

Money laundering in East and Southern Africa: An overview of the threat



Charles Goredema
Institute for Security Studies

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INTRODUCTION

Much has been written during the last decade or so concerning the phenomenon of money laundering, both as a manifestation of organised criminal activity and as a catalyst to it. Against the background of much-publicised outrages, the most graphic of which was the attack on New York's Twin Towers on 11 September 2001, attention is beginning to turn to the connection between money laundering and terrorism. There seems to be consensus that money laundering is a universal phenomenon, and further, that it is both iniquitous and problematic. Nevertheless, it remains a relatively understudied problem in East and Southern Africa. There is not much data on the nature, varieties, and extent of money laundering in the region. This may partly account for the lethargy, evident in certain parts of the region, which invalidates the adoption or prevents the implementation of effective measures to remedy the macroeconomic and structural weaknesses conducive to money laundering.

This preliminary overview is an attempt to contribute to an understanding of the dimensions of money laundering in the countries which comprise the East and Southern African Anti-Money Laundering Group (ESAAMLG). These are Botswana, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Namibia, the Seychelles, South Africa, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe.¹ The overview is mainly based on observations and perceptions recorded in the first six months of 2002 by researchers commissioned by the Institute for Security Studies. The study was premised on certain assumptions, and the report does not endeavour to discuss their validity in detail. The key assumption is that money laundering is of strategic importance to organised crime generally, and to

corruption in particular. A second assumption is that organised economic crime of one form or another exists in most of the ESAAMLG countries. Specific forms of organised crime that have been linked to money laundering include drug trafficking, armed robbery, tax evasion or customs fraud, exchange control evasion, and motor vehicle theft. A third assumption is that serious corruption plagues virtually every country in the region.

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The report commences with a profile of the definition of money laundering as a distinct crime. It then outlines the strategic importance of money laundering, and discusses laundering patterns within the ESAAMLG region from three different, but related, perspectives—the internal, incoming and outgoing. It refers to several examples of money laundering, drawn from the region, and concludes with an

attempt to quantify the scale of the threat that the practice presents.

THE EVOLVING DEFINITION

Money laundering, as a proscribed activity, was originally perceived to be a derivative offence, defined in terms of the origin of the money to be concealed, converted or otherwise processed. In his work on money laundering, Smit provides a useful starting point. According to him:

Money laundering aims to thwart the enforcement of criminal law by creating the justification for controlling or possessing *money or property derived from any form of criminal activity*. It is *defined* as all activities aimed at disguising or concealing the nature or source of, or entitlement to money or property derived from criminal activities.² (Emphasis added.)

Immediately apparent in Smit's propositions is that the term 'money' as a descriptive tag for the object of laundering is potentially misleading, as money is only one of a variety of susceptible assets. 'Asset laundering' would probably be a more accurate term, as all forms of property are envisaged. Experience has demonstrated that it is more difficult to define 'laundering'.

Various formulations have emerged, only to be superseded in due course.³ Among them is the original definition adopted by the Financial Action Task Force on Money Laundering (FATF), namely that laundering is the processing of criminal proceeds to disguise their origins. Subsequent to FATF, the United Nations Convention Against Transnational Organised Crime (the Palermo Convention) came up with the modified view that laundering is the concealment of the proceeds of *serious* crime, as determined by the potential sentence. Serious crime is crime punishable by at least four years' imprisonment. The implications of this attenuated conceptualisation for fledgling transnational initiatives against money laundering have yet to be fully considered, but they would appear to be quite grave. In the wake of the atrocities of 11 September 2001, the FATF definition was broadened to embrace the destination of assets as a source of liability. The new definition is adapted from the United Nations Convention on the Suppression of Funding of Terrorism (1999). It perceives laundering as including the concealment of assets to be used in, or to facilitate, the commission of crime.

The study on which this report is based accepted 'money laundering' to mean:⁴

all activities to disguise or conceal the nature or source of, or entitlement to money or property, or rights to either, being money or property or rights acquired from serious economic crime or corruption, as well as all activities to disguise or conceal money or property that is intended to be used in committing, or to facilitate the commission of serious crime.

Unlike the Palermo Convention, the study did not ascribe a meaning to the term 'serious'. In essence, the definition of money laundering included economic and non-economic misconduct, even if it was punishable by less than four years' imprisonment. It was believed that this would ensure that certain iniquitous conduct would not be unjustifiably defined out of the study.

Regardless of the definition adopted, there is consensus that systematic (rather than haphazard) money laundering usually has a traceable pattern, comprising:

- *the placement stage*, where the illegitimately acquired or destined assets are placed in the financial system;

- *the layering stage*, where numerous transactions are carried out with the assets or proceeds; and
- *the integration stage*, where the product of placement and layering is placed at the disposal of the criminal or prospective criminal.

Not every variety of money laundering surveyed in this report neatly demonstrates the three stages of the above model. It should also be pointed out that the stages are not cumulative constituent elements of money laundering, in the sense that they should all exist before the offence may be deemed to have been committed. The commission of any one of them may be sufficient for guilt to exist. It is, however, improbable that layering or integration could occur without placement having preceded them. As becomes apparent in the discussion of the three dimensions of laundering below, there may be cases where laundering is committed even before the placement stage.

A study of money laundering trends requires an appreciation of the strategic importance of the phenomenon.

As far as the criminal world is concerned, many of its qualities make it strategically important.

First, laundering can make it difficult to detect the underlying criminal activity that generates the profits.⁵ Second, laundering can sustain the enjoyment of the profits from crime or their reinvestment in future criminal activities. With time, it enhances professionalism in both the structure and operation of criminal syndicates, with managers and the financially astute ascending to the top. Third, it facilitates the development of transnational networks and linkages with criminal environments of disparate origins. Law enforcement authorities in many parts of the world have come to the conclusion that by combating

money laundering activities they can disrupt the cycle used by criminal groups to derive benefits from illegal profits, and thereby weaken or even destroy their viability. If the primary motivation behind syndicated crime is economic, and the economic gain is removed, the crime will cease.

Outside organised crime circles, money laundering serves certain investment objectives. It may speed up the acquisition of assets, or facilitate access to new commercial opportunities. Finally, it enables the launderer to take advantage of certain economic systems and transient circumstances or situations. In the context of the fragile socio-economic systems prevailing in much of the ESSAMLG region, these are significant considerations.

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TYPOLOGIES

It is convenient to consider the patterns of money laundering within ESSAMLG as consisting of three dimensions. These are:

- **Internal money laundering:** characterised by the laundering of proceeds of crime committed within a given country or assets to be used in committing crime there;
- **Incoming money laundering:** in which the assets laundered are derived from crime committed outside the country, and thereafter introduced into the country; and
- **Outgoing money laundering:** in which the proceeds of crimes committed within the country are exported (to one or more countries) for laundering.

Placement can occur in any of the three dimensions of laundering. So can layering and integration of the laundered assets. It is clear that in the case of internal laundering, all three phases would occur in the same jurisdiction. Where laundering is incoming, the assets may have been kept out of the formal institutions until their introduction into the jurisdiction in which placement is to occur. The same could apply to outgoing laundering. Subsequent to acquisition of the proceeds of crime, the launderer may conceal them, with a view to smuggling them to a foreign jurisdiction. The concealment *per se* constitutes laundering, even though it precedes placement in any financial or commercial system.

The study revealed the incidence of various kinds of laundering activity within each dimension.

Internal money laundering

The clandestine nature of money laundering makes it difficult to obtain accurate statistics on its scale and frequency. Commentators tend to rely on indicators and anecdotal evidence to draw conclusions about the incidence of laundering. Some of the indicators identified include the number of organised criminal groups identified by law enforcement authorities, the nature of the activity in which they engage, the number of suspicious transactions identified by financial institutions (where such transactions are recorded), the prosecutions for money laundering activities and forfeitures of the proceeds of criminal activities, and trends in trade and the flow of funds.⁶ The nature and incidence of organised economic crime are of particular utility, insofar as they highlight sources of proceeds to be laundered.

The trade in illicit drugs

Drug trafficking is identified most readily with money laundering virtually everywhere in the region. *Dagga* and mandrax (methaqualone) sales tend to feature prominently among the sources of illegal funds, but these narcotics are by no means the only ones familiar to crime syndicates. Significant sums are also generated from sales of cocaine, heroin and ecstasy. The drug industry is known to influence trends in 'downstream' crimes, notably motor vehicle theft, housebreaking and armed robbery. Because it is an industry which involves a range of participants, it is necessary to identify the important roleplayers for the purposes of money laundering. Studies of the *dagga* market in South Africa have identified a chain of entrepreneurs that includes small (subsistence) farmers, transporters, wholesalers, retailers, vendors (some operating off the street) and exporters. It appears that in the market chain,

the wholesaler makes the most money. Although his mark up [sic] is less than that of the retailer, the quantities in which he deals are much larger. Most poorly paid are the producer and the street dealer, who work for subsistence-level income. At no point in the domestic market chain is much money made, however, as the market is too diffuse and the unit cost too small. The real market is in export.⁷

Wholesalers are therefore best positioned to participate in significant money laundering from local *dagga* sales.

At its profitable levels, drug trafficking is cash intensive. Drug dealers usually rely on cash as a primary medium of exchange. Drug traffickers accumulate huge amounts of cash that must be hidden and converted to avoid detection of drug activity. They share at least three characteristics across the region:

- they need to conceal the origins and often the ownership of the money;
- they need to control the money; and
- they need to change the form of the money.

Money laundering is therefore an attractive option. In Malawi, drug trafficking continues to increase. *Dagga*, technically referred to as Indian hemp, is mainly grown in the northern part of Malawi around the town of Nkhotakota. From Nkhotakota the drug is transported to the cities of Blantyre and Lilongwe. Some is sold there and the funds are used to purchase basic and luxury commodities. Much of it, however, is exported to foreign jurisdictions, mainly Zimbabwe, Namibia and South Africa, for sale.

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The drug market in South Africa is the largest in the region. At the end of June 2002, two 'busts', in Douglassdale, north of Johannesburg, and in Roodepoort on the West Rand, yielded massive seizures of *dagga*, cocaine, ecstasy, mandrax and chemicals for the manufacture of mandrax. The haul was valued at R2.7 billion (US\$270 million). More than 100 syndicates are known to be active in the drug trafficking industry in South Africa. It appears that most of them launder their assets locally, in the acquisition of motor vehicles, legitimate businesses and front companies and residential properties. Asset seizures during the past twelve months give an indication of the scale of laundering of drug money. In June 2002, the Asset Forfeiture Unit of the National Prosecuting Authority reported that of the 150 cases in which assets had been seized,⁸ 31% involved drug trafficking.

The inclination of retail businesses in many countries to conduct transactions in cash facilitates the local laundering of funds derived from drug sales. Signs reading "Strictly no cheques accepted" or "Only cash or bank certified/guaranteed cheques" are a common sight in Malawi, Kenya, Tanzania, Uganda, Zambia and Zimbabwe. This makes it convenient for criminals to purchase commodities from these businesses without fear that the source of the cash will be detected. Large amounts of cash, some derived from drug trafficking, regularly change hands in the commercial districts of Mozambique and Zimbabwe. The advent of hyperinflation in Zimbabwe exacerbates the vulnerability of commerce to money laundering. Retailers involved in evading tax, for instance, are unlikely to report retail transactions involving tainted funds. It has been observed that retailers in Malawi generally do not issue receipts.⁹

Investment in motor vehicles is a common avenue for laundering illicit funds. Dealers in this industry in the majority of ESAAMLG countries are not under any responsibility to report any transaction to the police or anyone else merely because they are suspicious about the source of the funds. Any individual can buy a motor vehicle from a dealer with cash, whether legitimately or illegitimately acquired. In Malawi, a recent survey showed that no identity particulars are required in motor vehicle purchasing.¹⁰ One can easily buy a vehicle under a fictitious name. Several motor vehicle dealers did not even know what money laundering entails. Although figures are not available at this stage, it is probable that a significant proportion of motor vehicle sales in the region involve 'dirty' money. Vehicles usually bought are lorries, minibuses and pickups.

Drug merchants also use legitimate bank accounts of family members or third parties to de-link proceeds from underlying illegalities. In some schemes this is done with the connivance of the family member or third party, who allows the criminal to deposit and withdraw money from his or her account. In South Africa, the Centre for the Study of Economic Crime found that:¹¹

Criminals sometimes deposit money into their own bank accounts, but more sophisticated criminals will often open accounts with false identification documentation or will open these in the names of front companies or trusts. There is also a trend of using legitimate bank accounts of family members or third parties. An arrangement would be made with a family member who will allow the criminal to deposit and withdraw money from his or her account. In subsequent investigations, the family member will invariably plead ignorance of the true nature of the funds that were deposited. (Footnotes in the original have been omitted.)

Drug traffickers accumulate huge amounts of cash that must be hidden and converted to avoid detection of drug activity

Zambia's Drug Enforcement Commission has recorded instances of drug traffickers who use fictitious identity documents, or the identity particulars of third parties without their consent, to open and operate bank accounts. The accounts can subsequently be used to fund further crime, or as repositories of funds for outward laundering.¹²

Drug traffickers also use business entities, notably shell companies and front companies, to legitimise dealings in illicitly obtained funds. Shell companies are distinct from front companies in that they do not trade, but they can be used to open and operate accounts with financial institutions, such as banks and insurance houses. In the region, it is relatively easy to incorporate a shell company. In South Africa, the cost is as little as R450. Front companies, on the other hand, are identifiable trading concerns, used as a medium through which to infuse criminal proceeds into the financial system. They are frequently companies operating cash-based outlets such as shebeens, restaurants, cash loan businesses, and cellphone shops. In Namibia, South Africa and Zambia, commuter transportation fleets are a particular favourite.

Armed robbery proceeds

Armed robbery is both a crime of violence and a serious economic crime and it is frequently lucrative. It occurs with disturbing regularity in South Africa, but in general it afflicts more than half of the member countries of ESSAMLG.

Motor vehicles and cash account for the bulk of commodities stolen in armed robberies. Stolen motor vehicles have long been regarded in regional criminal circles as an important form of currency, to be used to pay for other goods or exchanged for cash. Most of the vehicles are stolen in South Africa. Interpol statistics indicate that in 2001, between 96% and 98.7% of the total number of vehicles stolen in the region were stolen in South Africa.¹³

Some of the stolen vehicles are sold to people involved in supplying the domestic market, where they are re-registered and re-sold. However, since the 1980s, an increasing number have crossed South African borders into neighbouring states, often to be exchanged for other illegal goods, such as *dagga*, firearms or diamonds.

As with motor vehicle robbery, most of the armed robberies of cash-in-transit in the region are committed in South Africa by relatively well-trained groups, which have access to weaponry, including automatic firearms. Between 1996 and 1998, armed robbers seized more than R150 million (US\$15 million) in 854 violent cash-in-transit attacks.¹⁴ One of the most widely publicised cases illustrates the link between armed robberies and money laundering. The reported facts are given below as Example 1.

In Kenya, robbers typically invest their money in real estate. They usually buy property in downmarket areas

of Nairobi or in small towns on the outskirts of the city. They avoid investing in upmarket property in Nairobi, as it would make them conspicuous. Typically, property is bought in the name of a female companion. If the property is residential, the companion might reside there; if not, she might be asked to manage it. One of the most notorious armed robbers in the history of Kenya held himself out to be a real estate developer in a small township 150 kilometres from Nairobi, where he had developed a complex of highrise properties.

In addition, or as an alternative, robbers will establish retail businesses that generate a lot of cash. Popular businesses include bars, butcheries and dry cleaning establishments, but by far the most favoured business enterprise among robbers is passenger transport, popularly called the *matatu* business.

One of the factors which determine whether proceeds of armed robbery are laundered locally or externalised is the strength of the connection between the perpetrators and the jurisdiction where the crime is committed. If the criminals are of foreign origin, it is likely that the proceeds will be externalised, at least initially. At the close of 2001, an armed robbery occurred at Johannesburg International airport. A large amount of money was stolen. It transpired that most of the criminals involved were Zimbabwean nationals. Within a month of the crime, some of the proceeds were discovered in Zimbabwe.

Example 1: *S v Dustigar and others* (Case no CC6/2000 (Durban and Coast Local Division) unreported)

Nineteen people were convicted for their involvement in what was then the biggest armed robbery in South Africa's history. Nine of the accused were convicted as accessories after the fact on the strength of their involvement in the laundering of the proceeds, and a 10 accused (Neethie Naidoo) was convicted of money laundering in terms of the Proceeds of Crime Act 76 of 1996. Many of the accused were family members or third parties who allowed their bank accounts to be abused to launder the money. In some cases they also allowed new accounts to be opened and fixed deposits to be made in their names.

Accused No. 9 was a practising attorney. A robber who turned state witness testified that the accused approached him at the court. After confirming confidentially that the witness participated in the robbery, the accused said that he "must (then) have a lot of money". Some time later he approached the witness and offered him an investment opportunity in a nightclub. The attorney then brokered a deal between the sellers and the witness. He drafted a sales agreement in which the name of the purchaser was

left blank. He handed R500,000 in cash to the sellers at his office as a deposit in terms of the agreement. He drafted another sham agreement in the name of another purchaser and also manipulated his trust account records to hide the identity of the purchaser and the actual amounts that were paid.

Accused No. 9 was sentenced to five years' imprisonment.

Accused No. 13 was a police captain who had served for 18 years in the South African Police Service. The judge described him as highly intelligent person with business acumen. He created the laundering scheme that involved seven of the other accused:

"Of all the accused who have been convicted as accessories, accused No. 13's role was undoubtedly by far the most serious. He took upon himself the task of organising the so-called money laundering. He did so spontaneously and apparently with considerable vigour. He did so, furthermore, in enormous proportions. His ingenuity was limitless. In doing what he did he over-reached and manipulated not only police colleagues but also the women in his life who were under his influence, being accused Nos 15, 16 and 19."

Accused No. 13 was sentenced to 15 years' imprisonment.

Currency speculation

The exploitation of fluctuations in the availability, and consequently, value, of foreign currency has become a major source of income in parts of the region afflicted by shortages. Zimbabwe presents classic examples of the practice at a crude level. It also illustrates how something that commences as a series of sporadic transactions for subsistence purposes can quickly become a species of syndicated economic crime.

In consequence of erroneous economic decisions, and ambivalent policy responses to the catastrophic devaluation of the local currency in comparison to foreign hard currencies, speculating in foreign currency has become one of the most lucrative enterprises in Zimbabwe. Participants range from street traders to senior public officials, including government ministers. Part of the reason for the 'currency rush' is the vast disparity between the stipulated rate at which the

Zimbabwe dollar should trade and the market rate. The example below highlights how, despite the simplicity of the transactions, they nevertheless have the potential to generate large amounts of money. It reflects the operations of street currency traders in the city of Bulawayo, who claimed that the foreign currency in which they dealt was from local sources. Their experience is typical and can be extrapolated to similarly placed traders in other centres in Zimbabwe.

The difficulties confronting law enforcement authorities intent on combating currency speculation are captured in the final few paragraphs of the inset. The dispersal of nationals in the diaspora ensures a steady flow of foreign currency to the streets, and the participation of informants involved in the financial services sector secures both a source of information on market trends (availability of currency being an important factor determining price) and a market. Currency traders

Example 2: Informal currency trading¹⁵

Foreign currency street traders use their personal savings to buy the South African rand, the Botswana pula, the British pound sterling and the United States (US) dollar—the most popular currencies—which they sell to individuals, banks and companies in need of the scarce commodity.

The dealers position themselves on street corners to conduct their (illegal) transactions, but say business has been hit by a crackdown by police on illegal money changing in the past few weeks.

Many now engage sentries at various points of the city to look out for the police.

The foreign currency dealers quickly disappear each time the sentries alert them of suspicious people who might be plainclothes policemen. Making handsome profits through the illegal trade, however, seems quite easy for most of them. They buy the foreign currency at a cheaper rate and sell it at exorbitant rates to foreign-currency-starved banks and companies.

"Apart from employing sentries, most of us now dress like shoppers in town to evade the police," Angie (a street trader) said. "But it is backfiring because they now know the trick."

If caught, the illegal foreign currency peddlers like Angie are fined Z\$500 (US\$10) on the spot but could face much stiffer sentences under the Exchange Control Act.

Police in Bulawayo denied that any of their officers could be taking bribes, as alleged by some of the moneychangers, to allow the illegal transactions of foreign currency. "Any member of the public who has paid anything to the police is free to report," said a police spokesman. "It is a crime for a police officer to take a bribe. Those who have done so in the past have been dealt with according to the laws."

Thembi, another dealer on the bustling Fort Street, said some of her colleagues had become instant millionaires because of the flourishing foreign currency exchange market.

"When the rates went mad about three weeks ago, most of the women made millions," she said, barely concealing her smile.

"The business is so lucrative that we don't mind being harassed by the police," said Thembi, one of the energetic women who sprint up and down to every car with foreign number plates driving along Fort Street.

Earlier this week, the dealers were buying the rand for \$55 and selling it for as much as \$70. They bought the Botswana pula for \$85 and sold it for \$110. The British pound was being bought at \$780 and sold for \$1 000 and the American greenback changed hands at \$800 after being bought for just \$590.

"This is good business. Why should the government want to make us poor?" protested Thembi, who said she studied commerce at high school. "We are not stealing from anyone; we are merely taking advantage of their poor economic policies." She said most dealers were in business because of large amounts of hard cash being sent into the country by Zimbabweans working abroad in countries such as Botswana, the United Kingdom, South Africa and the United States.

"This week, for instance, was a good one for some of us because of public holidays in Botswana," Thembi noted.

Asked how the dealers arrived at a particular exchange rate each day, she explained: "We liaise with some *bureaux de change* that we sell the foreign currency to. We also have friends at the banks. We work hand in hand with the financial institutions of this country. *The government should understand this and make sound economic policies.*" (Emphasis added.)

appear to have access to more reliable, up-to-date information on the state of the economy than state authorities.¹⁶ The italicised words point a finger at government economic policies as the major catalyst of the currency speculation industry.

Cross border traders swell the ranks of the informal currency traders. On account of greater access to foreign currency, as well as exposure to a variety of financial markets, these traders can do better than street currency dealers through currency interchanges. Until mid-2001, Zimbabwean currency could be traded in the Botswana financial market at a rate of Z\$10 to the pula (BWP). A trader could purchase 3,000 BWP for Z\$30,000 in Botswana. Once that currency was exported to Zimbabwe, however, it could be exchanged at a rate of Z\$60 units to the BWP, yielding Z\$180,000, six times its original nominal value. The trader could repeat the process by smuggling the Zimbabwean currency to Botswana, and using it to purchase a further amount of BWP. Z\$180,000 could be exchanged for BWP18,000. If taken across the border, the Botswana currency could be sold for Z\$1,080,000. The process could be carried out in a day. Over a longer period and with repeated transactions, the returns would rival any successful business in the legitimate formal sector.¹⁷

Until the end of 2002, the flourishing street trading in foreign currency was replicated in the numerous *bureaux de change* dotted all over the commercial centres of the country. *Bureau* operators were always aware of the competition from the streets. In spite of regulations requiring the display of applicable exchange rates and recording of transactions, *bureaux* traded at flexible rates, which reflected market trends rather than the dictates of government, and rarely prepared transaction records.¹⁸ Government officials had interests in some *bureaux de change* in Harare, Bulawayo, Victoria Falls and Beit Bridge. Unlike street traders, operators of *bureaux* were not desperate to procure local currency by offloading foreign currency received onto the market immediately. They were in a better position to 'warehouse' it for speculative purposes, or for outward laundering.

Some *bureaux de change* facilitated the externalisation of foreign currency without smuggling it out. On the pretext of assisting nationals living outside the country to transmit money home,¹⁹ Zimbabweans living abroad would be provided with external accounts into which to make deposits in hard currency. The Zimbabweans in turn provided accounts in Zimbabwe into which the local equivalent should be paid, at the parallel, bloated rate. No documents were exchanged, although reconciliation could later be effected. While this deprived the country of much-needed foreign currency, it enabled the expatriate Zimbabwean community to acquire funds for investment in high return spheres, such as real estate²⁰ and the stock market.

Regulatory authorities estimate that since 2000, at least 70% of foreign exchange transactions in Zimbabwe have taken place on the streets or in *bureaux de change*.²¹ Surveys reveal that *virtually all banks have, at one point or another, violated exchange control law* by selling or buying foreign currency at an unofficial exchange rate. In 2001, three commercial banks were fined by the Reserve Bank for dealing outside the controlled exchange rates. It is also a matter of record that government corporations like the National Oil Company of Zimbabwe (NOCZIM) and Air Zimbabwe procure foreign currency at the unofficial, parallel exchange rate, thereby breaking the law.²² At the end of November 2002, *bureaux de change* were closed by government directive in Zimbabwe. In a statement to parliament, the Minister of Finance accused the *bureaux* of illicit dealings in foreign currency, which escalated inflationary tendencies.²³ Simultaneous with the closure, government ordered that all foreign currency accruals should be remitted exclusively through commercial banks. Indications are that the flow of foreign currency to banks in December 2002 was insignificant. Economists and market players appear to agree that the initial impact of the directive was to drive speculative activity related to foreign currency underground.

Currency speculation also occurs in Malawi and Kenya although on a smaller scale.

Commercial crime and fraud

Apart from being a species of commercial crime, internal money laundering feeds on predicate commercial crimes of all varieties. The greater the incidence of the predicate crimes, the more likely it is that proceeds for laundering will be generated. For the purposes of this report, 'commercial crime' is defined widely to encompass corruption, and 'fraud' includes currency forgery.

While commercial fraud may not be universally prevalent in the region, it occurs in many forms. Some are well established. They invariably also constitute corruption. Among them is the phenomenon of 'ghost' employees, which has tended to take many guises. At the time of writing, a case arising from 'ghost' soldiers was pending in Namibia.

The Namibian Ministry of Health and Social Services has also sustained losses on account of ghost employee claims. See examples 3 and 4 on page 8.

Evasion of tax and duty

The evasion of tax and of customs duty is a common problem in the region. In Uganda, for instance, tax evasion, with or without the collusion of revenue officials, is common. The Uganda Revenue Authority (URA), which is responsible for collecting and managing

Example 3: Claims from ghost soldiers

Along with Zimbabwean and Angolan counterparts, the Namibia Defence Force (NDF) intervened in support of then President Laurent Kabila in the civil war in the Democratic Republic of Congo (DRC).

During the conflict, the army sustained casualties, in respect of which the Ministry of Defence paid out certain benefits to next of kin. It emerged that some claims were fraudulent.

'Ghost soldiers' had been created, using false identification particulars lodged in the Ministry of Defence.

The claims were made on the basis of the 'death' of the non-existent soldiers in action in the DRC and Angola. The Defence Force paid out several hundred thousand Namibian dollars.

A number of senior officers in the NDF have appeared in court on allegations of fraud.²⁴

Example 4: Fraud on the Ministry of Health

The case involved G H and others. Government employees in the Ministry of Health and Social Services created ghost workers. In order to effect payment to them, falsified requisitions were submitted to the Ministry of Finance. With the collusion of some employees in that ministry, cheque payments were approved.

When the cheques were ready, they were either physically collected or posted to post box numbers which had been opened in the names of non-existent or deceased persons. Some of the post box addresses were in Windhoek, while others were at Rundu, some 800 kilometres away.

A bank account had been opened with a modest sum of money at an obscure branch of Bank Windhoek in Katutura Township in Windhoek, using the identification particulars of a deceased person. Records at the bank showed that the teller who opened the account followed all the preliminary procedures, all account-opening questionnaires were completed and a copy of the photograph of the customer was taken and retained in the bank.

The cheques, made out in the name of the customer, were subsequently deposited into the account. Once the cheques were cleared, some of the money was withdrawn through the autoteller machine (ATM) network.

G H was arrested because he allegedly attempted to withdraw money from the account. A person resembling G H approached a teller. The teller

requested him to wait. When the teller went to the manager's office he disappeared. G H was later identified because he was the owner of a vehicle which had been seen parked in front of the bank at the time.

He denied making the attempted withdrawal. He was unemployed at the time, but owned a number of luxury motor vehicles and immovable property in Katutura Township. As there was little else to implicate him, the case was dropped.

The cheques posted to Rundu were deposited into the account of a person who, according to records held at the Registry office, did exist. A bank employee opened and operated the account, using a chequebook and an ATM card. On his arrest he claimed that he had done so on behalf of an employee at the Ministry of Health.

The employee was traced to the department where the ghost workers were created. However, he could not be linked to the ghost workers as the entries had been punched into the computer using a password which was different to his.

Checks made with the Registry office confirmed that an identification document bearing the particulars used at the Ministry of Health and to open the account at Bank Windhoek was indeed issued before 1990 to the person named, and that he lived at a village several hundred kilometres from Windhoek.

A visit to the village revealed that nobody there had ever heard of such a person.²⁵

taxes, is reported to be riddled with mismanagement and corruption, compromising its capacity to combat tax evasion. Officials from its Large Taxpayers Department have been suspended and detained for conniving with crooked exporters to lodge fictitious claims, resulting in losses estimated at US\$20 billion (US\$14million) between September 2000 and December 2001. The head of the Department is facing fraud charges. A commission of inquiry, headed by Justice Sebutinde, is probing the activities within the URA. It started public hearings on 22 July 2002.²⁶

The commission has exposed a long list of big and powerful tax evaders and bribe payers, including business tycoons. The owner of Genesis, Classics and a chain of companies was directed to pay a bill of US\$4 billion (about US\$2.5m) for taxes evaded between the beginning of 2000 and April 2002.²⁷ The URA successfully sued two companies for evading taxes amounting to US\$400,000.²⁸

Fiscal coffers in Malawi, Kenya and South Africa have also been subjected to plunder, resulting in the accumulation of substantial funds for laundering.

Example 5: Surtax fraud

Goods which are bought in Malawi for export are not subject to the 20% surtax levied on those consumed locally. Dishonest companies have taken advantage by purchasing some commodities on the pretext that they are for export, even though they subsequently sell them locally, with a markup which includes surtax. The money meant for surtax is thereafter laundered. The Malawi Revenue Authority is investigating a large company for this practice. The Anti-Corruption

Bureau, working with the Malawi Police, exposed a wholesaler who evaded surtax estimated at over MK80 million (US\$1,052,631.00) in a 12-month period. The wholesaler allegedly bought sugar meant for export, repacked it in one-kilogram packs and sold it locally, evading the surtax due. Forged Malawi Revenue Authority documents seized purported to show that the sugar was exported to countries outside Malawi. At the time of writing the wholesaler was on trial.²⁹

Kenya has long been afflicted by corruption in many forms, resulting in monumental losses of public resources. In the period 1990–95, the government lost a total of KSh127 billion (US\$1.693 billion) through corruption. In the 1996–97 financial year alone, the loss amounted to over KSh12 billion (US\$160 million) through fraudulent payments. These figures represent the loss of one in every six shillings allocated by the Kenyan parliament. Kenya has experienced one corruption scandal after another, but the biggest is probably the Goldenberg scandal (see example 6) which hit the headlines in the 1990s but has yet to be buried.

In South Africa, fraudulent claims for the refund of value added tax (VAT) for fictitious exports have been known to be a source of funds for laundering since the early 1990s. Their proliferation coincided with the re-establishment of commercial linkages with the rest of sub-Saharan Africa. Typical schemes involve companies

that may be engaged in the legitimate export of goods or services. A company could use a real or shell company in a foreign jurisdiction to create the false impression that goods have been exported and payment received. The export price includes VAT (currently pegged at 14%), which is subsequently claimed back from the South Africa Revenue Service. Invoices, delivery notes and export documentation may even support the false claim. Within a relatively short space of time, large sums of money can be generated virtually from nothing.

This kind of fraud (involving what SARS officials describe as ‘ghost exports’) is usually quite difficult to detect without infiltrating one of the companies involved or securing the co-operation of law enforcement in the foreign jurisdiction. It underscores the importance of vigilance and international co-operation in combating money laundering.

Example 6: The Goldenberg Scandal

What came to be known as the Goldenberg scandal or conspiracy comprised a series of financial scams, involving collusion between a young Nairobi entrepreneur, Kamlesh Pattni, and high-ranking state officials. The scams are believed to have cost the state an estimated US\$500 million. The actors in the scam included the country’s vice-president, a governor of the Central Bank of Kenya, the Commissioner of Geology and Mines, a permanent secretary, the head of national security intelligence and Pattni (P), who appeared to be the mastermind behind the many schemes.

In 1990, the government accepted a proposal from P to export gold and diamond jewellery from Kenya for an initial five-year period. The entrepreneur also requested authority to set up a commercial bank to handle the trade transactions. The government agreed to pay P 35% of the value of his exports, as compensation. (At the time there was an export incentive in terms of which government subsidised emerging exporters to the extent of 20% of the value of exports.) It initially rejected the proposal to establish a bank. Kenya has no known deposits of diamonds which could be the subject of export trade.

In 1990 P incorporated Goldenberg International Limited, to handle the exports, with himself and JK, the head of national security intelligence. From 1991 P started sending invoices to the government for the subsidy as agreed. P’s bankers, the First American Bank, produced records as evidence of export receipts. There were discrepancies between some of the receipts and the invoices, but with the intervention of the Governor of the Central Bank, P’s claims were paid.

As time went on, P’s claims were supported by evidence of payment in a cocktail of foreign currencies (dollars, sterling, deutsche marks and francs). Government paid them all. It was later to emerge that P was buying the assortment of foreign currencies in the local market and misrepresenting them as foreign exchange earnings from the sale of gold and diamonds. Occasionally this occurred with the collusion of his bankers. Moreover, Goldenberg’s exports were overpriced. In June 1992, the government granted P’s request to start his own commercial bank. He incorporated the Exchange Bank, with himself and JK as directors. He started using the bank in dealings with the Central Bank of Kenya.

continued on page 9

continued from page 9

When questions were raised about where the gold was being exported to, P named two consignees, both Zurich-based, Servino Securities and Solitaire. Inquiries revealed that these firms did not exist. P then claimed that exports, worth KSh13 billion (about U\$400 million), had been made to a company called World Duty Free based in Dubai. The company denied doing business with Goldenberg. Despite indications that money was being paid for non-existent exports, P's claims continued to be settled.

P also took advantage of the export-retention scheme introduced in 1992. The scheme allowed exporters to retain a portion of their foreign exchange earnings (50%) in special accounts. This would be available to them conveniently in subsequent transactions that needed foreign exchange.

Goldenberg claimed to be an exporter. The company received preferential treatment. Whereas other exporters of raw materials like coffee and tea were allowed to retain only 50% of their earnings, Goldenberg could retain its full 'earnings'. It is believed that Goldenberg amassed U\$75 million under the cover of this scheme. This money was put away in Exchange Bank, and laundered through various projects.

Laundering the proceeds of Goldenberg

During the early 1990s, P built a grand hotel in Nairobi, the Grand Regency, reported to be the best hotel in Kenya. The movables within the hotel are valued at KSh2 billion (US\$26.67 million) and the whole investment is worth about KSh10 billion. (US\$133.33 million) P himself likened the hotel to

the Taj Mahal. Uhuru Highway Development Limited, another of P's companies, owns the hotel.

The Exchange Bank, through which a vast number of Goldenberg's transactions were processed, went into voluntary liquidation, just before the Central Bank of Kenya commenced proceedings to recover a KSh13.5 billion obtained fraudulently from the CBK.³⁰ It has been revealed that these funds were multiplied enormously through investment in government treasury bills. In 1995, CBK was allowed to sell the hotel to recover the KSh13.5 billion. To date the hotel has not been sold.

There is evidence that P engaged in outward laundering of cash from Kenya, using the Exchange Bank. P is believed to have acted for both himself and others, some of whom were in positions of authority.

Some of the money externalised through Goldenberg has since been repatriated to Kenya in the form of 'foreign' investment in equities in new ventures. A strong body of opinion in Kenya holds the view that the primary motivation for the Goldenberg conspiracy was to raise funds for the erstwhile ruling KANU party in the wake of a competitive political playing field opened up by multipartyism in 1990. It was therefore inevitable that some of the illicitly procured funds would be laundered within Kenya, and even part of what was externalised would find its way back.

For the last seven years, P has been facing a charge of theft of a part of the Goldenberg money. He is jointly charged with the former Permanent Secretary. The case has not made much progress, and not many people believe that it will ever be finalised. However, the defeat of KANU in the December 2002 elections revived hope that the case would be resolved.³¹

Incoming money laundering

There are many reasons why criminals consider it prudent to move the proceeds of economic crime across territorial borders. The desire to complicate the investigation trail is only one of them. Another factor might be the existence of better investment opportunities, or weaker law enforcement, in the destination jurisdiction. Competition for investment and the demands for foreign currency render many countries in the region vulnerable to the infusion of tainted funds from abroad.

In Malawi, *bureaux de change* accept casual foreign currency cash transactions without any due diligence inquiries. The same applies to Zambia. In 2001, the Reserve Bank of Zimbabwe directed banks to accept foreign currency deposits without querying their sources. The importation of foreign currency ostensibly for investment tends to be encouraged by open door policies promoted by state investment agencies. In some countries, a prospective investor with foreign funds above a certain threshold can qualify for permanent residence.³² Law enforcement agencies occasionally find such an attitude

exasperating. A Tanzanian police delegation to a regional conference pointed out that the police encounter much difficulty in distinguishing between genuine and bogus investors. The delegation also lamented:³³

Being a poor country which welcomes investments from all over the world, sometimes it is felt that if you start inquiries against the so-called investors you risk the possibility of chasing them away with their much wanted investments. As a result we are always in [a] dilemma not knowing the right course of action to take.

The region is littered with examples of investments by shady characters. The nature and duration of such investments seems to depend on factors like the links between the launderer and the country, his or her perceptions about its political and economic stability, his or her estimation of the risk of detection, and the potential returns. Hence, where the launderer enjoys citizenship of both the country where the predicate crime was committed and the destination of the proceeds, and that destination has a stable economic



environment, funds are likely to be transferred between the two countries.

Example 7: The Widdowson funds

Although Widdowson was born in England, he had dual English and South African citizenship. During the period 1991 to 1997, he spent time working for Regent Security Services in England. He returned to South Africa in 1997, but continued to render services to the company on an intermittent basis.

The company discovered that between May 1995 and April 1999, £667 480.09 (US\$1,001,220) was stolen from its bank account and transferred to Widdowson's three bank accounts in England. There were subsequent transfers to a bank account in South Africa.

Widdowson then left England and returned to South Africa. At no stage did he try to earn other income from employment in South Africa. He did, however, make various investments in South Africa, in both movable and immovable property.

Following the discovery of the theft, a successful application was made for the seizure and forfeiture of Widdowson's assets.³⁴

Drug trafficking proceeds

The evidence from Malawi is that some drug dealers pass themselves off as curio-exporting businessmen conducting business in the South African market. They purport to convey curios to South Africa, but in reality mingle them with drugs for sale. In similar fashion, proceeds from curio sales are combined with the proceeds of drug trafficking. These illicit businessmen not only buy cars and furniture but sometimes physically bring foreign cash back to Malawi and exchange it for Malawi kwacha. In Malawi, the money is used according to the preferences of the launderer. Much of it is spent on consumer goods, as most transactions in Malawi are conducted in cash.

According to Namibian police intelligence reports, South African and Zimbabwean truckers smuggle *dagga* sourced from Swaziland, Lesotho and as far north as Malawi, into Namibia. For this purpose, the *dagga* from Swaziland and Lesotho is packed in South Africa before export to Namibia. Namibian permanent residents of South African origin have been found to be at the center of the distribution and marketing chain. Once the *dagga* has been sold, and the persons who provide the warehouses and salesmen have been paid, the proceeds are taken out of Namibia in cash. The South African currency is interchangeable with the Namibian dollar with no loss of value, and the proceeds can therefore be exported as rands.

The *dagga* from Malawi is smuggled by truck drivers through Zambia, Zimbabwe and South Africa and into

Namibia. Some of the *dagga* originates from South Africa itself. *Dagga* is the most popular drug among consumers in Namibia, generally being consumed in the lower echelons of Namibian society.

It was pointed out earlier that the more lucrative part of the drug industry generally, including the *dagga* trade, lies outside the region. Drug smuggling from southern Africa is a multi-million dollar business, exposed from time to time through high profile police successes in countries such as the United Kingdom. In one operation in July 2002, the Lancashire Constabulary discovered a consignment of three tonnes of *dagga* with an estimated street value of £6 million (US\$9 million) at a warehouse in Chorley. The *dagga* was vacuum packed in one-kilogram blocks and concealed in wooden crates. It appeared to have been imported from South Africa.

Stolen motor vehicles, cheques and illicit diamonds

There is a thriving trade between Namibia and South Africa, which involves the movement of stolen motor vehicles from South Africa to Namibia and the payment of the suppliers with funds stolen from Namibia. The vehicles are sold in Namibia and payment is made to the criminals in South Africa through transfers of funds from bank accounts of Namibian third parties. The government of Namibia has been a major victim. A common *modus operandi* involves the theft of specimen signatures of authorised signatories to government accounts and the forging of letters instructing a banking institution to effect transfer of funds to an account in South Africa. The funds are thereafter withdrawn without trace, partly because the operators of the account in South Africa will have used forged identity documents to open and operate the account.

Some fraudulent transactions may go undetected even by the government authorities. In terms of such schemes, the criminals in Namibia receive the motor vehicles without paying a cent, while their South African counterparts receive payment for the stolen vehicles.

Motor vehicles stolen in Botswana, South Africa and Namibia itself have been smuggled to Angola through the Oshikango border post. Particular types include sports cars and luxury 4x4 station wagons, whether single or double cabin. In roughly equal proportion, the stolen motor vehicles are exchanged for diamonds or paid for in hard currency, usually US dollars. The purchase price is repatriated to the source country. Angolans are generally more liquid in US dollars than are people of neighbouring nationalities. In Angola, the long-enduring civil war, with its associated economic and financial instability, has precipitated a calamitous lack of confidence in the Angolan monetary and banking system. Individuals and corporate entities generally do not convert their funds into the local currency. Neither do they entrust their liquid assets to the banking system. Only large companies and the



government make use of the banking system for their transactions. Medium-sized and small companies open bank accounts only to comply with one of the provisions of the governing legislation. Most will maintain their monetary wealth in hard cash, with large volumes of cash circulating in the economy completely outside the banking system. Business transactions, such as the purchase of real estate or cars, are carried out in once-off cash payments, in US dollars. It is probably unfortunate that Angola is outside the ESSAMLG.

Secondhand luxury motor vehicles from Japan

For many years, motor vehicles reportedly stolen from Japan have been traced to east and southern Africa. Since September 2000, the Motor Vehicle Theft Unit of the Namibian Police has been aware that some secondhand luxury 4x4 motor vehicles stolen in Japan have been imported into Namibia for sale to affluent buyers.

Outgoing money laundering

The transfer of money from the jurisdiction in which the predicate crime is committed is the other side of the coin of incoming money laundering. Outgoing laundering is not always motivated by an intention to invest in the destination jurisdiction. It can involve a number of transient jurisdictions, if only to obscure the laundering trail. The initial decision the launderer will make is whether or not to involve the financial services network.

The most basic mode of transferring the proceeds of crime, circumventing the financial services network, is to carry it out of the country. Movement of cash in bulk is common within and across the region. Reports from South Africa, Kenya and Tanzania provide ample illustrations of the movement of assets in the form of bulk cash within and across borders.³⁵ They also demonstrate the use of convertible assets as a mode of international laundering of funds.

A more insidious form of outgoing laundering, which partly sidesteps the banking system, involves a combination of tax fraud, currency speculation and resort to alternative remittance systems. It has been detected in the region, although its incidence has not been established. It is used in order to facilitate the externalisation of capital, for instance from the disposal of immovable property. Examples from South Africa and Zimbabwe abound.

In Zimbabwe it has been precipitated by a combination of three factors: first, the calamitous decline in the value of the currency; second, the evaporation of investor confidence; and third, the relocation of nationals to better-performing economies of the world. Its most common manifestation is the conduct of major sale transactions of real estate in foreign currency. Transactions usually involve speculators on both sides, and often both the seller and buyer are nationals. A

Example 8: Externalising currency through *bureaux de change*

In Tanzania the travel allowance system, in terms of which travelers are entitled to purchase hard currency up to US\$10 000, is open to abuse. Many travelers cannot afford to purchase that much. Syndicates and couriers prey on them by offering them a commission of one or two hundred dollars for applying for the maximum allowance, which is then laundered.

Indian, Pakistan and Arab trading communities in Tanzania have long-established linkages with groups in Dubai and other Gulf States, some of which have criminal inclinations. Dubai was the main centre through which most Tanzanians used to launder money. Since the September 11 terrorist attacks in New York, however, there has been a shift to centres in India, Jakarta and Hong Kong, which are believed to raise less suspicion.

In southern Africa, Malawi is a favoured transit country of most launderers from Tanzania, as it is perceived to have a banking system that is easy to use in sending foreign currency to any part of the world. Foreign currency, preferably US dollars, is transported from Tanzania to carry. The amount involved is not yet determined, but since leading *bureaux de change* are involved, it could be in hundreds of thousands or millions of US dollars.

In a few instances, laundering has taken cruder forms, such as absconding with receipts from foreign currency transactions. Instead of depositing proceeds from daily or weekly transactions with the Central Bank, in 1999 the owner of *Expresso Bureau de Change* disappeared with them – millions of US dollars, as it turned out.

In addition, some industrialists in Tanzania have been shown to have siphoned off capital abroad, declared their industries insolvent and then sold them to foreign proprietors, who paid them through foreign banks. In consequence, Tanzania receives no taxes from these industries.³⁶

house with an asking price of Z\$20 million, for instance, can be acquired for a South African equivalent price (at the non-official/parallel market rate of Z\$50 to the rand) of just over R400,000. If the purchaser can afford to pay in US dollars, the price converts (at the rate of Z\$650 to the US\$) to US\$30,769. The transaction does not entail any transnational currency remission, and for that reason is attractive and relatively safe for the parties involved.

A survey of estate agents in Harare in June 2002 revealed that several preferred to receive payment for residential property sales in foreign currency. In all cases, payment offshore was also preferred. Only one regional country featured among the reported destinations of funds thus externalised, namely South Africa. Others are the United States, the United Kingdom and Canada.



Example 9: The United Merchant Bank saga

The United Merchant Bank (the bank) was incorporated in May 1995. In less than three years its license was revoked after it became known that it had a low capital ratio and inadequate liquidity to meet the claims of depositors and other liabilities. Police investigations subsequently revealed that many illegal activities had taken place.

1. Fraud: Cold Storage Commission bills

Following its commercialisation (a prelude to privatisation), the Cold Storage Commission (the commission) contracted the bank to raise funds on its behalf on the local money market. This was to be done through the floatation of commission bills. The commission required Z\$413 million (US\$7.5 million). Government issued guarantees to the value of Z\$855.16 million (US\$15.55 million) as security during the floatation of the bills. The bank raised the amount required by the commission and remitted it. Thereafter the bank sold further bills worth Z\$1.263 billion (US\$22.96 million) on the local money market, and converted the entire amount to its own use. The founder and chief executive of the bank, Roger Boka, was found to have been at the centre of the illicit activities, with the assistance of five others. Boka died on 21 February 1999 before he could stand trial. Up to the time of writing it was not clear how much of the converted money had been recovered.

2. Conversion of depositors' funds

Various persons and institutions deposited funds with the bank. Upon cancellation of its licence, the bank owed just over Z\$1.558 billion (US\$28.32 million) to depositors, which it was not in a position to repay. Some bank documents and computers could not be found. Money laundering charges were laid against Boka and his accomplices in terms of the Serious Offences (Confiscation of Proceeds) Act, but he died before standing trial. The investigation was transferred from the police to a special investigator appointed by

the Minister of Justice, in terms of the Prevention of Corruption Act. The investigation does not seem to have moved much since. The then Minister of Justice was a known friend of Roger Boka and an acknowledged debtor of the United Merchant Bank.

3. Externalisation of funds: money laundering

In the short life of the bank, Roger Boka opened and operated several personal accounts at foreign banks in Botswana, South Africa, the United Kingdom, the United States of America, Germany, Luxembourg and France, as follows:

Botswana: First National Bank;

South Africa: Nedbank, Amalgamated Banks of South Africa (ABSA), First National Bank;

United Kingdom: Midland Bank plc, National Westminster Bank plc;

United States: Marine Midland Bank (New York), Merrill Lynch Bank (New York);

Germany: West Deutsche Landesbank;

Luxembourg: Hypo Bank;

France: Banque Société Générale.

Acting personally and sometimes through his lawyer, GS, Boka externalised at least US\$21 million. GS, who was the senior partner in a law firm in Harare, was a director bank's board and a signatory to its account at the Zimbabwe Banking Corporation. The firm acted as corporate secretaries for the bank and as legal advisors to both the bank and the Boka Group of Companies. The main business specialities of the group were tobacco and gold marketing.

GS disappeared from Zimbabwe shortly after the death of Roger Boka, by which time he had already been charged with violating the Prevention of Corruption Act and the Companies Act. It was later discovered that GS also operated a foreign bank account in England. None of the foreign funds appear to have been repatriated.

At the time of writing there was no reported detection of any transaction of this nature. It appeared, however, that in the destination countries, the foreign currency payments were made through the banking system. In Kenya, it was reported in July 2002 that a presidential aide had acquired immovable property valued at US\$6 million in London. Tanzania provides illustrations of the abuse of the ubiquitous *bureaux de change* to externalise currency (see example 8).

It is not always practical or prudent to completely outflank the banking system in an outgoing laundering scheme. Some funds are inevitably transferred through intermediaries in the financial services. A proportion of financial services intermediaries may facilitate transfer of illicit funds unwittingly, but some will do so knowingly, even as principal beneficiaries. Cases where institutions

were found to bear corporate responsibility for outgoing laundering include the BCCI case, which exploded in 1991, and the 1997 European Union Bank of Antigua case. Between these cases, and within the region, were cases involving the Meridian Biao Bank, whose collapse in the early 1990s impacted on both Zambia and Tanzania, and the United Merchant Bank, which had a short but disastrous existence (see example 9).

The Zambian Drug Enforcement Commission's activities have revealed the use by drug traffickers of bank accounts opened with fictitious identity documents to facilitate outgoing laundering. *The People v De Souza and others* (unreported) (CCR. SSP/8/2001) revolves around the opening of several bank accounts using a false name, between 1 January 1999 and 28 February 2001. The prosecution alleged that, acting in concert,

the accused opened several bank accounts in Kitwe and Ndola on the Copperbelt, using fraudulently obtained documentation. Using these accounts, the accused externalised a total of US\$1,158,533.2 to the United States of America and Taiwan.

In the first week of February 2003, the First National Building Society in Harare, Zimbabwe, was closed down after an inspection by the Reserve Bank revealed a discrepancy of nearly Z\$3 billion (US\$54.55 million) between funds held and what the building society owed creditors and depositors. There is evidence that one of the officials arrested invested in real estate in Cape Town, South Africa. At the time of writing, a curator was probing the extent of prejudice to creditors and tracing the destination of the funds.³⁷

THE ESAAMLG REGION AS A DESTINATION OF LAUNDERED FUNDS

Insofar as the discussion above shows that laundered funds have tended to flow in certain directions, it raises two issues: first, what makes a country attractive to such funds? and second, does the region attract laundered funds?

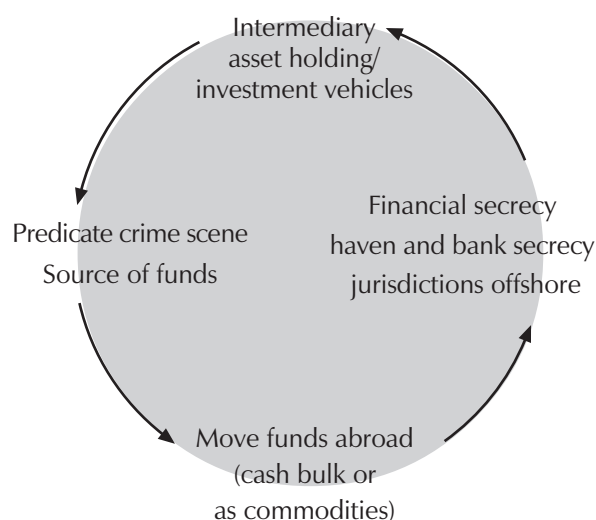
In a study prepared by Blum, Levi, Naylor and Williams, offshore financial systems were identified as being amenable to manipulation by money launderers.³⁸ Various components were found to be both characteristic and predisposing. The authors highlighted many factors, nine of which seem to be of particular importance. They are, not necessarily in order of precedence:

- an environment in which banking institutions can easily be established, with minimal due diligence investigations and where there is a preoccupation with basic capitalisation requirements;
- availability of instruments and mechanisms to facilitate anonymous conduct of investment business, while allowing the creator to retain a beneficial interest – examples are trusts, bearer shares and international business corporations;
- prevalence of bank-like institutions with the capacity to transfer funds rapidly, such as brokerages and *bureaux de change*;
- banking secrecy laws, or laws that create formidable impediments to the discovery of beneficial holders of bank accounts;
- availability of mobile or walking accounts, these being accounts opened on the understanding that any funds above a certain amount credited to the account should be immediately transferred to another location. Funds can be transferred thereafter to one or more other accounts;
- proliferation of loosely regulated casinos;

- availability of free-trade zones;
- facilitation by intermediaries in establishing corporate entities, opening accounts dishonestly or without any kind of due diligence; and
- permissibility of shell companies.

To these factors can be added a tenth, namely the existence of correspondent banking relationships linking banks in the source or intermediate countries with those in destination countries. The outgoing laundering trends can be graphically presented in the form of a circle, as shown in Figure 1.

Figure 1
Outgoing and incoming money laundering circle



No single member state of the ESAAMLG possesses all of the characteristics outlined. However, the region includes countries in which some of these characteristics are prominent.

Viable markets in which to trade in securities are well established across the region, particularly in Kenya, Zimbabwe, Swaziland, South Africa, Botswana, and Mauritius. In these countries, the law permits investors to deal in bearer securities and other negotiable instruments, including derivatives.³⁹ International trends show that these instruments can be abused in the setting up of laundering schemes. The involvement of shrewd intermediaries only increases the scope for such abuse. Lawyers have been used in outgoing laundering, as the Boka case shows.

There are indications that stockbrokers may be used as a conduit for money laundering. Shares can be issued in the names of nominees, to disguise beneficiaries. This disguises launderers engaged in criminal activities.⁴⁰

On account of their fungibility, securities in entities with dual or multiple listings, such as Old Mutual, can be

used to move currency between countries. Individuals and companies can purchase shares on the London stock exchange and trade them on one or more of the regional stock exchanges, and vice versa. At the time of writing, at least one commercial bank was under investigation by the Reserve Bank of Zimbabwe for having transferred Old Mutual shares to the London and Johannesburg stock exchanges without authorisation. The Reserve Bank claimed that the transfer resulted in prejudice of £1.4 million and SAR9 million. In addition to the securities market, the region boasts a relatively unregulated casino industry, and an evident proliferation of *bureaux de change*.

Within the region, Mauritius and the Seychelles, which have been classified by many experts as financial 'tax' havens, have generally been regarded as particularly vulnerable. The Seychelles virtually singled itself out as a prospective laundering haven by its decision, in the mid 1990s, to offer citizenship to any investor with at least US\$10 million, regardless of the source. The offer, which had been enshrined in legislation, was rescinded, following international objections. Mauritius' potential weakness stems from its offshore financial regime, which permits corporate institutions with no physical productive presence within Mauritius to open and operate bank accounts. From the standpoint of the offshore corporate, the rationale for establishing offshore is to take advantage of the lower rate of taxation in comparison to neighbouring jurisdictions. The primary incentive for the offshore jurisdiction is the revenue to be extracted through taxation and the potential to increase employment levels in the financial services sector. As a strategy to offset weaknesses in other areas of economic productivity, such as manufacturing and mining, offshore centres are likely to proliferate in the region in the short- to medium-term.

In 2001, Botswana took measures to expand its commercial sector by permitting the registration of international financial services companies (IFSCs). Income tax legislation facilitates the establishment of an International Financial Services Centre to register IFSCs. The structure and envisaged functions of the centre indicate that it is intended to facilitate and regulate an offshore investment sector. The sector will benefit from a taxation rate of 15%, which is 10% lower than the prevailing average corporate rate.

An analysis of the offshore financial system in the region indicates that one of its attractions is the relatively high level of confidentiality that it offers concerning the identity of shareholders of corporate entities operating in it. Although directors' and shareholders' names are filed with the government registry in Mauritius, the register is not accessible to the public. Mauritius has repeatedly expressed its commitment to maintain its

status as a premier offshore financial centre, and its acknowledgment of the vulnerability to tainted funds that this entails.

In the last few years there has been a deliberate tightening up of the legal and administrative framework relating to the offshore sector. Mauritius is among the few ESAAMLG member states to ratify the Palermo Convention, which has a strong emphasis on money laundering control.

Botswana's regulatory framework is located in the Proceeds of Serious Crime (Amendment) Act, 2000, which introduced a new section to the primary statute, as section 16A. Section 16A lays down basic client profiling requirements for designated institutions, which are defined as:

persons or bod(ies) of persons whose business consists of or includes the provision of services involving the acceptance or holding of money or property for or on behalf of other persons or whose business appears to the Minister to be otherwise liable to be used for the purpose of committing or facilitating the commission of a serious offence under this Act.

A discussion of the merits or weaknesses of the control mechanisms adopted in Botswana is beyond the scope of this report.

Offshore financial centres will always be susceptible to incoming money laundering, and it is incumbent upon their regulatory authorities and accountable institutions within them to be familiar with the laws of the jurisdictions from which incoming investment funds are derived, and prevailing outgoing money laundering trends. It is not sufficient to put up structures and mechanisms just to

contain internal money laundering.

To determine whether the region as a whole, or its constituent countries, attract more laundered funds than they lose requires, first, an empirical survey of the internal transfers of funds originating from outside the region and individual countries, and second, a study of outgoing transactions of suspect funds. The present study has not gone this far, partly on account of inadequate engagement with the financial services sector in the region. One can only give an outline of the areas which require analysis. It is important to note at the outset that it is not only the 'vulnerable' countries, as indicated by the high incidence of the risk factors adverted to above, that should be examined. Transactions to be examined include:

- cash transactions;
- bank accounts;

The Seychelles
virtually singled
itself out as a
prospective
laundering
haven by
offering
citizenship to
any investor
with at least
US\$10 million

- trade finance transactions;
- investment transactions, particularly in the stock, property and tourist markets;
- loans, whether secured or unsecured; and
- insurance transactions.

TERRORIST FUNDING

The transferability of equities also creates a possible avenue for laundering funds to finance terrorist activities.⁴¹ No transfers for this purpose were detected in the study. The scope for laundering of funds to advance terrorism deserves some examination.

Experts have identified two primary sources of terrorist funding. According to the FATF, the first method involves state sponsorship or funding by large organisations or wealthy individuals. State-sponsored terrorism is believed to be in decline.⁴² It appears to have been superseded by individual or corporate funding. The second method involves the mobilisation of funds from a multitude of revenue generating activities, some of which may be lawful. Among the lawful sources identified are:

- the collection of membership dues and/or subscriptions;
- the sale of publications;
- cultural and social events;
- door-to-door solicitations in the community;
- appeals to wealthy members of the community; and
- regular or irregular donations of part of personal earnings.

Unlawful activities to raise funds for terrorism identified in FATF countries include kidnapping and extortion, racketeering, smuggling operations, fraud, counter-

feiting currency trafficking,⁴³ and drug trafficking. Even robbery has been associated with terrorist fund raising.

While there are terrorist outfits operating in parts of the region, notably in East Africa, the study to date has not been able to trace terrorist groups to particular sources or methods of funding. Indications are that if such funding is occurring, it is likely to be associated with unlawful rather than lawful activities.

CONCLUSION

There is consensus that laundering is occurring in the region on a significant scale. The statistics often cited are based on the results of the Australian-developed Walker model. According to the model, a total of US\$22 billion was laundered through the financial systems of southern Africa in 1998. Of this US\$15 billion was generated within the region. It was estimated that US\$7 billion was infused from outside the region, with East Asia accounting for US\$1 billion, North America for US\$5 billion and Europe US\$1 billion.

A recent estimate stated that in the last six years money laundering has cost Zimbabwe Z\$55 billion (US\$1 billion).⁴⁴ Although the estimate was not substantiated, the underlying predicate crimes were identified as fraud, theft, corruption, illicit dealings in precious metals, and currency speculation.

A study conducted early in 2002 by the international forensic auditors, PriceWaterhouse-Coopers, found that, in terms of susceptibility to money laundering, 50% of ESAAMLG countries are regarded as high-risk, 35.7% fall into the medium-risk category and only 14.3% are regarded as low-risk jurisdictions.⁴⁵

Notes

- 1 Although all the named countries have declared their support for the aspirations and objectives of the ESAAMLG, not all of them are official members. At the time of writing, only two thirds had signed the memorandum of understanding, an essential step in the acquisition of membership. These were Kenya, Malawi, Mauritius, Mozambique, Namibia, the Seychelles, South Africa, Swaziland, Tanzania and Uganda.
- 2 Smit, P, *Clean money, suspect source: Turning organised crime against itself*, ISS Monograph Series, 2001, 51, p 9.
- 3 The first attempt at a universal definition and proscription of money laundering was the United Nations Convention Against the Illicit Traffic in Narcotic Drugs and Psychotropic Substances of 1988 (the Vienna Convention). It confined the definition of launderable assets to proceeds of drug trafficking.
- 4 The Institute for Security Studies commissioned a study of money laundering trends in ESAAMLG member states in the first half of 2002. The preliminary findings of the study formed the basis of this report.
- 5 The classic illustration is the transformation of commodities from illegal to legal circuits, exemplified by the insurance of a stolen motor vehicle, which is subsequently destroyed by the insured, who claims its replacement value.
- 6 Smit, op cit, p 18.
- 7 T Leggett, Perspectives on supply: The drug trade in Johannesburg, Durban and Cape Town, in T Leggett (ed), *Drugs and crime in South Africa: A study in three cities*, ISS Monograph Series, 2002, 69.
- 8 Over a period of two years.
- 9 J Banda, *Money laundering in Malawi*, ISS Monograph Series, forthcoming.
- 10 Ibid.
- 11 See L de Koker, *Money laundering trends in South Africa*, CenSec, 2002, p 19.
- 12 This was the basis of the allegation in the Zambian High Court case of *The People v De Souza and Others*, CCR SSP/8/01 (unreported at the time of writing).
- 13 Interpol sub-regional report to the SARPCCO Annual General meeting, Mauritius, 2001.
- 14 *African Security Review*, 1999, 8(6).
- 15 Adapted from *The Financial Gazette*, 18 July 2002.
- 16 Zimbabwe's Minister of Finance is quoted as having described Fort Street in Bulawayo as the World Bank of the country.
- 17 This information emerged during an interview with an official attached to the Tender Board in Gaborone, Botswana. It was subsequently confirmed by sources within the banking sector in Zimbabwe.
- 18 B Fundira, *Money laundering trends in Zimbabwe*, unpublished paper. This was subsequently confirmed by the author's personal observation.
- 19 *Financial Gazette*, 11–17 April 2002.
- 20 The rapid upward movement in the price of residential premises has in large part been attributed to citizens outside the country who illegally change their money on the parallel market in order to boost returns. It is common for such premises to appreciate by as much as ten times in a period of a few years. A four-roomed garden flat bought for Z\$750 000 in 1998 was sold in 2002 for Z\$7 million!
- 21 A source in the currency exchange market puts the share of *bureaux de change* at 20%.
- 22 Fundira, op cit.
- 23 Budget statement presented to Parliament of Zimbabwe by Minister Herbert Murerwa, Harare, 14 November 2002.
- 24 R Goba, *Money laundering in Namibia*, unpublished paper, 2002.
- 25 Ibid.
- 26 *The Sunday Monitor*, 21 July 2002, quoting Maureen Owor, lead Counsel to the commission.
- 27 The directive was set out in a letter from the URA to Genesis, dated 10 July 2002.
- 28 *Sunday Monitor*, 21 July 2002.
- 29 Banda, op cit.
- 30 The money had been obtained through a false declaration to the CBK by the Exchange Bank that Goldenberg had received US\$210 million from export activities, and deposited it into one of the CBK's foreign accounts. In return, Goldenberg received KSh13.5 billion.
- 31 Based on a report prepared by G Kegoro, *Money laundering in Kenya*, unpublished.
- 32 The *Comprehensive investment guide to Zimbabwe* promises that an investor who invests not less than US\$1 million in a project approved by the Zimbabwe Investment Centre will qualify for permanent residence on application. An investor who invests at least US\$300,000 qualifies for a residence permit of three years, as do professional or technical persons investing US\$100,000 in their respective field, or in a joint venture with a permanent resident. In South Africa, an applicant for permanent residence who can invest at least SAR1.5 million (approximately US\$150,000 at the 2002 exchange rate), which includes a deposit in a bank or a residential property maintained for three years, will be regarded favourably.
- 33 'Current situation and counter measures against money laundering: Tanzania's experience', paper presented by the Tanzania delegation to the First Southern Africa Regional Conference on Money Laundering, Johannesburg, 26–28 February 2002.
- 34 Based on a presentation by the investigating officer, given at a law enforcement conference on money laundering in southern Africa, Morningside, South Africa, 22 February 2002.
- 35 The South Africa study by the Centre for the Study of Economic Crime noted:

Evidence has been found that substantial amounts are transferred physically to and from destinations in South Africa, whether by the criminals themselves or by third parties who act as couriers. Cash can be transferred physically in many ways, but during the



workshop specific examples were cited where cash was strapped to bodies of passengers in motor vehicles and aircraft or hidden in their luggage. Similar methods are used to convey cash across the borders of South Africa. While it is legitimate to convey cash physically within South African borders, substantial cash amounts can only be transferred across South Africa's borders legally if the exchange control requirements have been met. (A footnote reference has been removed from the quotation.)

See L de Koker, op cit, p 18.

36 P Bagenda, *Money laundering in Tanzania*, unpublished.

37 *Financial Gazette*, 13 February 2003.

38 JA Blum, M Levi, RT Naylor and P Williams, *Financial havens, banking secrecy and money laundering*, a study commissioned by the United Nations Office for Drug Control and Crime Prevention, 1998, accessible at <www.imolin.org/finhaeng.htm>.

39 South Africa, Kenya, Mauritius and Zimbabwe.

40 *Motsi v Attorney General & ORS* 1995 ZLR 278 (H). In this case, nominee companies were used to conceal the proceeds of criminal activities that were perpetrated by a company chief executive and his accomplices.

41 Terrorist activities should be understood as set out in the Algiers Convention (1999), namely:

the unlawful or threatened use of violence against individuals or property to coerce and intimidate governments or societies for political, religious and ideological objectives. Terrorist attacks are generally carried out against civilian targets, instilling fear in the public and government of the day.

42 *FATF report on money laundering typologies 2001– 2002*, 2002, pp. 2–7.

43 The *Cape Argus*, 22 July 2002, reported that US customs agents had arrested a Jordanian-born man in possession of US\$12 million in false bank cheques, which he was attempting to smuggle into the country from Indonesia, a country suspected to have provided refuge to al Qaeda and Taliban fighters who escaped from Afghanistan.

44 *Herald*, 6 July 2002, quoting the government-aligned National Economic Consultative Forum.

45 The high-risk countries are Kenya, Malawi, Seychelles, Tanzania, Uganda, Zambia and Zimbabwe. Medium-risk countries are Botswana, Lesotho, Mauritius, Mozambique and South Africa. Only Namibia and Swaziland are regarded as low-risk countries.



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About this paper

In today's open and global financial world, characterised by rapid mobility of funds and the introduction of new payment technologies, the fight against money laundering needs to be globally co-ordinated in a comprehensive manner. Money launderers seek the weak links in the chain and the consequences for developing economies can be extremely detrimental. Confronting the menace of money laundering becomes even more challenging in the southern African sub-region, with its largely cash-based economies, its less developed and loosely regulated financial, business and intermediary sectors, its underground banking or money-remitting services, and the gaps in its legal and law-enforcement infrastructures and operational capacities.

This paper presents an overview of the prevailing situation in east and southern African countries, against which to predict the efficacy of proposed as well as recently introduced legislative initiatives.



About the author

CHARLES GOREDEMA is a senior research fellow in the Organised Crime and Corruption Programme at the ISS. He has been conducting research into forms of organized crime in Southern Africa and appropriate criminal and civil justice responses since mid-2000. Charles holds qualifications in law from the universities of Zimbabwe and London.

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