Banking confidentiality with reference to anti-money laundering and terrorist financing measures in South Africa and Lesotho

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ABSTRACT

Money laundering and terrorist financing negatively affect the global economy. This has worsened in the dawn of globalisation and technological advancements as the origin of money becomes more difficult to track. Banks are the hub of money laundering and terrorist financing activities owing to the duty of confidentiality that banks owe to their clients. As a result, the global fight against money laundering and terrorist financing activities is premised on the lifting of banking confidentiality. This allows for the disclosure of confidential client information that is relevant in the investigation, prosecution and conviction for money laundering and terrorist financing activities to money laundering authorities, without the consent of the client.

Lifting banking confidentiality was enunciated under the common law and is codified by AML/CFT statutory law. In South Africa, it is codified by *FICA* 38 of 2001 while in Lesotho it is codified by *MLPCA* 4 of 2008 as the main AML/CFT laws in the respective countries. At the core of their framework in efforts to combat money laundering and terrorist financing, is the obligation vested in financial institutions to apply intense risk-based CDD standards to clients and the keeping of records of their affairs. Ultimately, a duty falls on these institutions to report any suspicious transactions encountered thereafter, contrary to banking confidentiality.

The study seeks to determine the extent to which the AML/CFT framework in South Africa and Lesotho incorporates these measures in line with international instruments like the *FATF Recommendations* of 2003, the *Palermo Convention* (2000) and the *Vienna Convention* (1988). It finds that South Africa and Lesotho have both experienced challenges in the fight against money laundering and terrorist financing in line with these international standards. However, South Africa was able to address all its challenges through the implementation of the *FIC Amendment Act* 1 of 2017 and is now fully compliant with international anti-money laundering standards. On the other hand, Lesotho was unable to address its challenges despite the implementation of the *MLPC Amendment Act* 7 of 2016 and remains not in line with international anti-money laundering standards. It therefore concludes that Lesotho needs to draw

lessons from the South African AML/CFT framework in order to strengthen its own, in line with international standards.

Key words: Bank-customer relationship, lifting banking confidentiality, anti-money laundering measures and counter terrorist financing measures

OPSOMMING

Geldwassery en finansiering van terrorisme beïnvloed die wêreldekonomie negatief. Dit het vererger sedert die ontstaan van globalisering en tegnologiese vooruitgang, aangesien die oorsprong van geld moeiliker opspoorbaar is. Banke bevind hulself in die middelpunt van geldwassery en terrorismefinansieringsaktiwiteite as gevolg van die vertroulikheidsplig wat hulle teenoor hul kliënte het. Gevolglik word die wêreldwye stryd teen geldwassery en terreurfinansieringsaktiwiteite veroordeel oor die opheffing van bankvertroulikheid. Dit laat die bekendmaking van vertroulike kliëntinligting wat relevant is vir die ondersoek, vervolging en skuldigbevinding aan geldwassery en terreurfinansieringsaktiwiteite aan geldwassery owerhede toe, sonder die toestemming van die kliënt.

Die opheffing van bank vertroulikheid is onder die gemenereg afgekondig en word deur die statutêre wet AML/CFT gekodifiseer. In Suid-Afrika, word dit deur *FICA 38* van 2001 gekodifiseer, terwyl dit in Lesotho gekodifiseer word deur *MLPCA* 4 van 2008 as die belangrikste AML/CFT wette in die onderskeie lande. Die kern van hul raamwerk in die stryd teen geldwassery en finansiering van terrorisme is die verpligting van finansiële instellings om streng risiko-gebaseerde CDD-standaarde aan kliënte te verskaf en om rekord te hou van hul sake. Uiteindelik rus daar 'n onus op hierdie instellings om enige verdagte transaksies wat daarna in stryd is met bankvertroulikheid aan te meld.

Hierdie studie het gepoog om te bepaal in watter mate die AML/CFT raamwerk in Suid-Afrika en Lesotho hierdie maatreëls in ooreenstemming bring met internasionale instrumente soos die FATF-aanbevelings van 2003, die Palermo-verdrag (2000) en die Wene-konvensie (1988). Dit is bevind dat Suid-Afrika en Lesotho albei uitdagings ervaar het in die stryd teen geldwassery en finansiering van terrorisme in ooreenstemming met hierdie internasionale standaarde. Suid-Afrika was egter in staat om al sy uitdagings aan te spreek deur die implementering van die FIC Wysigingswet 1 van 2017 en is nou ten volle in ooreenstemming met die internasionale geldwasserystandaarde. Aan die ander kant was Lesotho nie in staat om sy uitdagings aan te spreek nie ten spyte van die implementering van die *MLPC* Wysigingswet 7 van

2016 en bly nie in ooreenstemming met die internasionale geldwasserystandaarde nie. Daar kan dus tot die gevolgtrekking gekom word dat Lesotho lesse uit die Suid-Afrikaanse AML/CFT-raamwerk moet trek om sy eie te versterk, in ooreenstemming met internasionale standaarde.

Sleutelwoorde: bank-kliënt-verhouding, opheffing van bankvertroulikheid, anti-geldwasserymaatreëls en teen-terrorisme finansieringsmaatreëls

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DEDICATION

For Tumelo Mafoka

Your memory lives on. I carry you in my heart always.

TABLE OF CONTENTS

ABSTRACT.....i

OPSOMMING.....iii

ACKNOWLEDGEMENTS.....v

DEDICATION.....vi

LIST OF ABBREVIATIONS.....xii

CHAPTER 1 INTRODUCTION..... 1

1.1 Background..... 1

1.2 South Africa's response to money laundering and financing terrorism..... 2

1.3 Lesotho's response to money laundering and financing terrorism..... 3

1.4 Scope of the study..... 4

1.5 Framework of the study..... 4

CHAPTER 2 OVERVIEW OF THE CONCEPT OF BANKING CONFIDENTIALITY AND LIFTING BANKING CONFIDENTIALITY..... 6

2.1 The nature of the bank-customer relationship..... 6

2.2 Origin and development of the duty of banking confidentiality in English law 8

2.3 Adoption of the duty of banking confidentiality into South African and Lesotho law 10

2.4 Lifting banking confidentiality 12

2.5 Conclusion 18

CHAPTER 3 THE NATURE AND IMPACT OF MONEY LAUNDERING AND TERRORIST FINANCING AND THE ROLE OF BANKS IN THE COUNTERING THEREOF 19

3.1 Introduction 19

3.2 The nature and impact of money laundering and terrorist financing 19

3.3 International Anti-Money Laundering Framework 24

3.3.1 FATF Framework 24

3.3.2 The UN Convention against Narcotic Drug Trafficking and other Psychotropic Substances in Vienna 1988 28

3.3.3 Palermo Convention against Transnational Organised Crime of 2000. 28

3.3.4 The Basel Committee Statement of Principles 29

3.3.5 Strasbourg Convention and EU Directives 29

3.3.6 The Egmont Group 30

3.3.7 The Wolfsberg Group 30

3.3.8 The IMF and WB framework 30

3.4 The role of banks in the countering of money laundering and financing of terrorism 32

3.5 Conclusion 34

CHAPTER 4 SOUTH AFRICAN ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING FRAMEWORK 35

4.1 Introduction 35

4.2 The main South African AML/CTF laws 36

4.2.1 POCA 121 of 1998 36

4.2.2 FICA 38 of 2001 36

4.2.3 Prevention and Combating of Corrupt Activities Act 12 of 2004 (PRECCA) 41

4.2.4 POCDATARA 33 of 2004 41

4.2.5 The Banks Act 94 of 1990 43

4.3 Gaps in the framework 43

4.3.1 Politically Exposed Persons 44

4.3.2 Correspondent banking services 45

4.3.3 FATF Risk Based Approach (RBA) 46

4.3.4 National Risk Assessment (NRA) 47

4.3.5 Beneficial ownership 48

4.3.6 Exempted accountable institutions 49

4.3.7 Statistics 50

4.4 South Africa's response to gaps in its Anti-Money Laundering framework 50

4.5 Conclusion 52

CHAPTER 5 LESOTHO'S ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING FRAMEWORK 53

5.1 Introduction 53

5.2 The main Lesotho AML/CTF laws 54

5.2.1 MLPCA 4 of 2008 54

5.2.2 CP&E of 1981 58

5.3 Gaps in the framework 59

5.3.1 Criminalisation of predicate crimes 59

5.3.2 Criminalisation of terrorist financing 59

5.3.3 Freezing and seizing terrorist assets 60

5.3.4 Financial Intelligence Unit 60

5.3.5 Implementation of the MLPCA by financial institutions 61

5.3.6 Customer Due Diligence 61

5.3.7 Online transactions 62

5.3.8 Mutual legal assistance 62

5.3.9 Record keeping 62

5.3.10 Exempted accountable institutions 63

5.3.11 Internal measures 63

5.3.12 Statistics 63

5.4 Lesotho's response to gaps in its Anti-Money Laundering framework 64

5.5 Conclusion 68

CHAPTER 6 CONCLUSIONS AND RECOMMENDATIONS 69

6.1 Introduction 69

6.2 Recommendations 73

6.3 General conclusion 74

BIBLIOGRAPHY 76

LIST OF ABBREVIATIONS

AML	Anti-Money Laundering
CDD	Customer Due Diligence
CFT	Counter Terrorist Financing
CP&E	Criminal Procedure and Evidence Act
DCEO	Directorate on Corruption and Economic Offences
DSI	Development Strategy Implementation
ESAAMLG	Eastern and Southern African Anti-Money Laundering Group
EU	European Union
FATF	Financial Action Task Force
FIC	Financial Intelligence Centre
FICA	Financial Intelligence Centre Act
FIU	Financial Intelligence Unit
FSAP	Financial Sector Assessment Programme
IMF	International Monetary Fund
LMPS	Lesotho Mounted Police Services
ML	Money Laundering
MLPCA	Money Laundering and Proceeds of Crime Act
PCEOA	Prevention of Corrupt and Economic Offences Act
RBA	Risk Based Approach

ROSC	Reports on the Observance of Standards and Codes
SAPS	South African Police Services
SARS	South African Revenue Services
TF	Terrorist Financing
WB	World Bank

CHAPTER 1
INTRODUCTION

1.1 Background

Clients of financial institutions have a right to protection from unlawful access to their financial information by any third parties without the authorisation of the client.[1] Financial privacy extends from and is based on the constitutional right to privacy. As a result, a corresponding duty is thus placed on financial institutions not to divulge any confidential information in its possession without first consulting with and obtaining the consent of the client, as well as the other grounds mentioned below.[2]

The rationale is that, since clients open up their financial affairs to financial institutions, they are susceptible to economic harm and must therefore be protected and their economic safety be assured by the financial institutions.[3] This not only benefits the client but the entire financial sector as well because when clients trust the financial system, they invest in it and it keeps growing.[4]

This right, however, is not absolute and is subject to many exceptions at common law which have also been codified into statutory law in both South Africa and Lesotho. The reason for these exceptions is that strict bank confidentiality rules prevent the exchange of client records between states or with anti-corruption bodies when the client is suspected of commercial crimes. As a result, the prosecution of these crimes becomes difficult.[5]

The knowledge that banks are duty bound not to disclose client information makes it easy for perpetrators to transfer all types of money including illicit monies across

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1 Ping 2004 *JMLC* 376.
2 Ping 2004 *JMLC* 377.
3 Pasley 2002 *North Carolina Banking Institute* 153.
4 Chaikin 2011 *Sydney Law Review* 269. The existence of this duty encourages the customers to freely, fully and honestly communicate all the relevant information in respect of their financial affairs to the bank which will enable it to carry out the customers' mandate efficiently.
5 Ping 2004 *JMLC* 378.

borders through the financial system channels, thus allowing money laundering to flourish.[6] These commercial crimes hamper an individual country's economic growth and development and ultimately the whole global economy sags.[7] This is because of the overlap of economies owing to globalisation. As a result, a poor performance by either one country has a ripple effect on others.

While financial privacy is important, the need for global safety and security through combating drug trafficking, money laundering and terrorism, is equally important.[8] The conflict between preserving these two interests is evident, and the stride to balance these two is difficult as it places contradictory duties on banks, more so in light of the unending implementation and regulation of new laws by the international community that attempts to enhance better global security.[9] The purpose of this is to impose duties on financial institutions, especially banks, being the hub of economic crimes, to implement measures to avert or minimise the risks of being used as a tool to launder money.

1.2 South Africa's response to money laundering and financing terrorism

South Africa is affected by economic crimes such as money laundering, bribery, drug trafficking, corruption, fraud and smuggling.[10] Seeing a need to counter these crimes, it developed a three-tier framework consisting of legislation, regulations and sector specific guidelines.[11] The first provisions to this effect were encapsulated in the *Drugs and the Drug Trafficking Act* 140 of 1992 that dealt solely with the criminalisation of proceeds of drug-related offences. The second instalment of these provisions appeared in the *Proceeds of Crime Act* 76 of 1996 which, as opposed to the former legislation, provided for the criminalisation of proceeds of any offence, thus broadening the scope of anti-money laundering offences.

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6 Ping 2004 *JMLC* 377.
7 Modisagae *The Role of Internal Audit* 89.
8 Pasley 2002 *North Carolina Banking Institute* 148.
9 Pasley 2002 *North Carolina Banking Institute* 147.
10 ESAAMLG 2007 "DSI Assessment Report" 5.
11 Modisagae *The Role of Internal Audit* 91-92.

The third instalment and the most important of these laws came in the form of the *Prevention of Organised Crime Act* 121 of 1998, the *Financial Intelligent Centre Act* 38 of 2001 and the *Protection of Constitutional Democracy against Terrorist and Related Activities Act* 33 of 2004. These pieces of legislation are aimed at all transactions involving the proceeds of unlawful activities and the financing of terrorist acts and related activities. The Financial Intelligence Centre was then established to help combat money laundering and terrorist financing.

1.3 Lesotho's response to money laundering and financing terrorism

Lesotho, being completely landlocked by South Africa, is susceptible to becoming a safe haven for criminals escaping the law in South Africa for crimes related to money laundering and financing of terrorist acts.[12] However, it lacks adequate laws that criminalise money laundering and financing terrorist acts. It punishes drug trafficking, fraud, smuggling, theft, murder and sabotage through the *Prevention of Corruption and Economic Crimes Act* of 1999, the *Criminal Procedure and Evidence Act* of 1981, the *Penal Code* of 2010 and the *Financial Institutions Act* of 1999.

Money laundering as a stand-alone crime is provided for in the only anti-money laundering specific legislation, the *Money Laundering and Proceeds of Crime Act* 4 of 2008. In order to help combat economic offences, the Directorate on Corruption and Economic Offences was established as a body that will oversee corruption and economic offences through prevention, public education, investigation and prosecution of these crimes.[13]

Despite these measures, money laundering and the prosecution thereof continues to be a huge problem both internationally and domestically and banking confidentiality continues to be infringed.

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12 ESAAMLG 2007 "Development Strategy Implementation Report" 5.
13 *PCEOA* sections 3 and 6.

1.4 Scope of the study

The mini-dissertation will trace the development of the concept of banking confidentiality from its English Law origins. It will then consider its incorporation and development in South African and Lesotho law, taking into account its nature and scope of application in both jurisdictions.

Furthermore, the study will consider the role of banks in money laundering. It will delve into the international, regional and both the South African and Lesotho domestic legislative framework on money laundering and terrorist financing in an attempt to establish compliance with international anti-money laundering standards and challenges faced in the effective implementation thereof.

It attempts to provide a theoretical solution for the realisation of the constitutional right to privacy of clients of financial institutions in relation to the constant and various policy implementations of the global anti-money laundering and counter terrorist financing standards. It also attempts to provide a theoretical solution to the gaps and challenges in the implementation of the above standards in an attempt to ensure economic development, growth and democratic sustainability.

Overall, this research seeks to ascertain to what extent banks in South Africa and Lesotho incorporate and implement the global anti-money laundering (AML) and combating the financing of terrorism (CFT) standards to detect crime and protect the global financial system, whilst at the same time attempting to preserve the clients' right to confidentiality.

1.5 Framework of the study

This work is divided into six chapters. Chapter 1 will be an introductory chapter providing a general overview of the research topic. Chapter 2 delves into an overview of banking confidentiality and critical discussion on lifting this duty, by discussing the limitations as set out in the *Tournier* case and limitations in terms of South African and Lesotho statutory law. Chapter 3 will then discuss the nature and impact of money laundering and terrorist financing in the global economy and breaks down the role

played by banks in money laundering. Chapter 4 explores anti-money laundering and counter terrorist financing framework in place in South Africa while chapter 5 will discuss Lesotho's anti-money laundering and counter terrorist financing framework. Chapter 6 concludes the research and makes recommendations to counter the challenges in the prosecution of money laundering and other financial crimes in light of the limitations in both the South African and Lesotho AML/CFT frameworks.

The research is conducted by means of a literature review and comparative study that will consider all relevant domestic legislation, case law, textbooks, government policies and applicable electronic resources. Specific reference is also made to international and regional instruments, resolutions and recommendations relating to money laundering and the financing of terrorist acts.

CHAPTER 2
OVERVIEW OF THE CONCEPT OF BANKING CONFIDENTIALITY AND LIFTING BANKING CONFIDENTIALITY

2.1 The nature of the bank-customer relationship

The legal relationship between a bank and its customer is created immediately upon opening and controlling a bank account with that specific bank.[14] It gives rise to various reciprocal rights and duties between the bank and customer, thus rendering the relationship a contractual one.[15] Most importantly, it is based on confidentiality in terms of which the bank is obliged to keep the customers' information secure from third parties.[16]

Although as will be seen below, it has since been established that a bank owes a duty of confidentiality to its customer, for a long time there was a discourse regarding where the duty arose. This was owing to the uncertainty in South African law in respect of the definition of the bank-customer relationship. Generally, it has been said that this duty has a contractual foundation. It comes as a *naturale* of the contract between the bank and its customer. It follows therefore that liability for a breach of bank confidentiality is based on a breach of contract.

It has also been opined that the relationship between a bank and its customer replicates a contract of mandate wherein the bank has a duty to fulfil its duties towards

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14 In *The Great Western Railway Co. v London and County Banking Co. Ltd* [1901] AC 414 at 416, the court observed that "there must be some sort of account, either a deposit or a current account…to make a man a customer of a banker". In *Importers Company v Westminster Bank Ltd* [1927] 2 KB 297 when faced with the definition of word customer, the court found that "the most ordinary meaning …is a person who keeps an account at the bank."

15 Willis *Banking in South African Law* 24; *Standard Bank SA Ltd v Oneanate Investment (Pty) Ltd* 1995 4 SA 510(C); *Stydom NO v ABSA Bank Bpk* 2001 3 SA 185 (T) 192.

16 The court in *Hedley Byre and Co. Ltd v Heller and Partners Ltd* [1924] AC 465 observed that "it is a relationship that is voluntarily accepted or undertaken, either generally where a general relationship, such as…banker and customer, is created or specifically in relation to a particular transaction". It should be noted that the bank-customer relationship has not been defined in banking legislation but has rather been described by the courts.

its customers in utmost good faith. Of these duties, the duty to keep customer information and account dealings confidential is vital.[17]

Malan[18] is of the opinion, with which I agree, that a bank-customer relationship includes a debtor-creditor relationship.[19] The customer, when depositing his money into the bank, essentially lends the money to the bank with the understanding that it will be repaid. Sometimes it is the bank that lends the customer money.[20] However, much as this is so, the debtor-creditor relationship of a bank and its customer differs from other typical debtor-creditor relationships. Unless otherwise agreed by the bank and customer as to when the bank will repay the customer's money, the bank will not of its own accord repay the money. It is up to the customer to demand it whenever the need arises.[21]

Willis[22] on the other hand takes the stance that although the contract between the bank and the customer requires in many respects for the bank to act as its customer's agent, the relationship is not necessarily one of agency. The relationship according to him, resembles a contract of *mutuum*. For this assertion he relies on the decision in *Langford v Moore and Others*[23] where the court held that a bank- customer relationship is in the nature of a *mutuum.*

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17 In *OK Bazaars Ltd v Universal Stores Ltd* 1973 2 SA 281 (C) 288 the court outlined the principle that in essence the contract between bank and customer obliges the bank to render certain banking services, to the customer on his instructions, and for this reason it can be classified as a contract of *mandatum*.

18 Malan, Pretorius and Du Toit *Malan on Bills of Exchange* 295.

19 Malan, Pretorius and Du Toit *Malan on Bills of Exchange* 295.*London Joint Stock Bank Ltd v MacMillan and Arthur* 1918 AC 777 (HL) 789: "the relationship between banker and customer is that of debtor and creditor, with a superadded obligation on the part of the banker to honour the customer's cheques if the account is in credit". The same sentiments were shared in *Rousseau NO v Standard Bank of South Africa Ltd* 1976 4 SA 104 (C) 106:"The legal relationship between a banker and its customer whose account is in credit, is that of debtor and creditor. The customer is a creditor who has a claim against the bank in the sense that he has a right to have it make payments to him or to his order on cheques drawn by him up to the amount by which his account is in credit".

20 Nwabachili 2015 *International Journal of Business and Law Research* 62.

21 Nwabachili 2015 *International Journal of Business and Law Research* 62.

22 Willis *Banking in South African Law*39.

23 (1899) 17 SC 1.

In contrast, however, Cowen[24] is of the view that a bank-customer relationship cannot be one of *mutuum*, but rather can be defined as a contract *sui generis*. This was also outlined in *GS George Consultants and Investments (Pty) Ltd v Datasys (Pty) Ltd*[25]where the court pointed out that the fact that the contract is *sui generis* does not exclude the premise that the contract is one of *mutuum*. However, it has many superadded features including the banker's duty of confidentiality.

In light of this discussion it is concluded that the opinion held by Malan *et al* that a bank- customer relationship is one of *mandatum* best describes the nature of the bank-customer relationship as we know it. It stands to reason therefore to explore the concept of banking confidentiality next.

2.2 Origin and development of the duty of banking confidentiality in English law

The banks' duty of confidentiality can be traced back to English law in the landmark decision of *Tournier v National Provincial and Union Bank of England*,[26] where the court, when faced with the issue whether a bank owes a duty of confidentiality to its customer, held that:

> …it may be asserted with confidence that the duty is a legal one arising out of contract and that the duty is not absolute but qualified. It is not possible to frame any exhaustive definition of the duty. The most that can be done is to classify the qualification and to indicate its limits.

The court further noted that a bank assumes this duty the minute a relationship is created with the customer. It applies to any information divulged or secured in anticipation of the relationship as well as information acquired during its subsistence.[27] It is noteworthy that this duty continues even after the termination of the relationship.

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24 Cowen *The Law of Negotiable Instruments in South Africa* 366-377.

25 1988 3 SA 736.

26 [1924] 1 KB 471-472.

27 It is worth noting that some of the judges on the bench did not agree as to the scope of information that attracts bank confidentiality. Atkins LJ as he then was, found bank confidentiality to not only apply to information about the customer's account. It subsists even after termination of the contract. In contrast, Scrutton LJ as he then was opined that the duty does not apply to information acquired before or after the relationship as well as any information acquired from other sources other than the customer during the subsistence of the relationship.

After this decision, it has become an established principle of English law that the bank owes a duty of confidentiality to its customers.

However, this was not always the case. Prior to the *Tournier* case, the courts implied that the bank's duty of confidentiality was a moral one and not a legal obligation.[28] A case in point is *Tassell v Cooper*[29]in which the court did not determine in detail whether, as a principle of law, a bank has a duty of confidentiality towards its customer. Instead, the court suggested that its existence was a mere allegation of law and thus not a sustainable claim against a bank that divulged customer information to a third party.

In *Foster v Bank of London*[30]it was found that there existed a duty of confidentiality in a bank-customer relationship not because there was an established principle to that effect, but because it seemed the prudent decision to take, in light of the facts of the case and the fact that there was no rule of law to the contrary.

The same sentiments are shared in *Hardy v Veasey*[31]where the court held that a bank has an implied moral obligation towards its customer not to disclose his financial affairs to third parties. It further observed that although not a legal duty, it was a step towards recognising the existence of an obligation borne by banks towards their customers to keep their information secure.

The decision was well received. Some commentators opine that the approach is in accord with common sense and common usage that would urge all banks to exercise the trust endowed in them without a need for a legal duty.[32]

These cases reveal the court's reluctance to determine the existence of the bank's duty of confidentiality towards its customer. This was owing to the lack of jurisprudence on the matter in the 19th century. Courts were often faced with the

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28 Cranston *Principles of Banking Law* 180.
29 9 CB 509 (1850).
30 (1862) 3 F& F 214.
31 (1868) LR 3 Ex107.
32 The Bankers' Magazine 1868 https://babel.hatitrust.org/cgi/pt?id=umn.319510024388491;view=lup'seq=232

dilemma whether the duty of confidentiality was a moral or legal one. The lack of any detailed analysis, even when it is necessary as seen in the above cases, indicates the difficulty and uncertainty prevalent in this area of the law then.[33]

2.3 Adoption of the duty of banking confidentiality into South African and Lesotho law

In South Africa, the courts first had occasion to deal with the issue whether banks owe a duty of confidentiality to their customers in *Abrahams v Burns*[34] wherein the court held that a bank is liable to its customer for any loss suffered as a result of an unwarranted disclosure by the bank of the customer's affairs to a third party. Decades later, the same sentiments were shared in *Cambanis Buildings (Pty) Ltd v Gal.*[35]The court outlined that as a general principle of law in South Africa, the bank is duty bound not to disclose any information in respect of its customers to any third parties.

The court in *GS George Consultants and Investments (Pty) Ltd and Others v Datasys (Pty) Ltd*[36] observed that the bank's duty to confidentiality has long been recognised in English law and has since been acknowledged in South African law. It reasoned that the purpose of this duty is to protect customers from the disclosure of their affairs obtained by banks in the course of their relationship. This duty, although not absolute, constitutes an implied term in the bank-customer contract.[37]

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33 Stokes *Journal of Legal History* 288-289.

34 1914 CPD 452.

35 [1983] 1 All SA 383 (NC).

36 1988 3 SA 726 (W). This decision was overruled in *Densam (Pty) Ltd v Cywilnat (Pty) Ltd* 1991 1 SA 100(A) but the court eschewed from determining whether as a matter of law a bank owes a duty of confidentiality to its customer. It just assumed that such a duty exists. It also did not consider the legal position in South African law in respect of the exceptions in the *Tournier* case. The court held that: "There is no need to embark upon a consideration of the juristic nature of the contract between banker and customer, nor upon an investigation as to whether the bank owes the customer a duty of confidentiality or secrecy and if so, what its origin or limits may be. For the purpose of deciding this appeal I shall simply assume… (but, I must make it plain, without deciding) that the bank was contractually obliged to the appellant to maintain secrecy and confidentiality about its affairs in accordance with the decision in *Tournier*'s case."

37 This duty is imported into the relationship as a matter of law. If not, then it represents the tacit consent of the bank and its customer.

In *Firstrand Bank Limited v Chaucer Publications (Pty) Ltd & Another*[38] the court stated that in terms of public policy, the bank has a duty not to disclose information exchanged between it and its customer to third parties unless otherwise required to in light of a greater public interest. However, it is up to the customer to invoke this privilege and insist that the bank keeps the information confidential.

When also faced with the issue whether the bank owes a duty of confidentiality to its customer, the court in *Stevens v Investec Bank (Pty) Ltd*[39] held that:

> There is no doubt that a banker-client relationship requires the highest *uberrimae fides* and that confidentiality is one of the essential aspects of such relationship of trust as between banker and client. Privacy in financial and banking affairs is often an important aspect of successful business enterprise in a competitive economy.

The court further stated that:

> Penetration of the banking vault and disclosure of that which is contained therein is not always a breach of confidentiality or unlawful. One should realise there must always be circumstances where the needs of privacy must give way to the needs of the administration of justice.

In light of this case law, it is clear that South Africa recognises bank confidentiality with due regard to the exceptions thereto.[40] However, the dearth of cases dealing with the issue of bank confidentiality in South Africa should be understood against the background that generally the area has traditionally not been extensively explored.[41]

In Lesotho, on the other hand, there is no case law dealing directly with the bank's duty of confidentiality. However, the existence of this duty can be implied from common law which has incorporated various English law principles into the law of Lesotho. The common law was adopted in Lesotho through the *General Law Proclamation 2B* of 1884.[42] Because of this Proclamation, Lesotho's common law is

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38 [2007] ZAWCHC 59.

39 [2012] ZAGPJHC 226 paras 10 and 11.

40 Mujuzi *Law and Justice at the Dawn of the 21st Century* 131.

41 Mujuzi *Law and Justice at the Dawn of the 21st Century* 128. In *Tournier v National Provincial and Union Bank of England* [1924] 1 KB 479, the court highlighted that, "it is curious that there is so little authority as to the duty to keep customers' or clients affairs secret…the absence of authority appears to be greatly to the credit of English professional men, who have given so little excuse for its discussion".

42 The Proclamation made provision for a dual legal system made up of common law and customary law. It provides that the law to be administered in Lesotho, then Basutoland, shall to the extent

essentially the same as that of South Africa. The two countries share a mixed general legal system that arises out of the interaction with both Roman-Dutch civil law and English common law.[43]

This essentially means Lesotho's judicial structure roughly correlates with that of South Africa. Therefore, rules of precedence applied by South African courts are also applied by Lesotho courts to the extent that they are of relevance to Lesotho. However, it should be noted that Lesotho courts are not bound to follow South African decisions. These decisions are of persuasive authority and although Lesotho uses South Africa's common law, Lesotho courts are free to interpret the law as they deem fit. The administration of the common law can therefore be said to be subject to Lesotho's special circumstances in terms of political and moral attitudes as well as public opinion.[44]

In light of the above discussion, it stands to reason that the *Tournier* principles are applicable in the banking law of Lesotho.

2.4 Lifting banking confidentiality

Society relies on rules and regulations to balance conflicting interests among its members. However, no rule or regulation is absolute; exceptions are imposed in order to cater for various circumstances. Accordingly, like any other legal rule, the bank's duty of confidentiality is not absolute. These exceptions may vary across jurisdictions.[45]

The *Tournier* case constituted a benchmark decision as far as the bank's duty of confidentiality is concerned. It not only, as seen above, metamorphoses the nature of banking confidentiality from a mere moral obligation into a legal duty, but it has also prescribed four principal exceptions to this duty.[46]

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relevant, be the same as the law for the time being in force in South Africa, then the Cape of Good Hope.

43 Dube 2008www.nyulawglobal.org/globalex/lesotho.html.

44 Poulter 1969 *Journal of African Law* 137-141.

45 In *K Ltd v National Westminster Bank Plc & Others* (2006) 4 All ER 907 para 22 the court opined that limiting the bank-customer relationship a little is far better than enabling the widespread of money laundering in the financial sector.

46 Schulze 2007 *Juta's Business Law* 122.

These are:

a) Where disclosure is under compulsion by law,
b) Where there is a duty to the public to disclose,
c) Where the interests of the bank require disclosure,
d) Where the disclosure is made by the express or implied consent of the customer.[47]

These exceptions are individually examined below.

Banks will disclose their customers' confidential information if they are so compelled by law in terms of a court order.[48] This exception is only applicable in the country in which the account is held and it will not apply in favour of foreign countries, unless domestic courts in the country in which the account is held make an order to that effect. In this way, the exception helps enhance international cooperation and prosecution of transnational crimes but only to the extent that domestic courts allow the banking confidentiality veil to be pierced in favour of foreign countries.[49]

Disclosure of confidential customer information by compulsion of law is also found in statutes that specifically compel banks to disclose this information in specific circumstances tabulated therein. In South Africa, like in Lesotho, the legislature has restricted banking confidentiality through money laundering legislation[50] as will be seen below and in much detail in the next chapter.

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47 [1924] 1 KB 473.

48 An example could be where a court of law may direct a bank to adduce evidence that may reveal customer information. On application for the bank to be directed to disclose confidential information, the court in *Omar v Omar* [1995] 3 All ER 571 outlined the principle that a bank will be compelled by law to disclose customer information *if the sought disclosure is for legitimate reasons*. The same sentiments were expressed in *Williams and Others v Summerfield* 1972 2 QB 513 517F that where a bank is compelled to disclose its customer's info to third parties on the basis of the compulsion by law exception, it should be afforded serious consideration and based upon justifiable grounds. Disclosing customer information violates the customer's privacy and liberty.

49 Chaikin 2011 *Sydney Law Review* 267.

50 Schulze 2007 *Juta's Business Law* 122.

Banking confidentiality will also be overridden if disclosure of customer information serves the public interest.[51] Information is in the public interest if it has the potential to expose the state to any danger or if it contravenes a duty owed to society or morals the society holds in high regard.[52] It is worth noting that disclosure in the public interest should only be made to the extent necessary for the public to know.[53]

However, this exception has not provided substantial aid (or assistance) in combating money laundering because it begs the question what 'public interest' is. The notion of 'public interest' is very subjective depending on the state concerned. It is apparent that what may be in the public interest in one state may not necessarily be so in another. Therefore domestic courts hardly pierce the banking confidentiality veil in favour of foreign states as it would be a futile exercise.[54]

On the other hand, banking confidentiality can also be lifted if it is in the best interests of the bank, although this exception is interpreted narrowly in cases where the bank is engaged in a dispute with its own customer. This is because of the inherent bias a bank will have against a customer when there is a dispute. As a result, disclosure in the public interest forms a more sufficient and justifiable ground to override banking confidentiality than reliance on disclosure in the bank's own interest.[55]

Furthermore, banking confidentiality is lifted when a customer expressly authorises his/her bank to disclose his/her confidential information to third parties. In the absence of an express authority, authority is implied because of the nature of the transaction at hand or the conduct of the customer.[56] It is worth noting that it is an implied term

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51 In *Price Waterhouse v BCCI Holdings South Africa* [1992] BCLC 583 the court held that it has become trite that confidential customer information will be disclosed to third parties if it is in the public interest to do so. In *Weld-Blundell v Stephens* [1919] 1 KB 520 the principle outlined is that public policy supersedes any private duty.

52 Schulze 2007 *Juta's Business Law* 122. It is worth noting that in *Pharoan v BCCI* [1998] 4 All ER 455 the court outlined that where public duty overrides the bank's duty to confidentiality, the bank is only allowed to disclose to the extent reasonable to achieve the public interest in question.

53 *AG v Guardian Newspapers Ltd* [1988] 3 WLR 766.

54 Chaikin 2011 *Sydney Law Review* 267.

55 Spearman 2012 *Journal of International Banking and Financial Law* 80. When a bank is engaged in a dispute with its customer, it may in the absence of any alternative compelling evidence, need to divulge confidential information in order to make its case against the customer. The bank may also be required by law to include the information in the court documents.

56 Schulze 2007 *Juta's Business Law* 123.

of the bank-customer contract that a customer gives his consent to the bank to give his/her confidential information to his/her surety or other banks that offer services to the customer.[57]

This exception, however, has little to no bearing on money laundering because there is no clause in respect of the scope of the customer's consent and the whole contractual nature of banking confidentiality is undermined.[58]

Although the *Tournier* principles have been acknowledged and applied across jurisdictions including South Africa and Lesotho, they have been interpreted and applied rigidly. They have also been considered in isolation which has caused strain to the development of these principles in accordance with the ever-changing substantive law. Flexibility would encourage a more principled and detailed framework to adequately protect the misuse of private information.[59]

In light of the poor application of these exceptions, it was necessary to codify them into statutory law in order to brush over the uncertainties they bring and enhance their applicability to better combat money laundering.

Seeing this need, South Africa and Lesotho then enacted statutes and various guidelines which provide for limitations to banking confidentiality in an attempt to codify common law exceptions in a manner that improves their applicability.[60] The exception of disclosure by compulsion of law is encapsulated in a plethora of legislation. In South Africa for example, in terms of sections 74 and 99 of the *Income Tax Act* 58 of 1962, when a client of a bank owes the SARS a certain payment, the Commissioner may direct his bank to make such payment on behalf of the client or divulge any necessary information it needs regarding the client.[61]

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57 Section 10(2) *Usury Act* 73 of 1968.
58 Chaikin 2011 *Sydney Law Review* 267.
59 Spearman *Journal of International Banking and Financial Law* 78.
60 Clause 6.1 of the South African *Code of Banking Practice* of 2012 codifies the common law exceptions to banking confidentiality.
61 Masete 2012 *JICLT* 251.

Moreover, another statutory limitation to banking secrecy on grounds of compulsion by law is encapsulated in the *Auditor General Act* 12 of 1995 which in terms of section 8(a) and (b) gives the Auditor General the right to direct a bank to furnish any confidential information belonging to the client.

Furthermore, the *Exchange Control Regulations, Orders and Rules* of 1961[62] gives any representative of the Treasury the right to enter and inspect any books of accounts of any financial institution. Section 6 (a) of the *Investigation of Serious Economic Offences Act* 117 of 1991 echoes the same sentiments, granting the Director the power to summon anyone who possesses information or documents which can help in the investigation against a person. Financial institutions have a duty to inform the Narcotics Bureau under SAPS of any suspicion of proceeds of a drug related crime and provide any supporting evidence thereto.

In the case of Lesotho, the duty of banking confidentiality has been lifted by the *Money Laundering and Proceeds of Crime Act.*[63] In terms of section 32, the bank's common law duty of confidentiality is overridden to the extent that disclosure of information enables the investigation and confiscation of proceeds of all financial crime in an effort to combat money laundering. The *Act* places a duty on accountable institutions to record and report any suspicious transactions.[64]

Another piece of legislation that lifts banking confidentiality is the *Prevention of Corruption and Economic Offenses Act*[65] which establishes the Directorate on Corruption and Economic Offences (hereinafter referred to as the DCEO). It is vested with the power to investigate and prosecute any contravention of Lesotho's fiscal and revenue laws or any conduct that aids corruption.[66] As a corollary to this duty, the DCEO has the power to demand a bank to disclose its customers' information or transactions as part of its investigations.[67] The bank when requested to disclose

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62 Section 19(1).
63 4 of 2008.
64 Sections 16(10) and 17.
65 5 of 1999.
66 Sections 3 and 6 of the *Prevention of Corruption and Economic Offenses Act*.
67 In *Metsing v Director General DCEO and Others* [2015] LSCA 32 the court outlined the principle that in terms of the *Prevention of Corruption and Economic Offenses Act*, the DCEO as an anti-

information cannot rely on banking confidentiality as a ground for refusal to furnish information to the DCEO.

Banking confidentiality has also been lifted by international instruments. In terms of the *Vienna UN Convention* of 1988, the 1990 *Strasbourg Convention* and the 2000 *Palermo UN Convention*, banks cannot refuse furnishing customer information or deny access to their records on grounds of banking secrecy when same is requested by authorities.[68] Under the *FATF Recommendations* a duty is placed on banks to identify and record their customers' identity every time transactions are undertaken. Furthermore, they must report any large transactions and enquire into any suspicious transactions. If after the enquiry, it seems the money comes from criminal activity, it should be reported.[69]

The *EC Directives* also echo the above. Financial institutions are compelled to cooperate fully with authorities by informing them of property that may have been acquired through money laundering. In order to aid the investigations, supporting documentary evidence must be supplied to authorities. In terms of these directives, customer records must be kept for at least five years.[70]

Following the above discussion, it is gathered that the intention of lifting banking confidentiality is to ensure easy investigation and prosecution of money laundering and other financial crimes. This is because as stated earlier, banks are the gatekeepers of the legitimate financial system and thus vulnerable to money laundering and other financial crimes.[71] Therefore, to combat these crimes it is necessary to limit banking confidentiality.

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corruption body has a right to demand that banks disclose information or documents in relation to an investigation they are carrying out against its customer.

68 Ping 2004 *JMLC* 378.

69 Ping 2004 *JMLC* 378.

70 Ping 2004 *JMLC* 378.

71 Pramod, Li and Gao 2012 *Information Management and Computer Security* 172.

2.5 Conclusion

While financial privacy is important, the need for global safety and security through combating illicit activities is equally important.[72] The conflict between preserving these two interests is evident, and the stride to balance them is difficult. This is especially true in light of the unending implementation and regulation of new laws that attempt to enhance better global security.[73] As a result, banking confidentiality has been lifted as a means to achieve the latter interest. This is because criminals have hidden behind banking confidentiality in order to orchestrate their illegal operations without detection.[74]

The next chapter deals with the nature and impact of money laundering and terrorist financing in the global economy and the role played by banks in the combating of these crimes.

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72 Pasley 2002 *North Carolina Banking Institute* 148.

73 Pasley 2002 *North Carolina Banking Institute* 147.

74 Serhan 2016 *International Finance and Banking* 152-153. The importance of banks in the modern market economies should not be taken for granted. Banks play a pivotal role in the functioning of the global financial markets.

CHAPTER 3
THE NATURE AND IMPACT OF MONEY LAUNDERING AND TERRORIST FINANCING AND THE ROLE OF BANKS IN THE COUNTERING THEREOF

3.1 Introduction

As seen in chapter 2 above, excessive bank confidentiality has been identified globally as the single greatest obstacle in fighting transnational crime and to redress this problem, as already seen, there is a need to improve international cooperation by reducing banking confidentiality. There is growing and significant literature on how international anti-money laundering standards and terrorist financing measures have sought to achieve this. International policy-making bodies and powerful countries have since spawned the amendment of domestic anti-money laundering legislation and counter terrorist financing measures across the globe to this end. This chapter reflects on how banking confidentiality interacts with money laundering and terrorist financing.

3.2 The nature and impact of money laundering and terrorist financing

Money laundering has become a global issue in the recent years. Central thereto, is how the world economy can be protected from financial crime while being fully cognisant of the fact that financial globalisation itself makes it easy for criminals to transfer illicit property from one country to another through banking channels.[75] Banks are the easiest target for money launderers because they provide a diversity of financial services and instruments that can be used to conceal the actual source of money.[76]

Allowed to run rampant, money laundering shifts economic power to criminals who may use it to take over the operations of a bank and undertake further criminal activities. These may lead to terrorism which is also a threat to financial stability and

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[75] Kutubi 2011 *World Journal of Social Sciences* 36. It should be noted however that this is not to disregard the use of other non-bank financial institutions for the perpetuation of financial crimes.

[76] Kutubi 2011 *World Journal of Social Sciences* 38.

economic prosperity of a country, particularly in developing countries because capital formation within the economy is undermined by these acts.[77]

Just as is the case with money laundering, terrorism has also caused a widespread concern recently.[78] Although the international community is agreeable that it needs to be eradicated, there are ongoing debates as to how to counter this crime especially in light of the practical and conceptual differences between money laundering and terrorism.[79] That is, whether it requires a separate framework or whether it can be incorporated into the existing anti-money laundering framework.

This is owing to the observation that sometimes there is a nexus between money laundering and terrorism as the former plays a part in the latter.[80] This is because money is the centre of terrorist activities,[81] and at some point although terrorism financing is predominantly derived from legitimate funds, funding will wane and a need to launder money to ensure terrorist operations keep running will arise.

These debates remain unresolved. As a result, the financing of terrorism has been superimposed onto the anti-money laundering framework. This is to say that measures applied in combating money laundering also apply to combating financing of terrorism. Thus, for purposes of this paper, there will be no separate section dealing with the

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77 Kutubi 2011 *World Journal of Social Sciences* 38. According to the IMF, balance of payment errors result from spurious transactions of money laundering perpetuated through banks. This distorts capital markets thereby destabilizing the world economy.

78 Tafangsaz 2015 *JMLC* 112.

79 A discussion of the differences between money laundering and terrorist financing falls outside the ambit of this research.

80 Milosevic 2016 *Law and Politics* 556; Ihsan and Razi 2012 *Global Journal of Management and Business Research* 52; Fundanga "The Role of the Banking Sector in Combating Money Laundering" 1. A notably important event that established this nexus was the 11th September 2001 terrorist bombings against the United States of America. The thrust of these attacks goes beyond the scope of this research but suffice it to say, the success of these attacks was heavily influenced by financial support given by and to the terrorist groups. Given the obvious planning that went into the mission, large amounts of money were required and some had to go through the financial system before reaching these groups.

81 Simser 2011 *JMLC* 335. For example, in 2008 a report from AL-Qaeda in Iraq (AQI) a terrorist organization recruited 590 foreign fighters entering Iraq through Syria from 21 countries in an effort to use force and suicide bombings to achieve political goals. However, the organization failed because it could not financially sustain itself despite attempts to fundraise and donations from supporters, money had to go into buying weapons and ammunition, cellphones, vehicles and the daily sustenance of the foreign fighters. With scarce resources, this was not easy to manage.

financing of terrorism. The two crimes will be dealt with concurrently to the extent applicable.

I now turn to discuss in detail the concept of money laundering. Writers opine that it is not easy to understand the concept of money laundering when making (or drawing) conclusions regarding its impact on the economy. This is because of the elusive nature of money laundering. They further question whether money laundering is a stand-alone crime or a predicate crime to other crimes. This is because money laundering can occur in one of two ways. Firstly, it vests in the transfer of illicit funds into one's bank account and secondly it constitutes an activity that actually cleans the money and enables the criminal to use the money as if it were clean to begin with.[82]

It follows therefore, that it is important to know the difference between the two ways in which money laundering manifests because the determination of the effectiveness of the AML framework depends on it. This is because evidence used to prove the commission of money laundering is also the evidence that may be used to prove a predicate crime, in which case money laundering will be treated as a stand-alone crime as opposed to a predicate crime.[83]

In terms of the international law however, money laundering is treated as a stand-alone crime but it is accepted that most times it is prosecuted as a predicate crime. This is because by the time the money laundering process occurs, there has already been a crime that has been or is being committed and money laundering only comes as a subsidiary thereto.[84] This means that although prosecution of money laundering requires the existence of a predicate crime, a conviction of money laundering may be secured regardless of whether the criminal has not been convicted for the predicate crime as well.[85] Therefore, it can be concluded that money laundering can either be

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82 Levi and Reuter 2006 *Crime and Justice* 291.
83 Levi and Reuter 2006 *Crime and Justice* 292.
84 Keesoony 2016 *JMLC* 19.
85 Keesoony 2016 *JMLC* 19.

dependent on the commission of a predicate crime or it can be a stand-alone crime independent of the predicate crime.[86]

Moreover, in order to understand the concept of money laundering, one must first understand the nature and use of money.[87] Money is defined as value attached to different forms of objects that are used in trade.[88] Before the inception of the concept of money, communities used the barter system of trade wherein goods and services were exchanged for each other and/ or one for the other, however, as communities evolved, this system was replaced by the monetary trade system.[89] Although the concept of money has not been discussed in detail herein, for purposes of this research in respect of conceiving an understanding of the concept of money laundering, it is noteworthy that money laundering is not only perpetuated by means of cash, although this is the more notorious form but through other forms of trade as well.

Now, it becomes pertinent to define money laundering. Shawgat[90] defines money laundering as the manipulation of illegally acquired wealth to obscure its true source through banks and non-bank financial institutions across international borders. Money laundering is said to include fraud, complicity and defeating the ends of justice.[91] Turner defines money laundering in a thought-provoking phrase as being the "epitome of fraud methodology".[92] However, for purposes of this study the definition of money laundering is derived from the main AML/CFT legislation in South Africa and Lesotho, that is, *FICA* 38 of 2001 and the *MLPCA Act* of 2008 respectively.

In terms of section 1(1) of *FICA*, money laundering is an act that includes acts criminalised in terms of provisions of section 64 thereof and sections 4, 5 and 6 of

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86 Money laundering is generally accepted as a stand-alone crime, however some authors share a different opinion and resort to art 6(2)(e) of the *Convention against Transnational Organised Crime* in Palermo of 2000 to support that money laundering is not a stand-alone crime. This article provides that an offence as set out in para 1 of the article will be said not to apply to one who commits a predicate offence if it is so required in terms of the domestic law of a state party.

87 Madinger *Money Laundering: A Guide for Criminal Investigators* 1.

88 Madinger *Money Laundering: A Guide for Criminal Investigators* 1.

89 Heidensohn, Jackman and Zafiris *The Book of Money: A Visual Study of Economics* 10-13.

90 Kutubi 2011 *World Journal of Social Sciences* 38-39.

91 Masete 2012 *JICLT* 254.

92 Turner *Money Laundering Prevention: Deterring, Detecting and Resolving Financial Fraud* xi.

POCA.[93] This act hides or has the potential to so hide the character or identity, origin, situation or movement of the actual proceeds of illicit activities or interest one holds therein. From the Lesotho perspective, the *MLPCA* does not directly define the concept of money laundering but tries to define it by explaining conduct that is regarded as constituting the crime of money laundering.

Therefore, in terms of section 25 thereof, a person who acquires, converts or aids another to move or hide property with the aim to hide its illicit origin commits the crime of money laundering. This is provided he knows or reasonably suspects that such property is derived directly or indirectly from an act or omission made either in Lesotho or in another country, which act or omission is or would be punishable under any law in Lesotho.

Having defined money laundering, it is important to discuss the processes involved therein. It is accepted that in order for money laundering to occur, it has to complete a cycle of three stages. First, during the placement stage,[94] the money is placed in the banking system, retail industry or smuggled out of a country and then layered in the second stage. During this stage, the money is gradually divided into many transactions in order to cloud the audit trail[95] before finally being integrated into the economy in the third and final stage, at which point the laundered proceeds re-enter the system as normal funds.[96]

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93 121 of 1998.

94 Clark 1996 *Dickson Journal of International Law* 470-471. This has proven to be the most difficult as it is at this point that the money is at its most illegal and consequently launders at the most vulnerable to discovery. They therefore need to be extra careful at this stage and make deposits below the suspicious monetary roof and this may be time consuming as launders deal with massive amounts of money. When the illegal money is initially placed into the system it forms a noticeable ripple which if it is not noticed at that stage it most likely will remain undiscovered throughout the whole laundering process. Banks therefore need to be vigilant in detecting it at this stage.

95 Masete 2012 *JICLT* 254. Layering is achieved through conversion of funds into other forms or transmission into other jurisdictions through online banking.

96 Kidwai 2006 *JSTOR* 44; Helmy *et al* 2016 *Journal of Theoretical and Applied InformationTechnology* 425. For example, this stage mostly involves the creation of shell companies whose purpose is to disguise the source of funds and having the proceeds at the launders' disposal. At this stage, detection is minimal if an audit trail was not set up during the first two stages.

Following the above discussion one may question the origins of money laundering as a way to understand the concept better. Money laundering has always been a part of society but was not criminalised until recently.[97] Initially, it was criminalised by the United States of America in 1986 after the sale of illegal alcohol infiltrated its financial sector to the detriment of its economy as common businessmen engaged in other forms of business like laundromats would illegally sell alcohol beyond the established alcoholic content threshold and hide the proceeds of the illegal sales. The US then criminalised money laundering as a response to what it termed "a war on drugs".[98]

Owing to globalisation,[99] the trafficking of drugs ceased being only the US's problem as it gradually spread across jurisdictions and became a global concern.[100] The international community then came together in the fight against drug-related money laundering. This is because although money laundering may affect a single country, its effects have a ripple effect on the entire global economy; hence the cooperation of countries in the fight against money laundering. This cooperation also promises a better outcome in the fight against money laundering.[101]

This cooperation of countries saw the birth of the FATF as discussed below.

3.3 International Anti-Money Laundering Framework

3.3.1 FATF Framework

FATF is an international body established in 1989 by seven highly industrialised countries of the time dubbed the G7 which came together to deal with the prevalent

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97 IBA Anti-Money Laundering Forum Date unknownhttp://www.anti-moneylaundering.org/Money_Laundering.aspx. It was a US case *United States v 4255625.39* 551 F. Supp. 314 (S.D. fla.1982) that first legally coined the act of hiding of the origin of money as money laundering. However, years before that people were already laundering money. See Hinterseer *Criminal Finance: The Political Economy of Money Laundering in a Comparative Legal Context* 23.

98 Tuba 2012 *Southern African Journal of Criminology* 104; Unger "Introduction" 1-4.

99 Hinterseer *Criminal Finance: The Political Economy of Money Laundering in a Comparative Legal Context* 24. Globalization is caused by the integration of the global economic system that makes trade and investment between countries easier as well as the transfer skills, expertise and labour.

100 Bassiouni and Gultieri "International and National Responses to the Globalisation of Money Laundering" 2-9.

101 Ping *Money Laundering Suppression and Prevention* 10.

money laundering.[102] The body is endowed with the power to establish the average AML/CFT rules against which individual member country compliance is measured.[103] The *FATF Recommendations* are just that and bear no legislative authority. This means that member states are at liberty to incorporate them in their AML/CFT framework to the extent that they are relevant to their individual needs. Nevertheless, these recommendations remain highly influential on AML policies across the globe.[104]

To ensure the success of the Recommendations in the countries that have adopted them into their legislation, FATF obliges the creation of other measures that would allow the detection, monitoring and reporting of suspicious activities. These measures would include retaining and confiscating illicit proceeds and would require the waiving of banking confidentiality.[105]

FATF initially had 40 recommendations that dealt with ML and a further nine were included in response to the 2001 terrorist attacks on America.[106] Its provisions were not legally binding at first but have since become mandatory as it serves as a blueprint for the AML framework for the international community and the nature of the bulk of its provisions requires them to be mandatory in order for them to respond to ML/TF.

Some of these recommendations include the national and international criminalisation of ML and the implementation of measures in the financial sector that screen customers such that it is easy to detect and trace illicit assets and their proceeds. At the core of the FATF system, is the self-assessment and mutual evaluation between member states for continued compliance with international AML/CFT standards. It also comes together with like organisations to go over new ML trends and brainstorm ideas on strategies to overcome them.[107]

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102 Unger "Money Laundering Regulation: From Al Capone to Al Qaeda" 2-23; International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation: The FATF Recommendations (2012) 7.

103 Jensen and Png 2011 *JMLC* 112.

104 Kersop and Du Toit 2015 *PELJ* 1623.

105 AfDB 2007 https://www.afdb.org/fileadmin/uploads/afdb/Documents/Policy-Documents/10000012-EN-STRATEGY-FOR-THE-PREVENTION-OF-MONEY-LAUNDERING_01.pdf

106 Muller, Kalin and Goldsworth *Anti-Money Laundering: International Law and Practice* 71.

107 Mugarura 2011 *JFRC* 182.

The role played by the financial system, particularly banks, in ML/TF is also at the core of the improvement of the FATF system because as the hub of these crimes, it is through it that they are countered. Thus FATF places a duty on financial institutions to exercise due diligence when handling customer affairs based on a risk-based approach.[108] This means that the real identity of the customer must be established. Care must be taken to ensure that accounts belong to their holders and are not being used as decoys to hide the real identity of the owners who use them for ML purposes. This is achieved through ensuring that the customer provides consistent information to the financial institution.

Under FATF, extra caution must be taken when transactions involve cross-border financial institutions. This ensures that they have a strong ML framework and are themselves free from any ML investigations.[109] Part of customer due diligence is the keeping of customer records for at least 5 years which should be availed to authorities upon reporting of any suspicious activities.[110] This gives the authorities a chance to carry out any investigations during that period effectively through a clear paper trail.

If at any stage of customer due diligence, the financial institution encounters large sums of money that are not accounted for or serve no economic purpose, it should raise a suspicion of ML activities and thus the financial institution is obliged under the FATF to report it to the AML authorities. Moreover, transactions that are out of character for the kind of business the client is engaged in ought to be reported as they are suspicious. Since these reports would have been made in good faith, the reporting party is immune from any liability for disclosure of the confidential information their customer placed with them.[111]

Having acted on these suspicions, the financial institutions must then be in a position to freeze, seize and confiscate any funds or assets that are derived from ML/TF activities. Without such powers, financial institutions may as well tip off launderers to hide the suspicious property before authorities with the relevant powers confiscate it.

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108 Jensen and Png 2011 *JMLC* 112.
109 Mugarura 2011 *JFRC* 183.
110 FATF *Recommendation* 14.
111 Mugarura 2011 *JFRC* 184.

The centrepiece of the *FATF Recommendations* is the supervision of the financial sector to ensure proper implementation of AML/CFT measures and the enhancement of international cooperation in the fight against ML/TF.[112]

Although FATF does not have a formal authority to sanction governments for non-compliance, as a way to ensure their implementation, it pressurises its members to comply through letters and a dispatch of a group of delegates to the country involved. If this does not work, then the international community is encouraged to shun the non-complying member by heavily scrutinising transactions and customers from that country.[113] This is also applicable even against non-members whereby FATF encourages its members to shun financial institutions and businesses from non-member countries with poor AML framework.[114] These economic sanctions make it difficult for the financial sector in these countries, particularly banks, to operate on an international level.

Due to the volatility of money laundering trends, the *FATF Recommendations* have been revised three times since they were first published in 1990. They are possibly subject to more revision as the world economy grows and opens a floodgate of an increase in money laundering activity.

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112 Jensen and Png 2011 *JMLC* 112.

113 FATF Recommendation 21. For example, this measure proved fruitful against Turkey in 1996. After a FATF annual report for the period from 1995-1996 indicated that Turkey was not in compliance with international money laundering standards, FATF issued a press statement shunning Turkey and encouraging the international community to scrutinise its transactions and businesses. It was only then that the country enacted an AML framework and implemented the FATF recommendations to the extent that the opening of anonymous accounts was prohibited. FATF also invoked Recommendation 21 against Austria and required it to put in place an effective AML framework that would get rid of banking confidentiality through the operation of anonymous bank accounts in its banks. Austria like Turkey had ignored all FATF efforts to implement an AML framework until it was publicly ridiculed and was under international scrutiny and was faced with the possibility of suspension. Only then did the Austrian government amend its banking laws to incorporate AML provisions that led to the elimination of anonymous accounts.

114 FATF Recommendation 21 was invoked as a plea to FATF members to scrutinise Seychelles, a non-member state, financial institutions and business transactions after it implemented a law that essentially facilitated ML. Governments across the globe created a media frenzy shunning this behaviour until Seychelles succumbed to pressure and rescinded the law.

3.3.2 The UN Convention against Narcotic Drug Trafficking and other Psychotropic Substances in Vienna 1988

This was the first international Convention adopted as a response to the drug abuse and trafficking-related money laundering. In terms of article 3(1), countries are obliged to criminalise at domestic level every crime related to the abuse and trafficking of drugs irrespective of where such act occurred in the world. This encourages international cooperation in the fight against money laundering. To ensure the effectiveness of article 3, article 6 establishes extradition of criminals who have hidden in money laundering lax jurisdictions back to the countries where the crime was committed. It also provides for the seizure and confiscation of proceeds of illicit activities arising from ML and its predicate crimes.[115]

However, this Convention was limited to the extent that it dealt only with drug-related money laundering. This means that money laundering that occurred using proceeds derived from non-drug sources remained unpunished. Another challenge experienced in the effective implementation of this Convention is the fact that it was difficult for law enforcement agencies to trace money across jurisdictions owing to the poor coordination of international laws. Nevertheless, this Convention was effective for over a decade before the *Palermo Convention against Transnational Organised Crime* of 2000 superseded it.

3.3.3 Palermo Convention against Transnational Organised Crime of 2000.

Like its predecessor, the *Palermo Convention* is committed to the eradication of organised transnational crime through most importantly obligating its member states to nationalise its provisions. It reinforces the criminalisation of money laundering and its predicate crimes regardless of the jurisdiction in which they occur. It also requires the implementation of measures that detect and curb the perpetuation of ML activities. These measures include customer due diligence which is based on the screening of customers, keeping of records and reporting of any suspicious transactions.

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115 Mugarura 2011 *JFRC* 176.

The Convention also emphasises the importance of cooperation in the sharing of financial intelligence between law enforcement, regulatory and administrative agencies within a country, regionally and with international stakeholders in the successful and effective fight against ML. For the most part the *Palermo Convention* echoes the sentiments enshrined in the *Vienna Convention* above. However, in its own way it supplements and broadens the global perspective on ML. This is because from the long title of its predecessor, it is clear that ML was viewed from the drug trafficking point of view and as a point of departure, the *Palermo Convention* provides a holistic view to ML by not confining the criminalisation of money laundering to drug-related activities but extending it to all serious crimes.[116]

3.3.4 The Basel Committee Statement of Principles

Another measure adopted by the international community to combat money laundering is the Statement of Principles established by the Basel Committee on Banking Regulations and Supervisory Practices in 1988. These principles deal with banking supervision in light of customer identification and cooperation with law enforcement agencies in efforts to curb the perpetuation of money laundering activities through banks.[117] This was in response to criminals using the financial system to launder money.[118]

3.3.5 Strasbourg Convention and EU Directives

The Council of the European Union adopted the *Strasbourg Convention* in 1990. It then issued the *Money Laundering Directives* of 1991, 2001 and 2005 to ensure that provisions of the Convention are implemented by member states. The Convention, through its Directives, forms the foundation of the international AML framework because it was only after the Recommendations that AML measures constituted the legal framework of countries around the world.[119] Under the Convention, member-

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116 Miloservic 2016 *Law and Politics* 553.

117 Ping *Money Laundering: Suppression and Prevention*13.

118 Preamble to the Basel Committee on Banking Regulations and Supervisory Practices: Statement on Prevention of Criminal Use of Banking System for the Purposes of Money Laundering (1988).

119 Booth *Money Laundering Law and Regulation: A Practical Guide* 4-5.

states are obliged to adopt a broad definition of predicate offences. This would cover many criminal acts and deter criminals from engaging in many money-laundering activities. Under the *Palermo Convention,* predicate crimes were limited to any acts committed with the intention to acquire illicit proceeds.[120]

3.3.6 The Egmont Group

The Egmont group was established in 1995 to bring together all FIUs around the world as a platform for them to exchange the information they have on money laundering activities in their respective countries. This makes it easy for cross border investigations to happen with a view to combat money laundering. This is because FIUs are vested with the power to collect, analyse and distribute information in respect of suspicious transactions and ML/TF related activities. Therefore they are in the possession of critical information which could help combat money laundering.[121]

3.3.7 The Wolfsberg Group

The Wolfsberg Group plays a significant role in the fight against money laundering. It is comprised of 13 international banks and was established in 2000 in order to regulate the financial services sector through the creation of AML/CFT policies that mitigate the risk of financial crime. The purpose of the group is to foster the application of a risk-based approach to money laundering in domestic and international laws. In order to fulfil its mission, the group adopts the *Wolfsberg Global Anti-Money Laundering Guidelines for Private Banking* that make provision for know your customer standards, customer due diligence principles and the training of employees of financial institutions.[122]

3.3.8 The IMF and WB framework

The IMF and WB stand for the promotion and strengthening of the global economy. Being fully aware of the role played by the financial sector in the stability of the global

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120 Milosevic 2016 *Law and Politics* 553.
121 Muller, Kalin and Goldsworth *Anti-Money Laundering: International Law and Practice* 85-86.
122 Aiolfi and Bauer 2017 http://www.wolfsberg-principles.com/pdf/home/The-Wolfsberg-Group.pdf.

economy, particularly of developing countries which are highly susceptible to financial abuse, these institutions urge the adoption of an effective structural, regulatory and legal framework within financial services as a way to curb global financial services abuse.[123]

They achieve this through the IMF's Financial Sector Assessment Programmes (FSAP) and the WB Financial Sector Adjustment Programmes designed to find discreetly the weaknesses in the economic and legislative framework of countries and their financial systems and suggesting corrective measures that will help fight ML/TF and other predicate crimes thereto. In order for their mission to remain progressive, the IMF and WB impose conditions on countries to qualify for financial and technical support in the eradication of ML/TF. Once the conditions are unfulfilled, then support is withdrawn.[124]

However, this assistance may not be sufficient to support the implementation of an effective AML framework in developing countries at par with international standards. Developed countries do not experience the same problem since they already have better structures and laws in place and can therefore easily implement AML/CFT standards.

To ensure countries' compliance with these AML/CFT measures, their financial institutions through international standards and codes of good financial and economic practice, are monitored and assessed. A report is then written on the country's situation. These Reports on the Observance of Standards and Codes (ROSC) provide the IMF and WB with a good background into the country in question to ensure smooth surveillance.

Another IMF/WB initiative to monitor compliance was the OFC adopted in the early 2000s to address risks posed to the international financial sector as well that threaten its stability. To obvert this, its sole focus is on the supervision of financial institutions through regular assessments that seek to determine the overall financial situation

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123 Holder 2003 *JMLC* 383.

124 International Financial Institutions (IFIs) monitor compliance to international standards and best practices in respect of proper financial regulation and supervision as well as fiscal and monetary policies with the view to promote financial sector integrity.

based on the level of risks and vulnerabilities and the observance of financial and economic standards.[125]

3.4 The role of banks in the countering of money laundering and financing of terrorism

As already seen, banks are the easiest way through which criminals can legitimise illicit proceeds because all they have to do is carry out a lot of transactions and just like the audit trail is clouded.[126] This is especially true in light of globalisation whereby launderers move assets across jurisdictions easily and quickly without detection. As a result, it becomes difficult to trace these assets.[127] It follows that it is easy to detect illicit assets as they enter the economy through banks because once they are integrated it is almost impossible to detect and trace them.[128]

It is for this reason that although *FATF Recommendation* 19 obliges financial institutions to adopt measures and controls that combat money laundering, banks are specifically endowed with a further duty to undertake programmes for their employees to arm them with special skills required in the detection and control of money laundering.[129]

From the above, one gathers that a sector-specific response to money laundering is necessary. Both South Africa and Lesotho have devised laws and guidelines that impose certain obligations specifically on banks with the view to mitigate money laundering.

In terms of clause 2 of the South African *Code of Banking Practice* 2012, the rationale behind implementing the Code is to offer a standardised approach by banks to the treatment of customers based on good banking practice principles. This will increase transparency between the customer and the bank and as a result promote confidence in the banking system. When customers have confidence in the banking system, it

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125 Holder 2003 *JMLC* 384.
126 Simwayi and Guohua 2011 *JMLC* 328.
127 Fundanga "The Role of the Banking Sector in Combating Money Laundering" 3.
128 Schneider and Windishbauer 2010 "Money Laundering: Some Facts" 6.
129 Al Qadi et al 2012 *Canadian Social Science* 20.

decreases informal financial transactions that could provide a breeding place for money laundering activities.

Under the Code, banks have certain obligations that include in terms of clause 6.1 the disclosure of confidential customer information subject to the exceptions to banking confidentiality. In this way, the money-laundering risk is mitigated because launderers will not be able to carry on their illicit activities using banks with the hope of being shielded from discovery by money laundering authorities by virtue of the bank's duty to confidentiality.

However, sometimes the role banks play in ML/TF is not only positive. In fact, banks may indirectly cause ML/TF to occur, thus negatively affecting the global financial sector as a whole. This is because enhanced CDD standards may call for employees of banks to engage with customers on a personal basis to ensure they divulge as much information as is necessary to disclose the source of their funds.[130]

Once this type of relationship is fostered, the employees develop a sense of loyalty towards the customers, all the while neglecting their duty to curb ML. This is most likely to occur when dealing with influential customers who use wealth to dictate to banks. Consequently, banks tend to shy away from asking and investigating into the origin of their funds, thereby encouraging ML activities.[131]

The need to increase profits may also cause banks to provide a conducive ML/TF environment without so intending. This occurs when they lure customers by relaxing their regulations and controls against ML as a way to gain new customers while also keeping old ones. This is a marketing strategy used against competitors in the market and is the very one that unknowingly opens a floodgate of further ML operations.[132]

Furthermore, in some ways, the very services and products offered by banks themselves invite ML. For example, some banks encourage customers to operate multiple accounts under their names; even riskier, under multiple names. Controlling

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130 Al-Qadi et al *Canadian Social Science* 19.
131 Al-Qadi et al *Canadian Social Science* 19.
132 Al-Qadi et al *Canadian Social Science* 19.

all these accounts is not easy and eventually one or more of them will become quiescent and thus most vulnerable to forgery and identity theft. This creates an unanticipated cycle of aggravated ML.[133]

Moreover, when banks provide big credits to their customers and hold their money as collateral against the loan, it opens the opportunity for launderers to place dirty money into the banking system without any repercussions. This is because with the loan-money, banks exchange the dirty money for clean money without knowing it, thus helping launderers to clean their money.[134]

3.5 Conclusion

The banks' role in ML and the financing of terrorism is important because banks possess the relevant suspicious information used to infiltrate the financial system; even worse, information intended to infiltrate the financial system. This reiterates the need to supervise banks in order to combat ML and the financing of terrorism or at least, limit them to the bare-minimum. This is achieved through the implementation of domestic laws and eventually integrating the region, continent and the world at large in the fight against ML/TF as seen above.[135] This is necessary as it stops money launderers dead in their tracks as they try to identify jurisdictions with relaxed laws from which to continue their activities.

The following chapters deal with South Africa and Lesotho's response to ML and terrorist financing in light of the existing international AML and CFT initiatives set out in this chapter.

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133 Al-Qadi et al *Canadian Social Science* 20.
134 Al-Qadi et al *Canadian Social Science* 20.
135 Hammouri and Al Wedian 2013 *European Scientific Journal* 60.

CHAPTER 4
SOUTH AFRICAN ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING FRAMEWORK

4.1 Introduction

The South African AML/CTF measures comprise a three-tier framework consisting of legislation, regulations and sector specific guidelines. The first generation of statutory AML provisions in South African law was provided in the *Drugs and Drug Trafficking Act* 140 of 1992. It introduced ML as an independent crime and criminalised it in section 6 and 7 thereof. However, the Act was only limited to the criminalisation of proceeds of drug-related offences[136] and thus not satisfactory to combat ML.

The second generation of these provisions was introduced by the *Proceeds of Crime Act* 76 of 1996, broadening the scope of AML provisions to include criminalisation of the proceeds of any offence.[137] However, both these Acts were not effective in the prosecution of money laundering and were repealed. A third generation of AML provisions was introduced when the *Prevention of Organised Crime Act* 121 of 1998 (POCA), the *Financial Intelligence Centre Act* 38 of 2001 (FICA) and the *Protection of Constitutional democracy against Terrorist and Related Activities Act* 33 of 2004 (POCDATARA) were enacted.

These latter three Acts serve as the main AML/CTF laws in South Africa aimed at criminalising transactions involving the proceeds of unlawful activities or the financing of terrorist related activities as well as ancillary offences therein in terms of common law and statutory law.[138] These Acts are discussed below, together with the *Prevention and Combating of Corrupt Activities Act* 12 of 2004 (PRECCA) and *Banks Act* 94 of 1990 whose provisions also aid financial institutions to fight financial abuse.

136 Tuba 2012 *Southern African Journal of Criminology* 109.
137 Tuba 2012 *Southern African Journal of Criminology* 109.
138 Tuba 2012 *Southern African Journal of Criminology* 110.

4.2 The main South African AML/CTF laws

4.2.1 POCA 121 of 1998

POCA was adopted in an effort to keep up with international AML measures based on the realisation that criminal law procedures and penalties already in place in South Africa were inadequate to combat and deter organised crime.[139] It expressly defines money laundering under three separate provisions that cover conversion, transfer, concealment of funds and possession and acquisition of property.[140] This is in terms of the *Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances* (1988) and the *Convention against Transnational Organised Crime* (2000),[141] both of which provide for the application of money laundering to serious crimes in order to cover more predicate crimes.[142] By so doing, *POCA* complies with *FATF Recommendation* 3.[143]

However, the Act fails to outline measures that are invoked to curb money laundering. *FICA* addresses this shortcoming.[144]

4.2.2 FICA 38 of 2001

FICA outlines measures to be adopted in order to detect and combat money laundering effectively.[145] The basis of these measures is customer due diligence (CDD).[146] Summarily, *FICA* generally adopts a two-pronged approach in order to combat money laundering. Firstly, it obliges financial institutions to keep customer records and report

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139 *Mohunram and Another v NDPP and Another* 2007 2 SACR 145 (CC) para 144.

140 Kruger *Organised Crime and Proceeds of Crime Law in South Africa* 35. See also sections 4, 5 and 6 of *POCA* that give a detailed definition of money laundering.

141 Lawack 2013 *WJLTA* 330.

142 Article 3(1) (b) of the Vienna Convention gives a detailed definition of money laundering which is echoed in article 6(1) (a) of the Parlemo Convention.

143 *FATF Recommendation 3* obliges countries to criminalise money laundering in line with the Vienna Convention and Palermo Convention in terms of which money laundering is applied to all serious crimes in order to include as many predicate crimes as possible.

144 Lawack 2013 *WJLTA* 331.

145 Kersop and du Toit 2015 *PELJ* 1622.

146 *FICA* provides for the application of a Risk Based Approach (RBA) in the identification and verification of all customers. However, the RBA is not rigid. It should be flexible in application to cater for different customer risk levels. This means that other customers will then be subjected to more rigorous verification methods whilst others will be subject to lesser intense methods.

any suspicious conduct and secondly, it creates an offence if they fail to do so. In order to ensure compliance, *FICA* then has a compliance guideline that businesses must follow. In terms of section 1 and schedule 3, every business and all its employees have a duty to report any suspicious transactions during the course of their operations in a timely fashion. It further creates a maximum monetary threshold with which one may transact,[147] and it mandates foreigners to whom to declare their intention on presenting the particular business with money that exceeds the prescribed threshold.[148]

De Koker[149] observes that financial institutions, especially banks, are endowed with a further duty to identify and verify the identity of their customers and keep records of these customers' dealings. In order to ensure that this happens, financial institutions need to appoint an in-house compliance officer and train employees to equip them with the necessary skills required to deal with ML matters effectively. Also important is the duty to report large online transfers coming in and out of South Africa as they may be an indication of illicit activities and thus need thorough screening.

For clarity on the duty of financial institutions to report to the FIC, reporting must be based on cash transactions or the transfer thereof that exceeds the established threshold.[150] Any property directly or indirectly connected to ML/TF activities must also be reported,[151] as well as any large cross-border online transactions.[152] The duty to report extends to any other activities that are not normal.[153] Each of these reporting duties is later discussed in detail below.

It is important to note that the duty to report suspicious and unusual transactions is not placed on businesses and their employees alone, but on any person who knows or ought reasonably to have known or even suspected illicit activities. Such person is under a duty to report the reasons for their knowledge or suspicion and provide the

147 *FICA* s 28.
148 *FICA* s 30.
149 De Koker *South African Money Laundering and Terror Financing Law in South Africa* 6.
150 *FICA* s 28 and s 30.
151 *FICA* s 28A.
152 *FICA* s 31.
153 *FICA* s 29(1), (2).

particulars of that transaction to the FIC within a reasonable time of their knowledge or suspicion.[154]

Failure to report in terms of section 29 exposes one to the commission of an offence under section 52(2) of *FICA* punishable with a 15 years' imprisonment term or a R10 million fine in terms of section 68(1). Regulation 29 of the *Money Laundering and Terrorist Financing Control Regulations* also makes the failure to report to the FIC timeously in terms of section 29 of *FICA* an offence.

According to De Koker,[155] knowledge in section 29 is not only limited to actual knowledge but extends to a wilful blindness as well. The test used in determining whether one knew or ought to have suspected ML/TF activities from the facts and thus reported it accordingly is that of a reasonable man with knowledge, skill, training and experience reasonably expected of a person in his position and the experience that he actually has.[156] However, it should be clear that only suspicions with a sound ground should be reported, otherwise the FIC would be sent on a wild goose chase and deplete the much-needed resources that could be better utilised in the investigation of actual suspicious activities.[157]

Following this discussion, it is important to define suspicious activities. De Koker[158] states that when the customer provides vague and inconsistent information, it is always a red flag for ML activities. As a result, this warrants reporting. It should also raise a suspicion when he engages in large transactions which have no economic basis as he is neither employed nor runs a business, or where the transactions are out of his normal business dealings. Moreover, he states that where a customer uses financial institutions that are far from his residential or workplace, uses multiple accounts with the same bank but at different branches and refuses to disclose his other business

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154 *FICA* s 29 gives an array of examples of facts that may raise suspicion for ML/TF activities that should be reported to the FIC.

155 De Koker *South African Money Laundering and Terror Financing Law in South Africa* 7-14.

156 Muller, Kalin and Goldsworth *Anti-Money Laundering: International Law and Practice* 784.

157 Kruger *Organised Crime and Proceeds of Crime Law in South Africa* 46.

158 De Koker *South African Money Laundering and Terror Financing Law in South Africa* 7-14. He gives an array of examples of situations and facts related to transactions that should raise suspicion of ML activities. However, the full list is not discussed here.

dealings, such customer may be carrying on ML activities and should therefore raise a suspicion.

In the case of suspicious transactions, any large cash amounts deposited into several related accounts and subsequently moved into one account or withdrawn for no apparent reason should raise suspicion.[159] Furthermore, things such as the purchase and sale of securities at a generous amount for no clear reason or that do not fit the customer's profile render a transaction suspicious.[160]

In terms of Regulation 27 of the *Money Laundering and Terrorist Financing Control Regulations* of 2002, in order for the reporting of these suspicious and unusual transactions to be effective, financial institutions should implement internal rules and management in compliance with *FICA* and the *Money Laundering and Terrorist Financing Control Regulations.*[161] Cognisance should also be taken of any other sector guidelines on the reporting of suspicious and unusual transactions.

These internal rules should provide methods to assist employees in the easy detection of suspicious and unusual transactions in the course of their work and the same methods should be utilised to make the reporting process timeous. The employees of financial institutions should be allocated responsibilities and accountability in order to ensure that reporting is made effectively. The rules should stipulate disciplinary channels and steps to be taken against any employee who fails to comply with any responsibilities with which he is vested. These regulations have the same legislative authority as *FICA,*[162] and as a result, they have added to the effective implementation of a comprehensive AML framework in South Africa.[163]

Another reporting duty *FICA* has with financial institutions is in relation to cash transactions or the transfer thereof in and outside South Africa that exceeds the

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159 SFP 2014 www.sfpadvice.co.za/wp-content/uploads/2014/06/SFP-FICA-Internal-Rules-2014-Final-2.pdf

160 SFP 2014 www.sfpadvice.co.za/wp-content/uploads/2014/06/SFP-FICA-Internal-Rules-2014-Final-2.pdf

161 GN R1595 in GG 24176 of December 2002.

162 Kersop and Du Toit *PELJ* 1626.

163 Kersop and Du Toit *PELJ* 1626.

established threshold of R24 999.99[164] in terms of section 28.[165] This cash can either be received by or payment made by the financial institution to or on behalf of a customer or his agent.[166] The same rules apply in the cross border physical movement of cash and in the transfer of electronic funds. After the occurrence of these kinds of transactions, sections 30 and 31 of *FICA* respectively oblige the financial institutions to file a report to that effect within a reasonable time of occurrence.

Moreover, the duty to report suspicious and unusual transactions also extends to reporting property connected to terrorist activities. In terms of section 28A,[167] when a financial institution realises that it has in its possession or control, property owned or controlled by a person or institution that has committed, attempted to commit or help in the commission of activities connected to terrorism, it must report this to the FIC. It must then also surrender every document and disclose every piece of information it may have on the property. The financial institution or its representative must make the report on suspicious property within 5 days of knowing of it in terms of regulation 24(1) of the *Money Laundering and Terrorist Financing Control Regulations.*

Although there is no obligation on financial institutions to cross-check their records for possession or control of illicit property on behalf of their customers who could be possible terrorists, De Koker opines that financial institutions ought naturally to screen their customers for possible terrorism based on information that is also available to everyone. He states that this would help financial institutions escape liability for failure to report suspicious property based on wilful blindness or negligent ignorance since it is only standard for financial institutions to screen their customers.[168]

As a way to incentivise financial institutions to report suspicious and unusual transactions and furnish relevant information and documents, they are exempt from both criminal and civil liability as they are deemed to have made the reports in good

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164 Reg 22B in GN R867 in GG 33596 of 1 October 2010.

165 *FICA* s 32(1). This section also prescribes the manner in which the reports should be filed and the time within which they must be made.

166 *FICA* s 38.

167 *FICA*.

168 De Koker *South African Money Laundering and Terror Financing Law in South Africa* 7-44 – 7-45.

faith despite the fact that they may have had a duty of confidentiality towards the customer.

4.2.3 Prevention and Combating of Corrupt Activities Act 12 of 2004 (PRECCA)

Further legislation placing duties on financial institutions in efforts to combat ML/TF is the *Prevention and Combating of Corrupt Activities Act* 12 of 2004 (PRECCA). In terms of section 34[169] thereof, persons of authority are obliged to report any suspicious activities and failure thereof subjects them to criminal liability. However, *PRECCA* does not protect persons who make these reports. For this reason, *PRECCA* overlaps with section 29 of *FICA* that offers protection to persons who report.[170] If the person in authority reports under *FICA* but the same activities are offences in terms of section 34(1) of *PRECCA,* he is also obliged to report and this inconsistency in the protection of reporting persons may cause problems.

4.2.4 POCDATARA 33 of 2004

The duty to report is also encapsulated in *POCDATARA*. In terms of section 12(1) one has a duty to report when one reasonably suspects another to have the intention to commit or to have already committed an offence criminalised under Chapter 2 of the Act which includes crimes such as terrorism. This duty also arises where one has knowledge of a place at which there is a person suspected of having committed or having the intention to commit such crimes as stipulated in Chapter 2 of the Act.

It follows that a person who has a duty to report under section 29 of *FICA* also has a duty to report in terms of section 12 of *POCDATARA* and unlike the case with *PRECCA* overlapping with *FICA*, *POCDATARA* does not always overlap, as the reporting duties therein are wider. While section 29 requires the reporting party to have been involved in some way in the illicit activity, section 12 makes no such requirement as any person with the relevant reportable information may report it.

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169 The section gives a list of persons of authority and amongst them is included an executive manager of a bank or other financial institution.

170 IRBA 2011 https://www.irba.co.za/upload/irba-guide-for-ras-combating-money-laundering(1).pdf

Subject to the provisions of *FICA,* a report in terms of section 29 must be made to the FIC as soon as possible and no later than 15 working days after being aware of the existence of illicit activities.[171] However, late filing may be condoned in some cases,[172] for example, in instances of institutions with a great deal of filing to do, such as banks. In the report, the reporting party must indicate who they are, the transaction they are reporting and the party on whose behalf the transaction was conducted. If the activity involved an account, it should be stipulated. Moreover, the reporting party must always state the grounds for his suspicion and proof of steps taken to remedy the situation.[173]

Equally important as the duty to report is the financial institution's duty to keep customer records. This entails keeping records of the identity of the customer and that of a person on whose behalf the customer is acting if that is the case. The manner in which this identity was established and the details of the person who established it must be kept on record as well. The records must also reveal the nature of the business relationship,[174] parties to a transaction and the amount of money involved therein. If there are any accounts involved in the transaction, these should be made known too. It is always required that proof of identity be retained and kept safe.[175]

FICA grants an authority representing the FIC unrestricted access by search warrant to the records kept by financial institutions during normal working hours who may examine and make copies of records he requires.[176] The search warrant is granted where the court is convinced such records could reasonably help the FIC in the investigation of ML/TF related activities.[177] As a result, a duty is placed on the financial

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171 Reg 24 in GN R867 in GG 33596 of 1 October 2010.
172 Guidance Note 4 clause 6.4.
173 Reg 23 in GN R867 in GG 33596 of 1 October 2010.
174 Records relating to the establishment of a business relationship must be kept for at least 5 years after termination of the relationship while records relating to transactions must be kept for at least 5 years from the date the transaction was concluded.
175 *FICA* s 22.
176 *FICA* s 26(1).
177 *FICA* s 26(2), (4).

institution to provide reasonable help to the FIC to exercise the right of access to the records, the failure of which is a punishable offence.[178]

This help may be in the form of providing information to the FIC. In terms of section 27 and 35 of *FICA*, financial institutions may be compelled to furnish the FIC with information that establishes whether a person under suspicion has been or is a customer of or has acted on behalf of a customer of the financial institution. Disclosure may also be requested in respect of an account or facility.

4.2.5 The Banks Act 94 of 1990

In the stride to combat sector specific ML/TF, the *Banks' Act* mandates banks to implement internal policies and procedures which will help it avoid financial abuse.[179] The presence of a compliance officer is a necessary part of this risk management framework to ensure these policies and procedures are effectively implemented.[180]

4.3 Gaps in the framework

From the above discussion, it is gathered that the South African AML/CFT framework is strong and easy to understand,[181] however, there are still grey areas that need improvement based on the FATF and ESAALMG mutual evaluation report in 2009.[182] This evaluation revealed that South Africa is compliant with nine of FATF's Recommendations, largely compliant with ten of those, partially compliant with fourteen and non-compliant with seven.[183] It is to these shortcomings that I now turn.

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178 *FICA* s 49.

179 Majoni 2012 www.derebus.org.za/compliance-bank-matters/

180 *Banks Act* s 60A.

181 IMF "Financial Sector Assessment Programme: South Africa" 2015 8; De Koker 2003 *JMLC* 176; De Koker 2002 *Institute for Security Studies* 48.

182 IMF "Financial Sector Assessment Programme: South Africa" 2015 8.

183 FATF 2009 "Mutual Evaluation Report" 215-222. Compliance under the FATF is categorised under four levels, namely, complaint, largely complaint, partially complaint, non-complaint and sometimes not applicable.

4.3.1 Politically Exposed Persons

A politically exposed person (PEP) is a person who assumes a prominent public office in a particular country or abroad.[184] In South Africa, a PEP is defined as a natural person who presently or previously assumed a prominent public position in a particular country.[185] In terms of Recommendation 6, a duty is placed on financial institutions to undertake specific measures that will help them identify PEPs.[186] This is because owing to the positions they assume, they are treated differently from regular customers. Upon identification, managerial consent is required before any business relationship that should be regularly monitored is fostered with them.[187] Financial institutions are further placed under the obligation to enquire and verify the source of the funds of the PEP in question.[188] However, there is no specific law to this effect in the South African AML/CFT framework.[189]

In order to address this shortcoming, the *FICA Amendment Bill* 33 of 2015 was adopted but remained unsigned until 2017 when it was officially passed into law. The main objective of the *FIC Amendment Act* 1 of 2017 that is currently in force is to improve and strengthen South Africa's AML/CFT framework and the implementation of measures thereof. It introduces enhanced measures and progressive customer due diligence measures to be applied when establishing business relationships with PEPs. Financial institutions are now under an obligation to identify PEPs and take appropriate measures when handling them.

This is in terms of sections 21F and 21G. They provide that whenever an accountable institution encounters a foreign prominent public official or a domestic prominent influential person as a customer or beneficial owner of that customer, a thorough enquiry must be made into their source of income and senior managerial consent

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184 FATF *Recommendations* 2012 119-120.
185 Financial Intelligence Centre FAQhttps://www.fic.gov.za/Pages/FAQ.aspx?p=2.
186 FATF *Recommendations* 2003 3.
187 FATF *Recommendations* 2003 3.
188 FATF *Recommendations* 2003 3.
189 FATF 2009"Mutual Evaluation Report". Although *Guidance Note 3A* at26-28 defines PEPs and stipulates measures to be implemented when dealing with them as high-risk customers, it does not apply to all accountable institutions. Moreover, to those it applies it has no legal force and therefore not binding as it serves as a mere guideline.

acquired before any business relationship is established or continued. Thereafter, the relationship must be monitored regularly.

4.3.2 Correspondent banking services

Banks establishing correspondent banking services[190] are under the obligation to carry out enhanced customer due diligence against respondent banks.[191] The purpose of this exercise is to reveal the nature of their business operations and the reputation of these institutions. It also seeks to determine whether they have been or are under any suspicion or investigation for ML/TF related activities. The purpose is also to assess the extent to which these institutions implement and apply AML/CFT measures within their internal framework.[192] No duty is placed on the financial institutions to carry out CDD against customers of the respondent bank. However, the latter has a duty to carry out a satisfactory CDD on its customers whose accounts are directly linked to the correspondent bank and to furnish the correspondent bank with full information to this effect.[193]

Although there is no specific law in South Africa that imposes this obligation in response to Recommendation 7, it is a common practice within financial institutions to carry out enhanced CDD with respect to correspondent relationships as contemplated by this Recommendation.[194] The *FIC Guidance Note 3* also encourages banks to adopt Recommendation 7 when establishing correspondent relationships and to take particular steps when dealing with banks within countries with a poor AML/CFT framework.[195]

Although as stated earlier, the Guidance Notes have no legal effect, financial institutions that fail to adopt measures contemplated therein must furnish the Banking

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190 Glossary *FATF Recommendations* 2012 112. Correspondent banking is the relationship between a bank referred to as the correspondent bank which is usually large which renders its services to another referred to as the respondent bank which is usually a smaller bank.

191 This in terms of Recommendation 7 of *FATF Recommendations* 2003 revised to Recommendation 13 in *FATF Recommendations* 2012.

192 FATF 2016 *Guidance on Correspondent Banking Services* 4.

193 Recommendation 7(e) of FATF *Recommendations.*

194 IMF "Financial Sector Assessment Programme: South Africa" 2015 5.

195 FATF 2009 "Mutual Evaluation Report" 449.

Supervision department with a just cause why. The effect of this is to compel financial institutions to comply with Recommendation 7 even in the absence of such obligation in law. It would however, be wiser to enact legislation specifically imposing this obligation.[196] Moreover, there is no law that specifically deters the establishment of correspondent service relationships with shell banks, although Recommendation 18 directly prohibits the establishment of shell banks. It is not enough to prohibit the establishment of shell banks; specific provision must be made for the deterrence of maintaining or establishing correspondent banking services with shell banks.[197]

4.3.3 FATF Risk Based Approach (RBA)

In order to mitigate ML/TF risks a country is exposed to, it must adopt AML/CFT measures that are commensurate to the said risks.[198] It is therefore important for countries to investigate, assess and comprehend the exact ML/TF risks to which they are exposed. Knowing the extent to which and manner in which these risks affect them helps in the application of relevant measures.[199] The rationale behind the RBA to AML/CFT is to equip countries with stronger tools to fight financial crime and protect the integrity of the financial system. This approach also helps in the better implementation of the *FATF Recommendations*.

Upon application of an RBA, it will become clear which institutions need a wider and more intense AML/CFT framework owing to the risks detected and which institutions require a more relaxed AML/CFT framework. The purpose here is to mobilise resources to the areas of most concern and limit same from relatively low risk sectors. This however does not mean that low-level risks will be ignored. Once these measures are accordingly put in place, they should make provision as to how they can be complied with in order to successfully eradicate ML/TF. It follows that it is a prerequisite for these measures to be under constant supervision.[200]

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196 IMF "Financial Sector Assessment Programme: South Africa" 2015 15.
197 FATF 2009"Mutual Evaluation Report" 132.
198 Recommendation 1 of *FATF Recommendations* of 2012.
199 FATF 2014 "Guidance for a Risk Based Approach" 6.
200 FATF 2014 "Guidance for a Risk Based Approach" 7.

South Africa adopts a one-size fits all approach to risk whereby some financial institutions subject all their customers to the same due diligence standards. The repercussions of this practice are that where strict screening measures are required, they may not be applied and vice versa. This presents the perfect opportunity for ML/TF activities. The result is that limited funds which could better be utilised for high risk customers will be used for low-risk customers.[201] Failure to incorporate the RBA measure in domestic AML/CFT legislation constitutes a shortcoming in the South African AML/CFT framework.

In response to this shortcoming, section 42 of the *FICA Amendment Act* 1 of 2017 makes provision for a risk-based approach to CDD through a Risk Management and Compliance Programme (RMCP). In terms of this provision, financial institutions are obliged to examine the specific risks they are exposed to in order to determine the extent of AML/CFT resources required to mitigate such risks. This examination should be commensurate to the size and nature of operations of the specific financial institution. The same RBA is extended to the identification and verification of customers.[202]

4.3.4 National Risk Assessment (NRA)

In order to help financial institutions to adopt an RBA to ML/TF risk easily and effectively when carrying out CDD measures, it is important for South Africa to have national risk assessment measures in place.[203] The launch of these measures was introduced by the *FIC Amendment Act* 1 of 2017 and was long overdue. For a long time before its implementation, although there were informal talks of a national risk assessment strategy to combat ML/TF that would include government agencies, it was never formalised until now and this presented a challenge to financial institutions in the effective implementation of AML/CFT measures. Under the new Act, the objective

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201 Parkman *Mastering Anti-Money Laundering and Counter-Terrorist Financing* 99.

202 FIC 2017 "A New Approach to Combat Money Laundering and Terrorist Financing" 4-5.

203 *Interpretive Note to Recommendation 1* of the 2012 *FATF Recommendations*. In terms of Recommendation 1 of the *FATF Recommendations* of 2012, countries are obliged to adopt a national risk assessment strategy to ML/TF which goes to reveal weaknesses in the law that may then be amended. It also makes it easy for financial institutions to effectively implement a RBA to ML/TF as the levels of risk will be clearer.

of launching an NRA is to have a strong AML/CFT framework that is risk based and designed to deter and mitigate ML/TF activities and other serious financial crimes. An NRA will help authorities understand ML/TF dynamics facing South Africa as an individual country in all its departments and sectors and as a result help in the adoption of relevant measures and policies based on the acquired information to obvert the determined risk.[204]

4.3.5 Beneficial ownership

Another shortcoming to the South African AML/CFT framework that surfaced during the last FATF evaluation in 2009 was the lack of laws that oblige financial institutions to verify the identity of beneficial owners[205] or persons controlling a juristic person.[206] The old *FICA* places an obligation on financial institutions only in respect of the identification and verification of customers with whom the financial institution directly deals.[207] This does not fully comply with *Recommendations* 10, 24 and 25 of the revised *FATF Recommendations* of 2012. These provisions oblige financial institutions to adopt measures that will identify and verify the identity of beneficial owners and any corporate vehicle used by them based on the notion that transparency will enhance the integrity of financial institutions.

The lack of laws and literature on beneficial owners crippled the ability of financial institutions in the detection of suspicious transactions because although the direct customer may be clean, the beneficial owner may not be and failure to enquire into this exacerbates the perpetuation of ML/TF activities without detection.[208] This evidenced a need for South Africa to adopt provisions that deal with and provide information on beneficial owners.

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204 FIC 2017 "A New Approach to Combat Money Laundering and Terrorist Financing" 3.

205 Van der Does de Willebois *et al* 2011 *World Bank* 17-18. A beneficial owner is someone with whom control of an asset lies and is able to benefit from it. It could also be a person with a stake in illicit proceeds but hides behind the corporate vehicles.

206 FATF "Mutual Evaluation Report" 95.

207 *FICA* s 21.

208 IMF "Financial Sector Assessment Programme: South Africa" 2015 12.

The implementation of the *FICA Amendment Act* 1 of 2017 addresses this shortcoming by introducing the meaning of beneficial owner within the South African legislative framework. This is quite a breakthrough because beneficial ownership of assets through corporate vehicles plays a role in ML/TF activities as criminals use these vehicles to carry out illegal activities.[209] Knowing the identity and other relevant information on beneficial ownership helps financial institutions detect suspicious transactions and enhances ML/TF prosecutions and convictions.

4.3.6 Exempted accountable institutions

Some financial institutions are excluded from accountable institutions on the basis that they pose a very low risk to ML/TF.[210] The effect of this exclusion is that although they are also obliged to report suspicious transactions, they are not required to carry out CDD standards and keep customer records in pursuance of *FICA*.[211] These exclusions increase non-compliance with *FATF Recommendations* and create a gap in South Africa's AML/CFT framework. Exempting other financial institutions from accountable institutions promotes unfair competition between these institutions and those required to comply with *FICA* because the former operate without any limitations.[212]

In acknowledging these consequences, the new *FIC Amendment Act* 1 of 2017 has introduced a withdrawal of exemptions of certain financial institutions from provisions of *FICA* 2001.[213] The rationale is to improve South Africa's AML/CFT measures and remedy the redundancy of the exemptions in light of the introduction of an RBA to ML/TF. That is to say, instead of exempting these institutions entirely, an RBA that is commensurate to the risks they pose is applied to them. This will allow the detection of ML/TF activities even if they are minimal as opposed to none at all as is the case with an absolute exemption from *FICA* obligations.

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209 FIC 2017 "A New Approach to Combat Money Laundering and Terrorist Financing" 11.
210 FATF Mutual Evaluation Report Anti-Money Laundering and combating the Financing of Terrorism: South Africa 91.
211 FATF 2009"Mutual Evaluation Report" 91.
212 Portfolio Committee on Finance Comments on the *FIC Amendment Bill* 13.
213 https://www.fic.gov.za/Resources/Pages/FIC-Amendment-Act.aspx

4.3.7 Statistics

The FATF mutual evaluation of South Africa in 2009 revealed that there are inadequate statistics and information on ML, making it difficult to assess the effectiveness of the South African AML/CFT framework as a result.[214] *Recommendation* 32 places an obligation on financial institutions to provide comprehensive data and statistics concerning their AML/CFT measures to competent authorities. Comprehensive statistics and data comprise a list of reported suspicious transactions, ML investigations, prosecution and convictions, mutual legal assistance rendered and requested as well as all frozen, seized and confiscated property.

However, despite this, South Africa does not provide sufficient statistics as required by FATF and until before the commencement of the *FIC Amendment Act* did not make any improvements in the collection of ML statistics and information. This posed a continuing difficulty in accurately assessing the effectiveness of its AML/CFT framework.[215]

4.4 South Africa's response to gaps in its Anti-Money Laundering framework

In order to address these shortcomings South Africa has finally amended its primary AML/CFT legislation. In efforts to address the weaknesses established above and strengthen its AML/CFT framework, South Africa has enacted the *FIC Amendment Act* 1 of 2017.[216]

One of the most important changes in the new Act is in respect of enhanced CDD standards in respect of corporate customers.[217] In terms of section 21B(2)(a) CDD standards have been improved to the effect that they are no longer only limited to the customer with whom the financial institution has direct dealing but extend also to the

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214 FATF 2009 "Mutual Evaluation Report" 107.
215 FATF 2009"Mutual Evaluation Report" 7.
216 Sedutla 2017 www.derebus.org.za/financial-intelligence -centre-amendment-act-gazetted/.
217 National Treasury 2017 www.treasury.gov.za/comm_media/press/2017/20170508-2017 FICA Act pamphlet.pdf

identification of beneficial owners who have the ultimate ownership, control or right over the property in question.

The rationale behind this section is that although the direct customer with which a financial institution deals may not engage in any ML/TF activity, the person on whose behalf he acts may be so involved and not screening him for such possibility is flawed. This amendment therefore obliges financial institutions to get to know the people who make up the corporate structure. This reduces the abuse of the financial sector because then financial institutions will apply appropriate and commensurate risk control measures.

Also under the realm of CDD is the obligation placed on financial institutions to carry out on-going monitoring of the business relationship under section 21C, established after obtaining managerial consent, with customers classified as high risk. The purpose is to ensure that the information regarding their source of income remains up to date and relevant in the financial institutions' records. This enhanced CDD is required in terms of section 21F and 21G for both domestic and foreign PEPs that include prominent persons in the private sector who engage in business relationships with government.

However, much as this is so, a different approach is adopted when dealing with foreign and domestic PEPs because the former are generally regarded as high risk while the latter are regarded as low risk. It will be remembered that under the principal *FICA*, only a standard CDD standard was required which entailed nothing more than the identification and verification of customers and this was flawed.

Therefore, the reason for an enhanced CDD towards PEPs is because these persons are more likely to engage in illicit activities and therefore pose a higher risk to the abuse of the financial sector. Moreover, a risk-based approach under the new Act makes compliance with obligations imposed on financial institutions easy and this in turn promotes business operations.

Another significant change introduced by the new Act is the enhanced duty to keep financial records. In terms of section 22A(1), financial institutions are obliged to keep

records of every transaction regardless of whether it is a once-off single transaction or a transaction with a view to a long-term banking relationship or whether the transaction is suspicious or not. This will help clear the audit trail that will come in handy at any point in time if an investigation ensues against a customer on suspicion of involvement in ML/TF activities.

Furthermore, the new Act introduces the powers of the FIC to regulate the enforcement of sanctions enshrined in the *Money Laundering and Terrorist Financing Control Resolutions* including the freezing of property involved in terrorist activities in pursuance with the UN Security Council findings. It also broadens the powers of the FIC to include the initiation and analysis of suspicious transactions on its own accord.[218]

4.5 Conclusion

The new amendment Act evidences South Africa's commitment to combat money laundering and financing of terrorism in compliance with international standards. This is because the new Act is more compliant with international standards of the FATF,[219] and generally provides more transparency and makes it more difficult for illicit proceeds to remain hidden, thus promoting financial sector integrity. To evidence this, in 2017 FATF carried out a mutual evaluation follow-up process on South Africa based on the limitations established in its mutual evaluation report. FATF decided to stop the process on the basis that the implementation of the *FIC Amendment Act* and amendments to the *Money Laundering and Terrorist Financing Regulations* have satisfactorily addressed all the gaps identified during its last assessment in 2009.[220]

The next chapter discusses Lesotho's anti-money laundering framework in detail.

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218 *FIC Amendment Act* s 60.

219 Nkhwashu 2017 http://www.derebus.org.za/no-two-accountable-institutions-financial-intelligence-centre-amendment-act-2017s-risk-based-approach-legal-profession/

220 FIC 2017 https://www.fic.gov.za/Documents/FATF%20Outcome%20%20Press%20Release%20%2010%20November%202017%20+FIC.pdf

CHAPTER 5
LESOTHO'S ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING FRAMEWORK

5.1 Introduction

It will be remembered from the previous chapters that Lesotho, being completely landlocked by South Africa, makes it vulnerable to financial abuse and other crimes, particularly from criminals avoiding detection from South Africa who seek a safe haven in Lesotho. This has led to predicate crimes that mostly take the form of drug and human trafficking, smuggling of diamonds, robbery, stock theft and corruption at government level.

The corollary to being landlocked is the close link Lesotho's small and concentrated financial sector has with that of South Africa. Lesotho's financial sector offers very limited financial services itself with the bulk of financial institutions being subsidiaries of South African banks. One bank is fully state owned – the Lesotho Postbank, while Standard Lesotho Bank, Nedbank Lesotho and FNB Lesotho are South African subsidiaries. This means that any adverse effects experienced by these banks have a major ripple effect on Lesotho's economy and this includes ML/TF activities.

As part of its AML/CFT mission, Lesotho joined the *ESAAMLG* in 2003[221] whose purpose is to ensure its members properly implement international standards like the *FATF Recommendations* in order to combat ML/TF. In response to this goal, the Central Bank of Lesotho (CBL) together with the Ministry of Finance and Development Planning established a Task Team with the sole mandate to create a framework that would combat both ML and TF in Lesotho.

The *Money Laundering and Proceeds of Crime Act* of 2008 (MLPCA) then came into effect and would become the main legislation that directly criminalises ML and TF in

[221] ESAAMLG is a FATF-styled regional body under FATF supervision and guidance in fighting money laundering and financing of terrorism.

Lesotho.[222] It outlines measures to be adopted to detect and combat money laundering effectively based on the identification and verification of customers, the keeping of records and the reporting of suspicious transactions. The Act works hand in hand with the *Criminal Procedure and Evidence Act* of 1981 (CP&E).[223]

5.2 The main Lesotho AML/CTF laws

5.2.1 MLPCA 4 of 2008

A pertinent strategy the *MLPCA* uses in combating ML/TF is by appointing an AML/CFT authority namely the Directorate on Corruption and Economic Offences (DCEO). This authority is vested with the responsibility to prevent, investigate and prosecute with the guidance of the Director of Public Prosecutions, ML/TF related activities.[224] In order to exercise its powers, the DCEO may direct accountable institutions to take all necessary steps to facilitate the DCEO's investigations or it may alternatively consult with relevant persons or institutions to the extent necessary to allow it to exercise its powers effectively.[225]

In order to investigate an offence under the *MLPCA,* the DCEO has the power by virtue of a search warrant[226] to enter the premises of the accountable institution at reasonable times. The authority may access records, examine them and make copies thereof to be kept by an accountable institution if it reasonably suspects the

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222 *MLPCA* s 25 is in line with article 3(1)(b)(i),(ii), 3(1)(c)(i),(ii) and(iii) of the *Vienna Convention* and article 6(1)(a)(i),(ii) and 6(1)(b)(i) of the *Palermo Convention*. They criminalise knowingly dealing with either in the form of transferring, acquiring, possession of or using assets or concealing the true nature, origin, location, ownership of assets derived from trafficking or ML activities. It also criminalises the harbouring of persons who participated in the acts of ML/TF with the purpose to evade the law. Financing of terrorism is criminalised in Part IV of *MLPCA*. It provides extensively for the seizure and detention of terrorist funds and property.

223 Lesotho government ministries also play an important role in combating money laundering and terrorist financing. In particular, the ministry of finance oversees AML/CTF framework formulation and the supervision of any institutions vested with carrying out AML/CTF implementation programmes. The Ministry of Home Affairs and Public Safety coordinates human trafficking related issues and AML/CTF measures as part of its responsibility towards public safety, immigration, and passport services and aliens control. Furthermore, the Ministry of Foreign Affairs and International Relations is tasked with amongst others, the facilitation of international cooperation and relations.

224 *MLPCA* s 11(1).

225 *MLPCA* s 11(3).

226 *MLPCA* s 29. It is the court's discretion whether to grant the search warrant or not and this discretion is subject to the court being satisfied that the accountable institution failed to keep records or report suspicious transactions as obliged to under the Act.

commission of an offence under the Act that could be solved by information contained in the records.[227] To ensure the DCEO exercises its right to access, the accountable institution is under a duty to provide the necessary assistance in this regard and this includes the furnishing of all information the authority may require. Failure to comply exposes the accountable institution to a punishable offence in terms of which it will be liable to a fine of not less than M 100 000.00 or an imprisonment term of up to 10 years.[228]

Another critical component of Lesotho's AML/CFT strategy is the creation of the Financial Intelligence Unit (FIU)[229] which is a specialised law enforcement agency vested with the power to receive, analyse and disseminate information relating to ML/TF activities to law enforcement agencies which will then carry out the requisite investigations in terms of section 15. Central to its mandate is to devise and issue guidelines and training programmes relating to AML/CTF to accountable institutions.[230]

Over and above the establishment of these two authorities as just seen above in response to ML/TF, the *MLPCA* places duties on accountable institutions and adopts a three-legged approach to ML/TF in that respect. That is, the verification of customers' identity, record keeping and the reporting of suspicious transactions.

As part of its verification of customers' identity obligation, accountable institutions must ascertain, using identity documents, the names and addresses of customers who are natural persons, as well as their occupation.[231] On the other hand, where the customer is a corporate body, it is the duty of the accountable institution to confirm its name and that of the person purporting to act on its behalf, its business address and that of its directors as well as its legal status.[232]

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227 *MLPCA* s 12.
228 *MLPCA* s 13(4).
229 *MLPCA* s 14.
230 Since the adoption of the *MLPCA* in 2008, its implementation has been slow because the country is still very new to the concept of money laundering. The FIU was not yet fully equipped in terms of adequate resources and personnel expertise to enable it to implement the provisions of the Act until 2017.
231 *MLPCA* s 16(1)(b).
232 *MLPCA* s 16(1)(b), (c).

Assessors of the ESAALMG Mutual Evaluation of Lesotho[233] opine that the same level of screening is not required when the accountable institution is establishing a business relationship as it is only required that the nature and purpose of that relationship is revealed.[234] They draw a conclusion that this evidences a weakness in the Act and failure to adhere to *FATF Recommendations*[235] which require customer due diligence through customer identity verification to be applied on every customer in respect of every dealing he may have.

However, the Finmark Trust[236] assessors share a different view, with which I agree. In terms of section 16(1) (b), an obligation is placed on accountable institutions to identify customers whenever they transact. This process ought to reveal the name, address and occupation of the customer based on their identification document. It could not have been the intention of the legislature to deprive the word 'transaction' of its ordinary meaning which also encompasses the establishment of a business relationship between an accountable institution and a customer.[237] This view is reinforced in terms of section 6(2) and (3) of the *Financial Institutions (Anti-Money Laundering) Guidelines* of 2000 which oblige financial institutions to identify their customers based on an identification document when establishing business relationships or conducting transactions.

The second leg of the *MLPCA*'s approach to ML/TF is the duty of accountable institutions to keep customer records of suspicious transactions at least 5 years from the completion of the transaction or the termination of the business relationship.[238]

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233 The last ESAALMG Mutual Evaluation was conducted in Lesotho in 2010 and a report of its findings compiled in 2011. It is to this report that reference is made.

234 *MLPCA* s 16(1)(a).

235 *FATF Recommendation* 10(i). CDD is required when establishing business relations.

236 The Finmark Trust is an independent trust whose purpose is to promote financial inclusion and regional financial integration within the SADC.

237 Finmark Trust 2015 http://www.finmark.org.za/wpcontent/uploads/2016/01/Rep_AML_Country_Lesotho_2015.pdf.

238 *MLPCA* s 17(4). On the other hand, s 39(3)(b) of the *Financial Institutions Act* 2012 imposes the duty on financial institutions to keep records of suspicious transactions at least 10 years from the completion of a transaction. The nature of records kept under s 39 is broader than the nature of records kept under s 17. As a result, this overlap needs to be remedied. An Amendment Bill to the *MLPCA* 4 of 2008 has been drafted to cure this shortcoming but has not been passed into law yet.

These records must always be reflected in the true names of the customer and any documentary evidence of suspicious transactions must be retained.[239]

In terms of section 17(3), it is important for the records to reveal the names, address and occupation of the customer or those of the persons on whose behalf the transaction is made, as well as the nature and date of the transaction in question. The record must also make mention of the type of account held with the accountable institution that was involved and the amount of money involved in the transaction. The record must be signed off with the details of the representative of the accountable institution.

In pursuance of the above two obligations imposed on financial institutions, the *MLPCA* further places a duty to report suspicious transactions.[240] In terms of section 18, an accountable institution must, within a reasonable time of formulating a suspicion of a commission of ML/TF activity, take reasonable steps to ascertain the purpose of the transaction, origin and ultimate destination and beneficiary of the funds. It must then compile a report and furnish it with the FIU and the DCEO.[241]

It is necessary for the report to indicate the basis of the suspicion and must be signed by the accountable institution that must be ready to provide any further information relating to the reported matter as may be required by the FIU/DCEO. In order to incentivise accountable institutions to report suspicious transactions, the *MLPCA* offers protection to reporting parties from criminal and civil suits as it presumes the reports are bona fide.[242]

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239 *MLPCA* s 17(1),(2).

240 Although there is no obligation directly imposed on accountable institutions to continuously apply the CDD standard to customers, or to ensure that all records and information acquired during this process is up to date, it is required that particular attention should be paid to suspicious transactions. In terms of s 21 of *MLPCA,* these include all complex, unusual or large transactions which have no economic reason or lawful purpose. S 10 of the *Financial Institutions (Anti-Money Laundering) Guidelines of 2000* echoes s 21 of *MLPCA*.

241 This causes a duplicity of roles and may cause problems when these authorities have information that is not coordinated or deal with similar matters in different ways. Having more than one suspicious transactions reporting authority may make it difficult to assess progress of AML/CFT measures in compliance with international standards. Steps should be taken to ensure the FIU is the only authority endowed with the power to receive financial intelligence.

242 *MLPCA* ss 33 and 34.

Corollary to the duty to report to the FIU/DCEO is the establishment of an internal reporting procedure that creates an authority[243] to whom employees of the accountable institution will be accountable for compliance of the provisions of the *MLPCA*.[244] This procedure will help employees bring any information that raises suspicion for ML/TF activities to the attention of the accountable institution easily for its prompt action. This will help sieve relevant information that is ultimately sent to the authorities that accountable institutions were unable to address.

Within this internal reporting procedure framework, accountable institutions must make their employees aware of domestic AML/CFT legislation and provide training on how to appropriately deal with ML/TF transactions. Compliance with these measures must be monitored.[245]

5.2.2 CP&E of 1981

Part IV of the *MLPCA* grants police officers, subject to the provisions of the *CP&E*, the power to enter and search by warrant or occupier's consent, a person's premises and seize any property in pursuance of a reasonable suspicion of commission of a crime.[246] The Act places a duty on the police officer who has so seized property to keep it reasonably safe and make a monthly report to the authority on the status of the seized property.[247]

However, the *CP&E* overlaps with the *MLPCA* and thereby undermines its application owing to the different sentencing criteria. Under the *CP&E,* the only offences that attract a sentence of 10 years are murder, robbery, conspiracy, incitement or attempt to commit murder or robbery. Any other crime is sentenced subject to the discretion of the courts and may be suspended for 3 years.[248] This means that sentencing ML/TF crimes is subject to the courts' discretion and can be suspended for 3 years. On the

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243 *MLPCA* s 19(2). The compliance officer must be qualified and experienced to be such and must be responsible for creating and maintaining compliance procedures to which employees must always comply.
244 *MLPCA* s 19(1).
245 *MLPCA* s 20.
246 *MLPCA* s 56(1); ss 46, 47 and 52 *CP&E*.
247 *MLPCA* s 59.
248 Section 314(1), (2).

other hand, persons prosecuted under the *MLPCA* for ML/TF activities are liable to at least 10 years imprisonment or a M50 000 fine for natural persons or M500 000 for juristic persons.[249]

5.3 Gaps in the framework

Lesotho has come a long way in its mission to combat ML/TF and this is clear from the establishment of the *MLPCA*. However, there are shortcomings in this framework that hinder effectiveness of AML/CFT measures.[250]

5.3.1 Criminalisation of predicate crimes

During its on site visit to Lesotho in 2010, the ESAALMG[251] observed amongst others that Lesotho has a dual legal system that criminalises offences under both statutory law and common law. Owing to this nature, there may be overlaps in the treatment of certain offences. For example, predicate offences to ML are serious crimes subject to imprisonment of not less than 24 months under the *MLPCA*. Some common-law offences are not codified and their sentencing is subject to the discretion of the courts and it becomes uncertain what constitutes a predicate crime to ML. There is clearly a need for a clearer definition that does not depend on the sentencing threshold.

5.3.2 Criminalisation of terrorist financing

Another deficiency is that although Part IV of the Act criminalises financing terrorism, its application is narrow. This is because it acknowledges only the financing of terrorism perpetuated by a group and overlooks the fact that the funds may be used towards financing an individual terrorist.[252] This means that criminals supported by terrorist funds will go free under the Act if they do not act in concert. There is therefore

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249 *MLPCA* s 26(1).

250 It should be noted that these are gaps identified in 2010 up to 2015; in February 2017 government passed the *Money Laundering and Proceeds of Crime Amendment Act* 7 of 2016 in response to the gaps identified during the ESAALMG mutual evaluation. However, the effectiveness of this amendment Act in the combating of ML/TF in compliance with international standards has not yet been tested and for purposes of this research the gaps identifies during the last evaluation remain relevant.

251 ESAAMLG 2011 "Mutual Evaluation Report" 4.

252 ESAAMLG 2011 "Mutual Evaluation Report" 5.

a need for the inclusion of individual terrorist acts in order to strengthen Lesotho's AML/CFT framework.

In the same breath, the term of imprisonment for TF activities is not dissuasive, especially when compared with other countries in the region. In terms of section 65(4) of the *MLPCA*, contravention of the charging section 65(1) is subject to a fine of M10 000 or imprisonment of not less than 2 years. South Africa on the other hand, in terms of section 4 of *POCDATARA*, sentences TF to a R100 000 000 fine or imprisonment of 15 years. In order to deter commission of these offences, it is necessary to impose punishment that is commensurate to the seriousness of the crime. The sentencing criteria under the *MLPCA* is grossly disproportionate to the serious nature of financing terrorism and requires amending.

5.3.3 Freezing and seizing terrorist assets

The report also reveals that the *MLPCA* does not comply with *FATF Special Recommendation III* in terms of which countries are obliged to freeze and seize terrorist-related assets and also to adopt and implement measures that will enable authorities to exercise this duty. The *MLPCA* does not oblige accountable institutions to report the freezing of assets related to ML/TF activities. In terms of section 66 of the Act, an accountable institution may be required to freeze assets held by it on behalf of customers involved in terrorist activities. This provision is not specific enough and as a result does not fully comply with international standards.

5.3.4 Financial Intelligence Unit

Another loophole in Lesotho's AML/CFT framework is that although the Act establishes the Lesotho FIU reposed with the duty to receive, analyse and distribute financial intelligence to the relevant law enforcement agencies and the DCEO, it is not yet operational owing to a lack of resources and expertise. This means that accountable institutions are operating without supervision for AML/CFT compliance. It is noteworthy that even if it were operational, the *MLPCA* does not provide for how it should deal with non-compliance. This poor enforcement will not help the Act fulfil its purpose because then ML activities will continue without reprimand.

Owing to this operational limitation, the Commercial Crimes Unit of the Lesotho Mounted Police Services (LMPS) and the CBL receive financial intelligence. This results in a duplicity of roles and may cause problems when these authorities have information that does not synchronise or deal with similar matters in different ways. Dealing with more than one STR authority may make it difficult to assess the progress of AML/CFT measures in compliance with international standards. The FIU should be the only authority endowed with the above powers.[253]

5.3.5 Implementation of the MLPCA by financial institutions

Moreover, the evaluation report reveals that financial institutions have not yet adopted the *MLPCA* in their internal controls, despite the Act being in force since 2008. This makes it difficult to determine the effectiveness of AML/CFT measures in Lesotho. This is because, although the Act provides for various preventative measures including CDD, reporting obligations, correspondence banking relationships and the implementation of internal controls, it makes no difference in combating ML/TF if financial institutions do not implement these measures.

This is true especially in light of the fact that these institutions are the hub for these crimes at the outset. These institutions use AML Guidelines issued by the CBL and these have no legal effect. They also fail as "other enforceable means" in terms of the FATF standards.[254]

5.3.6 Customer Due Diligence

A loophole in the Act is also in the failure to require CDD by financial institutions while customers establish a business relationship. This is only required when customers transact. To comply with FATF standards, CDD applies to every customer and in respect of any undertakings. Another measure to reduce financial institutions'

253 ESAAMLG 2011 "Mutual Evaluation Report" 6.
254 ESAAMLG 2011 "Mutual Evaluation Report" 6.

exposure to ML/TF, especially banks, is to ensure that any foreign dealings with other banks or customers are strictly scrutinised.[255]

5.3.7 Online transactions

One other shortcoming is that the Act lacks specific measures dealing with ML/TF activities perpetuated through online transactions, in particular wire transfers. As will be remembered from the chapters above, the dawn of technological advancements has promoted more financial crime. It is therefore important for effective AML/CFT framework to encompass measures directly targeted at specific online transactions.[256]

5.3.8 Mutual legal assistance

Lesotho does not have an adequate mutual legal assistance framework. In cases where financial institutions in a foreign country have information related to ML/TF activities that Lesotho is interested in, mutual legal assistance is required to the extent that the act in question would be a crime in Lesotho if it had occurred there. The implication here is that foreign search and seizure warrants apply upon domestication. As a result, Lesotho should adopt a more detailed mutual legal assistance legislation.[257]

5.3.9 Record keeping

Moreover, it is a deficiency that the Act only requires the keeping and maintenance of records of suspicious transactions.[258] This is insufficient and contrary to FATF standards which require financial institutions to keep records of all customer records safely for a period of five years.[259] This helps in future, should there be any investigations against any of the customers as the audit trail will be clean. These records are to be disclosed timeously upon request on suspicion for ML/TF activities.

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255 ESAAMLG 2011"Mutual Evaluation Report" 8.

256 Finmark Trust 2015 http://www.finmark.org.za/wp-content/uploads/2016/01/Rep_AML_Country_Lesotho_2015.pdf.

257 FIU *Kingdom of Lesotho Anti-Money Laundering and Combating the Financing of Terrorism Regime: National Strategy* 14.

258 *MLPCA* s 17.

259 FATF *Recommendation* 11.

5.3.10 Exempted accountable institutions

The exemption of some financial institutions from the provisions of the *MLPCA* also poses a problem. The provision that only financial institutions licensed under the *Financial Institutions Act* can report transactions reasonably suspected to involve proceeds of ML/TF is flawed. This hampers the effectiveness of the Act because it means other non-reporting institutions will be used for ML activities.

5.3.11 Internal measures

Another flaw in the Act is the constriction of internal measures provisions.[260] It does not specifically require the establishment and maintenance of internal procedures and controls that directly address CDD, keeping of records and the detection of unusual and suspicious transactions to combat ML/TF. This is contrary to *FATF Recommendation* 18.[261] The Recommendation is to the effect that in order to combat ML/TF activities, it is necessary for a financial institution to implement an internal control framework that suits the size of the business and financial risk to which it is exposed .

This is to be applied to the employees of the institution itself to ensure that they are not involved in any illicit activities. To ensure that they are also not put in that position in future, they need to be regularly monitored and for this to happen, there must be a compliance mechanism in place. The framework must also be subject to an independent audit to ensure its effectiveness.

5.3.12 Statistics

As in the South African case as seen in chapter 4 above, it is generally difficult to assess the effectiveness of Lesotho's AML/CFT framework owing to a lack of comprehensive statistical information on the application of the measures in place. Lesotho has also failed to keep record of the investigations, prosecutions and

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260 *MLPCA* ss 19 and 20 require accountable institutions to adopt internal reporting procedures and refer to appropriate measures and training of employees, but this is not broad enough.

261 Finmark Trust 2015 http://www.finmark.org.za/wpcontent/uploads/2016/01/Rep_AML_Country_Lesotho_2015.pdf.

convictions of ML/TF crimes so it is difficult to say how these crimes have been dealt with.

5.4 Lesotho's response to gaps in its Anti-Money Laundering framework

I now turn to the changes Lesotho effected in efforts to address the weaknesses in its AML/CFT framework. After its last mutual evaluation, Lesotho has responded positively to the critique in its AML/CFT framework by implementing the *Money Laundering and Proceeds of Crime Amendment Act* 1 of 2016. The purpose of the Amendment Act is to address the deficiencies established by the ESAALMG mutual evaluation report in order to strengthen Lesotho's AML/CFT framework and to bring the principal law in compliance with international standards in the fight against ML/TF.[262]

The new Act thus incorporates provisions that enable the independent operation of the FIU in line with *FATF Recommendation* 29. This strengthens Lesotho's AML/CFT framework because financial institutions will now be supervised for compliance with AML/CFT measures during their operations. Although this institution was created under the principal Act, it has not been operational.

The Act also broadens in terms of sections 20 and 29 the criminalisation of ML/TF by allowing an inference of the intention and knowledge to commit these crimes to be drawn from the surrounding facts of an issue. Moreover, it criminalises ML/TF activities that did not happen within Lesotho. In this way, many criminals are brought to justice and ultimately ML/TF activities are reduced.

Moreover, the Act improves criminal sanctions for non-compliance with its provisions that are to be applied proportionately and dissuasively. In terms of section 18D, it also imposes civil and administrative sanctions on financial institutions to foster compliance with measures and obligations under the Act regardless of whether criminal sanctions have also been imposed on them or not. This serves as an incentive to ensure an effective implementation of the Act into the internal control measures of financial

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262 GN 51 in GG 73 of 23 December 2016.

institutions. As a result, they will be in a better position to detect suspicious activities easily and adopt appropriate measures.

In order to address the risk posed by ML/TF, the Act enhances preventative measures to be implemented by financial institutions in terms of section 16. These measures include but are not limited to any measure that limit the possibility of the manipulation of technology to encourage ML/TF activities. Financial institutions are also obliged to adopt internal policies targeted at different risk levels of ML/TF activities in order to counter them appropriately. This risk-based approach will save time and administrative costs. It is also important to keep training employees of financial institutions because ML/TF trends are volatile and if these crimes are to be combated, financial institutions are to always be aware of the change in trends and have ways to deal with them.

It will be remembered from above that there was an uncertainty with regard to whether CDD standards are required when establishing a business relationship between financial institutions and their customers. Section 11 of the new Act remedies this deficiency in terms of which CDD standards are applied whenever a customer transacts occasionally, establishes a business relationship or carries out a wire transfer. An even application of CDD standards across every customer regardless of the nature of their undertaking with the financial institution makes it easier to detect ML/TF activities, while on the other hand excluding certain undertakings promotes the concealment of these activities and the proceeds thereof.

The same standards imposed by section 11 extend to the identification and verification of a beneficial owner of the customer of the financial institution. The rationale is to get to know customers better because they hide behind corporate entities to perpetuate their illicit activities. To enable financial institutions to do this, they must gather all the information of the beneficial owner and undertake an on-going monitoring process to ensure their records are up to date at all times.

The Act also introduces under section 11 the necessity of undertaking a more intensive CDD procedure when the customer or beneficial owner is a PEP. It is worth noting that different risk control measures apply to a domestic and foreign PEP with the latter classified as posing a much higher risk than the former. The measures used to carry

out CDD against PEPs include acquiring managerial consent before any business relationship is established or continued with a PEP, in which case regular monitoring of the relationship is required.

Over and above this, it is the financial institution's duty to investigate this kind of a customer's source of income. Generally, the Act introduces a risk-based approach to ML/TF in terms of a more intensive CDD applied to high-risk customers and a lesser intensive standard applied to low risk customers.

The *MLPCA Amendment Act* also ushers in a broader treatment of the financial institutions' duty of the establishment and keeping of customer records in terms of section 12. Financial institutions are obliged to keep up to date records and information especially of high-risk customers for a period of 5 years or more as requested by the ML/TF authority from the date of completion of the transaction or business relationship.

In terms of the new Act, the power that vested solely in the DCEO to investigate ML/TF activities in the principal Act is now spread across the Lesotho Revenue Authority and the LMPS. Moreover, the Act vests the FIU and related institutions with the power to supervise and monitor compliance by financial institutions.

To determine whether the new Act is effective, in 2017 FATF carried out a post evaluation progress process and decided that Lesotho's AML/CFT framework remains flawed in some aspects despite the implementation of the *MLPC Amendment Act* and the *Money Laundering and Proceeds of Crime Regulations*. The Post Evaluation Progress Report of Lesotho[263] indicates that Lesotho has still not fully implemented the Vienna and Palermo Conventions.

It fails to put mutual legal assistance measures in place in response to international cooperation obligations under these Conventions, despite section 6(h) of the amendment Act empowering investigating officers to take statements on behalf of foreign states. This is because in order for the section to be enforceable, several other

263 Assessment of progress from August 2016 to July 2017.

laws need amending and this has not been done, although the process of amendment is ongoing.[264]

This weakness also translates to the inability of Lesotho to exchange information with other countries. The *Prevention of Corruption and Economic Crimes Act* as the empowering Act of the DCEO fails to explicitly require it to enter MOUs with other foreign money laundering authorities similar to it in order to exchange information. This further hampers Lesotho's international obligation to cooperate in the fight against ML/TF through sharing information. There is therefore a need to amend this Act.[265]

One of the weaknesses that persist is the duplicity of roles of the anti-money laundering authority.[266] The FIU shares the power to receive financial intelligence and the investigation of suspicious activities with the DCEO and LMPS and this is a challenge for financial institutions as this imposes double obligations. It follows that the *MLPCA* and *Prevention of Corruption and Economic Crimes Act* need to be harmonised in this regard. Moreover, the FIU remains not operational owing to a lack of resources and personnel. This is disadvantageous because financial institutions operate without supervision and ML/TF activities will go unpunished.

Lesotho has not fully implemented a system for the collection of statistical data in respect of the investigation, prosecution and conviction of ML/TF related activities.[267] This makes it difficult to assess the effectiveness of its AML/CFT framework and it exposes financial institutions to more risk, as they will not be in a position to mitigate it appropriately if they do not know what the weaknesses in the existing framework are. There is an ongoing plan to address this but the more it delays the more detriment to financial institutions.

Another issue that remains is the implementation of measures that will make the management of confiscated assets on suspicion of ML/TF related activities easy. There

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264 ESAAMLG 2017 "Post Evaluation Progress Report" 4-5.
265 ESAAMLG 2017 "Post Evaluation Report" 4, 6.
266 ESAAMLG 2017 "Post Evaluation Report" 8.
267 ESAAMLG 2017 "Post Evaluation Report" 10.

is an ongoing UNODC[268] based plan to improve the asset recovery framework but this is not yet enforceable. This plan also includes mobilising resources to enable law enforcement agencies to utilise specialised techniques in the investigation of ML/TF related activities.

Lesotho also still lacks a specific counter terrorist financing framework that aims to monitor Non Profit Organisations in compliance with international standards.[269] This is important because they are susceptible to operation as front organisations by terrorist financiers and not regulating them specifically opens room for illicit activities.

5.5 Conclusion

Following the gaps that still exist in Lesotho's AML/CFT framework despite the implementation of the *MLPC Amendment Act* and its Regulations, it is evident that the country is not fully compliant with international ML/TF standards. As such, it remains vulnerable to ML/TF activities that hamper its economic growth. As a result, ESAAMLG has recommended that Lesotho implement all ongoing plans as soon as possible and address all these outstanding issues. Whether this Act will eventually achieve its goal in the fight against ML/TF is dependent on the changes Lesotho will make in response to the progress report.

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268 https://www.unodc.org/southernafrica/en/sa/about.html. UNODC oversees the global fight against the trade in illicit drugs, corruption and financial crime. It ensures the *Palermo Convention* and *Vienna Convention* are implemented across the globe, thus strengthening the legislative and judicial capacity of countries.

269 ESAAMLG 2017 "Post Evaluation Report" 10.

CHAPTER 6
CONCLUSIONS AND RECOMMENDATIONS

6.1 Introduction

The objectives of this research have been to understand the rationale behind money laundering and its ultimate impact together with terrorist financing as its predicate crime and stand-alone crime, on the financial sector of an individual country's economy and the global economy in general. This was achieved through a detailed analysis of the concept of money laundering and the techniques used therein. The analysis revealed that banks are the primary hub through which the money laundering process occurs without detection owing to the duty placed on banks to keep customer information confidential. The basis of this duty is to offer protection against unlawful access to confidential information of customers from third parties.

To understand the relevance of the duty of confidentiality in the perpetuation of money laundering, financing of terrorism and other financial crimes, it was necessary to carry out a historical overview of the bank's duty of confidentiality to its customers. It was found and concluded that indeed banks play a major role in money laundering and financing of terrorism and out of the number of ways in which these crimes are combated, lifting banking confidentiality has proven to be the centrepiece of these strategies.

This is because the knowledge that banks are duty-bound not to disclose customer information makes it easy for perpetrators to transfer all sorts of money including illicit monies across borders through the financial system channels, thus allowing money laundering to flourish.[270] As a result, it makes sense to uproot the problem of money laundering from its very source before it can spread across other sectors of the economy and there is no better way in which to achieve this, except through lifting banking confidentiality.

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[270] Ping 2004 *Journal of Money Laundering* 377.

It is noteworthy that lifting banking confidentiality does not underestimate the importance of banks upholding the duty of confidentiality they owe to their customers because their operational reputation depends on it.[271] However, the global financial sector integrity and stability are equally important.[272] This is especially relevant in the dawn of globalisation that makes trade and the transfer of monies across borders very easy. This is because the more trade barriers are removed between jurisdictions, the more difficult it is to trace assets.

This provides criminals with a perfect opportunity to engage in their illicit activities that eventually erode the legitimate global economy. Therefore, to avoid this from happening, it is necessary to lift banking confidentiality to the extent that it enables the disclosure of customer information that is useful in the investigation, prosecution and conviction of money laundering and terrorist financing activities.

Thus, this duty is lifted in terms of the common law as enunciated in *Tournier*[273] in instances where disclosure is required by law, arises out of a duty to the public to disclose, the interests of the bank require such disclosure and where the customer himself gives express or implied consent for the disclosure of his confidential information. *FICA* and the *MLPCA* have codified these exceptions, and as a result, they lift banking confidentiality. In terms of sections 37 and 32 thereof respectively, no matter how it vests, the duty of confidentiality of a bank does not restrict the disclosure of information. This disclosure is in the form of reports of suspicious activities by financial institutions to anti-money laundering authorities in South Africa and Lesotho. To ensure the effectiveness of these sections, both Acts offer immunity from civil and criminal prosecution as protection to persons who report.

It follows therefore that the excessive CDD and reporting duties vested in financial institutions by *FICA* and the *MLPCA* fall under the exceptions to banking confidentiality. One may classify them under the compulsion by law or duty to the public to disclose exceptions. As a result, there can be no breach of banking confidentiality under *FICA*

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271 Ismail 2008 *Codicillus* 3.
272 Pasley 2002 *North Carolina Banking Institute* 148.
273 [1924] 1 KB 471.

and the *MLPCA* and related legislation as long as the reporting and disclosure of information is *bona fide* and in strict compliance with the procedures laid down by *FICA* and the *MLPCA.*

However, with respect to the above-mentioned analysis, one gathers that although banking confidentiality is being violated in terms of *FICA* and the *MLPCA* at the expense of an individual customer, it is essentially for the greater good of society and the international community on the basis of combating money laundering, and as such it is justified.[274]

Following this inference, a pertinent question may arise whether banking confidentiality still exists. In both South Africa and Lesotho there has not been a judgement renouncing the existence of this duty since it was first recognised in their respective jurisdictions. As a result, it always applies with respect to a bank customer relationship until an exception thereto is invoked.[275] Thus, one may draw a conclusion that South Africa and Lesotho protect customer information vested with the banks in confidence subject to the common-law exceptions to banking confidentiality as codified and extended by *FICA* and the *MLPCA*.

This means that these Acts merely limit banking confidentiality, but it continues to exist in South Africa and Lesotho in the absence of the exceptions being invoked. However, it can also not be denied that with the ever-changing money laundering trends, this will call on the need to constantly amend anti-money laundering and counter-terrorist financing laws and this will have a greater impact on banking confidentiality that is already limited and may eventually be forced into extinction.[276]

To illustrate this, owing to globalisation, there is easy transfer of workers across jurisdictions, which means more money is remitted home, but since it is not always easy to open a bank account in a foreign country especially when one has an informal

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274 Godfrey *et al* 2016 *Business Law International* 196; in *FirstRand Bank Ltd v Chaucer Publications (Pty) Ltd* 2008 2 SA 592 (C) para 20 the court stated that banking confidentiality is superseded by a greater public interest.

275 Godfrey et al 2016 *Business Law International* 197.

276 Van der Walt 2012 http://www.thesait.org.za/news/103563/Opinion-Bank-secrecy--the-difference-between-theory-and-reality.htm

job and lacks proper documentation, some of these people will not use the legitimate financial system. As a result, they find alternative remittance systems that may at times be illegitimate and this increases money laundering as funds become difficult to trace. This obviously poses a threat to the financial sector, specifically to banks and to counter it requires resources and specialised techniques. With the constant push for transparency in efforts to minimise financial risks of banks through vigorous AML/CFT regulations comes the diminishment of banking confidentiality and rise of illicit activities.[277]

As a result, one may conclude that, although anti-money laundering and counter terrorist financing regulations positively influence the banking sectors of individual countries and of the globe at large, they are a negative development that does away with one of the core duties banks owe to their customers. Therefore, these regulations should be removed in the interests of the privacy of customers. This conclusion would however be wrong. This is because customers are aware that in this era of globalisation and technological advancements, it is necessary to protect them and the financial sector as a whole from financial crime by all means necessary, even if this means limiting their privacy.

Furthermore, it would be unwise to remove these regulations because as with any other regulation, the implementation of AML/CFT regulations has been exposed to poor implementation for various reasons as seen in this research. This however does not mean the regulations are a negative development; instead, they fail owing to factors such as poor enforcement, lack of cross-border cooperation between relevant authorities, lack of statistical data and information on the investigation and lack of prosecution and conviction of ML/TF related activities. All these factors hamper the actual effectiveness and assessment of the effectiveness of the AML/CFT framework.

Some of these problems speak directly to the challenges faced in the effective implementation of AML/CFT frameworks of South Africa and Lesotho as indicated in the FATF mutual evaluation reports in 2009 and 2010 respectively. Instead of

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277 Peterson 2013 *Journal of Strategic Security* 304-305.

abandoning the regulations, *FICA* and the *MLPCA* were amended. In the case of South Africa, the amendments have worked and FATF has declared its AML/CFT framework satisfactory and in line with international standards. This means that AML/CFT framework in South Africa is a positive development; it only experienced problems before that are now rectified.

In respect of Lesotho, FATF carried out a post-evaluation progress process and found Lesotho's AML/CFT framework still unsatisfactory.[278] This is because many issues indicated in its mutual evaluation report back in 2010 remain unaddressed despite the implementation of the *MLPC Amendment Act* and its regulations. It follows therefore that Lesotho can draw lessons from the South African AML/CFT framework. I deal with some of the changes it can implement with specificity below, as they are the main issues pointed out in the recommendation of the progress report.

6.2 Recommendations

Firstly, in South Africa the FIC is the sole and independent money laundering authority. It works hand in hand with the supervisory body through entering MOUs that enable the exchange of information between the two bodies, thus making the exercise of their duties easier. This cooperation helps in the effective and consistent implementation of *FICA* as it avoids any overlapping of obligations.[279] Lesotho needs to harmonise its laws such that the FIU is the only money laundering authority and it should work in cooperation with both the DCEO and LMPS to avoid an overlap of duties. This will make a clearer and comprehensive AML/CFT framework.

In order to address the implementation of an asset recovery framework, Lesotho needs to follow South Africa's example and establish a separate criminal assets recovery account under the stewardship of the revenue authority.[280] This account will hold property that is confiscated following investigations for ML/TF related activities. This is a necessary step to take and will strengthen Lesotho's AML/CFT framework, as it will deter criminals from continuing their operations from fear of confiscation of their

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278 FATF 2017 "Post-Evaluation Report" 11.
279 FIC Amendment Act s 31.
280 *POCA* s 63 establishes the criminal assets recovery account.

assets or proceeds thereof. A criminal assets recovery committee must also be established to manage these assets.[281]

A lack of specific provisions enabling Lesotho to acquire or provide mutual legal assistance hampers its international law obligations. This is because as stated earlier globalisation has increased financial crime and in order for it to be countered, there is a need for international cooperation. This is because no one state has the power under international law to enter the territory of another state and undertake investigations or prosecute any person therein. There is therefore a need for mutual legal assistance measures in place for an AML/CFT framework to be effective.

Lesotho needs to follow South Africa's example and implement an equivalent of the *International Co-Operation in Criminal Matters Act* 75 of 1996. This Act enables the mutual exchange of ML/TF information, execution of convictions, exchange of confiscated property and proceeds thereof between South Africa and the international community.[282]

An effective mutual legal assistance framework also consists of comprehensive extradition laws that deal with foreign offenders. Lesotho needs to amend its *Fugitives Offenders Act* 38 of 1967 in line with the *Commonwealth Scheme for the Rendition of Fugitive Offenders* of 1990 and implement an equivalent of South Africa's *Extradition Act* 67 of 1962. This will enable an easy transfer of criminals from one state to another, thus helping Lesotho fulfil its international cooperation obligations.

6.3 General conclusion

From the above it is clear that government, with the help of accountable institutions, is the primary custodian of financial integrity. Thus, it bears the responsibility to ensure the eradication of financial crime through the creation of a conducive environment in the financial sector to discourage the perpetuation of ML/TF activities. This includes the establishment of an AML/CFT framework within a country and the promotion of

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281 *POCA* s 65 creates a criminal assets recovery committee vested with power to manage confiscated assets.

282 Watney 2012 *PELJ* 294-569.

inter-agency cooperation and international cooperation that is necessary in the free and expeditious exchange of relevant and accurate information in respect of ML/TF activities to enhance the effectiveness of AML/CFT measures. However, while doing so, governments through financial institutions essentially limit banking confidentiality.

The research thus finds that there is satisfactory AML/CFT framework in place in South Africa after the implementation of the *FICA Amendment Act* 1 of 2017 and amendments to its regulations, in compliance with international standards. At the core of its AML/CFT framework is the identification and verification of customers, record keeping and the reporting of unusual and suspicious transactions by accountable institutions. It further finds that Lesotho's framework is not satisfactory despite the implementation of *MLPCA Amendment Act* 7 of 2016 together with its regulations.

Nonetheless, these changes evidence, just as is the case with South Africa, Lesotho's commitment to eradicate ML/TF and other financial crimes. These changes, together with the many more not discussed herein, enable financial institutions to assess and manage their risks more flexibly and in a cost and administrative effective manner.

More importantly, the *Amendment Acts* will encourage trade and investment in South Africa and Lesotho, thus helping in economic growth because they provide for a more stable financial sector at par with the international financial system and this attracts the international community. In the case of Lesotho however, this will be the case provided the necessary changes are made in terms of the progress report. Lesotho should also mimic South Africa's framework. It is worth noting that the ongoing effectiveness of these new Acts requires regular monitoring.

In order for this to happen, it is necessary that South Africa and Lesotho keep records of statistical data on the investigation, prosecution and conviction of ML/TF activities as well as information of customers and reports made and received by the relevant authorities. This will make it easy to assess the effectiveness of these Acts in combating ML and countering TF in future. As a result, it will be equally easy to determine areas that still need addressing, particularly in the case of Lesotho where a great deal still needs to be done, as seen in the research.

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