>78</sup> As such, the greater population of the country will not be able to participate in the formal economic sector.<sup>79</sup> This population then resorts to informal sectors where their transactions are unmonitored, hence becoming a money laundering risk.<sup>80</sup> The researcher shares the view that South Africa requires a flexible customer due diligence regulation to adequately achieve its purpose of combating money laundering in South Africa.

Bester *et al*<sup>81</sup> suggest that, for customer due diligence to adequately serve its purpose, South African regulatory framework should formulate regulations that cover the informal sector. This view is credible considering the residential setting of South Africa where a considerable population cannot produce the documents required for verification for registration by any financial institution.<sup>82</sup> An effective way of relying on customer due diligence to combat money laundering is to provide low-cost, user

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<sup>75</sup> Bester H, De Koker L and Hawthorn R "Access to Financial Services in South Africa: A Brief Case Study of the Effect of the Implementation of the Financial Action Task Force Recommendations" *G:enesis Report* (7 April 2004) 2-5.

<sup>76</sup> De Koker 2011 *Journal of Financial Crime* 366; see also Henning and Ebersohn 2001 *Transactions of the Centre for Business Law* 130.

<sup>77</sup> De Koker 2011 *Journal of Financial Crime* 365.

<sup>78</sup> Bester *et al* *G:enesis Report* 6.

<sup>79</sup> Bester *et al* *G:enesis Report* 9.

<sup>80</sup> De Koker 2004 *TSAR* 722.

<sup>81</sup> Kersop M *Anti-Money Laundering Regulations and the Effective use of Mobile Money in South Africa* (LLM – dissertation Northwest University 2014) 57; Bester *et al* *G:enesis Report* 17.

<sup>82</sup> Lawack VA "Mobile Money, Financial Inclusion and Financial Integrity: The South African Case" 2013 *Washington Journal of Law, Technology & Arts* 317, 336.

friendly services that do not require much administration from clients.<sup>83</sup> This creates less chances of disappearance of transactions into informal sectors. It is these disappearances that undermine the objectives of anti-money laundering regulations.<sup>84</sup> This research shows that it is imperative for the international community to allow developing countries like South Africa to create their own unique, context sensitive and risk-based customer due diligence in an effective manner.<sup>85</sup> This increases the effectiveness of customer due diligence in the combating of money laundering by involving more citizens.

Mugarura<sup>86</sup> argues that the possibility of harnessing customer due diligence as a global anti-money laundering measure is limited. The argument advanced by Mugarura is centred on the premise that every jurisdiction requires its own unique customer due diligence model, one that does not rely on international standards and relates to its own economy. It is important that when enforced globally, customer due diligence should be applied pragmatically to enable reflections on varying economic dynamics of the countries it is being applied to.<sup>87</sup>

Furthermore, in as much as the ongoing monitoring of transactions safeguards against money laundering,<sup>88</sup> it should be kept in mind that it costs financial institutions more money to generate and consolidate customer profiles. Financial institutions need to minimise their expenses to maximise profits but when they fail to exercise proper streamlining and application of customer due diligence, more resources are put to waste.<sup>89</sup> The need to combat money laundering follows the need to maximise profits and avoid losses through laundered money.<sup>90</sup> Financial institutions should therefore focus on gathering quality rather than quantity information on their customers. This increases the chances of less resourceful customer due diligence but still adequate for the combating of money laundering.

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<sup>83</sup> Tuba M and Westhuizen C "An Analysis of The 'Know Your Customer' Policy As an Effective Tool to Combat Money Laundering: Is it About Who or What to Know That Matters?" 2014 *International Journal of Public Law and Policy* 53,60; Bester *et al* *Genesis Report* 18.

<sup>84</sup> Bester *et al* *Genesis Report* 18.

<sup>85</sup> Henning JJ, Du Toit A and Nel P "Decriminalisation of Money Laundering: A Systematic Approach" 1998 *Transactions Centre for Business Law* 66, 70.

<sup>86</sup> Mugarura 2014 *Journal of Money Laundering Control* 80.

<sup>87</sup> Mugarura 2014 *Journal of Money Laundering Control* 81.

<sup>88</sup> Section 21C of the *Amendment Act*.

<sup>89</sup> Mugarura 2014 *Journal of Money Laundering Control* 81.

<sup>90</sup> De Koker 2014 *Journal of Money Laundering Control* 285.

Demetriades<sup>91</sup> submits that due to technological evolution, customer due diligence has become more efficient than ever. Effective anti-money laundering measures help preserve the reputation of a country by reducing the chances of its financial institutions becoming victims or vehicles of money laundering. Demetriades<sup>92</sup> brings it to light that the methods of identification and verification used by financial institutions are the same regardless of the type of business to be concluded. Financial institutions overlook the fact that there is no single customer due diligence procedure that can be fit for all purposes and all institutions yet in South Africa the same model is used in all institutions. As such, the efficiency of customer due diligence to combat money laundering is with doubts. The likelihood is that money launders have already learnt how to manipulate the procedure, thus lessening the chances of an efficient customer due diligence in the combating of money laundering.

De Koker<sup>93</sup> argues that the requirements of customer due diligence sometimes increase the rate of financial exclusion when the regulators fail to formulate them with care and reflection of the particular country's setting. De Koker notes that regulatory bodies should design their own unique anti-money laundering systems with circumspection.<sup>94</sup> The researcher shows that when designed and applied with no circumspection, customer due diligence prevents the possibility of extending financial services to marginalised societies. When this happens, economic development is crippled and impacts negatively on the combating of money laundering.<sup>95</sup> Customer due diligence is aimed at activities within the formal economy. As such when the greater population is excluded from the formal economy, reliance on customer due diligence to combat money laundering becomes a myth.<sup>96</sup>

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<sup>91</sup> Demetriades G "Is the person who he claims to be?" *Old Fashion Due Diligence May Give the Correct Answer!* 2016 *Journal of Money Laundering* 79, 82.

<sup>92</sup> Detriades 2016 *Journal of Money Laundering* 83.

<sup>93</sup> De Koker 2011 *Journal of Financial Crime* 365.

<sup>94</sup> De Koker 2011 *Journal of Financial Crime* 365.

<sup>95</sup> De Koker 2011 *Journal of Financial Crime* 366.

<sup>96</sup> Bester et al *G:enesis Report* 18.

Tuba and Westhuizen argue that it is adequate for a country to rely on customer due diligence in the fight against money laundering.<sup>97</sup> De Koker however questions whether customer due diligence is fit for its purpose considering the flaws and inconsistencies surrounding its implementation.<sup>98</sup> Tuba and Westhuizen suggest an integration of customer due diligence and the risk based approach for an effective application.<sup>99</sup> The risk based approach will be applied to determine potential money laundering risk involved.<sup>100</sup> Alerting the institutions on the potential risk assists them in exercising enhanced diligence when required which lessens the probability of any money laundering cases.<sup>101</sup> It can therefore be said that the reliance on customer due diligence to combat money laundering in South Africa can be adequate if financial institutions develop risk management compliance programmes.<sup>102</sup>

It suffices that reliance on customer due diligence to combat money laundering under the *Amendment Act* is achievable when implemented with the risk based approach.<sup>103</sup> Henning describes money laundering as a risk that requires the establishment of a framework for the realisation of a risk based approach on an ongoing basis.<sup>104</sup> In as much as customer due diligence is a significant anti-money laundering measure, it is still correct to say that the incorporation of the risk based approach to customer due diligence in the fight against money laundering improves the effect of customer due diligence. Risk based approach is applicable in every risk scenario.<sup>105</sup> Money laundering is a global risk.<sup>106</sup> On the same note, it becomes credible to state that risk management and compliance programmes should be incorporated in all anti-money laundering measures to increase the effectiveness of the measures.

From the array of data highlighted above, it can therefore be said that the reliance on customer due diligence to combat money laundering in South Africa is questionable.

<sup>97</sup> Tuba M and Westhuizen C "An Analysis of The 'Know Your Customer' Policy As an Effective Tool to Combat Money Laundering: Is it About Who or What to Know That Matters?" 2014 *International Journal of Public Law and Policy* 53, 55.

<sup>98</sup> De Koker 2014 *Journal of Money Laundering Control* 285.

<sup>99</sup> Section 42 of the *Amendment Act*.

<sup>100</sup> Sharrock *Law of Banking and Payment in South Africa* 103.

<sup>101</sup> Tuba and Westhuizen 2014 *International Journal of Public Law and Policy* 60.

<sup>102</sup> Section 42 of the *Amendment Act*.

<sup>103</sup> Henning J "Fortifying a Risk-Based Approach in the South African AML/CFT Process" 2017 *Journal of Financial Crime* 520, 521.

<sup>104</sup> Henning 2017 *Journal of Financial Crime* 522.

<sup>105</sup> Mugarura 2014 *Journal of Money Laundering Control* 79.

<sup>106</sup> Mugarura 2014 *Journal of Money Laundering Control* 79.

This follows several considerations that have been stated which make the reliance inadequate unless these considerations have been addressed. It however remains the task of this research to examine and analyse further how the reliance on customer due diligence to combat money laundering can be achieved in South Africa.

## **1.9 Assumptions and hypothesis**

### **1.9.1 Assumptions**

This research is premised on the following assumptions:

- a) money laundering practices negatively affect public investor confidence and the integrity of the financial markets in many countries, including South Africa.
- b) money laundering practices are usually outlawed in several countries, including South Africa. Consequently, various anti-money laundering approaches are employed from country to country in a bid to effectively combat money laundering practices.

### **1.9.2 Hypothesis**

It is generally accepted that poor money laundering laws will give rise to rampant money laundering activities in any country. South Africa has somewhat struggled to detect and effectively prevent money laundering practices through its financial institutions and financial markets since the early 1970s to date. Consequently, the researcher investigates whether customer due diligence as introduced by the *Amendment Act* is consistently utilised by all the enforcement authorities and other relevant persons to detect and combat money laundering in South Africa. This follows a widely acknowledged fact that the inconsistent enforcement of anti-money laundering laws, measures and/or rules results in illicit financial trading activities such as terrorist financing schemes and money laundering in any country. To this end, this research discusses the possible shortcomings associated with the enforcement of the anti-money laundering laws and regulations in South Africa in a bid to revamp and/or enhance their enforcement in respect thereof.

### **1.10 Scope and limitations of the study**

This research focuses on the provisions of the *Amendment Act* that cover the concept of customer due diligence as an anti-money laundering measure in South Africa. Other South African legislations that make provision of customer due diligence are referred to where necessary. However, this research mainly focuses on customer due diligence as an anti-money laundering measures in terms of the *Amendment Act*. Statutory provisions that regulated money laundering in South Africa before 2001 are referred to for historical and background purposes. Moreover, for the purposes of this research, the term financial institutions is only used to refer to institutions listed in the *Amendment Act*.<sup>107</sup>

### **1.11 Research Methodology**

This research is a qualitative study based on literature review and the following research methods are used:

#### **a) Primary and secondary sources**

The researcher makes use of the library to access relevant books, case law, journals, statutes and other relevant materials. Reference is made to relevant websites for information. This is important because it provides the researcher with more access to the opinions of various renowned commentators and authors. The dates referred to are the dates on which the websites were accessed by the researcher. **For purposes of this research, the North West University Potchefstroom Electronic Law Journal Referencing style was utilised.**

#### **b) Relevant case law**

The researcher examines and analyses case law that is relevant to money laundering and customer due diligence.

#### **c) Relevant legislation**

This research focuses on the *Amendment Act*. Other relevant statutes are referred to for historical and comparative purposes.

#### **d) Historical analysis**

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<sup>107</sup> . Schedule 1 of the *Amendment Act*.

This method is used in chapter two and three of the research. The researcher gives historical analysis of customer due diligence and money laundering in separate chapters for a period from 1992 to date.

### **1.12 *Relevance to Research Unit***

This research focuses on the combating of money laundering in South Africa. Therefore, the research falls under the Finance, Trade and Investment Research Unit of the faculty of law. Moreover, the research falls under the Securities and Financial Markets Law ancillary module under the Master's in Mercantile Law module of the faculty of law. As stated earlier under the rationale of the study, the research exposes the shortcomings in the current anti-money laundering regulatory statutory framework in a bid to recommend some measures that could be employed to discourage money laundering practices in South Africa. It is hoped that the final research findings contained in the LLM dissertation and/or some parts of this research will be published as book chapters or journal articles.

### **1.13 *Ethics***

This work is a qualitative research in which all primary and secondary sources used are referenced. No individual or group interviews and questionnaires are used as instruments of research with the objective of holding discussions concerning any topics or issues that might be sensitive, embarrassing or upsetting. No criminal or other disclosures requiring legal action and having potential adverse effects, risk or hazards for research participants are made in the course of the study. There is therefore no need for arrangements to be made in respect of insurance and/or indemnity to meet the potential legal liability of the North West University for harm to participants arising from the conduct of the research.

### **1.14 *Structure of the dissertation***

This research consists of six chapters including this chapter.

Chapter One provides the introduction and background of the research. It outlines the aims, objectives, research questions, literature review, scope and limitations of the research, statement of the problem, rationale of the study and the research methodology.

Chapter Two focuses on the historical development of the concept of customer due diligence in South Africa. This chapter focuses on how customer due diligence was introduced into the South African anti-money laundering laws.

Chapter Three discusses the current regulatory framework of money laundering in South Africa. The provisions of the *Amendment Act* and other relevant anti-money laundering legislations are examined in this chapter.

Chapter Four examines and provides an overview of the adequacy and effectiveness of customer due diligence as an anti-money laundering measure. The chapter discusses the problems associated with the reliance on customer due diligence to combat money laundering in South Africa.

Chapter Five discusses customer due diligence measures, international best practices and the regulation of anti-money laundering measures in the UK. The chapter provides a comparative analysis of the regulation of customer due diligence in South Africa and the UK. This is done to investigate whether South Africa can adopt and/or take lessons from the UK customer due diligence measures approach.

Chapter Six provides recommendations and conclusions on the reliance on customer due diligence under the *Amendment Act* to combat money laundering in South Africa.

## CHAPTER TWO

### HISTORICAL ASPECTS OF CUSTOMER DUE DILIGENCE AND MONEY LAUNDERING IN SOUTH AFRICA

#### 2.1 Introduction

Customer due diligence was introduced into the South African anti-money laundering regulatory framework in 2001 by the *Financial Intelligence Centre Act*.<sup>108</sup> Before the amendment of the *FICA*, customer due diligence was formerly referred to as customer identification and verification.<sup>109</sup> In some jurisdictions like the United Kingdom (UK), the concept of customer identification and verification is referred to as the know-your-customer policy.<sup>110</sup> Attempts to regulate the combating of money laundering in South Africa have been carried out from as early as 1992.<sup>111</sup> This is evidenced by the prohibition of money laundering in the *Drugs and Drugs Trafficking Act*<sup>112</sup> which was repealed by the *Proceeds of Crime Act*<sup>113</sup> in 1996.<sup>114</sup> The provisions of the *Drugs Act* and the *Proceeds of Crime Act* were more focused on money laundering crimes emanating from the proceeds of drug offences only.<sup>115</sup> Before 2001, there were no express provisions to control and detect money laundering in South Africa.<sup>116</sup> The prohibition of money laundering was not good enough to curb money laundering in South Africa. As a result there was need for measures to detect and control money laundering in South Africa.<sup>117</sup> International

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<sup>108</sup> 38 of 2001 (*FICA*) as amended by the *Financial Intelligence Centre Amendment Act 1 of 2017 (Amendment Act)*, see section 21.

<sup>109</sup> Havenga P *et al* *General Principles of Commercial Law* 6<sup>th</sup> ed (Juta Capetown 2007) 381-382.

<sup>110</sup> Havenga *General Principles of Commercial Law* 381; see also Ahlosani W *Anti-Money Laundering: A Comparative and Critical Analysis of the United Kingdom and the UAE'S Financial Intelligence Units* (Palgrave Macmillan London 2016) 205.

<sup>111</sup> De Koker L "Money Laundering Control and Suppression of Financing of Terrorism: Some Thoughts on the Impact of Customer Due Diligence Measures on Financial Exclusion" 2006 *Journal of Financial Crime* 26, 27.

<sup>112</sup> 140 of 1992 (*Drugs Act*), see section 14. The adoption of anti-money laundering measures was influenced by the *United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances* (1988) (*Vienna Convention*), see article 3(c)(i).

<sup>113</sup> 76 of 1996, see sections 8-14.

<sup>114</sup> Njotini MN "The Transaction or Activity Monitoring Process: An Analysis of the Customer Due Diligence Systems of the United Kingdom and South Africa" 2006 *Obiter* 556, 557.

<sup>115</sup> Van Jaarsveld "Mimicking Sisyphus? An Evaluation of the Know Your Customer Policy" 2006 *Obiter* 228, 229.

<sup>116</sup> Van Jaarsveld 2006 *Obiter* 229.

<sup>117</sup> De Koker L "Client Identification and Money Laundering Control: Perspectives on the Financial Intelligence Centre Act 38 of 2001" 2004 *TSAR* 715, 717.

bodies such as the Financial Action Task Force (FATF) played a pivotal role in the introduction of anti-money laundering measures in South Africa.<sup>118</sup> The FATF provided anti-money laundering measures that were adopted by South Africa in order to combat money laundering.<sup>119</sup> The anti-money laundering statutory framework of South Africa is mainly regulated by two statutes, namely the *Prevention of Organised Crime Act*<sup>120</sup> and the *Financial Intelligence Centre Act* as amended.<sup>121</sup> The first legislation to be enacted and to primarily focus on anti-money laundering measures was the *FICA*.<sup>122</sup> The *FICA* had auxiliary measures to assist the implementation of its provisions.<sup>123</sup> Such auxiliary measures include the *Money Laundering Control Regulations*.<sup>124</sup>

Money laundering is a global crime and South Africa is not the only country that prohibits money laundering.<sup>125</sup> This led the policy makers to adopt international anti-money laundering measures such as the customer due diligence.<sup>126</sup> Customer due diligence consists of four internationally recognised elements,<sup>127</sup> namely customer identification,<sup>128</sup> record keeping,<sup>129</sup> recognition and reporting of suspicious transactions<sup>130</sup> and training.<sup>131</sup> These elements are discussed in detail in chapter three of this research. Customer due diligence and other administrative measures were introduced to supplement the prohibition and confiscation of the proceeds of

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<sup>118</sup> The international bodies that played an important role in this regard include the Financial Action Task Force, the Bank for International Settlement (BIS), the International Association of Insurance Supervisors (IAIS), the International Organisation of Securities Commissions (IOSCO) and the Egmont Group of Financial Intelligence Units; see also Njotini 2000 *Obiter* 557.

<sup>119</sup> FATF "International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation" *FATF Recommendations* (February 1996, updated October 2001), recommendations 4-12.

<sup>120</sup> 121 of 1998 (*POCA*), see sections 4-6.

<sup>121</sup> 1 of 2017 (*Amendment Act*); see also De Koker 2004 *TSAR* 716; section 20 of the *Prevention and Combating of Corrupt Activities Act* 12 of 2004 also creates an offence that overlaps with the money laundering offences of the *POCA*.

<sup>122</sup> See sections 20A-21H of the *FICA*.

<sup>123</sup> Van Jaarsveld 2006 *Obiter* 229.

<sup>124</sup> Regulations 2-19 of GN R1595 in GG 24176 of 20 December 2002.

<sup>125</sup> Njotini 2010 *Obiter* 566.

<sup>126</sup> Njotini 2010 *Obiter* 566.

<sup>127</sup> Njotini MN *The Verification and Exchange of Customer Due Diligence (CDD) Data in Terms of the Financial Intelligence Centre Act 38 of 2001* (LLM – Dissertation University of South Africa 2009)19.

<sup>128</sup> Section 21 of the *FICA*.

<sup>129</sup> Sections 22-24 of the *FICA*.

<sup>130</sup> Section 29 of the *FICA*.

<sup>131</sup> Section 43 of the *FICA*.

money laundering in South Africa.<sup>132</sup> The administrative measures such as customer identification and verification were meant to identify and enable financial institutions to know their customers.<sup>133</sup> South Africa enacted the first legislation, the *FICA*, which regulated customer identification and verification measures.<sup>134</sup> From 30 June 2003, the *FICA* compelled all financial institutions to identify and verify their customers before concluding any transactions with them.<sup>135</sup> The *FICA* provides a list of the financial institutions obliged to conduct customer identification and verification in South Africa.<sup>136</sup> This chapter is a historical chapter, it discusses the regulation of money laundering control and customer due diligence before the current *Amendment Act*.

## **2.2 Definition of Customer Due Diligence**

Customer due diligence refers to a regular investigation procedure of a customer's background that is conducted by financial institutions prior to signing commercial agreements with a new customer.<sup>137</sup> Customer due diligence is aimed at assessing the potential risk that may exist between the financial institution and the customer.<sup>138</sup> "Due" refers to something that is expected by the relevant authorities.<sup>139</sup> "Diligence" refers to a vigilant and methodical work or exertion by a financial institution.<sup>140</sup> For the purpose of this research, the term due diligence refers to a concept that safeguards a customer's actions to conform to the financial institution's policies, procedures, regulations and methodologies.<sup>141</sup> Acquiring knowledge about customers enables financial institutions to apply the relevant risk assessment required for each customer.<sup>142</sup> This is important because financial institution can apply customer due diligence measures that are relevant to the level of risk the

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<sup>132</sup> Havenga *General Principles of Commercial Law* 381.

<sup>133</sup> De Koker L and Henning JJ *Money Laundering Control in South Africa* (UOVS/UOFS Bloemfontein 1998) 43-44.

<sup>134</sup> South African Law Commission Discussion Paper 64, Project 104 "Money Laundering Control and Related Matters" *Twenty-Fourth Annual Report* (7 August 1996) 32-34.

<sup>135</sup> Section 21(1) of the *FICA*.

<sup>136</sup> Schedule 1 of the *FICA*.

<sup>137</sup> Ai L and Jun T "The International Standards of Customer Due Diligence and Chinese Practice" 2009 *Journal of Money Laundering Control* 406, 407.

<sup>138</sup> Ai and Jun Tang 2009 *Journal of Money Laundering Control* 407.

<sup>139</sup> Hornby AS *Oxford Advanced Learner's Dictionary of Current English* 7<sup>th</sup> ed (Oxford University 2005) 474.

<sup>140</sup> Horny *Oxford Advanced Learner's Dictionary of Current English* 432.

<sup>141</sup> Njotini *Customer Due Diligence in Terms of the Financial Intelligence Centre Act* 21.

<sup>142</sup> De Koker 2004 *TSAR* 720.

customer poses to the financial institution.<sup>143</sup> Inconsistencies in the financial institution's knowledge of a customer and the customer's account activities could raise money laundering suspicions or give rise to money laundering.<sup>144</sup> Financial institutions are obliged to report unusual and suspicious transactions.<sup>145</sup> The researcher submits that customer due diligence is a means of ensuring that financial institutions know their customers and customers are risk assessed before concluding any transactions with them.<sup>146</sup>

### 2.3 The Meaning of Money Laundering

Money laundering is defined as the concealment of illegally acquired money or property in order to disguise its real nature or source.<sup>147</sup> Money laundering is achieved by concluding several transactions that disguise illegal proceeds to appear as legitimate transactions or investments.<sup>148</sup> Money laundering also includes converting illegally obtained wealth into assets that cannot be traced back to the money launderers or the underlying crime.<sup>149</sup> From this definition, it can be argued that money laundering can only be committed after another underlying crime, such as fraud, corruption and drug trafficking.<sup>150</sup> Illegally acquired wealth includes cash or property that is acquired through criminal activities.<sup>151</sup> When one commits money laundering, the underlying aim is normally concealing the proceeds of crime to escape prosecution while still able to use and control the proceeds.<sup>152</sup> This can be

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<sup>143</sup> De Koker and Henning *Money Laundering Control in South Africa* 45.

<sup>144</sup> Njotini 2010 *Obiter* 559.

<sup>145</sup> Njotini 2010 *Obiter* 559.

<sup>146</sup> Njotini *Customer Due Diligence in Terms of the Financial Intelligence Centre Act* 49.

<sup>147</sup> Millard D and Vergano V "Hung Out to Dry? Attorney Client Confidentiality and the Reporting Duties Imposed by the Financial Intelligence Centre Act 38 of 2001" 2013 *Obiter* 389, 391.

<sup>148</sup> Millard and Vergano *Obiter* 391.

<sup>149</sup> Reuter P and Truman EM *Chasing Dirty Money: The Fight against Money Laundering* (Institute for International Economics Washington DC 2004) 25.

<sup>150</sup> Millard and Vergano *Obiter* 391; see also Nyaude *The Compliance Duties of Commercial Banks* 25.

<sup>151</sup> Reuter and Truman *Chasing Dirty Money* 25. In terms of section 1 of the *Prevention of Crime Act*, the term means "any property or any service, advantage, benefit or reward which was derived, received or retained, directly or indirectly, in the Republic or elsewhere, at any time before or after the commencement of the *FICA*, in connection with or as a result of any unlawful activity carried on by any person, and includes any property representing property so derived."

<sup>152</sup> Nyaude *The Compliance Duties of Commercial Banks* 25.

accomplished through conducting several transactions that will portray the illegal proceeds as products of legitimate transactions.<sup>153</sup>

Money laundering is also defined as a process through which money launderers conceal the origin or owners of the proceeds of crime or the illegal nature of a financial transaction.<sup>154</sup> The purpose of concealing the origins of the proceeds of crime is to destroy the nexus that exists between the preceding crime and the proceeds of the crime.<sup>155</sup> When the nexus is destroyed, it is difficult for the relevant authorities to detect money laundering activities.<sup>156</sup> The South African Law Reform Commission defines money laundering as the control of illegally procured money so as to disguise its actual source.<sup>157</sup> The control of the illegally procured money is done by money launderers to evade prosecution and disguise the laundered proceeds as legally acquired property.<sup>158</sup> The *POCA* prohibits any act or conduct aimed at disguising the source, nature or disposition of the proceeds of crime<sup>159</sup> and regulates the confiscation of the proceeds.<sup>160</sup> The *POCA* provides penalties for money laundering and other relevant crimes.<sup>161</sup> Several definitions have been provided by different authors. Nonetheless, for the purpose of this research, the definition provided by the *Amendment Act*<sup>162</sup> is preferred. Money laundering is defined as an activity which has the effect of disguising or concealing the source or nature of illegal activities.<sup>163</sup> This definition shows that successful money laundering activities utilise the money or proceeds of the crime to further other crimes in a way that makes it difficult or impossible to create a nexus between the perpetrator and

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<sup>153</sup> Kruger A *Organised Crime and Proceeds of Crime Law in South Africa* 2<sup>nd</sup> ed (Lexis Nexis Durban 2013) 92; see also Van Jaarsveld *Money Laundering Control and Banks* part 1 122.

<sup>154</sup> Van Jaarsveld *Money Laundering Control and Banks* part 1 117.

<sup>155</sup> Van Jaarsveld *Money Laundering Control and Banks* part 1 178.

<sup>156</sup> Reuter and Truman *Chasing Dirty Money* 25; see also Millard and Vergano *Obiter* 395.

<sup>157</sup> Van Jaarsveld *Money Laundering Control and Banks* part 1 122.

<sup>158</sup> Millard and Vergan 2013 *Obiter* 391.

<sup>159</sup> Section 4 of the *POCA*

<sup>160</sup> Section 18 of the *POCA*, see also Van Jaarsveld *Money Laundering Control and Banks* part 1 123.

<sup>161</sup> Section 8 of the *POCA*.

<sup>162</sup> Section 1 of the *Amendment Act*.

<sup>163</sup> See section 64 of the *Amendment Act*; see also sections 4-6 of the *POCA*; Njotini *Customer Due Diligence in Terms of the Financial Intelligence Centre Act* 16.

the crime.<sup>164</sup> This is done to disguise the source of the money or proceeds of crime to avoid prosecution by the relevant authorities.<sup>165</sup>

Three typologies of money laundering are common in South Africa.<sup>166</sup> Internal money laundering is when the proceeds of crime emanate from South Africa and are effected towards money laundering in South Africa. Incoming money laundering is when proceeds from crimes committed in foreign countries are brought into the country and are used towards money laundering in South Africa. Outgoing money laundering is when proceeds of crimes committed in South Africa are exported to other countries for the purposes of money laundering.<sup>167</sup> The types of money laundering show that money laundering activities are not only committed in one country, but involve several other countries.<sup>168</sup> This entails that there is need for South Africa to conform to the international anti-money laundering standard to combat money laundering in South Africa.

Money laundering is a single process that can be broken down into three different stages. The placement stage<sup>169</sup> is the first stage of money laundering.<sup>170</sup> It is often labeled the initial stage because it is the stage at which laundered money or illegal proceeds are deposited into a formal financial system.<sup>171</sup> Placement allows the money launderer to be relieved from possessing large amounts of cash and the money is deposited into the legitimate financial system.<sup>172</sup> This stage is risky because depositing large amounts of cash into the formal financial system may raise

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<sup>164</sup> Kersop M and Du Toit SF "Anti-Money Laundering Regulations and the Effective Use of Money in South Africa" 2015 *PER/PELJ* 1603, 1620.

<sup>165</sup> Reuter and Truman *Chasing Dirty Money* 25.

<sup>166</sup> Ahlers C *The South African Anti-Money Laundering Regulatory Framework Relevant to Politically Exposed Persons* (MPhil in Fraud Risk Management – dissertation University of Pretoria 2013) 28.

<sup>167</sup> Ahlers *The South African Anti-Money Laundering Regulatory Framework* 28, see also Goredema C and Madzima J "An Assessment of the Links Between Corruption and the Implementation of Anti-Money Laundering Strategies and Measures in the ESAAMLG Region" *ESAAMLG Group* (18 May 2009) 3.

<sup>168</sup> Goredema and Madzima *ESAAMLG Group* 14; see also Henning JJ, Du Toit A and Nel P "Decriminalisation of Money Laundering: A Systematic Approach" 1998 *Transaction of the Centre for Business Law* 66, 92.

<sup>169</sup> Madinger J *Money Laundering: A Guide for Criminal Investigators* 3<sup>rd</sup> ed (CRC Australia 2011) 7.

<sup>170</sup> Nyaude *The Compliance Duties of Commercial Banks* 23.

<sup>171</sup> Savla S *Money laundering and Financial Intermediaries* (Kluwer Law International The Hague 2001) 10.

<sup>172</sup> Tuba M and Van der Westhuizen C "An Analysis of the 'Know Your Customer' Policy as an Effective Tool to Combat Money Laundering: Is it about Who or What to Know that Counts?" 2014 *International Journal Public Law and Policy* 53, 55.

the suspicions of financial institutions.<sup>173</sup> As such money launderers are more vulnerable to detection by financial institutions as large deposits raise suspicions of money laundering activities.<sup>174</sup> In order to avoid being detected and raising suspicions, money launderers use several methods to deposit the money.<sup>175</sup> These methods include smurfing which is the use of many people to deposit small shares of a large amount into a financial institution's system.<sup>176</sup> Money launderers also use blending, thus the use of legit businesses to mix their daily sales with dirty money.<sup>177</sup> The last method of money laundering in the placement stage is smuggling. Smuggling is the physical movement of money into the country through border points.<sup>178</sup>

The layering stage is the second stage of money laundering.<sup>179</sup> At this stage, the money launderers separate and distance the proceeds of crime from the criminal activity or the source.<sup>180</sup> This is done to avoid detection by relevant authorities. The money launderer creates a money web that involves several people in many jurisdictions so as to mislead the trail of the transaction.<sup>181</sup> The money web is created to destroy the nexus between the proceeds of crime and the preceding crime.<sup>182</sup> One of the methods used by the money launderers to achieve their goal is making payments in expectation of refunds in the form of cheque or cash.<sup>183</sup> This is done to acquire legitimate transaction records from financial institutions, thus limiting suspicions of money laundering activities from relevant authorities.<sup>184</sup> Electronic Funds Transfers (EFTs) are also a much faster method of layering that is conducted even on a long distance set-up producing minimum audit trail and more anonymity,

<sup>173</sup> Savia *Money laundering and Financial Intermediaries* 11.

<sup>174</sup> Tuba and Van der Westhuizen 2014 *International Journal Public Law and Policy* 55.

<sup>175</sup> Savia *Money laundering and Financial Intermediaries* 11.

<sup>176</sup> Section 64 of the *Amendment Act*; see also Itzikowitz A "South Africa: Money Laundering – The Duty to Report under the Law" 2008 *Journal of Financial Crime* 182, 185.

<sup>177</sup> Itzikowitz 2008 *Journal of Financial Crime* 185; see also Njotini *Customer Due Diligence in Terms of the Financial Intelligence Centre Act* 21.

<sup>178</sup> Henning JJ and Ebersohn GJ "Insider Trading, Money Laundering and Computer Crime" 2001 *Transactions of the Centre for Business Law: Combating Economic Crime* 105, 130; see also Nyaude *The Compliance Duties of Commercial Banks* 23.

<sup>179</sup> Madinger *Money Laundering: A Guide for Criminal Investigators* 9; see also Nyaude *The Compliance Duties of Commercial Banks* 23.

<sup>180</sup> Savia *Money laundering and Financial Intermediaries* 13 see also Van Jaarsveld *Money Laundering Control and Banks part 1* 193.

<sup>181</sup> Madinger *Money Laundering: A Guide for Criminal Investigators* 9.

<sup>182</sup> Henning and Ebersohn 2001 *Transactions of the Centre for Business Law: Combating Economic Crime* 105.

<sup>183</sup> *Commissioner of South African Reserve Service v Absa Bank* 2003 (2) SA 96 (W).

<sup>184</sup> Njotini *Customer Due Diligence in Terms of the Financial Intelligence Centre Act* 45.

thus distancing the proceeds of crime from the crime.<sup>185</sup> In this stage, money launderers aim at mixing laundered money and legitimate money without creating a nexus between laundered money and the preceding crime.<sup>186</sup>

The integration stage is the final stage.<sup>187</sup> At integration, the laundered money is legally transferred back to the money launderers through formal financial systems.<sup>188</sup> The money launderers may now use criminal proceeds for different purposes. For instance, purchasing property, or any other valuables are some of the methods through which the money is integrated back to the money launderers without raising suspicion.<sup>189</sup> This is because at this stage money launderers would have destroyed the nexus between the laundered money and the preceding criminal activities and integrate the money into the formal financial system.<sup>190</sup>

## **2.4 Historical Overview of the Regulation of Money Laundering in South Africa**

Before 1986, money laundering was not prohibited in many jurisdictions including South Africa and the United Kingdom.<sup>191</sup> To date, more than 170 countries have enacted legislation to prohibit money laundering. Money laundering is an international crime affecting many countries, hence the establishment of international anti-money laundering measures to create a wider approach towards the combating of money laundering.<sup>192</sup> Under South African common law, the crime of money laundering was not prohibited and there were no regulations controlling money laundering.<sup>193</sup> Under common law, the launderers of illicit proceeds were prosecuted

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<sup>185</sup> Henning and Ebersohn 2001 *Transactions of the Centre for Business Law* 132.

<sup>186</sup> Henning JJ, Du Toit A and Nel P "Decriminalisation of Money Laundering: A Systematic Approach" 1998 *Transaction of the Centre for Business Law* 66, 69; see related discussion by Nyaude *The Compliance Duties of Commercial Banks* 24.

<sup>187</sup> Madinger J *Money Laundering: A Guide for Criminal Investigators* 10.

<sup>188</sup> Nyaude *The Compliance Duties of Commercial Banks* 25.

<sup>189</sup> Goredema C and Montsi F "Towards Effective Control of Money Laundering in Southern Africa-Some Practical Dilemmas" 2002 *African Security Review* 2, 9; see also Millard and Vergan 2013 *Obiter* 393.

<sup>190</sup> Madinger *Money Laundering: A Guide for Criminal Investigators* 10.

<sup>191</sup> Sharman JC "Power and Discourse in Policy Diffusion: Anti-Money Laundering in Developing States" 2008 *International Studies Quarterly* 635, 636.

<sup>192</sup> Ping H *Money Laundering: Suppression and Prevention - The Research on the Legislation Concerning Money Laundering* (VDM Germany 2008) 10.

<sup>193</sup> De Koker 2003 *Journal of Money Laundering Control* 166.

as accessories after the fact.<sup>194</sup> An accessory after the commission of a crime is a person who unlawfully and intentionally engages in activities intended to enable the perpetrator to evade criminal liability for the crime or assists the perpetrator to evade liability.<sup>195</sup> This shows that there was no regulation of money laundering activities in the South African common law.<sup>196</sup>

The first legislation to prohibit money laundering in South Africa was influenced by international instruments.<sup>197</sup> The *Drugs Act* introduced the first statutory regulation of money laundering as an independent crime in South Africa.<sup>198</sup> Following the *Drugs Act*, several other legislations were enacted to control and prohibit money laundering but none provided anti-money laundering measures until the *Financial Intelligence Centre Act*.<sup>199</sup> The *FICA* introduced the regulation of customer due diligence as an anti-money laundering measure in South Africa.<sup>200</sup> The prohibition of money laundering activities under the *Drugs Act*,<sup>201</sup> the *Proceeds of Crime Act*<sup>202</sup> and the *POCA*<sup>203</sup> did not provide measures to combat money laundering in South Africa. The prohibition of money laundering activities was not good enough to curb money laundering in South Africa.<sup>204</sup>

#### 2.4.1 Drugs and Drug Trafficking Act

The enactment of the *Drugs Act* followed the recommendation to sign the *Vienna Convention* by the government advisory council.<sup>205</sup> The *Vienna Convention*

<sup>194</sup> *S v Dustigar* (Durban and Coast Local Division) (unreported) case number CC6/2000; see also De Koker L "Money Laundering Control: The South African Model" 2003 *Journal of Money Laundering Control* 163, 166.

<sup>195</sup> Snyman CR *Criminal Law* 6<sup>th</sup> ed (Lexis Nexis Durban 2014) 25.

<sup>196</sup> De Koker 2003 *Journal of Money Laundering Control* 166.

<sup>197</sup> The adoption of anti-money laundering measures was influenced by the *United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances* (1988) (*Vienna Convention*), see article 3(c)(i).

<sup>198</sup> Sections 4-6 of the *Drugs Act*.

<sup>199</sup> See section 21 of the *FICA*. The *Proceeds of Crime Act* and the *POCA* were enacted before the *FICA* but they did not provide measures to combat money laundering in South Africa.

<sup>200</sup> De Koker 2003 *Journal of Money Laundering Control* 166.

<sup>201</sup> Sections 4-6 of the *Drugs Act* see also Madinger *Money Laundering: A Guide for Criminal Investigators* 10.

<sup>202</sup> Sections 28-33 of the *Proceeds of Crime Act*; see also Madinger *Money Laundering: A Guide for Criminal Investigators* 10.

<sup>203</sup> See sections 4-6 of the *POCA*; see also Williams C *An Analysis of the Critical Shortcomings in South Africa's Anti-Money Laundering Legislation* (LLM – dissertation University of Western Cape 2017) 25.

<sup>204</sup> De Koker L and Henning JJ "Money Laundering Control in South Africa" 1998 *Transactions of the Centre for Business Law* 24.

<sup>205</sup> Van Jaarsveld I.L. "Mimicking Sisyphus? An Evaluation of the Know Your Customer Policy" 2006 *Obiter* 228, 240.

prohibited drug related money laundering activities and encouraged its signatory jurisdictions to implement provisions to prohibit drug related money laundering.<sup>206</sup> Subsequently, the *Drugs Act* was enacted to prohibit the acquisition of property or money<sup>207</sup> that proceeds from a defined crime, such as drug trafficking or fraud.<sup>208</sup> Some provisions of the *Drugs Act* are included in the regulation of customer due diligence measures though the *Drugs Act* did not expressly regulate the implementation of customer due diligence measures in South Africa.<sup>209</sup> An example is the regulation of the duty upon financial institutions to report suspicious transactions<sup>210</sup> and the duty to establish the source of funds involved in customer transactions.<sup>211</sup> These duties form part of customer due diligence measures under the *FICA*.<sup>212</sup>

The *Drugs Act* had weaknesses. One major weakness which led to its repeal was that it only prohibited money laundering activities which were related to drug-offences.<sup>213</sup> As mentioned earlier, money laundering can be committed through various crimes such as fraud and corruption, not drug trafficking alone.<sup>214</sup> The researcher submits that the *Drugs Act* was not robust enough to curb money laundering in South Africa. Its application was narrowed to drug-related proceeds and overlooked the influence of other causes of money laundering like corruption and fraud.<sup>215</sup> The mere prohibition of money laundering in the *Drugs Act* was not sufficient to fight money laundering in South Africa.<sup>216</sup> There was a need for more measures to detect, control and combat money laundering in South Africa.<sup>217</sup> The

<sup>206</sup> Article 3(c)(i) of the *Vienna Convention*.

<sup>207</sup> Section 1 of the *Drugs Act*.

The *Drugs Act* defines property as money or any other movable or immovable, corporeal or incorporeal thing.

<sup>208</sup> Section 22 of the *Drugs Act*.

The term "defined crime" was comprised of two components, one subscribes to the meaning of drug offences and the second described the offence. See also section 1 of the *Drugs Act*.

<sup>209</sup> Section 10(2) of the *Drugs Act*; Nyaude *The Compliance Duties of Commercial Banks* 36.

<sup>210</sup> Section 10 of the *Drugs Act*. See also Van Jaarsveld 2006 *Obiter* 240.

<sup>211</sup> Section 10 of the *Drugs Act*.

<sup>212</sup> Section 29 of the *FICA*.

<sup>213</sup> See section 5 of the *Drugs Act*; see also Van Jaarsveld *Money Laundering Control and Banks* 272.

<sup>214</sup> Nyaude *The Compliance Duties of Commercial Banks* 25.

<sup>215</sup> Section 4-6 of the *Drugs Act*; see also Nyaude *The Compliance Duties of Commercial Banks* 25.

<sup>216</sup> See section 4 of the *Drugs Act*; see also De Koker and Henning 1998 *Transactions of the Centre for Business Law* 26.

<sup>217</sup> De Koker and Henning 1998 *Transactions of the Centre for Business Law* 26.

*Drugs Act* failed to provide measures to combat money laundering, rather it punished the perpetrators and failed to deter them from committing money laundering.<sup>218</sup>

#### 2.4.2 *The Proceeds of Crime Act*

When the financial sanctions against South Africa were lifted in 1992, South Africa re-joined the international trade community.<sup>219</sup> This exposed South Africa to criminal abuse by money launderers and became a target of international financial crimes such as money laundering.<sup>220</sup> This was because South Africa began engaging in trade with other countries that exposed South Africa to money laundering activities during business transactions.<sup>221</sup> The globalization of money laundering exacerbated the need for a legislation to regulate and control money laundering in South Africa.<sup>222</sup> In 1996, the *Proceeds of Crime Act*<sup>223</sup> was enacted, with a wide scope of money laundering offences.<sup>224</sup> Unlike the *Drugs Act*, the *Proceeds of Crime Act* included crime emanating from proceeds of all types of illegal activities, not drug-related activities only.<sup>225</sup> The *Proceeds of Crime Act* was enacted as an improvement of the *Drugs Act*.<sup>226</sup> The *Proceeds of Crime Act* introduced other offences that were not provided in the *Drugs Act*.<sup>227</sup> The offences introduced by the *Proceeds of Crime Act* included offences of assisting another person to benefit from the possession of proceeds of a crime<sup>228</sup> and also putting information on customer transactions to misuse.<sup>229</sup>

Under the *Proceeds of Crime Act*, all suspicious transactions were reported to the Commercial Crime Unit of the South African Police Service.<sup>230</sup> Financial institutions were only required to make investigations on the legitimacy of the source of funds

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<sup>218</sup> See section 6 of the *Drugs Act*.

<sup>219</sup> Henning, Du Toit and Nel 1998 *Transaction of the Centre for Business Law* 82.

<sup>220</sup> Van Jaarsveld *Money Laundering Control and Banks* 272.

<sup>221</sup> Gordon R "Losing the War against Dirty Money: Rethinking Global Standards on Preventing Money Laundering and Terrorism Financing" 2011 *Duke Journal of Comparative and International Law* 503, 540.

<sup>222</sup> Van Jaarsveld *Money Laundering Control and Banks* 272.

<sup>223</sup> See sections 28-33 of the *Proceeds of Crime Act*.

<sup>224</sup> Van Jaarsveld *Money Laundering Control and Banks* 272.

<sup>225</sup> Itzikowitz A "Money Laundering" 2010 *SA Merc Law Journal* 302, 309.

<sup>226</sup> Nyaude *The Compliance Duties of Commercial Banks with Regard to Online Money Laundering* 37.

<sup>227</sup> Sections 29 and 32 of the *Proceeds of Crime Act*.

<sup>228</sup> Section 29 of the *Proceeds of Crime Act*.

<sup>229</sup> Section 32 of the *Proceeds of Crime Act*.

<sup>230</sup> Section 31(1) of the *Proceeds of Crime Act*.

and transactions of their customers.<sup>231</sup> This is because financial institutions were not required to have money laundering control officers who would handle suspicious transactions.<sup>232</sup> As a result, the process of reporting and filing reports of money laundering was ineffective due to poor administration.<sup>233</sup> The South African Police Service normally has much workload to attend to all issues thoroughly and on time.<sup>234</sup>

The Act made no provision of the importance of customer identification and verification.<sup>235</sup> The shortfalls of this act led the South African Commission to propose a *Draft Bill* that was aimed at creating an effective and adequate anti-money laundering framework in South Africa.<sup>236</sup> The *Proceeds of Crime Act* did not establish measures to prevent money laundering in South Africa. Mere punishment of offenders was not enough to curb money laundering in South Africa. The reliance on the *Proceeds of Crime Act* to combat money laundering in South Africa was ineffective. The *Proceeds of Crime Act* was repealed and the POCA was enacted.

## 2.5 Conclusion

The proceeds of criminal activities can be movable, immovable, corporeal or incorporeal property and not precisely money alone.<sup>237</sup> The above Acts regulated the prohibition of the use or possession of proceeds of unlawful activities such as drug trafficking.<sup>238</sup> The *Drugs Act* and the *Proceeds of Crime Act* provided a broad ambit of the prohibition of money laundering and did not provide anti-money laundering measures.<sup>239</sup> The lack of measures to curb money laundering hindered the effectiveness of the *Drugs Act* and the *Proceeds of Crime Act* towards the combating of money laundering in South Africa.<sup>240</sup> Before the adoption and implementation of

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<sup>231</sup> Van Jaarsveld 2006 *Obiter* 241.

<sup>232</sup> Itzikowitz 2000SA *Merc Law Journal* 310.

<sup>233</sup> Van Jaarsveld *Money Laundering Control and Banks* 273.

<sup>234</sup> Van Jaarsveld *Money Laundering Control and Banks* 273.

<sup>235</sup> De Koker and Henning 1998 *Transactions of the Centre for Business Law* 26.

<sup>236</sup> Van Jaarsveld 2006 *Obiter* 241; see also Rahn RW "Why the War on Money Laundering Should Be Aborted" 156.

<sup>237</sup> Williams *An Analysis of the Critical Shortcomings in South Africa's Anti-Money Laundering Legislation* 29.

<sup>238</sup> Williams *An Analysis of the Critical Shortcomings in South Africa's Anti-Money Laundering Legislation* 27.

<sup>239</sup> See sections 4-6 of the *Drugs Act* and sections 28-33 of the *Proceeds of Crime Act*; see also De Koker 2003 *Journal of Money Laundering Control* 166.

<sup>240</sup> See sections 4-6 of the *Drugs Act* and sections 28-33 of the *Proceeds of Crime Act*; see also De Koker and Henning 1998 *Transactions of the Centre for Business Law* 26.

customer due diligence in the South African money laundering regulatory framework, there were no money laundering control measures.<sup>241</sup> This was not adequate to combat money laundering activities in South Africa. The regulation of lenient penalties for money laundering activities was not sufficient.<sup>242</sup> The enactment of customer due diligence as a measure to combat money laundering created a risk-sensitive approach towards the curbing of money laundering in South Africa.<sup>243</sup> The following chapter discusses the regulation of customer due diligence in South Africa and it also determines whether customer due diligence is an effective measure to combat money laundering in South Africa.

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<sup>241</sup> Itzikowitz 2000 *SA Merc Law Journal* 310; see also Henning, Du Toit and Nel 1998 *Transaction of the Centre for Business Law* 82.

<sup>242</sup> De Koker 2003 *Journal of Money Laundering Control* 166.

<sup>243</sup> Van Jaarsveld *Money Laundering Control and Banks* 280.

## CHAPTER THREE

### CURRENT REGULATORY ASPECTS OF MONEY LAUNDERING IN SOUTH AFRICA

#### 3.1 Introduction

Several anti-money laundering laws have been enacted to combat money laundering in South Africa. The primary anti-money laundering legislation in South Africa is the *Prevention of Organised Crime Act*,<sup>244</sup> the *Banks Act* as amended<sup>245</sup> and the *Financial Intelligence Centre Act* as amended.<sup>246</sup> However, comprehensive anti-money laundering regulations are provided in the *POCA* and the *Amendment Act*.<sup>247</sup> The South African Courts have also passed judgements on money laundering offences which have been applied in other cases for anti-money laundering measures to be applied consistently in South Africa.<sup>248</sup> Money laundering has a negative effect on the country's economy. Consequently various anti-money laundering measures have been adopted in South Africa to date.<sup>249</sup> The *POCA* is the main legislation that provides conduct that constitutes money laundering.<sup>250</sup> The *Amendment Act* provides measures to control and detect money laundering.<sup>251</sup> In other terms, the *POCA* outlines money laundering activities and the *Amendment Act* prescribes measures to combat money laundering.<sup>252</sup> The *POCA* and the *Amendment Act* should be read together. South Africa's anti-money laundering regulatory framework provides for the prevention of money laundering activities and the enforcement of anti-money laundering measures.<sup>253</sup> This research examines the prevention of money laundering activities through the implementation of customer

<sup>244</sup> 121 of 1998 (*POCA*), see sections 4-6.

<sup>245</sup> 94 of 1990, see section 84B.

<sup>246</sup> 38 of 2001 as amended by *Financial Intelligence Centre Amendment Act 1 of 2017 (Amendment Act)*, sections see 20A-21H.

<sup>247</sup> Lawack VA "Mobile Money, Financial Inclusion and Financial Integrity: The South African Case" 2013 *Washington Journal of Law, Technology and Arts* 317, 331.

<sup>248</sup> *S v Shaik* 2007 (1) SACR 247 (SCA) is the most high profile case on money laundering where the advisor of the then Deputy President was convicted of corruption and money laundering offences in terms of the *POCA*.

<sup>249</sup> Ramalu B *An Examination of Anti-Money Laundering Initiatives Undertaken by Six Major Banks in South Africa* (Magister in Business Administration – dissertation University of Johannesburg 2006) 47.

<sup>250</sup> Lawack 2013 *WJLTA* 331.

<sup>251</sup> See sections 20A-21H of the *Amendment Act*; see also Lawack 2013 *WJLTA* 331.

<sup>252</sup> See sections 4-6 of the *POCA*; see also sections 20A-21H of the *Amendment Act*; see also Reuter P and Truman EM "Chasing Dirty Money: The Fight against Money Laundering" 2004 *Institute for International Economics* 1, 30.

<sup>253</sup> Reuter and Truman 2004 *Institute for International Economics* 4.

due diligence measures.<sup>254</sup> This chapter discusses the current regulatory framework of the anti-money laundering measures in South Africa to determine whether customer due diligence measures are applied consistently in South Africa.

### 3.2 *The Regulation of Money Laundering under the POCA*

When the *POCA* was enacted in 1999, it became the main legislation prohibiting money laundering activities in South Africa.<sup>255</sup> The *POCA* regulates money laundering as a criminal activity.<sup>256</sup> A person is found guilty of money laundering when he or she knows or ought to have reasonably known that certain property is proceeds from criminal conduct and continues to act in connection with the property.<sup>257</sup> Money laundering activities have two effects.<sup>258</sup> Firstly, money laundering activities result in disguising or concealing the nature, ownership or location of laundered property.<sup>259</sup> Secondly, money laundering activities also result in assisting a person who has committed money laundering crimes in South Africa to evade prosecution or conceal property acquired through criminal acts.<sup>260</sup> The *POCA* provides that a person who enters into agreement to the effect of making illegally obtained property available to another person is guilty of money laundering.<sup>261</sup> The third instance when a person is guilty of money laundering under the *POCA* is when a person obtains or uses proceeds of criminal activities with the knowledge that the property proceeds from unlawful acts.<sup>262</sup> However, the researcher argues that

<sup>254</sup> Sections 20A-21H of the *Amendment Act*.

<sup>255</sup> See sections 4-6 of the *POCA*; see also De Koker L "Money Laundering Control: The South African Model" 2003 *Journal of Money Laundering Control* 165, 166.

<sup>256</sup> Sections 4-6 of the *POCA*; see also Williams C *An Analysis of the Critical Shortcomings in South Africa's Anti-Money Laundering Legislation* (LLM – dissertation University of Western Cape 2017) 25.

<sup>257</sup> Section 4 of the *POCA*; see also De Koker 2003 *Journal of Money laundering Control* 166.

<sup>258</sup> Section 4(a)-(b) of the *POCA*; see also Borlini L "The Economics of Money Laundering" in Reichel P and Abanese J (eds) *Handbook of Transnational Crime and Justice* (SAGE Publications 2014) 228.

<sup>259</sup> Section 4(b)(i) of the *POCA*; see also Williams *Critical Shortcomings in South Africa's Anti-Money Laundering Legislation* 26.

<sup>260</sup> Section 4(b)(ii) of the *POCA*; see also Kersop M and Du Toit S.F "Anti-money Laundering Regulations and the Effective Use of Mobile Money in South Africa – Part 1" 2015 *PER/PELJ* 1603, 1624.

<sup>261</sup> Section 5 of the *POCA*; see also De Koker L "Money Laundering in South Africa" 2002 *Institute for Security Studies* 1, 5.

<sup>262</sup> See section 6 of the *POCA*; see also Sujee Z.J *A study of the Anti-Money Laundering Framework in South Africa and the United Kingdom* (LLM – dissertation University of Pretoria 2016) 9.

section 6 of the *POCA* does not prohibit money laundering.<sup>263</sup> Instead, the section applies to persons indirectly associated with money laundering activities and to complement section 4 so as to secure conviction of money launderers by providing evidence of money laundering activities.<sup>264</sup>

In all instances where a person may be found guilty of money laundering under the *POCA*, the person ought to have known or reasonably known that the property is proceeds from unlawful acts.<sup>265</sup> On the other hand, a person may also be convicted of money laundering if the person negligently fails to discern that the property is proceeds from illegal activities.<sup>266</sup> Negligence is established when a person with the general knowledge, skill, training and expertise of a person in his or her position fails to detect money laundering as expected of a person with the same general knowledge, skill, training and expertise.<sup>267</sup> This means that when an employee of a financial institution concludes transfers or transactions that subsequently result in money laundering but fails to reasonably detect money laundering, he or she commits an act of money laundering through negligence.<sup>268</sup> The *POCA* also provides important definitions of the main concepts of money laundering.<sup>269</sup>

The *POCA* does not provide any specific measures to combat money laundering in South Africa.<sup>270</sup> The *POCA* only regulates the prohibition of money laundering in South Africa.<sup>271</sup> The mere prohibition of money laundering activities is not sufficient

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<sup>263</sup> Section 6 of the *POCA*; see also Williams *Critical Shortcomings in South Africa's Anti-Money Laundering Legislation* 26.

<sup>264</sup> Tuba M "Prosecuting Money Laundering the FATF Way: An Analysis of Gaps and Challenges in South African Legislation from a Comparative Perspective" 2012 *Acta Criminologica* 103, 109.

<sup>265</sup> Section 4-6 of the *POCA*; see also De Koker 2002 *Institute for Security Studies* 6. Section 1(3) of the *POCA* states that a person ought to have reasonably known or suspected a fact if the conclusions that he or she might have reached are those which would have been reached by a reasonably diligent and vigilant person having both; the general knowledge, skill, training and experience that may reasonably be expected of a person in his or her position; and the general knowledge, skill, training and experience that he or she in fact has'.

<sup>266</sup> Section 1(3) of the *POCA*; see also Henning JJ and Ebersohn GJ "Insider Trading, Money Laundering and Computer Crime" 2001 *Transactions of the Centre for Business Law: Combating Economic Crime* 105, 112.

<sup>267</sup> Section 1(3) of the *POCA*.

<sup>268</sup> Van Jaarsveld *Money Laundering Control and Banks* 280.

<sup>269</sup> Williams C *An Analysis of the Critical Shortcomings in South Africa's Anti-Money Laundering Legislation* 27.

<sup>270</sup> See section 4-6 of the *POCA*; see also Tuba M and Van der Westhuizen C "An Analysis of the "Know-Your-Customer Policy as an Effective Tool to Combat Money Laundering: Is it about Who or What to Know that Counts?" 2014 *International Journal Public Law and Policy* 53, 58.

<sup>271</sup> Section 8 of the *POCA*; see also Tuba 2012 *Acta Criminologica* 170.

to curb money laundering in South Africa.<sup>272</sup> This is because there is need to detect money laundering activities for relevant anti-money laundering measures to be applied by the financial institutions.<sup>273</sup> As such there remained gaps in the regulatory framework of money laundering in South Africa because there were no measures to control money laundering activities.<sup>274</sup> The enactment of the *Amendment Act* alleviated the lack of express measures to curb money laundering by introducing customer due diligence measures.<sup>275</sup> The *POCA* prohibits money laundering and should always be read with the *Amendment Act* which provides measures to control, detect and curb money laundering in South Africa.<sup>276</sup> The *Amendment Act* addressed the need to implement anti-money laundering measures to enhance the combating of money laundering in South Africa.<sup>277</sup>

### **3.3 The Regulation of Money Laundering under the Amendment Act**

The provisions of the *Amendment Act* are enforced by the Financial Intelligence Centre (FIC) and the Money Laundering Advisory Council.<sup>278</sup> Amongst other obligations, the FIC and the Money Laundering Advisory Council are tasked with the duty to combat money laundering activities<sup>279</sup> and also impose this duty on all financial institutions registered under the *Amendment Act*.<sup>280</sup> The duties imposed by the FIC and the Money Laundering Advisory Council are used to safeguard the control of money laundering in financial institutions in South Africa.<sup>281</sup>

The South African anti-money laundering regulatory framework does not only prohibit money laundering activities, it also provides several measures to control, suppress, detect and enable money laundering investigations.<sup>282</sup> The money

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<sup>272</sup> Henning JJ and Hauman M "Fortifying a Risk-Based Approach in the South African AML/CFT Process" 2017 *Journal of Financial Crime* 520, 525.

<sup>273</sup> Henning and Hauman 2017 *Journal of Financial Crime* 525.

<sup>274</sup> Williams C *An Analysis of the Critical Shortcomings in South Africa's Anti-Money Laundering Legislation* 27.

<sup>275</sup> Section 20A-21H of the *Amendment Act*; see also Millard D and Vergano V "Hung Out to Dry? Attorney Client Confidentiality and the Reporting Duties Imposed by the Financial Intelligence Centre Act 38 of 2001" 2013 *Obiter* 389, 391.

<sup>276</sup> See sections 4-6 of the *POCA*; see also sections 20A-21H of the *Amendment Act*; Millard and Vergano *Obiter* 397.

<sup>277</sup> Sections 20A-21H of the *Amendment Act*; Millard and Vergano *Obiter* 397.

<sup>278</sup> See section 2 of the *Amendment Act*; see also Sharrock R *Law of Banking and Payment in South Africa* (Juta Cape Town 2016) 100.

<sup>279</sup> Lawack 2013 *WJLTA* 331; see also preamble of the *Amendment Act*.

<sup>280</sup> See schedule 1 of the *Amendment Act*.

<sup>281</sup> Section 4 of the *Amendment Act*.

<sup>282</sup> Lawack 2013 *WJLTA* 331.

laundrying control measures of South Africa are regulated by the *Amendment Act* which regulates the implementation of customer due diligence measures to combat money laundering in South Africa.<sup>283</sup> The money laundering measures provided in the *Amendment Act* are based on three principles. These are, financial institutions should have knowledge of their customers,<sup>284</sup> transaction records must be kept by the financial institutions<sup>285</sup> and financial institutions should report unusual and suspicious transactions to the relevant authorities.<sup>286</sup> Chapter 3 of the *Amendment Act* specifically regulates customer due diligence measures, thus the establishment and verification of customer identity.<sup>287</sup> This research focuses on customer due diligence measures as discussed in detail below.

### 3.3.1 *Customer identification and verification as an anti-money laundering measure under the Amendment Act*

The *Amendment Act* does not expressly state the documents that should be used to establish customer identity.<sup>288</sup> However, the *Amendment Act* accepts the use of the green-bar coded identity document when establishing customer identity and for verification purposes.<sup>289</sup> The green-bar coded identity document is accepted as one of the official identity documents in South Africa.<sup>290</sup> The process of customer identification and verification regulated by the *Amendment Act* is also recognized by the South African courts.<sup>291</sup> In *Energy Measurements (Pty) Ltd v First National Bank of South Africa Ltd* the court held that financial institutions have a duty to establish

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<sup>283</sup> See section 20A-21H of *Amendment Act*; see also Kersop M *Anti-Money Laundering Regulations and the Effective use of Mobile Money in South Africa* (LLM-dissertation Northwest University 2014) 30.

<sup>284</sup> See section 21 of the *Amendment Act*; see also Kersop *Anti-Money Laundering Regulations* 29.

<sup>285</sup> See section 22 of the *Amendment Act*; see also Njotini MN *The Verification and Exchange of Customer Due Diligence (CDD) Data in Terms of the Financial Intelligence Centre Act 38 of 2001* (LLM – Dissertation University of South Africa 2009) 49.

<sup>286</sup> See sections 29 and 32 of the *Amendment Act*; see also Millard and Vergano *Obiter* 397.

<sup>287</sup> See section 20A-21H of the *Amendment Act*; see also Kersop *Anti-Money Laundering Regulations* 30.

<sup>288</sup> Sharrock *Law of Banking and Payment in South Africa* 101.

<sup>289</sup> *Regulation of the Interception of Communication and Provision of Communication-Related Information Act* 70 of 2002, section 1.

<sup>290</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 50.

<sup>291</sup> *Columbus Joint Venture v Absa Bank Ltd* 2002 (1) All SA 105 (SCA) and *Indac Electronics (Pty) Ltd v Volkskas Bank Ltd* 1992 (1) All SA 411 (A) para 413-416.

and verify customer identity before concluding transactions to enable money laundering investigations.<sup>292</sup>

Customer due diligence measures must be performed to both current and existing customers to enable financial institutions to know all their customers.<sup>293</sup> Existing customers are customers who had established business relationships with a financial institution before the duty to identify and verify customer identity on 30 June 2003.<sup>294</sup> Current customers are customers who seek to establish business relationships with a financial institution after the commencement of the duty to identify and verify customer identities under the *Amendment Act*.<sup>295</sup> Customer due diligence measures are applied according to the level of money laundering risk the customer poses to the financial institution.<sup>296</sup> Financial institutions use customer data to identify and distinguish between high-risk and low-risk customers for effective implementation of anti-money laundering measures.<sup>297</sup> High-risk customers are customers who pose high money laundering risk to the financial institution.<sup>298</sup> For example politically exposed persons.<sup>299</sup> Low-risk customers are customers who pose low money laundering risks to the financial institution.<sup>300</sup> For example low-income earners.<sup>301</sup>

### 3.3.1.1 Comprehensive Due Diligence Measures

Comprehensive customer due diligence measures are enforced by financial institutions to reduce the risk of money laundering posed by high-risk customers.<sup>302</sup> Comprehensive customer due diligence measures require financial institutions to obtain additional information from high-risk customers.<sup>303</sup> Additional information

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<sup>292</sup> *Energy Measurements (Pty) Ltd v First National Bank of South Africa Ltd* 2000 (2) All SA 396 (W) para 399-401.

<sup>293</sup> Section 21(1) of the *Amendment Act*; see discussion by De Koker 2004 *Journal of South African Law* 718.

<sup>294</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 51.

<sup>295</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 51.

<sup>296</sup> De Koker 2004 TSAR 725; see also De Koker L "Money Laundering Trends in South Africa" 2003 *Journal of Money Laundering Control* 27, 30.

<sup>297</sup> De Koker 2004 *Journal of South African Law* 725.

<sup>298</sup> Scott KA and Stephenson R "Enhanced Customer Due Diligence for Banks in the UK and the US" 2008 *Journal of International Banking and Financial Law* 86, 89.

<sup>299</sup> Section 21F-21G of the *Amendment Act*; see also schedule 3A of the *Amendment Act*.

<sup>300</sup> Ahlosani W *Anti-Money Laundering: A Comparative and Critical Analysis of the United Kingdom and the UAE's Financial Intelligence Units* (Palgrave Macmillan London 2016) 205. Ahlosani *Anti-Money Laundering* 212.

<sup>302</sup> Financial Intelligence Centre "Guidance Note 3 on the Implementation of Various Aspects of the Financial Intelligence Centre Act, 2001 (Act 38 of 2001)" *Guidance Note* (28 March 2013), note 3.

<sup>303</sup> Reg 21 in GN R1062 in GG41154 of 29 September 2017.

enables financial institutions to obtain information that is essential for money laundering investigations.<sup>304</sup> For example, the source of funds involved in customer transactions.<sup>305</sup> The additional information must be reasonably adequate to enable the financial institution to determine whether the customer's account activities are consistent with the financial institution's knowledge of the customer.<sup>306</sup> This procedure enables financial institutions to detect suspicious account activities, to enhance the reliance on customer due diligence to combat money laundering in South Africa.<sup>307</sup> The following discussion examines the application of comprehensive customer due diligence measures to high-risk customers and its relevancy in combating money laundering in South Africa.

Politically exposed persons are high-risk customers.<sup>308</sup> Politically exposed persons are natural persons who occupy or have previously occupied senior public positions in South Africa or other countries.<sup>309</sup> For example Heads of State or government, senior politicians, judicial or military officials, senior executives of state owned corporations and important political party officials.<sup>310</sup> They are considered a high money laundering risk due to their positions which make them susceptible to abuse of state funds by means of corruption and embezzlement.<sup>311</sup> The *Amendment Act* provides that comprehensive customer due diligence measures should be implemented in all transactions involving politically exposed persons or their family members.<sup>312</sup> This is because they pose high money laundering risks to financial institutions and financial institutions should obtain enough information to scrutinise their account activities so as to detect and report suspicious transactions.<sup>313</sup> However

<sup>304</sup> Itzikowitz A "South Africa: Money Laundering – The Duty to Report under the Law" 2008 *Journal of Financial Crime* 186, 187; see also Reg 21 in GN R1062 in GG41154 of 29 September 2017.

<sup>305</sup> Section 21B of the *Amendment Act*, see also Kersop *Anti-Money Laundering Regulations* 31.

<sup>306</sup> De Koker 2004 *Journal of South African Law* 724.

<sup>307</sup> De Koker 2004 *Journal of South African Law* 724.

<sup>308</sup> Njotini *Customer Due Diligence in terms of the FICA* 51.

<sup>309</sup> Leppan D "Refining the PEP Definition" *World-Check White Paper* (2005) 9; see also Nyaude AB *The Compliance Duties of Commercial Banks with Regard to Online Money Laundering* (LLM – dissertation University of Pretoria 2015) 22.

<sup>310</sup> Leppan *World-Check White Paper* 9.

<sup>311</sup> Ahlers C *The South African Anti-Money Laundering Regulatory Framework Relevant to Politically Exposed Persons* (Master of Philosophy in Fraud Risk Management – dissertation University of Pretoria 2013) 69; see related discussion by De Koker 2004 *Journal of South African Law* 724.

<sup>312</sup> See section 21F(c), 21G(c) and 21H of the *Amendment Act*; see also Ahlers *The South African Anti-Money Laundering Regulatory Framework* 70.

<sup>313</sup> Sections 29 and 32 of the *Amendment Act*; see also Leppan "Refining the PEP Definition" 19.

the lack of express anti-money laundering regulations relevant to politically exposed persons in South Africa limits the effectiveness of comprehensive measures on politically exposed persons.<sup>314</sup>

The regulation of money laundering in South Africa also provides for the implementation of comprehensive customer due diligence measures on correspondent banking transactions.<sup>315</sup> Correspondent banks are institutions acting as agents of certain banks (respondent banks) when these banks have no representation in banking centers.<sup>316</sup> The FIC recognizes the high money laundering risks associated with correspondent banking and urges financial institutions to establish business relationships with banks that implement anti-money laundering measures.<sup>317</sup> In this instance, comprehensive customer due diligence measures enable financial institutions to determine the owners of correspondent bank accounts, whether politically exposed persons are involved and whether the banks apply anti-money laundering measures.<sup>318</sup>

Lastly, comprehensive customer due diligence measures are also applied in transactions involving anonymous customers.<sup>319</sup> Anonymous customers are customers who are not physically present at the financial institution during identification and verification.<sup>320</sup> Comprehensive customer due diligence measures are applied to establish the existence of anonymous customers before concluding any transactions.<sup>321</sup> Financial institutions should obtain additional information such as proof of other transactions concluded from an account in the anonymous customer's name with other financial institutions that are subject to anti-money

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<sup>314</sup> Ahlers C *The South African Anti-Money Laundering Regulatory Framework* 98; see also De Klerk A "The Importance and Relevance of Financial Institutions Doing Business With Politically Exposed Persons In The Global Fight Against Money Laundering" 2007 *Journal of SA Law* 368, 370.

<sup>315</sup> Reg 18 in GN R1062 in GG41154 of 29 September 2017.

<sup>316</sup> Njotini *Customer Due Diligence Data in terms of the Financial Intelligence Centre Act* 30;

<sup>317</sup> Reg 18 in GN R1062 in GG41154 of 29 September 2017.

<sup>318</sup> Borlini L "The Economics of Money Laundering" 230; see also Financial Intelligence Centre "Guidance Note 05B On Cash Threshold Reporting to the Financial Intelligence Centre in Terms of Section 21 of The Financial Intelligence Centre Act, 2001 (Act 38 of 2001)" *Guidance Note* (2 October 2017) 31-32.

<sup>319</sup> See section 20A of the *Amendment Act*.

<sup>320</sup> Reg 18 in GN R1062 in GG41154 of 29 September 2017; see also Njotini *Customer Due Diligence Data in terms of the Financial Intelligence Centre Act* 60.

<sup>321</sup> Kersop *Anti-Money Laundering Regulations* 32.

laundrying measures.<sup>322</sup> Customer due diligence measures are implemented to mitigate the money laundering risks posed by anonymous customers to financial institutions.

### 3.3.1.2 Simplified customer due diligence measures

Simplified customer due diligence measures are anti-money laundering measures implemented to low-risk customers.<sup>323</sup> The *Amendment Act* does not provide a list of low-risk customers but it can be argued that low-risk customers include wage earners receiving periodical income.<sup>324</sup> The identification of low-risk customers is essential in ensuring that financial institutions implement relevant customer due diligence measures to the customers.<sup>325</sup> Low-risk customers do not pose high money laundering risks to the financial institutions such that ordinary and basic customer due diligence measures are applied to establish and verify their identity, thus simplified customer due diligence measures.<sup>326</sup> Simplified customer due diligence measures involve relaxed or minimum identification and verification measures.<sup>327</sup> Financial institutions only obtain basic information relating to the customer's name, date of birth, identity number and residential addresses.<sup>328</sup> Financial institutions establish and verify customer identity before they commence a business relationships with the customer to enable them to identify suspicious money laundering activities when their knowledge of the customer is not commensurate with the customer's account activities.<sup>329</sup> Accordingly, simplified customer due diligence measures enable financial institutions to detect and control money laundering activities and enhance the reliance on customer due diligence measures to combat money laundering in South Africa.<sup>330</sup>

322 Njotini MN "The Transaction or Activity Monitoring Process: An Analysis of the Customer Due Diligence Systems of the United Kingdom and South Africa" 2000 *Obiter* 556, 567.

323 De Koker 2004 *Journal of South African Law* 722.

324 Section 21 of the *Amendment Act*; see also Njotini *Customer Due Diligence Data in terms of the Financial Intelligence Centre Act* 58.

325 De Koker 2004 *Journal of South African Law* 722.

326 Njotini 2010 *Obiter* 560.

327 Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 52.

328 De Koker 2004 *Journal of South African Law* 722; see also Ryder N "The Financial Services Authority and Money Laundering: A Game of Cat and Mouse" 2008 *Cambridge Law Journal and Contributors* 635, 641.

329 Muller WH, Kälin C and Goldsmith JG *Anti-Money Laundering: International Law and Practice* (John Wiley West Sussex 2007) 3.

330 Lawack 2013 *WJLTA* 331.

### 3.3.1.3 A risk-based customer due diligence approach to combat money laundering

The FIC issues guidance notes on how the provisions of the *Amendment Act* should be interpreted to enhance the combating of money laundering in South Africa.<sup>331</sup> The guidance notes are not legally binding but are of legal significance because they are formally issued in terms of the *Amendment Act*.<sup>332</sup> The FIC guidance notes established a risk-based approach in the implementation of customer due diligence towards the combating of money laundering in South Africa.<sup>333</sup> The risk-based approach is a regulated procedure of anti-money laundering measures in South Africa.<sup>334</sup> The *Amendment Act* regulates a risk-based approach as a measure of ensuring that financial institutions understand their exposure to money laundering risks.<sup>335</sup> Financial institutions protect their businesses from money laundering when they understand and manage the money laundering risks they are exposed to. It is essential for customers to be risk assessed before a business relationship is established.<sup>336</sup>

In the context of money laundering control, risk refers to the likelihood and impact of money laundering that could occur due to money laundering threats and vulnerabilities arising in a financial institution.<sup>337</sup> Money laundering risks and vulnerabilities expose financial institutions to money laundering activities.<sup>338</sup> Accordingly, the implementation of risk-based approach customer due diligence measures enables financial institutions to detect money laundering risks before they materialize.<sup>339</sup> Risk-based customer due diligence measures enable financial institutions to apply the appropriate level of customer due diligence measures to the

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<sup>331</sup> See section 4 of the *Amendment Act*; see also Financial Intelligence Centre "Guidance Note 07: The Implementation of Various Aspects of the Financial Intelligence Centre Act 38 of 2001" *Guidance Note 07* (02 October 2017) 2.

<sup>332</sup> See section 4 of the *Amendment Act*; see also Henning JJ "Fortifying a Risk-Based Approach in the South African AML/CFT Process" 2017 *Journal of Financial Crime* 520, 526.

<sup>333</sup> Financial Intelligence Centre *Guidance Note 07* para 19; see also De Koker 2004 *Journal of South African Law* 720

<sup>334</sup> See section 42 of the *Amendment Act*; see also Kersop M and Du Toit SF "Anti-Money Laundering Regulations and the Effective Use of Motile Money in South Africa part 2" 2015 *PER/PELJ* 1637, 1638.

<sup>335</sup> Financial Intelligence Centre *Guidance Note 07* para 3.

<sup>336</sup> Henning 2017 *Journal of Financial Crime* 523.

<sup>337</sup> Financial Intelligence Centre *Guidance Note 07* para 13.

<sup>338</sup> Kersop and Du Toit 2015 *PER/PELJ* 1657.

<sup>339</sup> De Koker 2004 *Journal of South African Law* 720.

customers.<sup>340</sup> Thus, high-risk customers are subjected to comprehensive due diligence measures than low-risk customers.<sup>341</sup> Financial institutions implementing the risk-based approach are able to determine money laundering risks posed by different customers.<sup>342</sup> This is done through establishing clear guidelines on the different levels of customer due diligence measures applicable to customers of different risk categories.<sup>343</sup>

The risk-based approach is an essential element of customer due diligence measures and the fight against money laundering in South Africa.<sup>344</sup> The risk-based approach is essential because it enables financial institutions to distinguish between high-risk and low-risk customers through creating risk matrixes which determine the application of customer due diligence measures.<sup>345</sup> The distinction of high-risk and low-risk customers allows financial institutions to devote more resources to high-risk customers and ensure a robust and consistent application of customer due diligence measures in South Africa.<sup>346</sup> A robust application of customer due diligence measures enhances the reliance on customer due diligence measures to combat money laundering in South Africa.

#### 3.3.1.4 Ongoing due diligence measures to combat money laundering

The *Amendment Act* provides that financial institutions should monitor the transactions concluded by the customer throughout their business relationship to enable the detection of suspicious money laundering activities.<sup>347</sup> An ongoing monitoring approach entails a continuous monitoring of customer transactions by the financial institution throughout the business relationship.<sup>348</sup> Ongoing monitoring enables financial institutions to identify inconsistencies between the financial

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<sup>340</sup> Henning 2017 *Journal of Financial Crime* 528; see also De Koker 2004 *Journal of South African Law* 720.

<sup>341</sup> Lawack 2013 *WJLTA* 341.

<sup>342</sup> Financial Intelligence Centre *Guidance Note 07* para 30.

<sup>343</sup> Financial Intelligence Centre *Guidance Note 07* para 31.

<sup>344</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 63; see also Henning 2017 *Journal of Financial Crime* 526.

<sup>345</sup> De Koker 2004 *Journal of South African Law* 722.

<sup>346</sup> Henning 2017 *Journal of Financial Crime* 526; see also Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 63.

<sup>347</sup> Section 21C of the *Amendment Act*; see also De Koker 2004 *Journal of South African Law* 723.

<sup>348</sup> Section 21C of the *Amendment Act*; see also Financial Intelligence Centre *Guidance Note 07* para 127.

institution's knowledge of the customer and the customer's account activities.<sup>349</sup> These inconsistencies may lead to money laundering investigations by the relevant authorities.<sup>350</sup> The regulation of ongoing due diligence by the *Amendment Act* is a measure that enables financial institutions to detect money laundering activities through identification of unusual and suspicious transactions.<sup>351</sup> In this regard, ongoing due diligence enhances the reliance on customer due diligence measures to combat money laundering in South Africa.

### 3.4 *The Regulation of Customer Due Diligence under the Banks Act*

The South African banking institutions have a common law duty to identify and verify the identity of their prospective customers.<sup>352</sup> According to the *Banks Act*, banking institutions are obliged to have a senior compliance officer who enforces the duty to identify and verify customers as a measure to combat money laundering in South Africa.<sup>353</sup> Banks are also obliged to uphold and implement anti-money laundering measures regulated by the *Amendment Act*.<sup>354</sup> The *Banks Act* does not provide measures to control or prohibit money laundering in South Africa.<sup>355</sup> However, the *Banks Act* regulates policies and procedures that guarantee the prohibition and control of money laundering activities. These measures include the duty to report suspicious money laundering activities to the Registrar of banks.<sup>356</sup>

### 3.5 *Conclusion*

The mere existence of anti-money laundering legislation, regulations and measures is not a guarantee of its adequacy and effectiveness in the combating of money laundering in South Africa. From the preceding analysis it can be concluded that customer due diligence measures are an important anti-money laundering measure

<sup>349</sup> De Koker 2004 *Journal of South African Law* 723.

<sup>350</sup> Njotini 2000 *Obiter* 567.

<sup>351</sup> See sections 21C and 29 of the *Amendment Act*.

<sup>352</sup> *Energy Measurements (Pty) Ltd v First National Bank of South Africa Ltd* 2001 3 SA 132 (W) 427B-C. The identification requirement is in relation with the duty of banks to identify and verify their customers as described by Cameron JA in *Columbus Joint Ventures v Absa Bank Ltd* 2002 (1) All SA 105 (SCA) para 97-98.

<sup>353</sup> GN R9872 in GG 35950 of 12 December 2012, Regl 48; see also Sharrock *Law of Banking and Payment in South Africa* 101.

<sup>354</sup> Section 20A-21H of the *Amendment Act*.

<sup>355</sup> Section 84B of the *Banks Act*; see also Sharrock *Law of Banking and Payment in South Africa* 103.

<sup>356</sup> Section 4 of the *Banks Act*; see also Sujee *A study of the Anti-Money Laundering Framework in South Africa and the United Kingdom* 18.

in the combating of money laundering in South Africa. Customer due diligence aims at preventing the criminal abuse of financial institutions through criminal conducts such as money laundering.<sup>357</sup> The analysis of the anti-money laundering framework shows a coherent approach towards the combating of money laundering in South Africa. Financial institutions have designed systems that are able to detect money laundering activities and enhance the reliance on customer due diligence measures to combat money laundering in South Africa.<sup>358</sup>

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<sup>357</sup> De Koker 2006 *Journal of Financial Crime* 43.

<sup>358</sup> Sections 20A-21H of the *Amendment Act*; see also *Energy Measurements (Pty) Ltd v First National Bank of South Africa Ltd* 2000 (2) All SA 396 (W) para 425.

## CHAPTER FOUR

### CHALLENGES ASSOCIATED WITH THE RELIANCE ON CUSTOMER DUE DILIGENCE TO CURB MONEY LAUNDERING IN SOUTH AFRICA

#### 4.1 Introduction

From 1992 to date, South Africa managed to develop a comprehensive statutory regulatory structure towards the combating of money laundering in South Africa.<sup>359</sup> This is evidenced by the enforcement of anti-money laundering laws by several legislations including the *Financial Intelligence Center Amendment Act*,<sup>360</sup> the *Prevention of Organised Crime Act*<sup>361</sup> and the *Banks Act* (as amended).<sup>362</sup> At the center of the anti-money laundering measures in South Africa is customer due diligence. Technically, it is the only anti-money laundering measure regulated in South Africa.<sup>363</sup> Customer due diligence is an internationally accepted anti-money laundering measure<sup>364</sup> that is provided by the *Amendment Act*.<sup>365</sup> The provisions of customer due diligence in the *Amendment Act* are in most aspects analogous to the Financial Action Task Force recommendations.<sup>366</sup> This is because the regulation of customer due diligence measures in South Africa stems from the FATF recommendations.<sup>367</sup> Customer due diligence is aimed at ensuring that financial institutions conduct business with identified customers that are genuinely willing to do business with such financial institutions.<sup>368</sup> Financial institutions have the duty to conduct identification and verification of customers before any transaction is

<sup>359</sup> Van Jaarsveld IL "Mimicking Sisyphus? An Evaluation of the Know-Your-Customer Policy" 2006 *Obiter* 228, 229.

<sup>360</sup> 38 of 2001 as amended by the *Financial Intelligence Centre Amendment Act* 1 of 2017 (*Amendment Act*), see sections 20A-21H.

<sup>361</sup> 121 of 1998 (*POCA*), see sections 4-8.

<sup>362</sup> 94 of 1990, see section 84B.

<sup>363</sup> Nkwashu N "Is South Africa's Anti-Money Laundering and Counter Terrorism Financing Regime Effective?" *De Rebus* (1 May 2018) 26; Itzikowitz A "South Africa: Money Laundering- The Duty to Report under the Law" 2008 *Journal of Financial Crime* 180, 187.

<sup>364</sup> Van Jaarsveld 2006 *Obiter* 229.

<sup>365</sup> 1 of 2017 (*Amendment Act*), sections 20A-21H.

<sup>366</sup> See sections 21(a) and (c), 22 and 42-43 of the *Amendment Act*; Van Jaarsveld 2006 *Obiter* 241; see also Financial Action Task Force (FATF) "International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation" *FATF Recommendations* (February 2018), recommendation 10.

<sup>367</sup> Henning JJ and Ebersohn GJ "Insider Trading, Money Laundering and Computer Crime" 2001 *Transactions of the Centre for Business Law: Combating Economic Crime* 105, 110.

<sup>368</sup> *KwaMashu Bakery Ltd v Standard Bank of South Africa Ltd* 1995 1 SA 377 (D) 395I-396B; *Energy Measurements (Pty) Ltd v First National Bank of South Africa Ltd* 2001 3 SA 132 (W) 427B-C. The identification requirement is in relation with the duty of banks to identify and verify their customers as described by Cameron JA in *Columbus Joint Ventures v Absa Bank Ltd* 2002 (1) All SA 105 (SCA) para 97-98.

concluded between a customer and the financial institution.<sup>369</sup> This process forms the core of customer due diligence in South Africa.<sup>370</sup> However, the stringent requirements of identification and verification sometimes obstruct the fight against money laundering.<sup>371</sup> This submission follows reports that customer due diligence's stringent requirements form barriers that prevent low-income earners and the people from marginalized areas from accessing financial services, thus undermining financial inclusion and anti-money laundering measures.<sup>372</sup> Stringent requirements include the requirement of residential addresses and proof of residency which have been a set-back to most South Africans because some still reside in informal dwellings where residential addresses cannot be proven.<sup>373</sup>

Van Jaarsveld submits that the fight against money laundering is hardly achievable if financial institutions choose to rely on customer due diligence as the only anti-money laundering measure because of the challenges that are discussed in this chapter.<sup>374</sup> The rapid developments of technology and the adoption of new money laundering methods make it difficult to rely on customer due diligence as it fails to address the major concerns of money laundering.<sup>375</sup> One of such concerns is, *inter alia*, the failure to prosecute money laundering cases in South Africa.<sup>376</sup> This chapter analyses the implementation of customer due diligence in South Africa. This is done to determine whether the reliance on customer due diligence to combat money laundering in South Africa is an effective and adequate measure.

## 4.2 Challenges

### 4.2.1 The implementation of customer due diligence challenges in South Africa

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<sup>369</sup> Sharrock R *Law of Banking and Payment in South Africa* (Juta Cape Town 2016) 103; Van Jaarsveld 2006 *Obiter* 241.

<sup>370</sup> De Ponti S "Democratising International Policy-making by Involving Civil Society?" in *Global Policy Without Democracy? The Participation and Interface of Parliamentarians and Civil Societies for Global Policy Conference* (26-27 November 2001 Bonn, Germany) 17; Van Jaarsveld 2006 *Obiter* 241.

<sup>371</sup> De Koker 2006 *Journal of Financial Crime* 27.

<sup>372</sup> Bester H, De Koker L and Hawthorn R "Access to Financial Services in South Africa: A Brief Case Study of the Effect of the Implementation of the Financial Action Task Force Recommendations" *G:enesis Report* (7 April 2004) 2.

<sup>373</sup> Goredema and Monsti 2002 *African Security Review* 10.

<sup>374</sup> Van Jaarsveld 2006 *Obiter* 243.

<sup>375</sup> Van Jaarsveld 2006 *Obiter* 244.

<sup>376</sup> Tanzi V "Macroeconomic Aspects of Offshore Centers and the Importance of Money-Laundering in Offshore Financial Flows" in *Global Programme against Money Laundering Attacking the Profits of Crime: Drugs, Money and Laundering* in A Panel Discussion (10 June 2003 New York) 13.

Major challenges of implementing customer due diligence to combat money laundering arise from the assumption that money laundering is a global threat, therefore it requires a global anti-money laundering measure.<sup>377</sup> This assumption overlooks the fact that all jurisdictions cannot be subjected to the same regulatory regimes because of the dynamics in their economic developments.<sup>378</sup> The implementation of customer due diligence remains important in ensuring that financial institutions do not get exploited for money laundering but its application should be streamlined to avoid undermining the operation of financial institutions.<sup>379</sup> Desirable as it might be, the implementation of customer due diligence is conceptual if its application is conducted without consideration of the economic development of South Africa.<sup>380</sup> South Africa still lacks the capacity to consistently implement customer due diligence.<sup>381</sup> For example, some people reside in informal dwellings where they will not be able to prove their residential addresses during verification and therefore fail to register with a financial institution.<sup>382</sup> Consequently, these people are financially excluded and financial exclusion undermines the implementation of customer due diligence measures.<sup>383</sup> The capacity to implement customer due diligence measures is determined by the availability of both financial and human resources to be used by financial institutions.<sup>384</sup> Several questions should be answered to determine an effective application of customer due diligence by South African financial institutions. This discussion seeks to answer the questions below:

a) *does customer due diligence preserve the integrity of formal financial services?*

<sup>377</sup> Mugarura N "Customer Due Diligence (CDD) Mandate and the Propensity of its Application as A Global AML Paradigm" 2014 *Journal of Money Laundering Control* 77, 80.

<sup>378</sup> Mugarura 2014 *Journal of Money Laundering Control* 80.

<sup>379</sup> Davies RB "Section 311 Patriot Act: Is America Using this Legislation more as a Means of Cementing her Extraterritorial Reach than as a Legitimate Method of Preventing Money Laundering?" 2009 *Journal of Money Laundering Control* 299, 300.

<sup>380</sup> Mugarura 2014 *Journal of Money Laundering Control* 80.

<sup>381</sup> De Koker L "The FATF's Customer Identification Framework: Fit for Purpose?" 2014 *Journal of Money Laundering Control* 281, 283.

<sup>382</sup> Goredema C and Monsti F "Toward Effective Control of Money Laundering in Southern Africa-Some Practical Dilemmas" 2002 *African Security Review* 2, 8.

<sup>383</sup> See Bester *et al*: *genesis Report* 10.

<sup>384</sup> De Koker L "Aligning Anti-Money Laundering, Combating of Financing of Terror and Financial Inclusion: Questions to Consider when FATF Standards are Clarified" 2011 *Journal of Financial Crime* 361, 366; see also Mugarura 2014 *Journal of Money Laundering Control* 80.

The stringent requirements of customer due diligence have led to the exclusion of the low-income earners from accessing basic financial services in South Africa.<sup>385</sup> In an attempt to alleviate the problem, the South African authorities recommend the use of simplified customer due diligence on the low-risk customers.<sup>386</sup> Low-risk customers are customers who do not pose high money laundering threats to the financial institution.<sup>387</sup> However, this approach did not meet the FATF standards and it was argued that the use of simplified customer due diligence eroded the quality of anti-money laundering measures in South Africa.<sup>388</sup> Simplified customer due diligence created gaps in the enforcement of anti-money laundering measures such that money launderers still found means to penetrate and exploit South African financial institutions through identity fraud.<sup>389</sup> It should be noted that simplified customer due diligence does not mean diverting from the requirements of identification and verification.<sup>390</sup> Simplified customer due diligence measures in South Africa entail that identification and verification measures are being relaxed when offering services to customers who pose lower money laundering risk.<sup>391</sup> In South Africa, the standard and supplementary collection of standard information is still required during simplified due diligence unlike in the United Kingdom where financial institutions do not carry out identification and verification procedures during simplified due diligence.<sup>392</sup>

Financial exclusion is the inability of some societal groups, for example the socially marginalized, to access the formal financial system which offers appropriate, low-cost, fair and safe financial products.<sup>393</sup> The financially excluded persons are

<sup>385</sup> De Koker L "Money Laundering Control and Suppression of Financing of Terrorism: Some Thoughts on the Impact of Customer Due Diligence Measures on Financial Exclusion" 2006 *Journal of Financial Crime* 26, 27.

<sup>386</sup> De Koker 2014 *Journal of Money Laundering Control* 285.

<sup>387</sup> Njotini MN *The Verification and Exchange of Customer Due Diligence (CDD) Data in Terms of the Financial Intelligence Centre Act 38 of 2001* (LLM – Dissertation University of South Africa 2009) 52.

<sup>388</sup> See Henning JJ and Ebersohn GJ "Insider Trading, Money Laundering and Computer Crime" 2001 *Transactions of the Centre for Business Law: Combating Economic Crime* 105, 135; see also De Koker 2011 *Journal of Financial Crime* 366.

<sup>389</sup> De Koker 2011 *Journal of Financial Crime* 366.

<sup>390</sup> De Koker 2014 *Journal of Money Laundering Control* 283.

<sup>391</sup> Bester et al *Genesis Report* 2.

<sup>392</sup> Ahlosani W *Anti-Money Laundering: A Comparative and Critical Analysis of the United Kingdom and the UAE's Financial Intelligence Units* (Palgrave Macmillan London 2016) 212; see also De Koker 2014 *Journal of Money Laundering Control* 283.

<sup>393</sup> Carbo S, Gardener P and Molyneux P *Financial Exclusion* (Palgrave Macmillan New York 2005) 4; see also Mohan R "Economic Growth, Financial Deepening and Financial Inclusion" *Reserve Bank of India Bulletin* (November 2006) 1305.

excluded from participating as customers in financial institutions.<sup>394</sup> For example, they do not have bank accounts and insurance products like other members of the society.<sup>395</sup> Causes of financial exclusion include geographic isolation, illiteracy, costs of financial products and restriction of access to financial products.<sup>396</sup> The financially excluded people have limited access to consumer credit and have no secured savings.<sup>397</sup> Financial exclusion impacts negatively on the economic development of South Africa.<sup>398</sup> Financial exclusion also hinders the effectiveness of anti-money laundering measures in South Africa.<sup>399</sup> Customer due diligence measures are aimed at transactions and activities conducted within the formal sector.<sup>400</sup> This means transactions conducted in informal sectors are beyond the reach of customer due diligence. The provisions of the *Amendment Act* are limited to financial institutions listed in the act and do not include informal financial institutions.<sup>401</sup>

Customer due diligence involves the process of ongoing due diligence.<sup>402</sup> For instance, the monitoring of customer transactions after registration of the customer.<sup>403</sup> It is only the transactions of those who participate in the formal financial sector that can be monitored to this effect.<sup>404</sup> It is impossible to monitor transactions of people in the informal sector because the provisions of customer due diligence under the *Amendment Act* do not apply to the informal financial sector.<sup>405</sup> When most people are excluded from the formal financial sector they engage in informal financial services.<sup>406</sup> This undermines the efficacy of anti-money laundering measures because most people are pushed out of the formal sector and they resort to the unregulated financial sector with no paper trail transactions.<sup>407</sup> When this occurs, the prosecution of money launderers is limited and money laundering cases

<sup>394</sup> De Koker 2006 *Journal of Financial Crime* 27; See also Mylonidis N, Chletsos M and Barbagianni V "Financial Exclusion in the USA: Looking Beyond Demographics" 2017 *Journal of Financial Stability* 575, 575; see also De Koker 2006 *Journal of Financial Crime* 27.

<sup>395</sup> De Koker 2006 *Journal of Financial Crime* 27.

<sup>396</sup> Bester *et al* *G:enesis Report* 6.

<sup>397</sup> De Koker 2006 *Journal of Financial Crime* 27.

<sup>398</sup> De Jager N "The living standards measure as a market segmentation tool for selected retailers" 2004 *Nexus-Current and Completed Projects* 53, 56.

<sup>399</sup> See De Jager 2004 *Nexus-Current and Completed Projects* 57; De Koker 2011 *Journal of Financial Crime* 366.

<sup>400</sup> De Koker 2006 *Journal of Financial Crime* 27.

<sup>401</sup> Schedule 3 of the *Amendment Act*.

<sup>402</sup> Section 21C of the *Amendment Act*.

<sup>403</sup> Section 21C(a) of the *Amendment Act*.

<sup>404</sup> De Koker 2006 *Journal of Financial Crime* 27; see also Nkhwashu *De Rebus* 26.

<sup>405</sup> Sharrock R *Law of Banking and Payment in South Africa* 105.

<sup>406</sup> Bester *et al* *G:enesis Report* 7.

<sup>407</sup> De Koker 2006 *Journal of Financial Crime* 27.

increase in South Africa.<sup>408</sup> The need to increase financial inclusion to the greater population of South Africa and the effective use of anti-money laundering measures are complementary.<sup>409</sup> Financial inclusion and anti-money laundering measures are complementary in that customer due diligence is only applicable to financial institutions that offer formal financial services.<sup>410</sup> The authority of the *Amendment Act* is limited to the formal financial sector, which implies that the financial activities of the financially excluded people cannot be regulated by the *Amendment Act*.<sup>411</sup> Put differently, the South Africa anti-money laundering regulations safeguard a part of the financial sector,<sup>412</sup> yet an effective anti-money laundering regime should regulate the whole financial sector.<sup>413</sup> South Africa requires anti-money laundering measures that promote financial inclusion.<sup>414</sup> The application of customer due diligence in South Africa has resulted in financially excluding the socially marginalized people due to its stringent identification and verification requirements.<sup>415</sup>

*b) is customer due diligence primarily inclusionary or exclusionary?*

The answer to this question addresses whether the primary objective of customer due diligence is to keep proceeds of crime away from the regulated formal financial services or rather have the dirty money transactions monitored and reported.<sup>416</sup> It is submitted that a successful anti-money laundering framework identifies dirty money and brings the money launderers to prosecution.<sup>417</sup> The *Amendment Act* provides that financial institutions should keep the records,<sup>418</sup> monitor<sup>419</sup> and report any suspicious transactions.<sup>420</sup> These are the principle procedures to the detection of

<sup>408</sup> Van Rensburg WJ "Anti-Money Laundering is now Focused on Effectiveness: Does your System Work?" *Dispute Resolution Alert* (25 October 2017) 2-3.

<sup>409</sup> Bester *et al*: *Genesis Report* 8.

<sup>410</sup> Mugarura N "The Implications of Brexit for UK Anti-Money Laundering Regulations: Will the Fourth Anti-Money Laundering Directive be Implemented or be Binned?" 2018 *Journal of Money Laundering Control* 5, 16.

<sup>411</sup> Section 20A-21H of the *Amendment Act*; see also Millard D and Vergano C "Hung Out to Dry? Attorney Client Confidentiality and the Reporting Duties Imposed by the FICA 38 of 2001" 2013 *Obiter* 389, 395.

<sup>412</sup> De Koker 2011 *Journal of Financial Crime* 366.

<sup>413</sup> De Koker L *South African Money Laundering and Terrorist Financing Law* (Lexis Nexis Durban 2016) 32.

<sup>414</sup> De Koker 2011 *Journal of Financial Crime* 366.

<sup>415</sup> Goredema C *et al* "Profiling Money Laundering in Eastern and Southern Africa" 2003 *Institute for Security Studies Monographs* 50, 69.

<sup>416</sup> Van Jaarsveld 2006 *Obiter* 244; see also De Koker 2011 *Journal of Financial Crime* 367.

<sup>417</sup> De Ponti P "Democratising International Policy-Making by Involving Civil Society?" 17.

<sup>418</sup> Section 22A of the *Amendment Act*.

<sup>419</sup> Section 21C of the *Amendment Act*.

<sup>420</sup> Section 29 of the *Amendment Act*.

money laundering in South Africa.<sup>421</sup> The purpose of customer due diligence is to identify both the desirable and undesirable customers and keeping profiles of as many customers as possible as obliged by the *Amendment Act*.<sup>422</sup> Keeping records of all customers goes a long way in ensuring effective monitoring of transactions.<sup>423</sup>

The application and implementation of customer due diligence measures is costly for some financial institutions, especially, when the interpretation of the requirements is not properly streamlined.<sup>424</sup> The process of record keeping requires relevant machinery and technology to generate customer data profiles.<sup>425</sup> Customer due diligence measures also require expert and trained staff to conduct the customer identification and verification.<sup>426</sup> It is not necessary for financial institutions to generate profiles and keep records of all customers including the customers who pose low money laundering risks to the financial institution.<sup>427</sup> Financial institutions have introduced simplified due diligence for low-risk customers to cut excess costs incurred by financial institutions in South Africa.<sup>428</sup> However, simplified customer due diligence regulates the implementation of ongoing due diligence to all customers.<sup>429</sup> As such customer due diligence may be a costly measure for some financial institutions in South Africa.<sup>430</sup> When financial institutions have limited resources to conduct customer due diligence, chances are that the implementation of customer due diligence in these institutions becomes sub-standard or is not conducted at all.<sup>431</sup>

In as much as the goal is to curb money laundering, financial institutions remain profit driven and less costly measures are preferable.<sup>432</sup> It becomes a challenge to most financial institutions to implement measures that are costly. Challenges lack of

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<sup>421</sup> De Ponti "Democratising International Policy-Making by Involving Civil Society?" 18.

<sup>422</sup> Section 29 of the *Amendment Act*; see also De Koker 2011 *Journal of Financial Crime* 368.

<sup>423</sup> De Koker 2011 *Journal of Financial Crime* 368.

<sup>424</sup> Goredema C 2002 *African Security Review* 5.

<sup>425</sup> Van Jaarsveld 2006 *Obiter* 244.

<sup>426</sup> Mugarura 2014 *Journal of Money Laundering Control* 90.

<sup>427</sup> Mugarura 2014 *Journal of Money Laundering Control* 90.

<sup>428</sup> Alhosani W *Anti-Money Laundering: A Comparative and Critical Analysis of the United Kingdom and the UAE's Financial Intelligence Units* (Palgrave Macmillan London 2016) 212.

<sup>429</sup> De Koker 2014 *Journal of Money Laundering Control* 283.

<sup>430</sup> Alhosani W *Anti-Money Laundering* 211.

<sup>431</sup> De Koker 2011 *Journal of Financial Crime* 362.

<sup>432</sup> Itzikowitz A "South Africa: Money Laundering- The Duty to Report under the Law" 2008 *Journal of Financial Crime* 187.

financial infrastructure and corruption undermine the reliance on customer due diligence to combat money laundering in South Africa.

#### 4.2.2 *The risk-based approach challenges and customer due diligence measures*

The initial approach to the combating of money laundering under the *Financial Intelligence Centre Act* was rule-based.<sup>433</sup> A rule-based approach required financial institutions to apply customer due diligence according to the rules.<sup>434</sup> For instance, the rule to identify customers and report suspicious transactions.<sup>435</sup> Financial institutions offered services only after the conditions of a specific rule are fulfilled by the customer.<sup>436</sup> In terms of customer due diligence, this means that a customer would be registered if a financial institution is satisfied that a customer has produced relevant documents for identification and verification.<sup>437</sup> The rule-based approach was vulnerable to abuse by money launderers.<sup>438</sup> For example, money launderers would deposit small amounts of the dirty money into various accounts (smurfing) to fall below the threshold rule.<sup>439</sup> Whilst using this approach, the risk of money laundering remained high in South Africa, despite the compliance with the rules by financial institutions.<sup>440</sup> The risk-based approach was introduced in South Africa by the FATF recommendations in 2003.<sup>441</sup>

The risk-based approach provides that financial institutions should apply customer due diligence measures according to the extent of risk the customer poses to the financial institution.<sup>442</sup> The extent of risk is determined by the type of customer, business relationship or transactions concluded by the customer.<sup>443</sup> When applying the risk-based approach, financial institutions focus on cases which pose a high

<sup>433</sup> 38 of 2001 (*FICA*) as amended by the *Financial Intelligence Centre Amendment Act* 1 of 2017, section 21; see also Nyaude AB *The Compliance Duties of Commercial Banks with Regard to Online Money Laundering* (LLM – dissertation University of Pretoria 2015) 57.

<sup>434</sup> Tuba M and Van der Westhuizen C "An Analysis of the 'Know Your Customer' Policy as an Effective Tool to Combat Money Laundering: Is it about Who or What to Know that Counts?" 2014 *International Journal Public Law and Policy* 53,61.

<sup>435</sup> Sections 21 and 29 of the *FICA*.

<sup>436</sup> Tuba and Van der Westhuizen 2014 *International Journal Public Law and Policy* 61.

<sup>437</sup> Section 21 of the *FICA*; Tuba and Van der Westhuizen 2014 *International Journal Public Law and Policy* 61.

<sup>438</sup> Tuba and Van der Westhuizen 2014 *International Journal Public Law and Policy* 61.

<sup>439</sup> See 3.6 of this research.

<sup>440</sup> Tuba and Van der Westhuizen 2014 *International Journal Public Law and Policy* 62.

<sup>441</sup> Financial Intelligence Centre "Guidance Note 07: The Implementation of Various Aspects of the Financial Intelligence Centre Act 38 of 2001" *Guidance Note 07* (02 October 2017) para 16.

<sup>442</sup> Nyaude *The Compliance Duties of Commercial Banks Laundering* 58.

<sup>443</sup> Nyaude *The Compliance Duties of Commercial Banks Laundering* 58.

money laundering risk, for example politically exposed persons and corresponding banks transactions.<sup>444</sup> The risk-based approach determines the level and extent of customer due diligence measures to be performed on particular customers in South Africa.<sup>445</sup> The information obtained by financial institutions during identification and verification is used to determine the extent of risk a customer poses to the financial institution.<sup>446</sup>

The risk-based approach under the *Amendment Act* is criticized for failing to provide regulations on the application of the risk-based approach to customers who pose low money laundering risk to a financial institution.<sup>447</sup> The *Amendment Act* puts more focus on enhanced customer due diligence and omits the regulation of simplified customer due diligence.<sup>448</sup> The *Amendment Act* fails to differentiate transactions and customers that pose a high money laundering risk from transactions and customers posing a low- money laundering risk to the financial institution.<sup>449</sup> The *Amendment Act* provides that high-risk customers should be subjected to additional identification and verification.<sup>450</sup> Additional identification and verification includes the request of additional information from a customer.<sup>451</sup> For example, the source of funds involved in a customer's transactions should be established.<sup>452</sup> There is no specific reference to the way in which simplified customer due diligence should be conducted in South Africa.<sup>453</sup> This flaw has made financial institutions vulnerable to money launderers through smurfing in South Africa.<sup>454</sup> Money launderers still have ways of performing transactions in the formal financial sector without being detected. Accordingly, the reliance on customer due diligence to combat money laundering in South Africa is challenged.

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<sup>444</sup> De Koker L "Identifying and Managing Low Money Laundering Risk: Perspective on FATF's Risk-Based Guidance" 2009 *Journal of Financial Crime* 334, 335.

<sup>445</sup> Njotini *Customer Due Diligence in terms of the FICA* 52.

<sup>446</sup> Spedding LS *Due Diligence and Corporate Governance* (LexisNexis Butterworths Durban 2004) 5.

<sup>447</sup> De Koker L "Client Identification and Money Laundering Control: Perspectives on the Financial Intelligence Centre Act 38 of 2001" 2004 *TSAR* 715, 720.

<sup>448</sup> De Koker 2004 *TSAR* 721.

<sup>449</sup> Section 42(2)(m) of the *Amendment Act*.

<sup>450</sup> Section 21B of the *Amendment Act*; see also De Koker 2004 *TSAR* 721.

<sup>451</sup> Njotini *Customer Due Diligence in terms of the FICA* 52.

<sup>452</sup> Section 21B of the *Amendment Act*; see also Sharrock *Law of Banking and Payment in South Africa* 105.

<sup>453</sup> De Koker 2004 *TSAR* 721.

<sup>454</sup> De Koker 2011 *Journal of Financial Crime* 367.

#### 4.2.3 The remittances challenges and customer due diligence

The *Amendment Act* also regulates money remittances within the formal financial sector.<sup>455</sup> Remittance is defined as the act of transferring money by foreign workers to their families in their home countries.<sup>456</sup> Remittances have been the largest source of cash inflows to most developing countries in Africa.<sup>457</sup> South Africa undertook the implementation of anti-money laundering standards on money remitters to control money laundering by including money remitters in the list of financial institutions regulated by the *Amendment Act*.<sup>458</sup> However, it should be noted that South Africa has not yet given full effect to the undertaking of regulating the money remittance system to date.<sup>459</sup> Informal money remittances exist simultaneously with the formal remittance system in South Africa.<sup>460</sup> This is evidenced by the differences between the numbers of foreign migrants in South Africa and the number of transactions concluded by the formal remittance institutions in a year.<sup>461</sup>

In 2003, the FinMark Trust conducted a survey which showed clear differences in the transfer costs between the formal and informal financial institutions in South Africa.<sup>462</sup> The results showed that the costs of transferring money in the informal sector are cheaper than the formal sector.<sup>463</sup> This explains why most immigrants are using the informal sector as compared to the formal sector.<sup>464</sup> Most of the remittances from South Africa to other countries flow through the informal remittance system.<sup>465</sup> There are also illegal immigrants in South Africa who do not have the documents required for identification and verification.<sup>466</sup> In this regard, the illegal

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<sup>455</sup> Schedule 1 para 19 of the *Amendment Act*.

<sup>456</sup> Kok P *et al* *Post-Apartheid Patterns of Internal Migration in South Africa* (HSRC Publishers Cape Town 2003) 10.

<sup>457</sup> Kok *et al* *Post-Apartheid Patterns of Internal Migration in South Africa* 10.

<sup>458</sup> Schedule 1 para 19 of the *Amendment Act*; see also Bester *et al* *G:enesis Report* 11.

<sup>459</sup> Bester *et al* *G:enesis Report* 11.

<sup>460</sup> Matshe I "Migration and Remittances in SA: Preliminary Findings" *HSRC Winter Conference* (18 March 2010 Benoni) 2.

<sup>461</sup> Bester *et al* *G:enesis Report* 11.

<sup>462</sup> Coovadia C "African Families, African Money Bridging the Money Transfer Divide: A Study on the South African Money Transfer Environment" *G:enesis Analytics-FinMark Trust* (April 2003) 33.

<sup>463</sup> Coovadia *G:enesis Analytics* 33.

<sup>464</sup> Cross C "What are Africa's Issues in Migration Policy?" *African Migration Internal Workshop Winter Conference* (27-28 July 2005 Benoni) 12.

<sup>465</sup> Sander C "Capturing a Market Share?: Migrant Remittance Transfers and Commercialisation of Microfinance in Africa" *Current Issues in Microfinance Conference* (12-14 August 2003 Johannesburg) 6.

<sup>466</sup> Sander "Capturing a Market Share?: Migrant Remittance Transfers and Commercialisation of Microfinance in Africa" 10.

immigrants use the informal remittance system to send money to their home countries.<sup>467</sup> The informal remittance system is preferred because it is generally cheaper and has no administration procedures of identification and verification.<sup>468</sup> Accordingly, most South African immigrants conduct their transactions in the informal remittance system which is beyond the authority of the *Amendment Act* and other anti-money laundering regulations.<sup>469</sup> It is practically impossible to implement customer due diligence measures in the informal remittance system due to the limited capacity of the regulators.<sup>470</sup> Consequently, money launderers utilize the informal sector to smuggle money out of South Africa.<sup>471</sup> The existence of the informal remittance system provides means for money launderers to commit money laundering because customer due diligence measures are not implemented in the informal sector.<sup>472</sup> There are limited chances of detecting money laundering in the informal sector because anti-money laundering measures are not applicable.<sup>473</sup>

#### 4.2.4 Contextualisation challenges and customer due diligence regulations

The *Amendment Act* regulates transactions concluded within the formal financial institutions and has no authority over the informal institutions.<sup>474</sup> The designers of the customer due diligence regulated by the *Amendment Act* overlooked the fact that the international anti-money laundering standards were formulated based on the economies and situations in developed countries.<sup>475</sup> The adoption of international customer due diligence standards in South Africa require financial institutions to comply with anti-money laundering laws.<sup>476</sup> However, the implementation of customer due diligence measures has severe consequences like financially excluding the socially marginalized and low-income earners.<sup>477</sup> Consequently,

<sup>467</sup> Coovadia G: *genesis Analytics* 33.

<sup>468</sup> Srivastava A, Simpson M and Moffat N *International Guide to Money Laundering Law and Practice* 4<sup>th</sup> ed (Bloomsberry Professional 2013) 76; see also Bester *et al*: *genesis Report* 13.

<sup>469</sup> Schedule 1 of the *Amendment Act*; see also Bester *et al*: *genesis Report* 13.

<sup>470</sup> Cross C "What are Africa's Issues in Migration Policy?" 33.

<sup>471</sup> Kok *et al* *Post-Apartheid Patterns of Internal Migration in South Africa* 19.

<sup>472</sup> Matshe I "Migration and Remittances in SA: Preliminary Findings" 3.

<sup>473</sup> Goredema and Monsti 2002 *African Security Review* 10.

<sup>474</sup> Section 4(c) and schedule 1 of the *Amendment Act*.

<sup>475</sup> Section 20A-21H of the *Amendment Act*; see also Bester *et al*: *genesis Report* 14.

<sup>476</sup> Section 27 of the *Amendment Act*; see also Srivastava *et al*: *International Guide to Money Laundering Law and Practice* 77.

<sup>477</sup> De Koker 2014 *Journal of Money Laundering Control* 285.

financial institutions are most likely to violate anti-money laundering laws so as to promote financial inclusion in South Africa.<sup>478</sup>

The customer due diligence requirement of residential addresses and proof of residency has been a set-back to most South Africans because some still reside in informal dwellings where residential addresses cannot be proven.<sup>479</sup> However, financial institutions are obliged to comply with customer due diligence regulations even though they may financially exclude other people in South Africa.<sup>480</sup> This undermines the government broad-based black economic empowerment (BEE) policy.<sup>481</sup> The requirement of proving residency is incompatible with the fact that a third of South African population still resides in informal settlements and have no means to verify the address they would have cited.<sup>482</sup> Consequently, when a customer is faced with such stringent requirements, greater chances are that they resort to the informal sector.<sup>483</sup> The scope of the *Amendment Act* is limited to formal financial institutions such that money laundering keeps thriving through the informal institutions.<sup>484</sup> It can be argued that for as long as the customer due diligence requirements under the *Amendment Act* remain context-insensitive, the reliance on customer due diligence to combat money laundering in South Africa is unachievable.<sup>485</sup> There is need to design measures that are applicable in South Africa without financially excluding people.

#### 4.2.5 Identification and verification process challenges

The know-your-customer policy and client profiling are the two vital procedures that enable financial institutions to detect suspicious transactions in South Africa.<sup>486</sup> Unlike customer due diligence, the know-your-customer policy enables financial

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<sup>478</sup> Mugarura 2014 *Journal of Money Laundering Control* 90; see also Henning and Ebersohn 2001 *Transactions of the Centre for Business Law* 111.

<sup>479</sup> Goredema and Monsti 2002 *African Security Review* 10.

<sup>480</sup> Section 21 of the *Amendment Act*.

<sup>481</sup> Bester *et al*: *Genesis Report* 2. BEE is an affirmative action and racially selective programme run by the South African government in order to remedy the inequalities of the apartheid era. It aims at giving apartheid disadvantaged races of South Africa economic privileges.

<sup>482</sup> Bester *et al*: *Genesis Report* 14.

<sup>483</sup> Kersop M and Du Toit SF "Anti-Money Laundering Regulations and the Effective Use of Mobile Money in South Africa Part 2" 2015 *PER/PELJ* 1637, 1650.

<sup>484</sup> Madinger J *Money Laundering: A Guide for Criminal Investigators* 3<sup>rd</sup> ed (CRC Press Australia 2011) 89.

<sup>485</sup> Spedding *Due Diligence* 103.

<sup>486</sup> De Koker 2004 *TSAR* 727.

institutions to know and understand their clients and their businesses.<sup>487</sup> The information obtained during know-your-customer procedures is more comprehensive to create a detailed customer profile.<sup>488</sup> Customer due diligence and the know-your-customer policy are sometimes used interchangeably but are not absolutely the same.<sup>489</sup> The know-your-customer policy entails knowing the customer to be able to understand and relate to their transactions whereas customer due diligence is mere identification and verification of customer identity.<sup>490</sup> In the United Kingdom, the know-your-customer policy is preferred for effective monitoring of customer activities.<sup>491</sup> The know-your-customer policy requires financial institutions to obtain and verify customers' name, permanent address, nationality, date and place of birth, identity number, signature, occupation, public position held and/or name the employer, and type of account and nature of the banking relationship.<sup>492</sup>

Contrarily, customer due diligence under the *Amendment Act* requires financial institutions to obtain only the customer's full names, identity number, date of birth, and residential address.<sup>493</sup> The information requested during customer identification and verification forms building blocks to a customer's profile but are not sufficient to enable financial institutions to know that a customer's account activities are legitimate.<sup>494</sup> Customer profiles enable financial institutions to compare and match customer account activities with those of customers with similar profiles to detect money laundering suspicions.<sup>495</sup> Differences in these patterns could lead to money laundering suspicions and subsequently detection of money laundering or other financial crimes.<sup>496</sup> Know-your-customer policy helps the detection of suspicious transactions in financial institutions.<sup>497</sup>

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<sup>487</sup> De Koker 2004 TSAR 722.

<sup>488</sup> Van Jaarsveld 2006 *Obiter* 244.

<sup>489</sup> Tuba M "Prosecuting Money Laundering the FATF Way: An Analysis of Gaps and Challenges in South African Legislation from a Comparative Perspective" 2012 *Acta Criminologica* 103, 150.

<sup>490</sup> Nyaude *The Compliance Duties of Commercial Banks* 61.

<sup>491</sup> Alhosani W *Anti-Money Laundering* 211.

<sup>492</sup> The Basel Committee on Banking Supervision Consultative Guide "Customer Due Diligence for Banks" published 31 March 2001 <http://www.bis.org/publ/bcbs85.html> accessed 22 July 2018 32 para 10-11.

<sup>493</sup> Nyaude *The Compliance Duties of Commercial Banks* 61.

<sup>494</sup> De Koker 2004 TSAR 722.

<sup>495</sup> De Koker 2004 TSAR 722.

<sup>496</sup> Nyaude *The Compliance Duties of Commercial Banks* 62.

<sup>497</sup> Alhosani W *Anti-Money Laundering* 211.

A customer's occupation and employer are important to a customer's profile but customer due diligence under the *Amendment Act* makes no requirement of a customer's employment details.<sup>498</sup> Most criminals are in possession of false identification documents which they may use to register with financial institutions and commit money laundering under false identity.<sup>499</sup> This means that these criminals find means to evade prosecution and anti-money laundering laws.<sup>500</sup> Customer due diligence requires financial institutions to obtain sufficient information about customers who pose high money laundering risks.<sup>501</sup> Obtaining sufficient information from customers is relevant to money laundering investigations.<sup>502</sup>

In terms of the *Amendment Act*, the implementation of the risk based approach is restricted to customers who pose high money laundering risk in order to utilize and not waste resources on low-risk customers.<sup>503</sup> However, there is uncertainty surrounding the intention and the wording of this requirement.<sup>504</sup> Financial institutions have the discretion to choose the level of customer due diligence to apply depending on the levels of risk the financial institution is exposed to.<sup>505</sup> The *Amendment Act* does not provide regulations on a standard implementation of the risk-based approach in South Africa.<sup>506</sup> This means there is no uniform approach to the application of the risk-based approach which may create inconsistencies and gaps for money launderers to commit money laundering.<sup>507</sup>

The emphasis of customer due diligence is placed on mere identification and verification which do not have much value in detecting money laundering because money launderers may conclude transactions using false identity.<sup>508</sup> The requirements of the identification and verification under the *Amendment Act* are limited to enable reliance on customer due diligence to combat money laundering in South Africa. The efficacy of customer due diligence can be increased when

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<sup>498</sup> Sathye M "Estimating the Cost of Compliance of AML/CFT for Financial Institutions" 2008 *Journal of Financial Crime* 347, 356.

<sup>499</sup> De Koker 2004 TSAR 723.

<sup>500</sup> Section 8 of the *Prevention of Organised Crime Act* 121 of 1998.

<sup>501</sup> Section 21B of the *Amendment Act*.

<sup>502</sup> Sathye 2008 *Journal of Financial Crime* 363.

<sup>503</sup> Section 42 of the *Amendment Act*; see also Tuba and Van der Westhuizen 2014 *International Journal Public Law and Policy* 63.

<sup>504</sup> De Koker 2004 TSAR 724.

<sup>505</sup> Financial Intelligence Centre *Guidance Note 07* para 60. .

<sup>506</sup> Section 42 of the *Amendment Act*; De Koker 2004 TSAR 727.

<sup>507</sup> Nyaude *The Compliance Duties of Commercial Banks* 61.

<sup>508</sup> De Koker 2004 TSAR 723.

considerations have been taken to change the current identification and verification process. Financial institutions should be given authority to obtain sufficient information from customers, to enable the detection and investigation of money laundering.<sup>509</sup> This will enhance the reliance on customer due diligence to combat money laundering in South Africa because money launderers may not be able to access financial institutions and commit money laundering under false identity.<sup>510</sup>

#### 4.2.6 *Politically exposed persons and corruption challenges*

The war against money laundering cannot be won as long as corruption remains embedded in most developing countries.<sup>511</sup> As such, policy makers should provide policies, laws and regulations that combat both corruption and money laundering in South Africa.<sup>512</sup> An enhanced level of attention is required because money laundering and corruption are intertwined.<sup>513</sup> Accordingly, the implementation of customer due diligence to combat money laundering is not easy in corrupt countries.<sup>514</sup>

Creation of customer profiles enables financial institutions to control the risks of money laundering because they are aware of their customers and their dealings.<sup>515</sup> Customer profiles are the representation of customer information that financial institutions keep in a database.<sup>516</sup> An example of high-risk profiles is politically exposed persons.<sup>517</sup> Politically exposed persons are natural persons who are currently or have in the past been assigned prominent public functions.<sup>518</sup> Politically exposed persons are high-risk customers because of the powers vested in them which they may abuse to commit crimes like corruption and

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<sup>509</sup> Nyaude *The Compliance Duties of Commercial Banks* 62.

<sup>510</sup> Mylonidis *et al* 2017 *Journal of Financial Stability* 578

<sup>511</sup> Mugarura 2014 *Journal of Money Laundering Control* 91.

<sup>512</sup> Choo K "Politically Exposed Persons (PEPs): Risks and Mitigation" 2008 *Journal of Money Laundering Control* 371, 375.

<sup>513</sup> Mugarura 2014 *Journal of Money Laundering Control* 91.

<sup>514</sup> Mugarura 2014 *Journal of Money Laundering Control* 91.

<sup>515</sup> Ahlers C *The South African Anti-Money Laundering Regulatory Framework Relevant to Politically Exposed Persons* (MPhil in Fraud Risk Management – dissertation University of Pretoria 2013) 67.

<sup>516</sup> Kruger A *Organised Crime and Proceeds of Crime Law in South Africa* 2<sup>nd</sup> ed (Lexis Nexis Durban 2013) 92.

<sup>517</sup> Njotini *Customer Due Diligence in terms of the FICA* 51.

<sup>518</sup> Leppan D "Refining the PEP Definition" *World-Check White Paper* (2005) 9. Nyaude AB *The Compliance Duties of Commercial Banks with Regard to Online Money Laundering* (LLM – dissertation University of Pretoria 2015)

embezzlement.<sup>519</sup>Corruption and embezzlement may lead to money laundering to conceal the proceeds of the crimes.<sup>520</sup>The people who are closely linked to politically exposed persons are also regarded as high-risk customers.<sup>521</sup> For examples family members and business partners of politically exposed persons. Politically exposed persons sometimes use their family members to hide the embezzled funds.<sup>522</sup> It is apparent that politically exposed persons employ several methods to hide their corrupt earnings and one such method is money laundering.<sup>523</sup>

The link between money laundering and corruption shows that financial institutions should implement comprehensive customer due diligence measures on politically exposed persons as they expose financial institutions to high money laundering risks.<sup>524</sup> Politically exposed persons have influence in government departments including the judiciary system such that they may not be prosecuted on money laundering crimes.<sup>525</sup> This means that the combating of money laundering in South Africa cannot be successfully achieved without combating corruption as the preceding crime.<sup>526</sup> The *Amendment Act* regulates the implementation of rigid comprehensive measures to control the money laundering risks that are associated with politically exposed persons.<sup>527</sup> In light of the above, the reliance on customer due diligence measures to combat money laundering in South Africa is not achievable until the fight against corruption succeeds.

#### 4.2.7 Suspicious and unusual transactions challenges

The *Amendment Act* does not provide a clear definition of suspicious or unusual transactions.<sup>528</sup> However, financial institutions have the duty to report suspicious and unusual transactions.<sup>529</sup> The duty to report suspicious and unusual transactions is upon any person who has or is in charge of or manages a business in South

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<sup>519</sup> Choo 2008 *Journal of Money Laundering Control* 372.

<sup>520</sup> Ahlers *Anti-Money Laundering Regulatory Framework* 67.

<sup>521</sup> Leppan D "Refining the PEP Definition" 10; see also Choo 2008 *Journal of Money Laundering Control* 376.

<sup>522</sup> Ahlers *Anti-Money Laundering Regulatory Framework* 67.

<sup>523</sup> Ahlers *Anti-Money Laundering Regulatory Framework* 71.

<sup>524</sup> De Koker 2004 *Journal of South African Law* 724.

<sup>525</sup> Ahlers *Anti-Money Laundering Regulatory Framework* 72.

<sup>526</sup> Choo 2008 *Journal of Money Laundering Control* 376..

<sup>527</sup> Reg 21 in GN R1062 in GG41154 of 29 September 2017.

<sup>528</sup> Section 29 of the *Amendment Act*.

<sup>529</sup> Section 29(1) of the *Amendment Act*.

Africa.<sup>530</sup> The *Amendment Act* criminalises the failure to report suspicious and unusual transactions to the Financial Intelligence Centre.<sup>531</sup> The objective test is used to determine liability of a person who fails to report such transactions.<sup>532</sup> The person or offender ought to know or objectively know or suspect money laundering activities before filing the report for money laundering investigations to commence.<sup>533</sup>

Challenges lie in the provision that a financial institution may continue with a transaction that has been reported as unusual or suspicious.<sup>534</sup> Before the Financial Intelligence Centre settles a matter involving a suspicious transaction, a customer may proceed with the transaction.<sup>535</sup> This implies that a financial institution that filed a report in terms of section 29 of the *Amendment Act* assists its customer with money laundering activities by letting a customer continue with the transaction.<sup>536</sup> When a financial institution continues with the transaction in this instance, it would have failed to prioritise the control of money laundering because of a customer's instructions.<sup>537</sup> If financial institutions fail to take responsibility in the control of money laundering and/or to comply with the customer due diligence measures, the reliance on customer due diligence to combat money laundering in South Africa is difficult to achieve. Financial institutions have a duty to detect and report suspicious transactions and are not expected to assist customers to conclude money laundering transactions.

### 4.3 Conclusion

In light of the above, it can be concluded that the implementation of customer due diligence measures in South Africa is not flawless. Several challenges discussed in this chapter show that there is room to develop and amend the regulation of customer due diligence measures. However, customer due diligence measures remain at the cornerstone of anti-money laundering measures in South Africa.<sup>538</sup> To date, the *Amendment Act* is the only legislation that provides regulation of money

<sup>530</sup> Section 29(1) of the *Amendment Act*.

<sup>531</sup> Section 52(1)-(2) of the *Amendment Act*.

<sup>532</sup> Nyaude *The Compliance Duties of Commercial Banks* 64.

<sup>533</sup> Section 29(1) of the *Amendment Act*.

<sup>534</sup> Section 33 of the *Amendment Act*.

<sup>535</sup> Section 34 of the *Amendment Act*.

<sup>536</sup> Van Jaarsveld I *Money Laundering Control and Banks - An Analysis of Key Challenges Facing Banks Operating in the E.U., England, South Africa & the United States* (Lambert Academic Publishing 2012) 305.

<sup>537</sup> Van Jaarsveld *Money Laundering Control and Banks* part 1 305.

<sup>538</sup> De Koker 2014 *Journal of Money Laundering Control* 293.

laundering in South and the rate of money laundering cases are decreasing in South Africa. This shows that customer due diligence measures under the *Amendment Act* are robust to a considerable extent as compared to mere criminalization of money laundering as was the case before the enactment of the *Amendment Act*.<sup>539</sup> Accordingly, the researcher submits that customer due diligence measures are reliable in the combating of money laundering in South Africa.

This research discusses recommendations and proposed solutions to address some of the challenges that have been discussed in this chapter.

## CHAPTER FIVE

### CUSTOMER DUE DILIGENCE MEASURES, INTERNATIONAL BEST PRACTISES AND THE REGULATION OF MONEY LAUNDERING IN THE UNITED KINGDOM

#### 5.1 Introduction

The anti-money laundering regulatory framework of the United Kingdom (UK) is based on several regulatory tools unlike in South Africa. The anti-money laundering system of the UK is regulated by the *Proceeds of Crime Act*,<sup>540</sup> as amended by the *Serious Organised Crime and Police Act*,<sup>541</sup> the *Serious Crime Act*<sup>542</sup> and the *Crime and Courts Act*.<sup>543</sup> Prior to these Acts, money laundering offences were regulated by the *Drug Trafficking Offences Act* in the UK.<sup>544</sup> The *Money Laundering, Terrorist Financing and Transfer of Funds Regulations*<sup>545</sup> also forms part of the anti-money laundering framework of the UK.<sup>546</sup> The UK relies on both primary and secondary regulations to combat money laundering.<sup>547</sup> These secondary regulations include regulations issued by the Financial Conduct Authority and the Joint Money Laundering Steering Group.<sup>548</sup> The UK anti-money laundering framework was influenced by several international bodies like the European Union, the United Nations, the Basel Committee and the Financial Action Task Force (FATF).<sup>549</sup> The FATF was established in July in 1989 to establish measures to fight against money laundering internationally.<sup>550</sup> The FATF governs other international bodies which regulate the prevention of money laundering in the affected countries.<sup>551</sup>

<sup>540</sup> 2002 Chapter 29, see part 7.

<sup>541</sup> 2005 Chapter 15, see section 107.

<sup>542</sup> 2007 Chapter 27, see section 6.

<sup>543</sup> 2013 Chapter 22, see section 27.

<sup>544</sup> 1986 Chapter 32, section 1-5; see discussion by Booth R *et al Money Laundering Law and Regulations: A Practical Guide* (Oxford University Press 2011) 14-16.

<sup>545</sup> 2017 No. 2157 (*Money Laundering Regulations* 2017), regulations 27-37.

<sup>546</sup> Harrison K and Ryder N *The Law Relating to Financial Crime in the United Kingdom* (Ashgate Publishing Limited 2013) 162.

<sup>547</sup> Ahlosani W *Anti-Money Laundering: A Comparative and Critical Analysis of the United Kingdom and the UAE'S Financial Intelligence Units* (Palgrave Macmillan London 2016) 205.

<sup>548</sup> Ahlosani *Anti-Money Laundering* 205.

<sup>549</sup> Harrison and Ryder *The Law Relating to Financial Crime in the United Kingdom* 73.

<sup>550</sup> Goldsmith JG, Kalin C and Muller WH *Anti-Money Laundering International Law and Practice* (John Wiley West Sussex 2007) 3; see related discussion by Alldridge P "Money Laundering and Globalisation" 2008 *Journal of Law and Society* 440, 443.

<sup>551</sup> Njotini MN *The Verification and Exchange of Customer Due Diligence (CDD) Data in Terms of the Financial Intelligence Centre Act 38 of 2001* (LLM – Dissertation University of South Africa 2009) 5.

International bodies like the United Nations have set standards, developed technical understanding, facilitated international cooperation and implemented international standards to combat money laundering in the affected signatory jurisdictions.<sup>552</sup> Customer due diligence is at the core of the anti-money laundering measures used internationally.<sup>553</sup> This chapter discusses the international best practices of money laundering control and the regulation of money laundering in the UK. The chapter also comparatively examines the application of customer due diligence measures to combat money laundering in the UK and South Africa.

## **5.2 Customer Due Diligence and Anti-Money Laundering Measures in the UK**

The regulation of anti-money laundering laws in the UK date back to 1986. The anti-money laundering regulatory framework of the UK adopted various anti-money laundering provisions from the European Union, the FATF recommendations and the United Nations Conventions.<sup>554</sup> Although the UK has implemented provisions to implement the *United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances*<sup>555</sup> into its anti-money laundering regulatory framework, the *Drug Trafficking Offences Act*<sup>556</sup> precedes the *Vienna Convention*.<sup>557</sup> This shows that the UK began developing its anti-money laundering laws independent from the international best practices like the *Vienna Convention* and the FATF Recommendations.<sup>558</sup> This submission is also evidenced by the differences between the money laundering offences under the UK law and the money laundering offences in terms of the FATF recommendations.<sup>559</sup> The UK was the first country to draft the offence of money laundering which probably explains why the UK is regarded as

<sup>552</sup> World Bank *Combating Money Laundering and the Financing of Terrorism – A comprehensive Training Guide: Workbook 7* (Washington DC, The World Bank 2009) 28.

<sup>553</sup> Stokes R and Arora A "The Duty to Report under the Money Laundering Legislation within the United Kingdom" 2004 *Journal of Business Law* 332, 335.

<sup>554</sup> Harrison and Ryder *The Law Relating to Financial Crime in the United Kingdom* 73.

<sup>555</sup> *United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances* (1988) (*Vienna Convention*), see article 3(c)(i).

<sup>556</sup> 1986 Chapter 32, see section 24.

<sup>557</sup> Booth *et al* *Money Laundering Law and Regulations: A Practical Guide* 14.

<sup>558</sup> Fisher J "The Anti-Money Laundering Disclosure Regime and the Collection of Revenue in the United Kingdom" 2010 *British Tax Review* 235, 238.

<sup>559</sup> See sections 327-329 of the *Proceeds of Crime Act*, article 3 of the *Vienna Convention* and recommendation 2 of the FATF recommendations. The *Proceeds of Crime Act* makes no reference to the mental element of money laundering in sections 327-329. Unlike the *Proceeds of Crime Act*, the *Vienna Convention* and the *FATF recommendations* require an investigation into the criminal's state of mind, knowledge and intention before conviction on money laundering offences.

having the best anti-money laundering laws.<sup>560</sup> For the purpose of this research, the researcher discusses the regulation of the UK anti-money laundering measures from 1992 to date.

The anti-money laundering regulatory framework of the UK was brought about by the Money Laundering Regulations<sup>561</sup> which were effected on 1 April 1994. The second major reform of developing the anti-money laundering regulatory framework in the UK was the publication of the Performance and Innovation Unit report on Recovering the Proceeds of Crime.<sup>562</sup> The purpose of these two regulatory tools was to deter people from committing money laundering crimes and recovering proceeds of crime from the convicted criminals.<sup>563</sup> The PIU led to the enactment of the *Proceeds of Crime Act* in 2002.<sup>564</sup> The *Proceeds of Crime Act* 2002 combined drug related money laundering offences and money laundering activities from other crimes such as fraud and corruption.<sup>565</sup> However, it should be noted that these regulatory tools had no provisions on customer due diligence measures.<sup>566</sup> They only regulated the prohibition and penalties of money laundering offences in the UK.<sup>567</sup> Accordingly, there were no measures to detect and control money laundering activities in the UK during that period.<sup>568</sup> The current anti-money laundering legislative framework of the UK is made up of the *Proceeds of Crime Act* 2002<sup>569</sup> and the *Money Laundering Regulations*.<sup>570</sup>

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<sup>560</sup> Anyaoku E *Combating Money Laundering and Terrorist Financing: A Model of Best Practice for the Financial Sector, the Professions and other Designated Businesses* 2<sup>nd</sup> ed (Commonwealth Secretariat London 2006) 138.

<sup>561</sup> The *Money Laundering Regulations* of 1993 (*Money Laundering Regulations* 1993), regulation 5.

<sup>562</sup> Blair T "Performance and Innovation Unit" (PIU) *Report on Recovering the Proceeds of Crime* (June 2000) 45.

<sup>563</sup> Booth *et al* *Money Laundering Law and Regulations* 16; see also Leong A *The Disruption of International Organised Crime: An Analysis of Legal and Non-Legal Strategies* 3<sup>rd</sup> ed (Ashgate Publishing Limited 2016) 154.

<sup>564</sup> 2002 (c29), sections 327-334.

<sup>565</sup> Section 327 of the *Proceeds of Crime Act* 2002.

<sup>566</sup> Stokes and Arora 2004 *Journal of Business Law* 335.

<sup>567</sup> Ahlosani *Anti-Money Laundering* 205; see also Anyaoku *Combating Money Laundering and Terrorist Financing* 139.

<sup>568</sup> Booth *et al* *Money Laundering Law and Regulations* 16; see also Fisher 2010 *British Tax Review* 237.

<sup>569</sup> Sections 327-334 of the *Proceeds of Crime Act* 2002; see also Booth *et al* *Money Laundering Law and Regulations* 16.

<sup>570</sup> Regulations 27-37 of the *Money Laundering Regulations* 2017; see also Fisher 2010 *British Tax Review* 237.

### 5.2.1 *The Proceeds of Crime Act 2002*

The *Proceeds of Crime Act 2002* integrated all the money laundering crimes recognized in the UK into one legislation.<sup>571</sup> The UK money laundering laws recognize proceeds from fraud, corruption and drug related offences as money laundering activities.<sup>572</sup> The *Proceeds of Crime Act 2002* regulates three money laundering offences and four related offences namely; concealing criminal property, involvement in money laundering activities, acquiring criminal property and using or possessing criminal property.<sup>573</sup>

Concealing criminal property includes disguising, converting and transferring criminal property from the UK.<sup>574</sup> The concealed property should form proceeds of a criminal activity for money laundering to be established.<sup>575</sup> Acquiring, using or possessing criminal proceeds requires that the person in possession of criminal property should have knowledge that the property is proceeds from a criminal activity.<sup>576</sup> The crucial element of money laundering activities is criminal property because the anti-money laundering laws of the UK provide that money laundering emanates from a preceding criminal activity.<sup>577</sup> The *Proceeds of Crime Act 2002* defines criminal property as property that is known or suspected to represent proceeds or benefits from criminal activity.<sup>578</sup> This definition implies that it is impossible for one to commit money laundering unknowingly.<sup>579</sup> A person charged with money laundering offences should have actual knowledge of the criminal activity.<sup>580</sup> However, it should be noted that

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<sup>571</sup> Srivastava, Simpson and Moffat *International Guide to Money Laundering Law and Practice* 130.

<sup>572</sup> Section 327(1) of the *Proceeds of Crime Act 2002*; see also Ahlosani *Anti-Money Laundering* 224.

<sup>573</sup> See section 327 of the *Proceeds of Crime Act 2002*; see related discussion by Van Jaarsveld IL *Aspects of Money Laundering in South African Law* (unpublished LLD – dissertation University of South Africa 2011) 336.

<sup>574</sup> Section 327(1) of the *Proceeds of Crime Act 2002*; see also Ahlosani *Anti-Money Laundering* 225.

<sup>575</sup> *R v Montila* [2004] UKHL 50; see discussion by Fortson R “Money Laundering Offences under POCA 2002” in Blair W and Brent R (eds) *Banks and Financial Crime: The International Law of Tainted Money* (Oxford University Press 2008) 177.

<sup>576</sup> *Warner v Metropolitan Police Commissioner* [1969] 2A.C. 256

<sup>577</sup> Ahlosani *Anti-Money Laundering* 231; see also Bell E “Concealing and Disguising the Criminal Property” 2009 *Journal of Money Laundering Control* 268, 270.

<sup>578</sup> Section 326(4) of the *Proceeds of Crime Act 2002*; see also Srivastava, Simpson and Moffat *International Guide to Money Laundering Law and Practice* 130.

<sup>579</sup> Sujee A study of the *Anti-Money Laundering Framework in South Africa and the United Kingdom* 24; see also Van Jaarsveld IL *Aspects of Money Laundering in South African Law* 312.

<sup>580</sup> Section 340(3) of the *Proceeds of Crime Act 2002*; see also Ahlosani *Anti-Money Laundering* 235.

the *Proceeds of Crime Act 2002* regulates money laundering as a criminal offence and the penalties thereof.<sup>581</sup> The *Proceeds of Crime Act 2002* does not regulate the implementation of customer due diligence as a measure to combat money laundering in the UK.<sup>582</sup>

The *Proceeds of Crime Act 2002* also prohibits the failure to disclose or report possible money laundering activities and the act of prejudicing money laundering investigations.<sup>583</sup> The *Proceeds of Crime Act* does not provide any measures to control or curb money laundering in the UK.<sup>584</sup> Like the *Prevention of Organised Crime Act*<sup>585</sup> of South Africa, the *Proceeds of Crime Act 2002* does not expressly make provision for anti-money laundering measures.<sup>586</sup> There is no regulation of customer due diligence measures in the *Proceeds of Crime Act 2002*.<sup>587</sup> Provisions on the implementation of customer due diligence measures in the UK is found in the *Money Laundering Regulations 2017*.<sup>588</sup>

### 5.2.2 Money Laundering Regulations 2017

The *Money Laundering Regulations 2017* apply to all UK financial institutions.<sup>589</sup> Financial institutions are persons or institutions that provide money service businesses.<sup>590</sup> Financial institutions are vulnerable to money laundering activities because of their nature of dealing with money-related transactions and money launderers also utilize financial institutions to integrate laundered money.<sup>591</sup> Financial institutions are also crucial in the anti-money laundering regulatory framework of the UK because they are centers where money laundering activities may be detected

<sup>581</sup> Srivastava, Simpson and Moffat *International Guide to Money Laundering Law and Practice* 130.

<sup>582</sup> Sections 327-334 of the *Proceeds of Crime Act 2002*; see also Bell 2009 *Journal of Money Laundering Control* 269.

<sup>583</sup> Section 328 of the *Proceeds of Crime Act 2002*; see also Gentle S "Proceeds of Crime Act 2002: Update" *Compliance Officer Bulletin* (May 2008) 14.

<sup>584</sup> Sections 327-334 of the *Proceeds of Crime Act*.

<sup>585</sup> 121 of 1998 (POCA), sections 4-6.

<sup>586</sup> Sections 327-334 of the *Proceeds of Crime Act 2002*; see also Ahlosani *Anti-Money Laundering* 239.

<sup>587</sup> Section 327 of the *Proceeds of Crime Act 2002*; see also Booth *et al Money Laundering Law and Regulations* 16.

<sup>588</sup> *Money Laundering, Terrorist Financing and Transfer of Funds Regulations 2017* No. 2157, regulations 20-27; see related discussion by Stokes and Arora 2004 *Journal of Business Law* 335.

<sup>589</sup> Ahlosani *Anti-Money Laundering* 239; see also Ulph J and Tugendhath M *Commercial Fraud. Civil Liability, Human Rights and Money Laundering* (Oxford University Press 2006) 133.

<sup>590</sup> Regulation 3(1) of the *Money Laundering Regulations*.

<sup>591</sup> Srivastava, Simpson and Moffat *International Guide to Money Laundering Law and Practice* 145.

through implementation of anti-money laundering measures.<sup>592</sup> The *Money Laundering Regulations* 2017 regulate the implementation of customer due diligence as an anti-money laundering measure.<sup>593</sup> The application of customer due diligence measures in the UK is influenced by four factors, namely type of business relationships, type of customers, type of transactions and type of products.<sup>594</sup> These factors determine the level of customer due diligence measures that are applicable in every situation in the UK.<sup>595</sup> Effective application of customer due diligence measures entails implementing a level of customer due diligence measures that is commensurate with the level of money laundering risk the financial institution is exposed to.<sup>596</sup> The financial institutions perform customer due diligence measures on a simplified, enhanced, ongoing or risk sensitive basis, depending on the level of money laundering risk the customer poses to the financial institution.<sup>597</sup>

### 5.2.3 Standard approach to customer due diligence measures

The application of customer due diligence measures in the UK is based on a general rule.<sup>598</sup> The general rule states that customer due diligence measures must be performed when establishing business relationships between customers and financial institutions in the UK.<sup>599</sup> Customer due diligence measures are also performed where there is suspicion of money laundering activities, when concluding transactions or when there is suspicion that the information provided by a customer is unreliable.<sup>600</sup> According to the *Money Laundering Regulations*,<sup>601</sup> customer due diligence refers to the identification and verification of customers and beneficial

<sup>592</sup> Srivastava, Simpson and Moffat *International Guide to Money Laundering Law and Practice* 145.

<sup>593</sup> Regulation 27(1) of the *Money Laundering Regulations* 2017; see also Padified N "Country Report: Anti-Money Laundering Rules in the United Kingdom" in Pieth M and Aiolfi G *A Comparative Guide to Anti-Money Laundering: A Critical Analysis of Systems in Singapore, Switzerland, the United Kingdom and the USA* (Edward Elgar Cheltenham 2004) 265, 269.

<sup>594</sup> Regulation 7(3)(a) of the *Money Laundering Regulations*; see discussion by Padified N "Country Report: Anti-Money Laundering Rules in the United Kingdom" 270.

<sup>595</sup> Ulph and Tugendhath *Commercial Fraud* 135; see also Harrison and Ryder *The Law Relating to Financial Crime in the United Kingdom* 162.

<sup>596</sup> Booth *et al* *Money Laundering Law and Regulations: A Practical Guide* 16; see also Fisher 2010 *British Tax Review* 240.

<sup>597</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 39.

<sup>598</sup> Harrison and Ryder *The Law Relating to Financial Crime in the United Kingdom* 162.

<sup>599</sup> Regulation 27(1)(a) of the *Money Laundering Regulations* 2017; see Jung T and Lishan A "The International Standards of Criminal Due Diligence and Chinese Practice" 2009 *Journal of Money Laundering Control* 406, 407.

<sup>600</sup> Regulations 27(1)(a)-(e) of the *Money Laundering Regulations* 2017; see: Ahbsaini *Anti-Money Laundering* 207.

<sup>601</sup> Regulations 27 of the *Money Laundering Regulations* 2017; see also Ahlosani *Anti-Money Laundering* 208.

owners' identities or the obtaining of information for the purpose of establishing a business relationship between customers and financial institutions in the UK.<sup>602</sup> The *Money Laundering Regulations* 2017 do not provide an express definition of a customer.<sup>603</sup> It can be submitted that customer means persons or institutions carrying out transactions or involved in business relationships with the financial institution.<sup>604</sup>

The standard approach customer due diligence measures are mandatory to all financial institutions in the UK, except when simplified or enhanced measures are applied.<sup>605</sup> Standard measures include<sup>606</sup> establishing customer identity and verification of the identity, identifying beneficial owners and verifying their identity and establishing the nature and aim of the business relationship between the customer and the financial institution.<sup>607</sup> The data obtained by financial institutions from customers includes customer's names, addresses and date of birth.<sup>608</sup> Verification documents include valid passport, photograph, driving license, identity card, firearm certificate, shotgun license or any other document obtained from reliable sources.<sup>609</sup>

The *Money Laundering Regulations* 2017 allow financial institutions to complete verification procedures even after commencement of a business relationship between a customer and the financial institution.<sup>610</sup> This is because standard customer due diligence measures are performed on customers who do not pose high money laundering risks to the financial institution.<sup>611</sup> As such, customer due diligence measures are applied in a less stringent way. However, verification of customer details by the financial institution should still be carried out as soon as practicable to

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<sup>602</sup> Ahlosani *Anti-Money Laundering* 208-209; see also Blair and Brent Banks and Financial Crime 249.

<sup>603</sup> Regulations 27-37 of the *Money Laundering Regulations* 2017.

<sup>604</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 39, see also Regulation 2(1) of the *Money Laundering Regulations* 2017.

<sup>605</sup> Hudson A *The Law of Finance* 2<sup>nd</sup> ed (Sweet and Maxwell 2013) 434; see also Ahlosani *Anti-Money Laundering* 208.

<sup>606</sup> Regulation 27 of the *Money Laundering Regulations* 2017.

<sup>607</sup> Regulation 27 of the *Money Laundering Regulations* 2017; see discussion by Ahlosani *Anti-Money Laundering* 210.

<sup>608</sup> Blair and Brent Banks and Financial Crime 249; see also Harrison and Ryder *The Law Relating to Financial Crime in the United Kingdom* 162.

<sup>609</sup> Regulation 27 of the *Money Laundering Regulations* 2017; see also Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 40.

<sup>610</sup> Regulation 28(3) of the *Money Laundering Regulations* 2017.

<sup>611</sup> Regulation 28(3)(b) of the *Money Laundering Regulations* 2017.; see also Jung and Lishan *Journal of Money Laundering Control* 409.

enable the financial institution to create detailed customer profiles.<sup>612</sup> Detailed customer profiles provide the financial institution with relevant information about the customer for the purpose of implementing customer due diligence measures according to the customer's risk profile.<sup>613</sup>

Ongoing monitoring of customer account activities by financial institutions is also a procedure of standard customer due diligence measures.<sup>614</sup> Ongoing monitoring involves monitoring the customer's transactions and ensuring that the transactions conform to the financial institution's knowledge about the customer and the risk profile.<sup>615</sup> Ongoing due diligence also entails keeping updated records of the data and information obtained from customers during customer due diligence by the financial institution.<sup>616</sup> The process of monitoring is less stringent than identification and verification. It involves little administration as financial institutions already obtained information required to conduct ongoing monitoring from the customers.<sup>617</sup> A financial institution that fails to adopt and apply standard customer due diligence procedures may not establish business relationships with customers.<sup>618</sup> Customer due diligence are measures to reduce money laundering activities in the UK such that all financial institutions in the UK should apply customer due diligence measures for this purpose.<sup>619</sup>

#### 5.2.4 Simplified customer due diligence measures

In the UK, simplified customer due diligence entails a complete waiver of customer due diligence measures in exceptional circumstances.<sup>620</sup> It is argued that simplified customer due diligence measures are applied to customers who pose little or no

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<sup>612</sup> Regulation 30 of the *Money Laundering Regulations* 2017.

<sup>613</sup> De Koker L "Client Identification and Money Laundering Control: Perspectives on the Financial Intelligence Centre Act 38 of 2001" 2004 *TSAR* 715, 725.; see also Harrison and Ryder *The Law Relating to Financial Crime in the United Kingdom* 163.

<sup>614</sup> Hudson *The Law of Finance* 435; see related discussion by Ahlosani *Anti-Money Laundering* 210.

<sup>615</sup> Regulation 28(11) of the *Money Laundering Regulations* 2017.

<sup>616</sup> Ahlosani *Anti-Money Laundering* 210; see also Hudson *The Law of Finance* 436.

<sup>617</sup> Regulation 28 of the *Money Laundering Regulations* 2017.

<sup>618</sup> Regulation 31 of the *Money Laundering Regulations* 2017; see also Ahlosani *Anti-Money Laundering* 211.

<sup>619</sup> Srivastava, Simpson and Moffat *International Guide to Money Laundering Law and Practice* 147;

<sup>620</sup> Regulation 36 of the *Money Laundering Regulations* 2017; see also Ahlosani *Anti-Money Laundering* 212; Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 41.

money laundering risk to the financial institution.<sup>621</sup> Accordingly, the UK financial institutions prefer waiving customer due diligence measures on low-risk customers and preserve resources for high-risk customers.<sup>622</sup> Simplified customer due diligence measures are applied in exceptional circumstances such as during transactions with a public authority in the UK and transactions with financial institutions that are subject to the UK Regulations.<sup>623</sup> Under simplified due diligence, identification and verification of customer identities is disregarded.<sup>624</sup> However, it remains mandatory for financial institutions to conduct ongoing monitoring during simplified customer due diligence measures.<sup>625</sup> This implies that financial institutions in the UK should always assess their customer transactions to detect any inconsistencies, threats or emerging money laundering risks.<sup>626</sup>

#### 5.2.5 Comprehensive customer due diligence

In the UK, comprehensive customer due diligence measures are also referred to as enhanced customer due diligence measures.<sup>627</sup> Enhanced customer due diligence is applied to customers who pose a high money laundering risk or high-risk customers.<sup>628</sup> The *Money Laundering Regulations* expressly set out circumstances when financial institutions should implement enhanced customer due diligence measures.<sup>629</sup> The circumstances include non-face-to-face customers and politically exposed persons.

Non-face-to-face customers are customers who have not been physically present at the financial institution for identification and verification.<sup>630</sup> Physical presence of customers at the financial institution is essential for verification.<sup>631</sup> Verification entails verifying whether the photograph on the documents submitted by the customer is

<sup>621</sup> See Scott KA and Stephenson R "Enhanced Customer Due Diligence for Banks in the UK and the US" 2008 *Journal of International Banking and Financial Law* 86, 89.

<sup>622</sup> Scott and Stephenson 2008 *Journal of International Banking and Financial Law* 89.

<sup>623</sup> Regulation 36(1)(a)-(c) of the *Money Laundering Regulations* 2017.

<sup>624</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 41.

<sup>625</sup> Ahlosani *Anti-Money Laundering* 212.

<sup>626</sup> Scott and Stephenson 2008 *Journal of International Banking and Financial Law* 90.

<sup>627</sup> Regulations 33(1) of the *Money Laundering Regulations* 2017; see also Ahlosani *Anti-Money Laundering* 212.

<sup>628</sup> Regulations 33(1)(a) of the *Money Laundering Regulations* 2017; see discussion by Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 42.

<sup>629</sup> Regulation 33 of the *Money Laundering Regulations* 2017.

<sup>630</sup> Regulation 34 of the *Money Laundering Regulations* 2017.

<sup>631</sup> Scott and Stephenson 2008 *Journal of International Banking and Financial Law* 89.

similar to the appearance of the customer.<sup>632</sup> This implies that customers should be physically present at the financial institution during customer identification and verification.<sup>633</sup>

A politically exposed person is a person who has in the past or is currently occupying a senior public position in a jurisdiction other than the UK.<sup>634</sup> Politically exposed persons and their immediate family members are regarded as high-risk customers in the UK.<sup>635</sup> Financial institutions should get approval from their senior management to establish business relationships with politically exposed persons.<sup>636</sup> The source of wealth involved in the transactions should be established as a measures of deterring transactions concluded with proceeds from criminal activities.<sup>637</sup> Enhanced due diligence on politically exposed persons is relaxed a year after the customer leaves office.<sup>638</sup>

Enhanced customer due diligence includes requesting additional data or documents to supplement the data required for standard customer due diligence.<sup>639</sup> The additional information required should be relevant to the extent of money laundering risk the customer poses to the financial institution.<sup>640</sup> This improves the chances of detecting money laundering activities by monitoring customer activities and reporting suspicious account activity.<sup>641</sup> Additional information can be obtained from another institution that is subject to anti-money laundering measures in the UK.<sup>642</sup> The nature and type of business relationships requested by the customer determines the additional information the financial institution should obtain.<sup>643</sup> However, it should be noted that the classification of customers as high-risk does not mean that the

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<sup>632</sup> Scott and Stephenson 2008 *Journal of International Banking and Financial Law* 89; see also Ahlosani *Anti-Money Laundering* 215.

<sup>633</sup> Regulation 28 of the *Money Laundering Regulations* 2017.

<sup>634</sup> Regulation 14(5)(a) of the *Money Laundering Regulations*.

<sup>635</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 43.

<sup>636</sup> Regulation 14(4)(a) of the *Money Laundering Regulations*.

<sup>637</sup> Ahlosani *Anti-Money Laundering: A Comparative and Critical Analysis of the United Kingdom and the UAE's Financial Intelligence Units* 213.

<sup>638</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 44.

<sup>639</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 44.

<sup>640</sup> Ahlosani *Anti-Money Laundering* 213.

<sup>641</sup> Scott and Stephenson 2008 *Journal of International Banking and Financial Law* 89; see also Ahlosani *Anti-Money Laundering* 215.

<sup>642</sup> Regulation 14(2)(a)-(c) of the *Money Laundering Regulations*.

<sup>643</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 44.

customers are money launderers.<sup>644</sup> This is so because money laundering can also be committed by low-risk customers through methods such as smurfing and smuggling.<sup>645</sup> A cumulative criterion should be used by financial institutions when classifying customers as high or low-risk customers in the UK.<sup>646</sup>

#### 5.2.6 Ongoing due diligence

Ongoing due diligence is a measure applied to both low and high-risk customers in the UK.<sup>647</sup> Ongoing due diligence entails a careful monitoring of customer account activities and transactions by all financial institutions in the UK.<sup>648</sup> The purpose of monitoring customer transactions beyond registration of a customer with a financial institution is to ensure that the customer's transactions are consistent with the financial institution's knowledge of the customer and their risk profile.<sup>649</sup> This is done in the UK to reduce money laundering activities by detecting and reporting unusual transactions.<sup>650</sup> Ongoing customer due diligence also involves continuous update of data submitted to the financial institution at verification.<sup>651</sup> Financial institutions should maintain updated customer profiles to retain and adopt appropriate risk-based approach procedures.<sup>652</sup> Ongoing customer due diligence is applied according to the unusual nature of a customer's transactions, origin of payments, parties involved and the nature of a series of account activities.<sup>653</sup>

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<sup>644</sup> Srivastava, Simpson and Moffat *International Guide to Money Laundering Law and Practice* 80.

<sup>645</sup> See related discussion in para 2.3 in Chapter Two of this dissertation.

<sup>646</sup> Srivastava, Simpson and Moffat *International Guide to Money Laundering Law and Practice* 80.

<sup>647</sup> Regulation 28(11) of the *Money Laundering Regulations* 2017.

<sup>648</sup> Regulation 28(11) of the *Money Laundering Regulations* 2017; see discussion by Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 45.

<sup>649</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 46; see also Srivastava, Simpson and Moffat *International Guide to Money Laundering Law and Practice* 81.

<sup>650</sup> Scott and Stephenson 2008 *Journal of International Banking and Financial Law* 89; see also Shepherd 2009 *Real Property, Trust and Estate Law Journal* 625.

<sup>651</sup> Regulation 39 of the *Money Laundering Regulations* 2017; see also Rooke and Ward "Practical Systems and Controls" 206.

<sup>652</sup> Regulation 39 of the *Money Laundering Regulations* 2017; see also Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 47

<sup>653</sup> Rooke and Ward "Practical Systems and Controls" 206.

### 5.2.7 Risk sensitive approach to customer due diligence measures

The *Money Laundering Regulations* 2017 provide that the basis of a risk-sensitive approach is ensuring that customer due diligence measures are implemented equivalently to the risk established.<sup>654</sup>

The risk-sensitive approach is completed in several steps, such as identifying the money laundering risk, assessing the money laundering risk, designing risk control measures, implementing measures to mitigate risk, monitoring the effectiveness of the control measures and keeping record of the measures used to mitigate money laundering risks.<sup>655</sup>

The risk-sensitive approach is applied as a measure to alleviate the costs incurred by financial institutions when applying customer due diligence measures.<sup>656</sup> The risk-sensitive approach ensures that more resources are allocated to high-risk customers who require high attention in the prevention of money laundering in the UK.<sup>657</sup> The risk-sensitive approach effects stabilization of the costs of implementing customer due diligence measures.<sup>658</sup> Alleviation of customer due diligence costs is ensured through allocation of resources to high money laundering risks.<sup>659</sup> It is submitted that, the risk-sensitive approach is implemented to ensure that comprehensive customer due diligence measures receive more resources.<sup>660</sup> Implementation of the risk-sensitive approach in the UK enables financial institutions to assess and implement the relevant customer due diligence measures to different types of customers in all circumstances.<sup>661</sup> The risk-sensitive approach entails that comprehensive customer

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<sup>654</sup> Regulation 18(1) of the *Money Laundering Regulations* 2017; see also Spedding LS *Due Diligence and Corporate Governance* (LexisNexis Butterworths Durban 2004) 115.

<sup>655</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 47; see also Goldsmith, Kalin and Muller *Anti-Money Laundering International Law and Practice* 372.

<sup>656</sup> Recommendation 5 of the *FATF Recommendations*; see also Harrison and Ryder *The Law Relating to Financial Crime in the United Kingdom* 641.

<sup>657</sup> Harrison and Ryder *The Law Relating to Financial Crime in the United Kingdom* 642; see also Goldsmith, Kalin and Muller *Anti-Money Laundering International Law and Practice* 372-3.

<sup>658</sup> Regulation 18 of the *Money Laundering Regulations* 2017; see also Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 47.

<sup>659</sup> Shepherd KL "Guardians at the Gate: The Gatekeeper Initiative and the Risk-Based Approach for Transnational Laws" 2009 *Real Property, Trust and Estate Law Journal* 603, 625.

<sup>660</sup> Regulation 18(1) of the *Money Laundering Regulations* 2017; see also Harrison and Ryder *The Law Relating to Financial Crime in the United Kingdom* 641-642.

<sup>661</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 48.

due diligence measures are implemented on high-risk customers to enable detection of money laundering activities and unusual transactions.<sup>662</sup>

An analysis of the UK customer due diligence measures proves an insignificant departure by the UK from the FATF customer due diligence measures.<sup>663</sup> For example, the regulation of comprehensive customer due diligence measures that must be performed to high-risk customers that are provided in the FATF recommendations are also provided in the UK *Money Laundering Regulations* 2017.<sup>664</sup> Accordingly, it can be submitted that the UK has used the FATF recommendations as a yardstick for designing its regulation of customer due diligence measures.<sup>665</sup> The customer due diligence standards provided by the FATF and the UK have arguably influenced the regulation of customer due diligence measures in South Africa.<sup>666</sup> More particularly, South Africa adopted and implemented (almost without change) the FATF and the UK customer due diligence measures.

### **5.3 International Best Practices**

#### **5.3.1 Customer due diligence under the Basel Committee of Banking Supervision**

The Basel Committee on Banking Supervision was established in 1974 by bank governors of the signatory countries which include the UK.<sup>667</sup> The Basel Committee designed the first international regulations for combating money laundering in 1988.<sup>668</sup> The Basel Committee issued the "Statement on the Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering" which provided basic principles of customer identification.<sup>669</sup> This marked the first attempts to combat money laundering through customer identification and verification. The regulations of the Basel Committee are not legally binding.<sup>670</sup> The signatory

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<sup>662</sup> Shepherd 2009 *Real Property, Trust and Estate Law Journal* 625.

<sup>663</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 49; see also Sharrock R *et al* *Law of Banking and Payment in South Africa* (Juta Cape Town 2016) 101.

<sup>664</sup> Recommendation 10 of the *FATF Recommendations*; see also Regulations 33 of the *Money Laundering Regulations* 2017.

<sup>665</sup> Ahlosani *Anti-Money Laundering* 205; see also Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 47.

<sup>666</sup> De Koker 2004 *TSAR* 730; see also Henning JJ "Fortifying a Risk-based Approach in the South African AML/CFT Process" 2017 *Journal of Financial Crime* 520, 529.

<sup>667</sup> World Bank *Combating Money Laundering and the Financing of Terrorism* 31.

<sup>668</sup> World Bank *Combating Money Laundering and the Financing of Terrorism* 31.

<sup>669</sup> Ahlosani *Anti-Money Laundering* 206.

<sup>670</sup> Alldridge 2008 *Journal of Law and Society* 444.

jurisdictions of the Basel Committee are expected to implement the provisions of the Basel Committee Banking Supervision according to their domestic systems.<sup>671</sup> The 1998 regulations encouraged the cooperation of member states in the fight against money laundering globally.<sup>672</sup>

In October 2001, the Basel Committee issued detailed guidelines on customer due diligence.<sup>673</sup> The Basel Committee on Banking Supervision focuses on customer due diligence for banks and not other financial institutions because it only makes reference to banking institutions.<sup>674</sup> The Basel Committee on Banking Supervision is promotes sound customer due diligence because of the direct and indirect losses incurred by banks due to lack of appropriate procedures of customer due diligence.<sup>675</sup> Accordingly, the customer due diligence measures alleviate the losses incurred by banks due to money laundering activities.<sup>676</sup> Appropriate implementation of customer due diligence protects banking institutions from losses emanating from money laundering activities and also preserves the reputation of banks.<sup>677</sup> Customer due diligence measures deter money launderers from accessing banking institutions and by detecting suspicious money laundering activities through ongoing monitoring of transactions.<sup>678</sup> The Basel Committee on Banking Supervision submits that effective customer due diligence measures should be cooperated with risk management programmes and the two cannot be separated.<sup>679</sup> The regulations of customer due diligence measures under the Basel Committee are contained in three different papers which are discussed below.<sup>680</sup>

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<sup>671</sup> Alldridge 2008 *Journal of Law and Society* 444.

Before 2009 the Basel Committee was made up of developed countries only. For example, the UK, the United States of America, Germany and France. Currently the committee members of the Basel Committee include South Africa, the UK and Turkey.

<sup>672</sup> World Bank *Combating Money Laundering and the Financing of Terrorism* 31.

<sup>673</sup> Basel Committee on Banking Supervision "Core Principles for Effective Banking Supervision" *Bank for International Settlements* (updated September 2012) 5.

<sup>674</sup> World Bank *Combating Money Laundering and the Financing of Terrorism* 31; see also Basel Committee on Banking Supervision *Bank for International Settlements* 5.

<sup>675</sup> Basel Committee on Banking Supervision *Bank for International Settlements* 5.

<sup>676</sup> Basel Committee on Banking Supervision *Bank for International Settlements* 5.

<sup>677</sup> Goldsmith, Kalin and Muller *Anti-Money Laundering International Law and Practice* 10.

<sup>678</sup> Spedding *Due Diligence and Corporate Governance* 56; see also Ping H *Money Laundering: Suppression and Prevention - The Research on the Legislation Concerning Money Laundering* (VDM Germany 2008) 34.

<sup>679</sup> Basel Committee on Banking Supervision *Bank for International Settlements* 6.

<sup>680</sup> The provisions of these papers are discussed fully by Ahlson *Anti-Money Laundering* 115.

The Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering 1988<sup>681</sup> outlined the basic principles and procedures to be implemented by financial institutions to combat money laundering in the banking systems internationally.<sup>682</sup> This paper reinforced existing banking practices against criminal use of financial institutions and the implementation of money laundering preventive measures.<sup>683</sup> Banks were encouraged to ensure that financial systems are not used to transfer dirty money by determining the true identity of all their customers.<sup>684</sup> The Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering stated that significant transactions would not be concluded between financial institutions and customers who fail to provide their identity.<sup>685</sup> Accordingly, it is submitted that the provision of customer due diligence measures in the Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering was the first establishment of anti-money laundering measures globally.<sup>686</sup> At this time, the Basel Committee was comprised of developed countries.<sup>687</sup> In this regard, the researcher submits that the provisions of customer due diligence measures established by the Basel Committee were designed for developed countries and cannot be successfully implemented in developing countries like South Africa.

The Core Principles for Effective Banking Supervision 1997<sup>688</sup> were issued by the Basel Committee to enhance the implementation of customer due diligence in its member states.<sup>689</sup> The Core Principles strengthened the prevention of money laundering activities through customer due diligence measures in the financial institutions of the signatory countries.<sup>690</sup> The Core Principles also introduced the

<sup>681</sup> Basel Committee on Banking Supervision "Prevention of Criminal Use of the Banking System for the Purposes of Money Laundering" *Bank for International Settlements* (December 1988) 1-4.

<sup>682</sup> Basel Committee on Banking Supervision *Bank for International Settlements* 3.

<sup>683</sup> Basel Committee on Banking Supervision *Bank for International Settlements* 3; see discussion by Ahlosani *Anti-Money Laundering* 115.

<sup>684</sup> Ahlosani *Anti-Money Laundering* 115.

<sup>685</sup> Goldsmith, Kalin and Muller *Anti-Money Laundering International Law and Practice* 10.

<sup>686</sup> Ping H *Money Laundering: Suppression and Prevention* 34.

<sup>687</sup> Boothet *al Money Laundering Law and Regulations: A Practical Guide* 18; see also Mugarura N "Customer Due Diligence (CDD) Mandate and the Propensity of its Application a Global AML Paradigm" 2014 *Journal of Money Laundering Control* 76, 93.

<sup>688</sup> Basel Committee on Banking Supervision "Core Principles for Effective Banking Supervision: Consultative Document" (Core Principles) *Bank for International Settlements* (Updated September 2012) 1.

<sup>689</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 7.

<sup>690</sup> Basel Committee on Banking Supervision *Bank for International Settlements* 4; see also Ahlosani *Anti-Money Laundering* 120; see also Ping H *Money Laundering: Suppression and Prevention* 13.

implementation of risk management practices to customer due diligence.<sup>691</sup> Risk management practices ensured that financial institutions implement customer due diligence measures according to the level of money laundering risk the financial institution is exposed to.<sup>692</sup> Strict regulations to promote high standards of prevention of intentional and unintentional use of banks for criminal activities were also provided in the Core Principles.<sup>693</sup> Banking supervisors have the duty to assess compliance with customer due diligence requirements in all banking institutions.<sup>694</sup> The Core Principles prevented the criminal abuse of financial services by safeguarding strict implementation of customer due diligence measures.<sup>695</sup>

The Basel Committee also issued the Core Principles Methodology<sup>696</sup> to ensure that banks have policies to prevent money laundering in the financial system.<sup>697</sup> The Core Principles Methodology provides that banks should keep records of all transactions and also enforce customer identification policies and rules in all situations.<sup>698</sup> It is submitted that, the Basel Committee issued guidelines to foster the implementation of customer due diligence measures in its member states to enhance the combating of money laundering globally.<sup>699</sup> Although the guidelines issued by the Basel Committee referred to banking institutions only, they are also applicable to other financial institutions.<sup>700</sup> In this regard, the Basel Committee plays an important role in the enforcement of customer due diligence measures to fight money laundering globally. Money laundering is a global crime affecting many countries.

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<sup>691</sup> Ahlosani *Anti-Money Laundering* 120.

<sup>692</sup> Ping H *Money Laundering: Suppression and Prevention* 13; see also Williams C *An Analysis of the Critical Shortcomings in South Africa's Anti-Money Laundering Legislation* (LLM – dissertation University of Western Cape 2017) 17.

<sup>693</sup> Basel Committee on Banking Supervision *Bank for International Settlements* 4; see also Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 7.

<sup>694</sup> Basel Committee on Banking Supervision *Bank for International Settlements* 13.

<sup>695</sup> World Bank *Combating Money Laundering and the Financing of Terrorism* 31.

<sup>696</sup> Basel Committee on Banking Supervision "Core Principles Methodology" *Bank for International Settlements* (October 1999) 3.

<sup>697</sup> Basel Committee on Banking Supervision *Bank for International Settlements* 33; see discussion by Njotini *Customer Due Diligence in terms of the FICA* 7.

<sup>698</sup> Basel Committee on Banking Supervision *Bank for International Settlements* 33.

<sup>699</sup> Williams C *An Analysis of the Critical Shortcomings in South Africa's Anti-Money Laundering Legislation* 18; see also Ping H *Money Laundering: Suppression and Prevention* 217.

<sup>700</sup> Ping H *Money Laundering: Suppression and Prevention* 13; Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 7.

Accordingly, the Basel Committee made provisions for implementing customer due diligence measures to combat money laundering in its member states.<sup>701</sup>

### 5.3.2 Customer Due Diligence under the FATF

It is imperative to discuss the mandate of the FATF towards the combating of money laundering in its member states. The FATF was established for many countries to come together in the combating of money laundering.<sup>702</sup> The FATF is an inter-governmental body that was formed in 1989 by the collective input of Ministers of the member jurisdictions.<sup>703</sup> The FATF stigmatises non-cooperative countries to ensure that all member jurisdictions implement customer due diligence measures to combat money laundering.<sup>704</sup> According to the FATF, non-cooperative countries are countries that fail to implement and adopt anti-money laundering measures satisfactorily.<sup>705</sup> Satisfactory implementation of anti-money laundering measures includes, *inter alia*; defining money laundering activities, seizure and confiscation of proceeds of money laundering and enforcement of anti-money laundering measures.<sup>706</sup>

The first forty recommendations by the FATF which provided counter measures against money laundering were published in 1990.<sup>707</sup> The FATF promotes the effective application of legal and regulatory measures to combat money laundering in its signatory countries.<sup>708</sup> To achieve its aims, the FATF provides a framework of anti-money laundering measures that ought to be implemented by member countries in order to combat money laundering.<sup>709</sup> The FATF recommendations are non-binding on member states.<sup>710</sup> Member states are obliged to implement the anti-money laundering measures provided by the FATF in a way that suits their circumstances

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<sup>701</sup> Njotini MN "The Transaction or Activity Monitoring Process: An Analysis of the Customer Due Diligence Systems of the United Kingdom and South Africa" 2000 *Obiter* 556, 561.

<sup>702</sup> See introduction of the *FATF Recommendations* 7.

<sup>703</sup> See introduction of the *FATF Recommendations* 7.

The FATF has 34 member jurisdictions including South Africa and the UK.

<sup>704</sup> Njotini *Customer Due Diligence in terms of the FICA* 7.

<sup>705</sup> Recommendation 21 of the *FATF Recommendations*.

<sup>706</sup> Njotini *Customer Due Diligence in terms of the FICA* 7.

<sup>707</sup> Nyaude *The Compliance Duties Of Commercial Banks With Regard To On-Line Money Laundering* 6.

<sup>708</sup> See introduction of the *FATF Recommendations* 7; see related discussion by Nyaude *The Compliance Duties Of Commercial Banks With Regard To On-Line Money Laundering* 6.

<sup>709</sup> See introduction of the *FATF Recommendations* 8.

<sup>710</sup> Ai and Jun 2010 *Journal of Money Laundering Control* 218.

and constitutional frameworks.<sup>711</sup> This ensures an effective and context-sensitive application of customer due diligence measures in different jurisdictions.<sup>712</sup> After the FATF recommendations were issued in 1990, they have been revised several times in order to reflect on money laundering trends and expand their scope beyond drug trafficking money-laundering.<sup>713</sup> This has kept the recommendations updated and effective in changing economies and financial markets.<sup>714</sup>

The FATF recommendations set international standards of applying customer due diligence measures.<sup>715</sup> In terms of the FATF recommendations, customer due diligence is performed on a simplified, comprehensive, ongoing and risk-sensitive basis.<sup>716</sup> The application of customer due diligence measures differs according to the level of money laundering risk a customer poses to the financial institution.<sup>717</sup>

#### 5.3.2.1 Simplified customer due diligence measures under the FATF

Simplified customer due diligence measures are measures designed for customers who pose low money laundering risk to the financial institution.<sup>718</sup> Low-risk customers include financial institutions, government administrations, regulated companies and transactions involving small amounts of money.<sup>719</sup> Low-risk customers also include working natural persons with small account balances, who conclude transactions that do not pose high money laundering risks.<sup>720</sup> Simplified customer due diligence measures require unsophisticated and straightforward identification and verification documents such as customer identity card or passport.<sup>721</sup> Information obtained by the financial institution should enable the

<sup>711</sup> Henning J and Hauman M "Fortifying a Risk Based Approach in the South African AML/CFT Process" 2017 *Journal of Financial Crime* 520, 521.

<sup>712</sup> Ai and Jun 2010 *Journal of Money Laundering Control* 218; see also Gordon R "Losing the War against Dirty Money: Rethinking Global Standards on Preventing Money Laundering and Terrorism Financing" 2011 *Duke Journal of Comparative & International* 503, 506.

<sup>713</sup> See introduction of the *FATF Recommendations* 8; see also Gordon 2011 *Duke Journal of Comparative & International* 506.

<sup>714</sup> Damais A "The Financial Action Task Force" in Muller WH, Kälin CH & Goldsworth JG (eds) *Anti-Money Laundering: International Law and Practice* (John Wiley West Sussex 2007) 71.

<sup>715</sup> Njotini *Customer Due Diligence in terms of the FICA* 25.

<sup>716</sup> Recommendation 5-12 of the *FATF Recommendations*; see related discussion by Njotini *Customer Due Diligence in terms of the FICA* 25.

<sup>717</sup> Damais "The Financial Action Task Force" 73.

<sup>718</sup> Pini M "Country Report: Customer Due Diligence in Switzerland" in Peith M and Aiolfi G A *Comparative Guide to Anti-Money Laundering: A Critical Analysis of Systems in Singapore, Switzerland, the UK and the USA* (Edward Elgar Cheltenham 2004) 240-241.

<sup>719</sup> Recommendation 5 of the *FATF Recommendations*.

<sup>720</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 23.

<sup>721</sup> Recommendation 5 of the *FATF Recommendations*.

financial institution to have knowledge of the customer and the nature of business relationship to be formed between the customer and the financial institution.<sup>722</sup> This enables the financial institution to determine the level of money laundering risk the customer poses to the financial institution.<sup>723</sup> It is important for a financial institution to know the level of money laundering risk a customer poses for the purpose of implementing customer due diligence measures that are commensurate with the risk.<sup>724</sup> This entails effective implementation of customer due diligence measures.

The verification documents should contain the customer's background, business activities, country of origin and indicate whether the customer holds any public or high-profile office.<sup>725</sup> This information enables financial institutions to build detailed customer profiles which are essential when determining the level of risk a customer poses to the financial institution.<sup>726</sup> In other cases, the verification process can be conducted after establishment of the business relationship between the financial institution and the customer.<sup>727</sup> However, simplified customer due diligence measures do not exempt financial institutions from the duty to monitor the customer's activities.<sup>728</sup> This is because even though low-risk customers are a low money laundering risk, there still exists the probability that they can be money launderers. As such, their account activities should always be monitored to prevent and detect money laundering activities.<sup>729</sup>

### 5.3.2.2 Comprehensive customer due diligence measures under the FATF<sup>7</sup>

Comprehensive measures are also referred to as enhanced due diligence measures.<sup>730</sup> Under the FATF, enhanced customer due diligence measures are performed in specified situations such as transactions involving high-risk

<sup>722</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 26; see also recommendation 5(a) of the *FATF Recommendations*.

<sup>723</sup> Damais A "The Financial Action Task Force" 71; see also Ai and Jun 2010 *Journal of Money Laundering Control* 218; see also De Koker 2004 *TSAR* 740.

<sup>724</sup> De Koker 2004 *TSAR* 744; see: Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 26

<sup>725</sup> Recommendation 5(a) of the *FATF Recommendations*.

<sup>726</sup> Damais A "The Financial Action Task Force" 71; see also Gordon 2011 *Duke Journal of Comparative & International* 507.

<sup>727</sup> Recommendation 5 of the *FATF Recommendations*.

<sup>728</sup> Harrison and Ryder *The Law Relating to Financial Crime in the United Kingdom* 641.

<sup>729</sup> Henning and Hauman 2017 *Journal of Financial Crime* 525; see also Kersop M *Anti-money laundering Regulations and the Effective Use of Mobile Money in South Africa* (LLM – dissertation Northwest University 2014) 26.

<sup>730</sup> Harrison and Ryder *The Law Relating to Financial Crime in the United Kingdom* 643.

customers.<sup>731</sup> High-risk customers include politically exposed persons, cross-border correspondent banking and payable through accounts.<sup>732</sup> Financial institutions are required to apply extensive and stringent customer due diligence measures on all transactions concluded with high-risk customers.<sup>733</sup> This is due to the high money laundering risk levels high-risk customers pose to financial institutions and the need to protect financial institutions from money laundering activities.<sup>734</sup> Comprehensive customer due diligence measures require careful scrutiny of customer activities, transactions and behavior.<sup>735</sup> This is because financial institutions have the duty to safeguard their business from money laundering activities.<sup>736</sup> As such, scrutiny enables financial institutions to detect money laundering risks from the customer's behavior and activities.<sup>737</sup> It is important for financial institutions to implement enhanced customer due diligence on high-risk customers to ensure an effective application of customer due diligence measures according to the level of risks posed by the customer.<sup>738</sup> This means that the extent of customer due diligence applicable varies according to the money laundering risks identified by the financial institution.<sup>739</sup>

### 5.3.2.3 Ongoing monitoring measures under the FATF

The FATF provides that ongoing monitoring of customer activities is essential for a successful control and deterring of money laundering.<sup>740</sup> This is because ongoing monitoring enables financial institutions to keep updated records of the data and information obtained from customers during customer due diligence.<sup>741</sup> Ongoing monitoring is also referred to as ongoing customer due diligence. Ongoing monitoring entails a continuous monitoring of customer accounts activities by the financial institution throughout their business relationship.<sup>742</sup> This is done to enable

<sup>731</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 28.

<sup>732</sup> Recommendations 6-8 and 11 of the *FATF Recommendations*.

<sup>733</sup> Harrison and Ryder *The Law Relating to Financial Crime in the United Kingdom* 643.

<sup>734</sup> Damais A "The Financial Action Task Force" 73; see also Ahlosani *Anti-Money Laundering* 213.

<sup>735</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 33.

<sup>736</sup> Harrison and Ryder *The Law Relating to Financial Crime in the United Kingdom* 645; Ping H *Money Laundering: Suppression and Prevention* 13.

<sup>737</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 33.

<sup>738</sup> Henning and Hauman 2017 *Journal of Financial Crime* 525; see also Damais A "The Financial Action Task Force" 80.

<sup>739</sup> Harrison and Ryder *The Law Relating to Financial Crime in the United Kingdom* 643.

<sup>740</sup> Recommendation 5 of the *FATF Recommendations*.

<sup>741</sup> Ahlosani *Anti-Money Laundering* 210; see also Hudson *The Law of Finance* 436.

<sup>742</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 33.

financial institutions to detect unusual transactions by the customer.<sup>743</sup> Ongoing customer due diligence measures requires the staff of financial institutions to have expertise and skill to assess and monitor money laundering risks the financial institution is exposed to.<sup>744</sup> This means that financial institutions should perform customer due diligence measures on a risk sensitive basis.<sup>745</sup>

#### 5.3.2.4 Risk sensitive approach

The risk-sensitive approach to customer due diligence measures is also called the risk-based approach.<sup>746</sup> The application of the risk-based approach prepares financial institutions for money laundering risks before the risks ensue. This implies that financial institutions can determine the outcome of the risks they identify and prepare measures to prevent the risks.<sup>747</sup> Financial institutions rely on the proportionality between the identified money laundering risks and the performance of customer due diligence measures.<sup>748</sup> The risk-based approach entails that the level of customer due diligence measures implemented in every scenario should conform to the degree of money laundering risk posed by the customer.<sup>749</sup> This ensures that adequate levels of customer due diligence measures are applied according to the different money laundering risk levels.<sup>750</sup> The risk based approach provided by the FATF shows a shift from a rule based approach which relied on the interpretation of the rules rather than risk matrixes.<sup>751</sup> Proper identification of risks is a necessity because it improves the effectiveness of customer due diligence measures towards the combating of money laundering.<sup>752</sup>

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<sup>743</sup> Goldsmith, Kalin and Muller *Anti-Money Laundering International Law and Practice* 97.

<sup>744</sup> Ping H. *Money Laundering: Suppression and Prevention* 13; see also Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 35.

<sup>745</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 35; see also Kersop *Anti-money laundering Regulations in South Africa* 26.

<sup>746</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 36.

<sup>747</sup> Spedding *Due Diligence and Corporate Governance* 40.

<sup>748</sup> Spedding *Due Diligence and Corporate Governance* 40.

<sup>749</sup> Njotini *Customer Due Diligence in terms of the Financial Intelligence Centre Act* 35.

<sup>750</sup> Peith and Aiolfi *A Comparative Guide to Anti-Money Laundering* 27; see also De Koker 2004 TSAR 739.

<sup>751</sup> Spedding *Due Diligence and Corporate Governance* 40.

<sup>752</sup> Goldsmith, Kalin and Muller *Anti-Money Laundering International Law and Practice* 372.

## 5.4 Overall Comparative Analysis

From the discussion above, it can be alluded that the UK adopted a progressive framework to combat money laundering in the UK.<sup>753</sup> The UK regulation of customer due diligence measures is relatively one of the most adequate anti-money laundering regulatory systems.<sup>754</sup> As such, a comparative analysis of the anti-money laundering regulatory framework in the UK and South Africa is discussed in this chapter.

A comparative analysis is done to examine, investigate and explore the similarities and differences between the UK and the South African customer due diligence measures. Furthermore, this chapter isolates possible lessons that can be learnt from the UK by South Africa. The relevant customer due diligence provisions applied in South Africa are analysed and where relevant, compared to similar provisions in the UK. Additionally, this is done to recommend possible measures that can be employed by South Africa to enhance the reliance on customer due diligence measures to combat money laundering in South Africa.

### 5.4.1 Customer due diligence measures in a cash-based economy

A cash-based economy is an economy where cash is used to effect or conclude almost every transaction.<sup>755</sup> Cash transactions are the norm rather than the exception in South Africa.<sup>756</sup> Accordingly, the effective implementation of customer due diligence measures in South Africa is deterred by several challenges.<sup>757</sup> The challenges include porous land border posts which provide means for money launderers to smuggle money out of South Africa.<sup>758</sup> Smuggling is one of the methods used by money launderers to commit money laundering in South Africa.<sup>759</sup> Cash-based economies also make it difficult for relevant authorities to distinguish

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<sup>753</sup> SujeeA study of the Anti-Money Laundering Framework in South Africa and the United Kingdom 44.

<sup>754</sup> Commonwealth Secretariat *Combating Money Laundering and Terrorist Financing* 138.

<sup>755</sup> Geister D *Concepts in Customer Due Diligence: Meeting the Challenges of Regulatory Expectation* (Lexis Nexis New York 2009) 1-10.

<sup>756</sup> Mugarura 2014 *Journal of Money Laundering Control* 87.

<sup>757</sup> Coovadia C "African Families, African Money Bridging the Money Transfer Divide: A Study on the South African Money Transfer Environment" *G:enesis Analytics-FinMark Trust* (April 2003) 33.

<sup>758</sup> See Mugarura 2014 *Journal of Money Laundering Control* 87; see also Geister *Concepts in Customer Due Diligence* 5.

<sup>759</sup> See related discussion in para 2.3 in Chapter Two of this dissertation.

between laundered money and legitimate funds.<sup>760</sup> This is because of the nature of a cash-based economic system in South Africa where people are most likely to be in possession of cash.<sup>761</sup> However, the UK economy is not cash-based such that most transactions are concluded through financial institutions that implement ongoing customer due diligence measures to monitor all transactions.<sup>762</sup> In this regard, unusual transactions and suspicious money laundering activities can be detected and reported to the relevant authorities by financial institutions.<sup>763</sup> Accordingly, the UK customer due diligence measures can be effectively implemented and all business transactions can be monitored to prevent money laundering activities.<sup>764</sup>

#### 5.4.2 Customer due diligence measures and the informal financial sector

The current anti-money laundering laws of South Africa regulate the formal financial sector only.<sup>765</sup> On the other hand, the informal financial sector exists simultaneously with the formal financial sector.<sup>766</sup> The informal financial sector of South Africa is culminated with a lack of financial and business transaction records which makes the informal financial sector accessible to money launderers.<sup>767</sup> The informal financial sector is vulnerable to money launderers because there are no records of transactions which can be used as evidence of money laundering activities.<sup>768</sup> In this regard, it is difficult to dispute an alleged business turn-over and money laundering activities.<sup>769</sup>

Proceeds of criminal activities can be integrated and layered into the informal financial system where there are no customer due diligence measures to detect

<sup>760</sup> Bollen R "The International Financial System and Future Global Regulation" 2008 *Journal of International Banking and Financial Law Regulation* 465, 467.

<sup>761</sup> Bollen 2008 *Journal of International Banking and Financial Law Regulation* 467; see related discussion by Geister *Concepts in Customer Due Diligence* 5.

<sup>762</sup> Mugarura 2014 *Journal of Money Laundering Control* 87; see also Coovadia *Genesis Analytics* 34.

<sup>763</sup> Moshi H "Fighting Money Laundering: Challenges in Africa" 2007 *East African Human Rights Law Journal* 1, 1-7.

<sup>764</sup> Mugarura 2014 *Journal of Money Laundering Control* 87; see also Bollen 2008 *Journal of International Banking and Financial Law Regulation* 467.

<sup>765</sup> Schedule 3 of the *Financial Intelligence Centre Amendment Act* 1 of 2017 (*Amendment Act*).

<sup>766</sup> Shehu Y "Promoting Financial Sector Stability through an Effective AML/CFT Regime" 2010 *Journal of Money Laundering Control* 139, 150.

<sup>767</sup> Qorchi M, Maimbo S and Wilson J "Informal Funds Transfer System: An Analysis of the 'Informal Hawala System'" 2003 *Journal of Money Laundering Control* 23, 37.

<sup>768</sup> De Koker L "Money Laundering in South Africa" 2002 *Journal of Money Laundering Control* 166, 170.

<sup>769</sup> Qorchi, Maimbo and Wilson 2003 *Journal of Money Laundering Control* 38; see also Mulig EV and Murphy S "Understanding and Preventing Money Laundering" 2004 *Journal of Money Laundering Crime* 20, 22-25.

money laundering activities.<sup>770</sup> An example of informal financial sector is the Hawala system which is an alternative remittance system used to avoid cross-border money transfer fees.<sup>771</sup> Hawalas can conclude anonymous international transfers which can be used to effect money laundering activities.<sup>772</sup> Large amounts of money from criminal activities can be channeled out of South Africa without passing through the formal financial sector.<sup>773</sup> The Hawala system thus makes it difficult for relevant authorities in South Africa to detect money laundering activities.<sup>774</sup> However, this is not the case in the UK since the informal financial sector is not as common.<sup>775</sup> This implies that the relevant authorities have access to most transactions through formal financial institutions which implement customer due diligence measures.<sup>776</sup> The financial institutions in the UK are able to detect and report suspicious money laundering activities because they are conducted within the formal financial institutions.<sup>777</sup> Accordingly, most money laundering activities are easily identified in the UK. In this regard, it is submitted that South Africa can learn the importance of formalizing the informal financial sector from the UK example.<sup>778</sup> There is need to formalize the informal financial sector of South Africa to enhance the reliance on customer due diligence measures to combat money laundering in South Africa.<sup>779</sup>

#### 5.4.3 Resources to implement customer due diligence measures

The implementation of customer due diligence measures in South Africa faces challenges of lack of sufficient resources.<sup>780</sup> Even though South Africa has implemented the risk-based approach which also helps alleviate the problem of

<sup>770</sup> See related discussion in para 2.3 in Chapter Two of this dissertation.

<sup>771</sup> Mulig and Murphy 2004 *Journal of Money Laundering Control* 22; see also Shanmugan B "Hawala and Money Laundering: The Malaysian Perspective" 2004 *Journal of Money Laundering Control* 37, 38.

<sup>772</sup> Shanmugan 2004 *Journal of Money Laundering Control* 39; see also Mulig and Murphy 2004 *Journal of Money Laundering Control* 22.

<sup>773</sup> See discussion on smuggling in para 2.3 in Chapter Two of this dissertation

<sup>774</sup> Shehu 2010 *Journal of Money Laundering Control* 151; see also Shanmugan 2004 *Journal of Money Laundering Control* 39.

<sup>775</sup> Geister *Concepts in Customer Due Diligence* 5.

<sup>776</sup> Ross S and Hannan M "Money Laundering Regulation and Risk Based Decision Making" 2007 *Journal of Money Laundering Control* 106, 111.

<sup>777</sup> De Koker L "Money Laundering Control and Suppression of Financing of Terrorism: Some Thoughts on the Impact of Customer Due Diligence Measures on Financial Exclusion" 2006 *Journal of Financial Crime* 26, 27.

<sup>778</sup> De Koker L "Aligning Anti-Money Laundering, Combating of Financing of Terror and Financial Inclusion: Questions to Consider when FATF Standards are Clarified" 2011 *Journal of Financial Crime* 361, 366.

<sup>779</sup> De Koker 2006 *Journal of Financial Crime* 27; see also De Koker 2011 *Journal of Financial Crime* 366.

<sup>780</sup> Mugarura 2014 *Journal of Money Laundering Control* 61.

insufficient resources, some financial institutions in South Africa still face problems of lack of resources.<sup>781</sup> The risk-based approach under the *Amendment Act* is applied to both low-risk and high-risk customers in South Africa.<sup>782</sup> Unlike in South Africa, the UK does not implement customer due diligence measures on some low-risk customers.<sup>783</sup> In the UK simplified customer due diligence measures entail a waiver of customer due diligence measures on some customers.<sup>784</sup> This approach ensures that more resources are availed for comprehensive customer due diligence measures on high-risk customers.<sup>785</sup> As such, some challenges of lack of resources faced by South African financial institutions emanate from the implementation of customer due diligence measures on both low-risk and high-risk customers. Accordingly, South Africa can draw lessons from the UK approach where financial institutions do not use resources on simplified customer due diligence measures to alleviate customer due diligence costs. It is submitted that South African financial institutions should alleviate customer due diligence costs by allocating resources to high money laundering risks to enhance the reliance on customer due diligence measures to combat money laundering in South Africa.<sup>786</sup>

#### 5.4.4 Adoption of international customer due diligence standards

Given the background in this chapter, it is submitted that the customer due diligence measures regulated by the *Amendment Act* are based on international standards.<sup>787</sup> Seemingly, South Africa adopted customer due diligence measures from international best practices like the *Vienna Convention* and the FATF recommendations.<sup>788</sup> Mugarura submits that the implementation of customer due diligence measures as a global paradigm is less effective in developing countries like South Africa because of challenges such as financial exclusion and lack of

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<sup>781</sup> See section 42 of the *Amendment Act*; see also De Koker 2011 *Journal of Financial Crime* 368.

<sup>782</sup> Section 42 of the *Amendment Act*; see also Sujee A study of the Anti-Money Laundering Framework in South Africa and the United Kingdom 47.

<sup>783</sup> Ahlosani *Anti-Money Laundering* 212; see also Jung and Lishan *Journal of Money Laundering Control* 409.

<sup>784</sup> Regulation 27 of the *Money Laundering Regulations* 2017; see also Scott and Stephenson 2008 *Journal of International Banking and Financial Law* 89.

<sup>785</sup> Scott and Stephenson 2008 *Journal of International Banking and Financial Law* 89; see also Ahlosani *Anti-Money Laundering* 212.

<sup>786</sup> Mugarura 2014 *Journal of Money Laundering Control* 90; see also De Koker 2011 *Journal of Financial Crime* 368.

<sup>787</sup> See section 20A-21H of the *Amendment Act*; see also De Koker 2004 *TSAR* 744.

<sup>788</sup> Recommendation 10 of the *FATF Recommendations*; see also article3(c)(i) of the *Vienna Convention*.

resources.<sup>789</sup> The researcher concurs with this submission because South Africa lacks adequate economic and social infrastructure to implement customer due diligence measures on an international standard as compared to the UK.<sup>790</sup> The problems faced by South Africa such as financial exclusion deter an effective implementation of customer due diligence measures and these problems are foreign to developed countries like the UK.<sup>791</sup> In this regard, it is impossible for South Africa and the UK to implement the same standard of customer due diligence measures.<sup>792</sup>

The criminalization of money laundering activities in the UK precedes the establishment of the international anti-money laundering measures by the FATF and the United Nations.<sup>793</sup> This shows that the UK developed its anti-money laundering laws independent from international standards in the FATF recommendations and the *Vienna Convention*.<sup>794</sup> The UK adopted international customer due diligence measures to ensure coordinated checks and balances with the international standards, to overcome the weaknesses and challenges in its domestic anti-money laundering laws and not as the basis of its regulation of customer due diligence measures.<sup>795</sup> On the contrary, the regulation of customer due diligence measures in South Africa departed from international standards. For example, the first regulations prohibiting money laundering activities in the *Drugs and Drug Trafficking Act*<sup>796</sup> were influenced by the *Vienna Convention*.<sup>797</sup> This has resulted in the implementation of context-insensitive customer due diligence measures in South Africa.<sup>798</sup> Accordingly it is submitted that, like the UK, South Africa should design its own unique and context-sensitive customer due diligence measures. An establishment of context-

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<sup>789</sup> Mugarura 2014 *Journal of Money Laundering Control* 90; see also De Koker 2011 *Journal of Financial Crime* 366; De Koker 2006 *Journal of Financial Crime* 29.

<sup>790</sup> De Koker L "The FATF's Customer Identification Framework: Fit for Purpose?" 2014 *Journal of Money Laundering Control* 281, 290.

<sup>791</sup> De Koker 2004 TSAR 744; see also Mugarura 2014 *Journal of Money Laundering Control* 90.

<sup>792</sup> Mugarura 2014 *Journal of Money Laundering Control* 90.

<sup>793</sup> Booth *et al Money Laundering Law and Regulations: A Practical Guide* 14.

<sup>794</sup> Booth *et al Money Laundering Law and Regulations: A Practical Guide* 14; see also Fisher 2010 *British Tax Review* 236.

<sup>795</sup> Harrison and Ryder *The Law Relating to Financial Crime in the United Kingdom* 79; see also Goldsmith, Kalin and Muller *Anti-Money Laundering International Law and Practice* 372.

<sup>796</sup> 140 of 1992 (*Drugs Act*), section 14; see also De Koker L and Henning JJ "Money laundering Control in South Africa" 1998 *Transactions of the Centre for Business Law* 24.

<sup>797</sup> Article 3(c)(i) of the *Vienna Convention*.

<sup>798</sup> De Koker and Henning 1998 *Transactions of the Centre for Business Law* 25.

sensitive customer due diligence measures enhances the reliance on customer due diligence measures to combat money laundering in South Africa.<sup>799</sup>

### **5.5 Conclusion**

An analysis of the UK customer due diligence measures has shown an insignificant adoption of the international best practices and an enormous influence on the South African anti-money laundering framework.<sup>800</sup> The researcher also examined the implementation of customer due diligence on an international basis and has shown that the approach is undesirable in South Africa. Customer due diligence measures are more effective in developed countries than in developing countries due to the dynamics in economic development.<sup>801</sup> Financial institutions in South Africa should use their experience to design effective anti-money laundering measures. The implementation of customer due diligence measures should be properly streamlined in South Africa to achieve the purpose it was designed for.<sup>802</sup> The researcher contends that the South African relevant authorities should draw some useful lessons from its UK counterpart. The researcher strongly recommends a context-sensitive customer due diligence regulatory framework in South Africa to enhance the reliance on customer due diligence measures to combat money laundering in South Africa.

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<sup>799</sup> Mugarura 2014 *Journal of Money Laundering Control* 90; see also De Koker 2014 *Journal of Money Laundering Control* 290.

<sup>800</sup> Harrison and Ryder *The Law Relating to Financial Crime in the United Kingdom* 79.

<sup>801</sup> Moshi 2007 *East African Human Rights Law Journal* 7.

<sup>802</sup> Mugarura 2014 *Journal of Money Laundering Control* 90.

## CHAPTER SIX

### RECOMMENDATIONS AND CONCLUSION

#### 6.1 Introduction

The regulation of customer due diligence measures under the *Financial Intelligence Centre Act* as amended,<sup>803</sup> is at the cornerstone of the South African anti-money laundering framework. The implementation of customer due diligence measures to curb money laundering in South Africa is faced with many challenges, some of which have been discussed in this research.<sup>804</sup> For example, stringent identification and verification customer due diligence requirements form social and economic barriers to the low-income earners and socially marginalized people in South Africa.<sup>805</sup> These barriers prevent the socially marginalized people from accessing financial services such as opening bank accounts (the formal financial system). This affects the effective implementation of customer due diligence measures in South Africa because customer due diligence measures are only applicable in the formal financial system.<sup>806</sup> Customer due diligence measures are also financially costly.<sup>807</sup> Even though the consolidation and generation of customer profiles can be costly for financial institutions,<sup>808</sup> customer due diligence measures remains an important aspect of anti-money laundering measures. This is because customer due diligence measure reduce the vulnerability of financial institutions to money laundering activities by detecting money laundering activities before they pursue.<sup>809</sup> Customer due diligence measures enable financial institutions to understand the money

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<sup>803</sup> 38 of 2001 as amended *Financial Intelligence Centre Amendment Act 1 of 2017 (Amendment Act)*, see sections 20A-21H; see also De Koker L "The FATF's Customer Identification Framework: Fit for Purpose?" 2014 *Journal of Money Laundering Control* 281, 291; De Koker L "Client Identification and Money Laundering Control: Perspectives on the Financial Intelligence Centre Act 38 of 2001" 2004 *TSAR* 721, 742.

<sup>804</sup> See related comments para 4.2 in Chapter Four of this dissertation.

<sup>805</sup> De Koker 2014 *Journal of Money Laundering Control* 291.

<sup>806</sup> Bester H, De Koker L and Hawthorn R "Access to Financial Services in South Africa: A Brief Case Study of the Effect of the Implementation of the Financial Action Task Force Recommendations" *G:genesis Report* (7 April 2004) 2; see related discussion by De Koker 2006 *Journal of Financial Crime* 27.

<sup>807</sup> Sathye M "Estimating the Cost of Compliance of AML/CFT for Financial Crime in Australia" 2008 *Journal of Financial Crime* 347, 359.

<sup>808</sup> De Koker L "Money Laundering Control and Suppression of Financing of Terrorism: Some Thoughts on the Impact of Customer Due Diligence Measures on Financial Exclusion" 2006 *Journal of Financial Crime* 26, 48.

<sup>809</sup> De Koker 2006 *Journal of Financial Crime* 44.

laundering risks they are exposed to and manage the risks.<sup>810</sup> This chapter recommends possible solutions to the challenges of implementing customer due diligence so as to enhance the reliance on customer due diligence measures to combat money laundering in South Africa. It is hoped that the recommendations will assist policy makers to enhance and implement robust customer due diligence measures and regulations to effectively combat money laundering in South Africa.

## 6.2 Recommendations

Various recommendations aimed at enhancing the reliance on customer due diligence measures to combat money laundering in South Africa are provided below. It is hoped that these recommendations will be utilized by the relevant authorities to curb money laundering in South Africa. It is recommended that;

### **a) the *Amendment Act* should be amended to enact provisions that expressly regulate cross-border money transfers at reasonable remittance**

The simultaneous existence of informal cross border money transfer systems and formal cross border money transfers reveals a challenge in the regulation of anti-money laundering measures in South Africa.<sup>811</sup> A large proportion of money is channeled in and out of South Africa by smuggling through porous border posts.<sup>812</sup> Smuggling is one of the ways used by money launderers to commit money laundering.<sup>813</sup> Smuggling and informal cross-border money transfer systems are normally conducted by migrants who avoid high remittance costs of transferring money from one country to another.<sup>814</sup> Cross-border money transfers are associated with many problems.<sup>815</sup> Firstly, cross-border money transfers are mostly made by

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<sup>810</sup> Tuba M "Prosecuting Money Laundering the FATF Way: An Analysis of Gaps and Challenges in South African Legislation from a Comparative Perspective" 2012 *Acta Criminologica* 103, 125.

<sup>811</sup> Itzikowitz A "Money Laundering" 2000 *SA Merc Law Journal* 302, 310.

<sup>812</sup> Sander C "Capturing a Market Share?: Migrant Remittance Transfers and Commercialisation of Microfinance in Africa" *Current Issues in Microfinance* Conference (12-14 August 2003 Johannesburg) 6. Sander "Capturing a Market Share?: Migrant Remittance Transfers and Commercialisation of Microfinance in Africa" 7.

<sup>813</sup> Coovadia C "African Families, African Money Bridging the Money Transfer Divide: A Study on the South African Money Transfer Environment" *Genesis Analytics-FinMark Trust* (April 2003) 33; see related comments para 2.3 in Chapter two of this dissertation.

<sup>814</sup> Sander "Capturing a Market Share?: Migrant Remittance Transfers and Commercialisation of Microfinance in Africa" 7. An example is the Hawala system. The Hawala system is an alternative remittance system used to avoid cross-border money transfer fees.

<sup>815</sup> Henning JJ, Du Toit A and Nel P "Decriminalisation of Money Laundering: A Systematic Approach" 1998 *Transaction of the Centre of Business Law* 66, 92; see also Coovadia *Genesis Analytics-FinMark Trust* 32.

foreign immigrants who have no voting capacity and who do not have political influence to inspire the government to create policies to regulate the cross-border money transfer system.<sup>816</sup> Secondly, customer due diligence measures under the *Amendment Act* are implemented by domestic financial institutions that create efficiency in domestic money transfers but fail to effect cross-border transfers.<sup>817</sup> Thirdly, illegal migration and smuggling of money complicate the regulation of cross-border money transfer systems.<sup>818</sup> These challenges have resulted in the lack of express provisions regulating the implementation of customer due diligence measures during cross-border money transfers.<sup>819</sup> In this regard, it is recommended that the *Amendment Act* should regulate cross-border money transfer systems to control money laundering activities associated with cross border money transfers, such as smuggling.<sup>820</sup> The *Amendment Act* does not expressly provide for cross border money transfers and it is argued that cross-border money transfers are a high money laundering risk.<sup>821</sup> This implies that customer due diligence measures are not consistently applied during cross-border money transfers. Thus, increasing money laundering risks in South Africa.<sup>822</sup> The customer due diligence measures must be enforced to safeguard against money laundering and the failure thereof increases money laundering risks.<sup>823</sup> The application of customer due diligence measures to cross-border money transfer systems will alleviate money laundering risks influenced by informal cross-border money transfer systems.<sup>824</sup>

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<sup>816</sup> Reuter P and Truman EM *Chasing Dirty Money: The Fight against Money Laundering* (Institute for International Economics Washington DC 2004) 30; see also Coovadia *G:enesis Analytics-FinMark Trust* 32.

<sup>817</sup> Sections 20A-21H of the *Amendment Act*; see also Nyaude *The Compliance Duties of Commercial Banks* 76.

<sup>818</sup> Sander "Capturing a Market Share?: Migrant Remittance Transfers and Commercialisation of Microfinance in Africa" 7; see also Coovadia *G:enesis Analytics- FinMark Trust* 32.

<sup>819</sup> Coovadia *G:enesis Analytics-FinMark Trust* 32.

<sup>820</sup> Section 20A-21H of the *Amendment Act*; see Coovadia *G:enesis Analytics-FinMark Trust* 62; see related discussion by Sander "Capturing a Market Share?: Migrant Remittance Transfers and Commercialisation of Microfinance in Africa" 7.

<sup>821</sup> Schedule 1 of the *Amendment Act*.

<sup>822</sup> Reuter and Truman *Chasing Dirty Money: The Fight against Money Laundering* 96.

<sup>823</sup> Nyaude *The Compliance Duties of Commercial Banks* 76.

<sup>824</sup> Coovadia *G:enesis Analytics-FinMark Trust* 62.

**b) the *Amendment Act* should be amended to expressly deal with politically exposed persons and the ongoing monitoring of their transactions**

Financial institutions classify customers according to the level of money laundering risk they pose to the financial institution.<sup>825</sup> This enables commensurate application of anti-money laundering measures and the level of money laundering risk.<sup>826</sup> High-risk customers are customers who pose high money laundering risks by exposing financial institutions to money laundering.<sup>827</sup> Persons who occupy or have previously occupied senior public positions in South Africa or other countries, for example heads of states or government officials are classified as high-risk customers.<sup>828</sup> Politically exposed persons are a high money laundering risk persons because of their positions which make them susceptible to abuse of state funds by means of corruption and embezzlement.<sup>829</sup> Financial institutions require additional information when establishing business relationships with high-risk customers.<sup>830</sup> For example, they may request to know the source of funds involved in a customer's transactions.<sup>831</sup> The information obtained by a financial institution about a customer enables the institution to detect inconsistencies between their knowledge of the customer and the customer's account activities.<sup>832</sup> As such financial institutions should be allowed to establish the net worth of politically exposed persons as soon as they are appointed.<sup>833</sup> This will enable financial institutions to detect money laundering if the net worth unreasonably increases more than the expectation.<sup>834</sup> However, the *Amendment Act* does not authorize financial institutions to obtain as

<sup>825</sup> Ahlers C *The South African Anti-Money Laundering Regulatory Framework Relevant to Politically Exposed Persons* (MPhil in Fraud Risk Management – dissertation University of Pretoria 2013) 28.

<sup>826</sup> De Koker 2004 TSAR 741; see also Ahlosani W *Anti-Money Laundering: A Comparative and Critical Analysis of the United Kingdom and the UAE'S Financial Intelligence Units* (Palgrave Macmillan London 2016) 216.

<sup>827</sup> Schedule 3A of the *Amendment Act*.

<sup>828</sup> Leppan D "Refining the PEP Definition" *World-Check White Paper* (2005) 9.

<sup>829</sup> Henning JJ and Ebersohn GJ "Insider Trading, Money Laundering and Computer Crime" 2001 *Transactions of the Centre for Business Law: Combating Economic Crime* 105, 123; see also Ahlers *The South African Anti-Money Laundering Regulatory Framework* 63.

<sup>830</sup> Choo K "Politically Exposed Persons (PEPs): Risks and Mitigation" 2008 *Journal of Money Laundering Control* 371, 377; see related discussion by Ahlers *Anti-Money Laundering Regulatory Framework Relevant to Politically Exposed Persons* 68.

<sup>831</sup> Chaikin D "Commercial Corruption and Money Laundering: A Preliminary Analysis" 2008 *Journal of Financial Crime* 269, 270.

<sup>832</sup> Tuba M and Van der Westhuizen C "An Analysis of the 'Know Your Customer' Policy as an Effective Tool to Combat Money Laundering: Is it about Who or What to Know that Counts?" 2014 *International Journal Public Law and Policy* 53, 61.

<sup>833</sup> Choo 2008 *Journal of Money Laundering Control* 377.

<sup>834</sup> Choo 2008 *Journal of Money Laundering Control* 378

much information as they deem necessary from politically exposed persons.<sup>835</sup> The *Amendment Act* is silent about how financial institutions should deal with politically exposed persons to control their money laundering activities domestically and internationally.<sup>836</sup> Accordingly, the researcher recommends that the *Amendment Act* should regulate the implementation of customer due diligence measures that are specifically designed for politically exposed persons for a consistent application of customer due diligence measures.<sup>837</sup> Politically exposed persons expose financial institutions to high money laundering risks. The *Amendment Act* should be amended to enact provisions that enhance the monitoring and regulation of business transactions of politically exposed persons.<sup>838</sup> The customer due diligence measures should also be enhanced to include prosecution of politically exposed persons that commit money laundering offences.<sup>839</sup>

**c) the anti-money laundering measures under the *Amendment Act* should be amended to include measures to combat corruption**

Corruption is defined as an act of accepting or offering gratification to another person so as to influence the receiver to act in an unlawful or irregular exercise of their duties.<sup>840</sup> Corruption has become entrenched in most developing countries like South Africa due to lack of clear regulation of those in positions of authority.<sup>841</sup> Corruption provides means of moving criminal proceeds and criminal exploitation of financial institutions by money launderers through paying bribes to the money laundering officers.<sup>842</sup> In South Africa, public officials who are poorly paid may find it difficult to resist bribes from money launderers and assist them to move criminal proceeds.<sup>843</sup> The effects of corruption in the fight against money laundering in South Africa is evidenced by the recent VBS scandal where public offices lost large

<sup>835</sup> See section 21G of the *Amendment Act*; Chaikin 2008 *Journal of Financial Crime* 270; see related discussion by Choo 2008 *Journal of Money Laundering Control* 378.

<sup>836</sup> Mnguni S *Transnational Organised Crimes in Africa: A Case Study of Drug Trafficking and Money Laundering in Ghana and South Africa* (Master of Social Science in Political Science in the School of Social Sciences-dissertation University of Kwazulu-Natal 2013) 32; see also Ahlers *Anti-Money Laundering Regulatory Framework* 68.

<sup>837</sup> Sections 21G of the *Amendment Act*; see also Goredema C et al "Profiling Money Laundering in Eastern and Southern Africa" 2003 *Institute for Security Studies Monographs* 50, 69.

<sup>838</sup> Section 21G of the *Amendment Act*; see also Leppan *World-Check White Paper* 9.

<sup>839</sup> Ahlers *Anti-Money Laundering Regulatory Framework* 76.

<sup>840</sup> Snyman CR *Criminal Law* 5<sup>th</sup> ed (Lexis Nexis Durban 2008) 411.

<sup>841</sup> Ackerman SG *Corruption and Governments Causes, Consequences and Reforms* (Cambridge University Press Cambridge 1998) 27.

<sup>842</sup> Chaikin 2008 *Journal of Financial Crime* 270.

<sup>843</sup> Ackerman SG *Corruption and Governments Causes, Consequences and Reforms* 28.

amounts of money due to supposedly money laundering activities.<sup>844</sup> The VBS Bank was meant to benefit the public but was exploited through money laundering activities emanating from corrupt conduct to benefit private businesses.<sup>845</sup> This shows that customer due diligence measures may not be consistently applied in corrupt jurisdictions. Thus, it is imperative for the Amendment Act to enact measures to combat corruption in financial institutions. Corruption is less severe in developed countries like the UK which makes their customer due diligence measures more efficient.<sup>846</sup> To alleviate the problems caused by corruption, the researcher recommends that the *Amendment Act* should be amended to introduce measures that combat money laundering and corruption simultaneously.<sup>847</sup> This will control the money laundering risk emanating from corrupt activities. Financial institutions should implement measures to detect corruption to enable a robust anti-money laundering framework.<sup>848</sup>

**d) the *Amendment Act* should be amended to provide anti-money laundering regulations and measures that are context-sensitive**

The first regulation of customer due diligence measures were developed by the Basel Committee for Banking Supervision and were supposedly designed for developed countries like the UK.<sup>849</sup> This is because at the time the Basel Committee introduced customer due diligence measures its member states were developed countries only.<sup>850</sup> South Africa later became a signatory of the Financial Action Task Force (FATF) and adopted customer due diligence measures from the FATF recommendations.<sup>851</sup> The customer due diligence measures under the FATF were allegedly designed for developed countries like the UK as compared to developing

<sup>844</sup> Van Rensburg D "VBS Scandal goes Global" *Fin24 Newspaper* (05 August 2018) page unknown.

<sup>845</sup> Ziady H "KPMG Woes Deepen on VBS Scandal" 16 April 2018 *Business Day* page unknown.

<sup>846</sup> Hobbs D "Professionals and Organised Crime in Britain" in Maguire M, Morgan R and Reiner R (eds) *The Oxford Handbook of Criminology* (Oxford University Press Oxford 1994) 441, 450.

<sup>847</sup> Bester *et al*: *Genesis Report* 15.

<sup>848</sup> De Koker 2014 *Journal of Money Laundering Control* 295.

<sup>849</sup> De Koker L *South African Money Laundering and Terrorist Financing Law* 3<sup>rd</sup> ed (Lexis Nexis Durban 2014) 18.

<sup>850</sup> Basel Committee on Banking Supervision "Prevention of Criminal Use of the Banking System for the Purposes of Money Laundering" *Bank for International Settlements* (December 1988) 1-4.

<sup>851</sup> Lawack VA "Mobile Money, Financial Inclusion and Financial Integrity: The South African Case" 2013 *Washington Journal of Law, Technology & Arts* 317, 336; see also De Koker L *South African Money Laundering and Terrorist Financing Law* 14.

countries like South Africa.<sup>852</sup> This is because some identification and verification requirements, for example, the requirement to establish customer's residency is difficult in South Africa since a considerable number of people reside in informal dwellings they cannot prove.<sup>853</sup> This situation is not common in the UK since informal residential areas are not as common as they are in South Africa.<sup>854</sup> This shows that the adoption of customer due diligence measures as a global paradigm is unachievable.<sup>855</sup> As such, South Africa should design its own unique customer due diligence measures that are applicable to the South African social and economic infrastructure.<sup>856</sup> Instead of adopting international anti-money laundering standards, policy makers should align the South African regulatory framework with international standards.<sup>857</sup> Policy makers should design customer due diligence measures that are context-sensitive and fit for South Africa. In this regard, it is recommended that the customer due diligence measures under the *Amendment Act*<sup>858</sup> should be streamlined to fit the South African financial system.<sup>859</sup> South Africa should design its own context-sensitive anti-money laundering measures that are applicable to the South African economy.<sup>860</sup> This prevents financial exclusion emanating from the failure to meet identification and verification requirements by the socially marginalized people in South Africa.<sup>861</sup>

**e) the *Amendment Act* should be amended to enact provisions that expressly formalize the informal financial sector**

The informal financial sector is a financial sector that is not legally regulated by any South African legislation.<sup>862</sup> The informal financial sector exists simultaneously with the formal financial sector. The *Amendment Act* does not regulate activities

<sup>852</sup> Ahlosani W *Anti-Money Laundering: A Comparative and Critical Analysis of the United Kingdom and the UAE's Financial Intelligence Units* (Palgrave Macmillan London 2016) 199; see related discussion by Hobbs D "Professionals and Organised Crime in Britain" 451.

<sup>853</sup> Bester *et al*: *Genesis Report* 14; see also Lawack 2013 *Washington Journal of Law, Technology & Arts* 337.

<sup>854</sup> Alldridge P "Money Laundering and Globalisation" 2008 *Journal of Law and Society* 435, 440.

<sup>855</sup> Alldridge 2008 *Journal of Law and Society* 441.

<sup>856</sup> Nkwashu N "Is South Africa's Anti-Money Laundering and Counter Terrorism Financing Regime Effective?" *De Rebus* (1 May 2018) 26.

<sup>857</sup> Van Rensburg WJ "Anti-Money Laundering is now focused on Effectiveness: Does your System Work?" *Dispute Resolution Alert- Cliffe Dekker Hofmeyr* (25 October 2017) 2-3.

<sup>858</sup> Section 20A-21H of the *Amendment Act*.

<sup>859</sup> Van Rensburg WJ *Dispute Resolution Alert- Cliffe Dekker Hofmeyr* 3.

<sup>860</sup> De Koker 2014 *Journal of Money Laundering Control* 295.

<sup>861</sup> Bester *et al*: *Genesis Report* 14; see also Nkwashu *De Rebus* 27.

<sup>862</sup> Itzikowitz A "South Africa: Money Laundering – The Duty to Report under the Law" 2008 *Journal of Financial Crime* 180, 185; see also Bester *et al*: *Genesis Report* 16.

conducted in the informal sector, there is no implementation of customer due diligence measures in the informal sector.<sup>863</sup> As such, money laundering activities committed within the informal financial sector may be difficult to detect.<sup>864</sup> The informal financial sector creates room for money launderers to commit money laundering with little or no detection because there are no measures to detect money laundering in this sector in South Africa.<sup>865</sup> Customer due diligence measures are implemented to monitor customer activities to enable financial institutions to detect money laundering or suspicious transactions within the formal financial sector.<sup>866</sup> The absence of customer due diligence measures makes it difficult for financial institutions to detect money laundering in South Africa.<sup>867</sup> In this regard, the researcher recommends that the *Amendment Act* should be amended to enact regulations that formalise the informal financial sector.<sup>868</sup> This can be achieved by providing user-friendly and low-cost financial services that require minimal administration and non-stringent requirements in South Africa.<sup>869</sup> Less coercive regulations will attract people to the formal financial sector which is regulated by the *Amendment Act*. This could enhance the implementation and enforcement of anti-money laundering laws in South Africa by involving many customers in the formal financial sector.<sup>870</sup>

**f) the provisions of the risk-based approach under the *Amendment Act* should be revised to expressly include a yardstick to determine risk**

The *Amendment Act* incorporates a risk-based approach as a measure of ensuring that financial institutions understand their exposure to money laundering risks.<sup>871</sup> When financial institutions have knowledge of the risks they are exposed to, they are

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<sup>863</sup> See schedule 1 of the *Amendment Act*; see also Lawack 2013 *Washington Journal of Law, Technology & Arts* 344.

<sup>864</sup> Itzikowitz 2008 *Journal of Financial Crime* 186.

<sup>865</sup> Tuba D "Prosecuting Money Laundering the FATF Way: An Analysis of Gaps and Challenges in South Africa Legislation from a Comparative Perspective" 2012 *Acta Criminologica: Southern African Journal of Criminology* 103, 114.

<sup>866</sup> De Koker 2004 TSAR 740; see also De Koker 2006 *Journal of Financial Crime* 44.

<sup>867</sup> Tuba 2012 *Acta Criminologica: Southern African Journal of Criminology* 119.

<sup>868</sup> See schedule 1 of the *Amendment Act*; see also De Koker 2006 *Journal of Financial Crime* 44.

<sup>869</sup> Lawack 2013 *Washington Journal of Law, Technology & Arts* 344; see related discussion by De Koker "Money Laundering Control and the Financially Excluded" 6.

<sup>870</sup> De Koker 2006 *Journal of Financial Crime* 44; see also Tuba 2012 *Acta Criminologica: Southern African Journal of Criminology* 105.

<sup>871</sup> See section 42 of the *Amendment Act*; see also Financial Intelligence Centre "Guidance Note 07: The Implementation of Various Aspects of the Financial Intelligence Centre Act 38 of 2001" *Guidance Note 07* (02 October 2017) 2.

able to determine the relevant customer due diligence measures to apply to particular customers.<sup>872</sup> However, the *Amendment Act*<sup>873</sup> does not regulate how the risk-based approach should be applied by financial institutions.<sup>874</sup> Instead, the *Amendment Act* gives financial institutions the discretion to determine how to apply the risk-based approach.<sup>875</sup> This shows that there are no provisions to regulate and consistently enforce the risk-based approach in South Africa.<sup>876</sup> The risk-based approach focuses more on high-risk customers as compared to low-risk customers.<sup>877</sup> Low-risk customers are customers who do not pose high money laundering threats to the financial institution whereas high-risk customers are customers who pose high money laundering risks by exposing financial institutions to money laundering.<sup>878</sup> Most financial institutions in South Africa determine risk according to the amount involved in a customer's transactions.<sup>879</sup> Financial institutions overlook the fact that money laundering may be committed through small deposits, thus smurfing.<sup>880</sup> In this regard, determining risk based on the amount of money involved in customer transactions is misleading.<sup>881</sup> There is lack of certainty on the measure to determine risk for the purposes of applying the risk-based approach effectively in South Africa.<sup>882</sup> This has resulted in inconsistencies in the application of the risk-based approach. It is not advisable for financial institutions to enforce the same standards of due diligence because of limited resources, but financial institutions need to exercise caution in all transactions.<sup>883</sup>

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<sup>872</sup> De Koker 2004 TSAR 725.

<sup>873</sup> Section 42 of the *Amendment Act*; see discussion by Itzikowitz 2008 *Journal of Financial Crime* 186.

<sup>874</sup> Bester *et al*: *Genesis Report* 15.

<sup>875</sup> Section 42(2) of the *Amendment Act*; see also Bester *et al*: *Genesis Report* 15.

<sup>876</sup> Kersop M *Anti-Money Laundering Regulations and the Effective use of Mobile Money in South Africa* (LLM – dissertation Northwest University 2014) 57.

<sup>877</sup> There is no section that expressly provides for the regulation of low-risk customers under the *Amendment Act*; De Koker 2004 TSAR 721; see related discussion by Njotini *The Verification and Exchange of Customer Due Diligence* 61.

<sup>878</sup> Schedule 3A of the *Amendment Act*; see also Njotini *Customer Due Diligence in terms of the FICA* 52.

<sup>879</sup> Bester *et al*: *Genesis Report* 15.

<sup>880</sup> See related comments para 4.2 in Chapter Four of this dissertation.

<sup>881</sup> Section 64 of the *Amendment Act*; see also De Koker L "Identifying and Managing Low Money Laundering Risk: Perspective on FATF's Risk-Based Guidance" 2009 *Journal of Financial Crime* 334, 336; see also Tuba 2012 *Acta Criminologica: Southern African Journal of Criminology* 108.

<sup>882</sup> Bester *et al*: *Genesis Report* 15.

<sup>883</sup> Spedding LS *Due Diligence and Corporate Governance* (LexisNexis Butterworths Durban 2004) 6.

In light of the above, the researcher recommends that the *Amendment Act* should be amended to provide express provisions that determine money laundering risks for the purpose of money laundering control.<sup>884</sup> Financial institutions should not determine risk by the amount of money involved in a customer's transactions because it may be misleading considering the existence of smurfing as a method of money laundering.<sup>885</sup> The *Amendment Act* should also regulate the application of the risk-based approach to low-risk customers and measures to determine risk.<sup>886</sup> Although the UK regulation of the risk-based approach does not provide in express terms the yardstick to determine risk, several circumstances are identified in the UK system.<sup>887</sup> The circumstances include transactions involving non-citizen customers, customers conducting transactions through countries with high levels of drug production, money laundering and corruption and customers who failed to produce sufficient identification documents.<sup>888</sup> Accordingly, it is recommended that South Africa should also follow the UK approach on determining risk since it provides a broader scope of determining risk and not rely on one factor that can be misleading.<sup>889</sup> This could enhance the reliance on customer due diligence measures to combat money laundering in South Africa.

**g) customer due diligence identification requirements under the *Amendment Act* should be revised to make them more comprehensive**

The nature of information that a financial institution is supposed to obtain before concluding business transactions with a customer should enable the financial institution to know who their customers are.<sup>890</sup> A financial institution should obtain sufficient information about a customer to enable it to create a detailed profile about a customer for the purpose of monitoring the customer's account activities.<sup>891</sup> The purpose of monitoring customer account activities is to enable the financial institutions to maintain relevant and updated customer profiles.<sup>892</sup> Detailed customer

<sup>884</sup> Section 42 of the *Amendment Act*; De Koker 2009 *Journal of Financial Crime* 347.

<sup>885</sup> Bester *et al*: *Genesis Report* 15; see related discussion by De Koker 2009 *Journal of Financial Crime* 348.

<sup>886</sup> Nyaude *The Compliance Duties of Commercial Banks* 23.

<sup>887</sup> Ahlosani W *Anti-Money Laundering* 215.

<sup>888</sup> Stott C and Ullah Z "Money Laundering Regulations 2007: Part 1" 2008 *Journal of International Banking Law and Regulation* 175, 177.

<sup>889</sup> *Money Laundering, Terrorist Financing and Transfer of Funds Regulations* 2017 No. 2157 (*Money Laundering Regulations* 2017), regulations 18(1).

<sup>890</sup> De Koker 2004 *TSAR* 722.

<sup>891</sup> De Koker 2004 *TSAR* 722.

<sup>892</sup> Section 21C of the *Amendment Act*.

profiles help financial institutions to detect suspicious or unusual transactions by a particular customer.<sup>893</sup> Customer due diligence under the *Amendment Act* requires financial institutions to obtain and verify only the customer's full names, identity number, date of birth and residential addresses for identification of customers.<sup>894</sup> This information only provides the financial institution with basic knowledge about the customers and is not sufficient to create a detailed customer profile.<sup>895</sup> When compared to the customer due diligence measures in the UK, the identification requirements of under the *Amendment Act* are not sufficient for creating detailed customer profiles.<sup>896</sup> The UK financial institutions also obtain the client's nationality, type of account, place of birth, occupation, employer and nature of relationship to be established.<sup>897</sup> This information provides financial institutions in the UK with a comprehensive customer profile.<sup>898</sup> Customer profiles enable financial institutions to compare the customer's activities against similar customer profiles.<sup>899</sup> Deviation from the expected transaction patterns by the customer leads to money laundering inquiries and enable identification of suspicious transactions by the financial institution.<sup>900</sup> The value of the identification requirements of customer due diligence under the *Amendment Act* are overestimated.<sup>901</sup> The *Amendment Act* overlooks the reality that most money launderers can also commit identity fraud.<sup>902</sup> The customer due diligence identification requirements under the *Amendment Act* are not sufficient for the purpose of combating money laundering in South Africa because they do not provide financial institutions with adequate information about a customer's account activities.<sup>903</sup>

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<sup>893</sup> Tuba M and Van der Westhuizen C "An Analysis of the 'Know Your Customer' Policy as an Effective Tool to Combat Money Laundering: Is it about Who or What to Know that Counts?" 2014 *International Journal Public Law and Policy* 53, 60.

<sup>894</sup> Section 21 of the *Amendment Act*.

<sup>895</sup> De Koker 2004 TSAR 746.

<sup>896</sup> Regulation 27 of the *Money Laundering Regulations* 2017; see also Financial Intelligence Centre "Guidance Note 07: The Implementation of Various Aspects of the Financial Intelligence Centre Act 38 of 2001" *Guidance Note 07* (02 October 2017) para 85.

<sup>897</sup> De Koker 2004 TSAR 722.

<sup>898</sup> Ahlosani W *Anti-Money Laundering* 210.

<sup>899</sup> Tuba and Van der Westhuizen 2014 *International Journal Public Law and Policy* 55; see related discussion De Koker 2004 TSAR 746.

<sup>900</sup> De Koker 2004 TSAR 722.

<sup>901</sup> Section 21 of the *Amendment Act*; Bester *et al*: *Genesis Report* 16.

<sup>902</sup> See Ahlosani *Anti-Money Laundering* 210; Nyaude *The Compliance Duties of Commercial Banks* 61.

<sup>903</sup> Nyaude *The Compliance Duties of Commercial Banks* 61.

Accordingly, it is recommended that the identification requirements of customer due diligence under the *Amendment Act* should be revised.<sup>904</sup> South Africa should draw lessons from the UK customer due diligence requirements and implement them into the anti-money laundering regulations.<sup>905</sup> Customer due diligence measures under the *Amendment Act* should require more information to enable financial institutions to create detailed customer profiles in order to enable money laundering detection.<sup>906</sup>

#### **h) Specialist courts prosecuting money laundering or financial crime cases should be established in South Africa**

The *Amendment Act* does not expressly provide provisions on penalties relating to money laundering offences.<sup>907</sup> The *Amendment Act* merely provides that financial institutions that fail to identify customers or conclude transactions contravening customer due diligence requirements are subject to an administrative action.<sup>908</sup> This is not enough to control money laundering activities. Under the *Prevention of Organised Crime Act*,<sup>909</sup> a person who enters into agreement, transactions or arrangement with property that he or she knows or ought to have reasonably known that it is property is or is part of proceeds of criminal activities is guilty of an offence<sup>910</sup> and liable to a fine not exceeding R100 million or imprisonment for not more than thirty years.<sup>911</sup> This is not good enough to prevent and control money laundering activities in South Africa because there are no preventive measures. However, the *Amendment Act* does not provide adequate criminal penalties to combat money laundering in South Africa. To date, customer due diligence measures have not brought many successful money laundering prosecutions in South Africa.<sup>912</sup> This shows that the current anti-money laundering penalties under

<sup>904</sup> Section 21 of the *Amendment Act*.

<sup>905</sup> Harrison K and Ryder N *The Law Relating to Financial Crime in the United Kingdom* (Ashgate Publishing Limited 2013) 165.

<sup>906</sup> Section 21 of the *Amendment Act*; De Koker 2004 TSAR 746; see also Tuba and Van der Westhuizen 2014 *International Journal Public Law and Policy* 55.

<sup>907</sup> Van Jaarsveld IL "Mimicking Sisyphus? An Evaluation of the Know-Your-Customer Policy" 2006 *Obiter* 228, 243.

<sup>908</sup> Section 46 of the *Amendment Act*.

<sup>909</sup> 121 of 1998 (POCA), section 4.

<sup>910</sup> 121 of 1998 (POCA), section 4.

<sup>911</sup> Section 8(1) of the POCA.

<sup>912</sup> De Koker 2011 *Journal of Financial Crime* 361; see International Monetary Fund 2004 *South Africa: Report on the Observance of Standards and Codes-FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism* <http://www.imf.org> accessed 12 August 2018.

the *POCA* are minimal for deterrence purposes.<sup>913</sup> Minimal penalties do not deter people from engaging in money laundering activities, thus failure to combat money laundering. In this regard, the *Amendment Act* should be amended to expressly provide penalties for money laundering and failure to implement customer due diligence measures.<sup>914</sup> This could enhance the reliance on customer due diligence measures to combat money laundering in South Africa.

### **6.3 Conclusion**

The reliance on customer due diligence to combat money laundering in South Africa has various flaws and challenges such as lack of adequate resources, financial exclusion<sup>915</sup> and corruption.<sup>916</sup> Consequently, it is hoped that the policy makers could utilise the recommendations outlined in this chapter to enhance the regulation of customer due diligence under the *Amendment Act*. The customer due diligence measures under the *Amendment Act* should be implemented in a context-sensitive way to achieve the purpose of combating money laundering in South Africa.<sup>917</sup> South Africa can also draw lessons from the UK example and implement customer due diligence measures that are designed in terms of South African policies but are in line with international standards.

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<sup>913</sup> De Koker 2011 *Journal of Financial Crime* 361.

<sup>914</sup> see also Njotini *Customer Due Diligence in terms of the FICA* 120.

<sup>915</sup> Bester *et al*: *Genesis Report* 4; see related discussion by De Koker 2006 *Journal of Financial Crime* 44.

<sup>916</sup> Mugarura 2014 *Journal of Money Laundering Control* 91.

<sup>917</sup> Sections 20A-25 of the *Amendment Act*.

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*KwaMashu Bakery Ltd v Standard Bank of South Africa Ltd* 1995 1 SA 377 (D)

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**International instruments**

*United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances* (1988)

## LIST OF ABBREVIATIONS

|         |                                                                |
|---------|----------------------------------------------------------------|
| AML/CFT | Anti-Money Laundering and Combating the Financing of Terrorism |
| CDD     | Customer Due Diligence                                         |
| FATF    | Financial Action Task Force                                    |
| FICA    | Financial Intelligence Centre Act                              |
| FIC     | Financial Intelligence Centre                                  |
| POCA    | Prevention of Organised Crime Act                              |
| Per LJ  | Potchefstroom Electronic Law Journal                           |
| TSAR    | Journal of South African Law                                   |
| WJLTA   | Washington Journal of Law, Technology & Arts                   |

