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The role of the South African regulatory authorities in combating money laundering and terrorist financing perpetrated through alternative remittance systems

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Submitted in partial fulfilment of the requirements for the degree

MPhil in Fraud Risk Management

in the

FACULTY OF ECONOMIC AND MANAGEMENT SCIENCES

Department of Accounting

at the

UNIVERSITY OF PRETORIA

Subject:

FRM 807: Mini-dissertation

Study leader:

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Date of submission:

2010-04-06

Dedication:

I would like to thank the following people for their support and encouragement:

- My study leader, Danie du Plessis
- My parents, Andrew Barlow and Margie Gebser
- My daughter, Chandré Nortier

Thank you for understanding when I spent so many hours behind the computer.

Charene Nortier

Abstract

Money Service Businesses provide people and institutions with a way to send money (remit) from one place to another. This service is most often associated with migrants, who typically wish to send money or value home. Remittances can be sent both on a domestic and on a cross-border basis. The methods used to remit money or value can be used for both legitimate and illegal purposes. The question posed by this research is whether the Money Service Businesses that operate in South Africa and provide cross-border remittance services are adequately regulated, to ensure that it is not used for the purposes of money laundering and/or terror financing.

Key words:

Alternative remittance systems
Financial Intelligence Centre
Financial Services Board
Migrants
Money laundering
Money service business
Regulation
Remittance
South African Reserve Bank
Terror financing

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GLOSSARY OF TERMS

Al-Q'aida and Hamas

Al-Q'aida (Al Qaeda) and Hamas are international terrorist organisations (Zarate 2004, p.4).

Alternative remittance systems (ARSs)

An ARS is "an alternative [method] to conventional banking for remitting money" that "includes money/value transfer systems regardless of their legal status in particular jurisdictions and regardless of whether or not they are currently covered in part or in total by national regulatory systems" (FATF 2005, p.5).

Basel Committee on Banking Supervision

The Basel Committee on Banking Supervision is an international forum for cooperation between central banks on the monitoring and supervision of banks, aimed at identifying supervisory issues and improving the quality of supervision (FATF 2007b, p.30).

Central bank

A central bank is linked to the government of a country and is tasked with the creation and oversight of the monetary policy of that country (Mwenda 2006, p.9).

Egmont Group

A group of financial intelligence units across the world that is tasked with ensuring that money laundering and terrorist financing are identified and addressed (Levitt & Jacobson 2008, p.70)

Financial Intelligence Centre

In South Africa the Financial Intelligence Centre is the Financial Intelligence Unit. This act as an administrative centre and reports to the Minister of Finance (FATF & ESAAMLG 2009a, p.7)

Financial Action Task Force

The FATF is an international body tasked with setting standards and ensuring cooperation between countries in a bid to combat money laundering (Alldridge 2008, p.443; Vlcek 2008, p.288).

Financial Intelligence Unit

A financial intelligence unit is a central body tasked with the coordination of national anti-money laundering and the combating of terrorist financing policy, and developing statistics for risk assessment (FATF 2008a, p.8).

Formal financial systems

Formal financial systems refer to activities carried out by banks and wire transfer service providers (Marron 2008, p.442).

Functional regulation

Functional regulation refers to the regulation of the functions that are performed by financial services providers, rather than the types of business (Mwenda 2006, p.9).

Hawala/hundi

Hawala is defined as a “money transfer without actual movement of money” (Jost & Sandhu 2000, para.3). It has its origins in India and Asia (Jamwal 2002, p.182). Hawala is also referred to as hundi (Feldman 2006, p.356).

Institutional regulation

Institutional regulation refers to the regulation of every category of financial services, usually by different regulators (Mwenda 2006, pp.9, 10).

Integration

Integration is the final stage in the money laundering process. It involves the integration of the laundered funds into the financial system in ways which support the seeming legitimacy of such funds (Buchanan 2004, p.117).

Layering

Layering is regarded as the second stage in the money laundering process. It involves the creation of integrated and complex financial transactions that obscure the initial illegal nature of the funds (Buchanan 2004, p.117).

Migrants

Migrants are people "who crosses borders to find better opportunities for themselves and their families" (IFAD 2009, p.2).

Money Service Business (MSB)

An MSB is any organisation that offers services such as travellers' cheques, currency dealers or exchanges, money transmitters, but it excludes banks (FinCEN 2009, p.1).

Monitoring

The function of monitoring, which refers to checking whether the rules are adhered to, could be carried out by either regulatory bodies or supervisory bodies (Goodhart, Hartmann, Llewellyn, Rojas-Suarez, Weisbrod 1998, p.189)

Placement

Placement is typically regarded as the first stage in the money laundering process. It refers to the process where large amounts of cash derived from illegal activities are deposited into the formal financial systems, usually by breaking them into smaller amounts (Buchanan 2004, p.117).

Principles-based regulation

Principles-based regulation refers to a situation where regulators issue a set of principles and regulated businesses are compelled to comply with it (Mwenda 2006, p.12).

Prudential regulation

Regulation aimed at the safety and soundness of financial institutions in relation to consumer protection, as the consumer loses if an institution fails (Goodhart et al. 1998, p.5)

Regime

A regime is defined as "a system of government or a particular administration" (Collins 2004a, p.1366)

Regulate

Regulate means "to bring into conformity with a rule, principle, or usage" (Collins 2004b, p.1367)

Regulation

Regulation is described as the "promulgation of an authoritative set of rules, accompanied by some agency, typically a public agency, for monitoring and promoting compliance with these rules" (Baldwin et al. 1998, p.3). Mwenda (2006, p.5) simplifies this as a "set of binding rules issued by a private or public body".

Regulator/regulatory body

A regulator is the body that has the power to prepare and issue regulations, and endeavours to create a culture of compliance with the regulations (Mwenda 2006, p.5).

Remittance

A remittance is defined as the part of a migrant worker's income that is sent home to their families (IFAD 2006, para.1) .

Remittance corridors

Remittance corridors refer to the flows of money or value where the "net sending country" and the "net receiving country" can be clearly identified. The "market structure in the originator and the distribution countries, and the access to formal financial infrastructure in the countries" are identified (FATF 2005, p.11).

Rules-based regulation

Rules-based regulation refers to a situation where regulators impose a set of principles, but expand on it with a set of rules which regulated entities must adhere to in the strictest sense (Mwenda 2006, p.12).

Smurfing or structuring

Smurfing is the term used to describe the process of breaking up a large amount of illegal money that needs to be "placed" in the financial system into smaller amounts. Couriers or "smurfs" are used to make many deposits which avoids alerting a bank's suspicious reporting requirements (Lyden 2003, p.208).

Supervisory body

A supervisory body is tasked with the supervision, both on-site and off-site, of persons (natural and legal) who are required to adhere to the regulations, to ensure that these persons do comply (Goodhart et al. 1998, p.189; Mwenda 2006, p.5)

Terrorism/terrorist act

Terrorist groups usually have extreme political, social or religious beliefs, and they use acts of violence against non-combatants to achieve their aims or publicise their cause (Gup 2007, p.35).

Terrorist finance

Terrorist finance refers to the process of acquiring or the provision of funds with the knowledge that they will be used to finance terrorist activities (Clunan 2006, p.570).

Unbanked

Unbanked refers to those people who do not have any deposit account with a bank (Yujuico 2009, p.66).

Underbanked

Underbanked refers to those people who only make limited use of financial services (Yujuico 2009, p.66).

LIST OF ABBREVIATIONS

9/11	The terrorist attacks on America on 11 September 2001
AML	Anti-money laundering
APG	Asia Pacific Group on Money Laundering
ARS	Alternative remittance system
CFT	Combating the financing of terrorism
CMA	Common Monetary Area (South Africa, Swaziland, Lesotho, Namibia)
ESAAMLG	Eastern and Southern Africa Anti-Money Laundering Group (FSRB)
EU	European Union
EUROPOL	The European Police Office
FATF	Financial Action Task Force
FATF 40+9	FATF 40 Recommendations and 9 Special Recommendations
FICA	Financial Intelligence Centre Act, No 38 of 2001 (South Africa)
FIC	Financial Intelligence Centre (South Africa)
FIU	Financial Intelligence Unit
FSA	Financial Services Authority (United Kingdom)
FSB	Financial Services Board (South Africa)
FSRB	FATF-Style Regional Body
GBP	Great Britain Pound (monetary unit)
G7	Group of 7 countries (United Kingdom, United States of America, Canada, France, Germany, Italy and Japan)
G8	Group of 8 countries (Canada, France, Germany, Italy, Japan, Russia, United Kingdom, United States of America)
IAIS	International Association of Insurance Supervisors
IFAD	International Fund for Agricultural Development
Interpol	The International Police Organisation
IOSCO	International Organisation of Securities Commissioners
ISS	Institute for Security Studies
IVTS	Informal Value Transfer System
JSE	Johannesburg Securities Exchange
IMF	International Monetary Fund
MENAFATF	Middle East and North Africa Financial Action Task Force (FSRB)

MONEYVAL	Council of Europe Anti-Money Laundering Group (FSRB)
POCA	Prevention of Organised Crime Act, No 121 of 1998 (South Africa)
POCDATARA	Protection of Constitutional Democracy against Terrorist and Related Activities Act, No 33 of 2004 (South Africa)
PoDRS	Providers of Designated Remittance Services
SARB	South African Reserve Bank (Central Bank)
UAE	United Arab Emirates
UK	United Kingdom
UN	United Nations
USA	United States of America
USD	United States dollar (monetary unit)
ZAR	South African rand (monetary unit)

LIST OF CONVENTIONS AND DECLARATIONS

Vienna Convention, 1988

The United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Thornhill & Hyland 2000, p.9)

Council of Europe Convention, 1990

Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (Thornhill & Hyland 2000, pp.9, 10)

Strasbourg Convention, 1990

Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (Council of Europe 1990, p.1)

Algiers Convention, 1999

The Organisation of African Unity Convention against Terrorism (Goredema 2005, p.1)

United Nations, 1999

International Convention for the Suppression of the Financing of Terrorism (United Nations 1999, para.1)

Palermo Convention, 2000

United Nations Convention against Transnational Organised Crime (FATF & ESAAMLG 2009b, p.3)

Abu Dhabi Declaration on Hawala, 2002

The Abu Dhabi Declaration on Hawala was drawn up at the conclusion of the first International Conference on Hawala, held in Abu Dhabi in 2002 (Butler & Boyle 2003, p.9)

Warsaw Convention, 2005

Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism (Di Filippo 2008, p.538)

CHAPTER 1: GENERAL ORIENTATION

1.1. BACKGROUND AND RATIONALE

The global anti-money laundering efforts by governments and institutions have their origins in the latter half of the 1900s when governments started to understand the impact of the drug trade and its profits (Alldridge 2008, p.438; Sharman 2008, p.635). Although many activities associated with criminal gangs were recognised as illegal as early as the 1920s, money laundering was only criminalised in the United States of America (USA) in the 1980s (Hülsse 2007, p.156). Internationally, it has been established that it is fairly easy to move the proceeds of crime across borders, and it is this vulnerability that led to international cooperation in the fight against drugs and other crimes (Goredema 2007, p.xii).

The war against drugs led to the signing of the United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Vienna Convention) in 1988, and its subsequent adoption in 1990 (Lilley 2007, p.54; Alldridge 2008, p.438). As a result of the Vienna Convention, the Financial Action Task Force (FATF) was created in July 1989 during a Group-of-Seven (G7) Summit in Paris. Initially, the FATF consisted of fifteen member countries (FATF 2007a, p.1). Membership has grown and in 2007 there were thirty-four members, consisting of thirty-two member countries and territories and two regional organisations (FATF 2008b, p.1). To date, more than 170 countries have adopted some form of anti-money laundering legislation (Sharman 2008, p.635). South Africa has been a member of the FATF since 2003 (FATF 2009a, p.1).

As part of its actions to carry out its mandate, the FATF drew up the Forty Recommendations in 1990, amending them for the first time in 1996 and again in 2003, and implementing the second set of amendments in 2004 (FATF 2003, p.1). Although this is commendable, it is worth noting that the Basel Committee on Banking Supervision issued a statement of principles for the “Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering” as early as December 1988, indicating that the

banking industry had identified the seriousness of money laundering as early as the 1980s (Lilley 2007, p.55).

The purpose of the Forty Recommendations is to provide minimum standards and guidelines for countries to use when developing their own requirements and laws for anti-money laundering (AML) and the combating of terrorist financing (CTF) (FATF 2003, pt. Introduction). The Forty Recommendations provide a basis on which the countries that endorse them can develop and model their regulatory requirements for AML/CTF requirements (FATF 2003, pt. Introduction).

1.2. MONEY LAUNDERING AND TERRORIST FINANCING

In the aftermath of the 2001 terrorist attacks in the USA there has been an increased focus on CTF, as well as combating money laundering (Roberge 2007, p.196; IMF 2008, p.5). During 2001, institutions such as the United Nations (UN) and the FATF took specific action to address the combating of terrorist financing (FATF 2004, p.5; Roberge 2007, p.196). The FATF issued the Eight Special Recommendations on Terrorist Financing, and also expanded its mandate to include the combating of terrorist financing (FATF 2004, p.5). A ninth recommendation was added in 2004 (FATF 2007a, p.1) and the 40 + 9 Recommendations address both formal (regulated) and informal (non-regulated) financial institutions concerned with the transfer of value or money, which includes alternative remittance systems (ARSs) (FATF 2003, p.13).

The international focus and the resulting legislative and regulatory actions regarding money laundering and terrorist financing raise the question as to why it is so important that these activities should be so actively combated. The effects of money laundering on a country's economy can be seen when the financial integrity and stability is undermined, and the flow of international capital is adversely affected (IMF 2008, para.1). In countries where little or no action is taken to curb money laundering, there are more crime-related incidents, and there is a danger that foreign investments will be negatively affected as a result of the fear that the financial sector is more prone to money-laundering abuse (IMF 2008, 2; Vaithilingam & Nair 2009, 19).

Officials tasked with implementing or executing AML initiatives address the trade in drugs, maintain the financial systems, address corruption, and disrupt or curb the financing of terrorism (Tsingou 2005, p.4). It is more difficult to combat the financing of terrorism than to address money laundering, as terrorist financing can originate from legitimate sources (IMF 2005, p.11; Tsingou 2005, p.13; Takáts 2007, p.7).

The war on terrorism is conducted in part by governments' attempts at "finding and confiscating assets that belong to terrorists, terrorist groups and their supporters" (Vlcek 2008, p.268). Butler and Boyle (2003, p.5) report that the investigations that followed the 2001 terrorist attacks on the USA found indications that the financing of these terrorist activities had been achieved by using both the formal and informal financial systems, which included banking systems and ARSs.

1.3. THE RELEVANCE OF ALTERNATIVE REMITTANCE SYSTEMS

Alternative remittance systems (ARSs) can be found in both the formal (registered or regulated) and the informal (unregistered or unregulated) financial systems (IMF 2005, p.10). While regulatory regimes and processes are aimed at regulating the known financial environment, informal financial systems typically operate out of sight.

The FATF description of an ARS will be used for this research. A "money or value transfer system" is described as a

> … financial service that accepts cash, cheques, other monetary instruments or other stores of value in one location and pays a corresponding sum in cash or other form to a beneficiary in another location by means of a communication, message, transfer or through a clearing network to which the money/value transfer system belongs (FATF 2005, p.5).

ARSs operate not only across borders, but also on the domestic level (Amueda-Dorantes & Pozo 2005, p.557). For the purposes of this research the focus will be on remittance transactions that occur across borders.

ARSs typically allow or enable the movement of value or money between geographic locations, using financial processes that operate outside the regulated sphere (Butler & Boyle 2003, p.4). In this regard, the use of the word "alternative" may indicate the difference between remitters who operate in the regulated environment and those who operate outside the regulatory boundaries. However, this interpretation differs from that of the FATF, which uses the terminology "ARSs" to refer to both the formal and informal remittance systems, or stated differently, regulated and non-regulated remittance systems. ARSs are often referred to by other names such as "hawala, hundi or da shu gong ga" (Butler & Boyle 2003, p.4; FATF 2005, p.5).

It is important to recognise that it is not in the interests of the world economy to attempt to curtail remittances. In 2007, it was estimated that the remittances that were tracked amounted to double the amount of official aid received by developing countries, and "nearly two-thirds of foreign direct investment flows" (Ratha et al. 2007, p.2). As alternative remittances tend to flow from developed countries to developing countries, it is thus clear that curbing regulated remittances could have a negative financial impact on impoverished countries (IFAD 2006, para.1).

Although money laundering and terrorist financing can take place in various ways, this research will focus on how ARSs can be used to launder money or finance terrorism. It is thus important to understand what an ARS is. A remittance provider is any person who receives cash or an equivalent and makes it payable to a third party in another location, usually as part of a business or commercial transaction (IMF 2005, p.10).

This research is concerned with understanding the money laundering and terrorist financing risks inherent in using ARSs to transfer value or money, and whether regulatory requirements can adequately address the risks of abuse from a money laundering or terrorist financing perspective.

1.4. PURPOSE OF THE RESEARCH

The purpose of this research is to establish whether the South African regulatory system is robust enough to manage ARSs in such a way that the risks associated with cross-border money laundering or terrorist financing are mitigated. In order to evaluate the situation in

South Africa in terms of the international regulatory requirements, the research will also consider ARSs, money laundering, terrorist financing, and the international and regional regulatory efforts relating to the combating of money laundering and terrorist financing perpetrated through ARSs.

There is an extensive body of knowledge on the requirements of the FATF and international regulators with regard to ARSs. Various international, regional and national institutions have undertaken research on the potential for misusing ARSs for the purpose of money laundering or terrorist financing. These sources will be examined in order to establish whether it is feasible for a regulatory regime to limit or mitigate these risks, whilst allowing the existence of ARSs.

During this research a number of issues will be identified and considered, including the functioning of both formal and informal ARSs. The requirements of the FATF with regard to the regulatory requirements for ARSs will be identified, as will the actions taken by international regulators in regulating alternative remittances systems. The impact of the FATF's requirements for curtailing money laundering and terrorist financing will then be analysed and evaluated.

The use of ARSs to transfer money or value across borders is particularly prevalent in countries with high migrant populations. The International Fund for Agricultural Development (IFAD) (2006, para.1) refers to remittances in the context of migration as the "portion of migrant workers' earnings sent home to their families". The IFAD further indicates that although the scope of migrant remittances tended to be ignored in the past, this is no longer the case. As the volume of migration has increased, the value of remittances has increased correspondingly (IFAD 2006, para.1). As early as 2004 the total annual value of migrant remittances was estimated to be USD 100 billion, with the main purpose of "financing development in the workers' home countries" (Pieke, Van Hear, Lindley 2007, pp.348, 349). In 2006, it was estimated that there were a 150 million migrants worldwide, who sent USD 300 billion home through 1,5 billion separate remittance transactions, reaching 10% of the world's households (IFAD 2006, para.2, 3). Figures published in 2008 indicate that the value of remittances increased to USD 397 (The World Bank Group 2009b, para.1).

1.4.1 The research problem

The hypothesis of this research is that the regulatory regime in South Africa is not robust enough to prevent the misuse of cross-border formal ARSs for money laundering and terrorist financing purposes. In this regard, the FATF (2005, p.3) states that ARSs are vulnerable to misuse for money laundering and terrorist financing purposes. However, it also states that the vulnerability created by this gap for potential money laundering or terrorist financing should be regulated in such a way that the flow of legitimate remittances is not limited in an overzealous attempt to avoid all potential misuses (FATF 2005, p.3).

In order to determine the validity of the hypothesis stated above a number of sub-problems will be examined:

- To establish what money laundering and terrorist financing are
- to establish what ARSs are
- To establish what actions have been taken by international and regional institutions in terms of AML and CTF, especially in relation to ARSs
- To establish the legal framework in South Africa with regard to AML and CTF
- To determine which regulator is charged with the regulation and supervision of formal ARSs in South Africa
- To establish how cross-border, formal ARSs operating in South Africa are regulated.

There is thus the possibility that a regulatory imbalance exists in relation to ARSs, which could originate in the fact that the South African legal framework does not address such systems fully.

1.4.2 Research objectives

According to Alldridge (2008, p.437), a "regulatory framework must aspire to be universal and watertight". When weighed up against the requirement that regulatory frameworks should not be overly costly to implement, this is clearly an ambitious standard for any regulatory framework to achieve.

The introduction of anti-money laundering and terrorist financing measures by the formal financial systems has led to an increased use of ARSs by "money launderers and terrorist financiers" (Butler & Boyle 2003, p.4).

The importance of national borders in respect of financial activity is increasingly impacted on by the expansion of business across the globe (Eatwell 2002, p.238) and the international nature of business calls for international cooperation at a regulatory level, where national regulators can meet, share information and cooperate at various levels (Eatwell 2002, p.238; IMF 2007, p.xiv).

There are a number of international financial bodies and regulators, such as the international banking regulator, known as the Basel Committee on Banking Supervision, the insurance regulator, the International Association of Insurance Supervisors; and the Money Laundering Task Force, known as the Financial Action Task Force or FATF (Nell 1996, pp.199–207).

Certain regional bodies also provide a forum for regulatory guidance and cooperation, especially in the context of setting standards and guidelines. Regional bodies exist in a specific geographic region, creating a forum in which national governments and regulatory bodies can cooperate and share information about critical issues. These regional bodies tend to interpret the standards set by the international bodies, taking into account the particular constraints and realities of the specific geographic region. The regional body for Eastern and Southern Africa is the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG). The ESAAMLG was specifically created to enable cooperation between the countries in Eastern and Southern Africa in addressing anti-money laundering and terrorist financing (ESAAMLG 2008a, p.3).

This research will consider the requirements of international bodies, such as the FATF, and regional bodies, such as ESAAMLG, in relation to the regulation of ARSs. These bodies were chosen because of the impact they have made on international governments in general (FATF) and South Africa in particular (ESAAMLG). Other international bodies that impact on developments in South Africa in terms of regulatory development and considerations are the European Union (EU), the United Nations (UN) and the Egmont Group, as they provide internationally respected guidelines for the regulatory environment, AML and CTF.

National regulators are confined to the borders of the country they serve. A national financial regulator performs five tasks, which include ensuring market transparency; monitoring the observance of the codes of conduct and regulations; enforcing the regulations and codes of conduct; taking regulatory action when regulated entities do not adhere to the codes of conduct and regulations; and developing policies, codes and regulations (Eatwell 2002, pp.238, 239).

This research will attempt to determine whether the South African regulatory authorities are sufficiently well equipped in terms of a legal mandate and empowering legislation to address the combating of money laundering and terrorist financing via ARSs. The legal mandate refers to whether a regulator is allowed, within law, to perform certain actions, whilst the empowering legislation refers to the fact that legislation exists that gives it the powers to execute the mandate. The regulatory authorities that will be considered are the Financial Intelligence Centre (FIC), the South African Reserve Bank (SARB) and the Financial Services Board (FSB).

1.5. RESEARCH DESIGN

The research design adopted is a review of the literature available on the research topic. Definitions and descriptions are used to identify the regulatory approach to money laundering, terrorist financing and ARSs. The South African regulatory regime and requirements are compared with the FATF requirements to establish whether the intended results have been achieved. International, intergovernmental and governmental documents, academic books and academic articles published on this topic form the main

sources for research, supplemented by secondary sources such as official websites and institutional newsletters.

This research is limited in scope. Although alternative remittances involve both cross-border movement of cash or value and domestic remittances, this research will focus only on the cross-border movement of cash or value. It is acknowledged that there is significant migrant labour movement within the borders of South Africa, for example the historical movement of labour from rural areas to the mines, with corresponding remittances to their families; however, this will be excluded from this research.

The limited research available on South African remittances and their regulation impacts on the possible inferences that can be made in this research.

1.6. THE RESEARCH METHODOLOGY

The research methodology is limited to a literature study and an analysis of the sources available on the research problem. A literature study entails a review of other sources published by other people (Hofstee 2006, p.91), the purpose of which is to take a look at the literature available to provide a theoretical basis for the research (Leedy & Ormrod 2005, p.64; Hofstee 2006, p.98).

The critical aspect of a successful literature review is the ability to integrate information and present it in a way that makes sense (Leedy & Ormrod 2005, p.77). There are a number of important reasons for conducting thorough literature reviews. These include ensuring that previous work is not duplicated and identifying the most recent work done in the field, including the generally accepted definitions of key terms and concepts. In addition, a literature study helps to establish the generally accepted beliefs and theories about a topic and to identify the instruments that have been used for testing purposes. It also enables the most trustworthy results to be identified (Mouton 2005, p.87).

Literature reviews can have different purposes, including the development of a theory or the evaluation of an existing theory (Baumeister & Leary 1997, p.312). They allow the available knowledge on a subject to be assessed, a specific problem or shortcoming to be

evaluated and certain corrective action to be considered (Baumeister & Leary 1997, p.312).

1.6.1 Advantages and disadvantages of a literature review

One of the advantages of a literature review is that it allows related literature developed by other scholars to be evaluated and analysed. As not all works that have been published on a topic are necessarily accurate, unbiased or relevant, the analysis of the available literature allows for a sifting process whereby content is analysed for the value it adds to the specific research question (Leedy & Ormrod 2005, p.77). A literature review enables the evaluation of a broad range of knowledge and information about a problem or theory, and it can allow certain conclusions to be drawn (Baumeister & Leary 1997, p.313).

The disadvantage of limiting the study to a literature review is that the possibility of expanding the available knowledge to answer questions where there is a knowledge gap is limited. Any limitations in terms of available data will be highlighted where this impacts on the ability to analyse a set of data or draw conclusions.

1.6.2 Literature search conducted

The search for available data was constructed around the use of key words. The initial key words used were limited to *alternative remittances, remittance systems, hawala, money laundering* and *hundi*. This set of key words was later expanded to include other terms such as *regulatory regime, regulators, AML, terrorist finance, terrorist funding, financial crime* and *underground banking*. Later, this was expanded yet again to include *migrants, migration, economic impact,* and *South Africa.* These key words were used throughout the searches conducted. The literature search conducted included various search criteria and sources, which will be briefly discussed below.

1.6.2.1 Books

A catalogue search of the libraries of the Universities of Pretoria and South Africa for books written in this field of study was conducted and this was supplemented by a search for titles available on the internet. The initial search was disappointing, producing books

written in the 1980s focusing on the socioeconomic impact of migration and remittances. The search parameters were thus expanded to include keywords such as *financial crime*, *money laundering* and *terrorist finance*, which led to better results, producing publications dating from the late 1990s to 2008. The search was limited to works published between 1996 and 2009 in order to exclude outdated information.

1.6.2.2 Journal articles

A similar approach to the search for books was used to search for articles, with preference being given to articles published in peer-reviewed journals. Academic search engines and databases were mined for articles published in South African and international journals. Although many journals were available online, certain articles were also found in paper-based editions. Articles available in journals published by professional bodies and those published by international bodies, such as the World Bank and the International Monetary Fund (IMF), were included in the research.

1.6.2.3 Regulatory and institutional sources

The websites of respected regulatory, international and national institutions and organisations were searched for relevant information. This search included institutions such as the IMF, the FATF, the World Bank, the African Development Bank, Interpol (the international police organisation), the Institute for Security Studies (ISS) and the Financial Intelligence Centre (FIC) in South Africa and it often led to links to other bodies, such as the ESAAMLG and the Asia/Pacific Group (APG) on Money Laundering.

1.6.2.4 Original sources cited by authors

A search was conducted for original sources cited in other published works. Where books were cited this approach was less successful, as many of the books were not readily available in South Africa. A search for articles, conference papers and other reports was more successful, one example being the report published in 2004 by the National Commission on terrorist attacks on the United States of America (USA).

1.6.2.5 Other sources

Other sources that were accessed provided entrée to research reports on issue-specific research that has been conducted. Examples include reports published by, among others, FinMark Trust (a South African research organisation), Genesis Analytics (a South African research organisation that provides services to, among others, government departments and FinMark Trust), and the African Development Bank.

1.6.3 Exclusions and inclusions

Resources published before 1996 were excluded as far as possible, although relevant legislation pre-dating 1996 was included. Books and articles written in the style of popular fiction were also excluded, while articles published in recognised academic or professional journals were included, with the exception of articles published in popular magazines.

Research conducted and published in the form of draft papers, white papers, briefing sheets and fact sheets by reputable international, regional and national institutions, such as the IMF, the FATF and the ISS, were included. It should be noted, however, that there are very few academic publications on the role of regulatory authorities in regulating ARSs. Compounding the problem is the fact that there are also few sources addressing the South African regulatory environment and these were often either written prior to 2005, or had a narrow focus.

1.7. OUTLINE OF CHAPTERS

The following is an outline of the chapters developed in response to the research problem.

1.7.1 Chapter 1: General orientation

This chapter sets out the basis of the research that was conducted. This includes the background to the research, the problem statement, the objectives, the research methodology and the structure.

1.7.2 Chapter 2: Money laundering and terrorist financing

The research will consider the nature of money laundering and terrorist financing, and why they are regarded as serious international problems. The main methodologies adopted to launder money or finance acts of terror are discussed.

1.7.3 Chapter 3: Alternative remittance systems

This chapter considers what ARSs are and a distinction is made between formal or regulated ARSs and informal or unregulated remittance systems. The chapter determines whether informal ARSs are always underground, and whether underground equals criminal activity. The methods used by ARSs, both regulated and unregulated, to transfer value and money are discussed. In addition, the existence of remittance corridors and the most prevalent remittance corridors, as well as their links to informal ARSs, are considered.

1.7.4 Chapter 4: The use of alternative remittance systems for money laundering and terrorist financing

This chapter reviews the way in which formal and informal remittance systems can be used to launder money and finance terrorism. A number of instances where ARSs have been involved in money laundering and terrorist financing are briefly reviewed.

1.7.5 Chapter 5: International and regional regulatory requirements regarding alternative remittance systems

In this chapter, an overview is given of the international regulatory requirements for combating money laundering and terrorist financing using ARSs. This overview includes the FATF recommendations and considers the development of international and regional approaches to the regulation of ARSs. The chapter also establishes some guidelines for countries developing their own regulatory regimes in this regard.

1.7.6 Chapter 6: The South African situation regarding the regulation of alternative remittance systems

In this chapter, the regulatory requirements and actions undertaken by South Africa in terms of the regulation of ARSs are identified. The existing legal and regulatory framework for ARSs is identified and the regulatory and supervisory bodies and their scope or mandate are discussed.

1.7.7 Chapter 7: Conclusion and recommendations

This chapter draws conclusions based on an examination of the literature review conducted, which will indicate whether or not the problem statement could be validated. Some recommendations are made for the review or amendment of the regulatory requirements in South Africa in terms of the regulation of ARSs. The limitations experienced during this research and possible areas for future research are also discussed.

CHAPTER 2: MONEY LAUNDERING AND TERRORIST FINANCING

2.1 INTRODUCTION

Money laundering involves activities designed to hide the illicit origin of money and to give it the appearance of legitimacy. Illicit money transfers can have two main purposes: firstly the money can be obtained from illegal origins and there is a need to give it the semblance of legality (money laundering) or, secondly, the money may be legal in origin, but there is a need to hide the purpose it will be used for, as the intent is to fund terrorist activities (Takáts 2007, p.7). Money laundering is generally regarded as a financial crime (IMF 2001a, p.6).

Financial institutions, such as banks and non-bank institutions can be unknowingly used to launder money or provide terrorist finance. The non-bank institutions of particular interest in this research are money service businesses (MSBs) and ARSs, which are also sometimes referred to as informal value transfer systems (IVTSs). The methods used to launder money or finance terrorism are referred to as methods or typologies, and the two terms can be used interchangeably (Schott 2006, pp.I□11).

2.2 MONEY LAUNDERING

Money laundering can be described as the “process by which proceeds from a criminal activity are disguised to conceal their illicit origins” (Gilmore 2004, p.11; Schott 2006, pp.I□1; Lilley 2007, p.xii). Money laundering is regarded as a global risk because it can threaten a country’s political stability and economic soundness (Schroeder 2001, p.3). Various factors, such as the growth of the global financial network, easier international travel between countries, growing international trade and the increase in international crime have worked together to both enable money laundering across borders and ensure that global money laundering is an attractive venture for criminals (Schroeder 2001, p.3).

There is inherent secrecy surrounding money laundering. Unger (2007, p.29) states that “money laundering remains largely in the dark. It only comes to light when it is detected”.

This statement lies at the heart of the problem of money laundering; by its very nature it is a secretive, clandestine process, seeking to hide rather than flaunt. To detect it, regulators and financial institutions need to understand its nature and processes.

2.2.1 The impact of money laundering

Countries are affected by money laundering on three levels, namely enforcement, economics and governance (Schroeder 2001, p.5). This section briefly considers the impact of money laundering on these three levels.

2.2.1.1 The impact of money laundering on law enforcement

Crime increases in areas where the proceeds of the crime can be laundered. The laundered funds can be used to finance criminal activities, and this enables criminals to commit more crimes (Schroeder 2001, p.5). Crimes that are often associated with money laundering include corruption and fraud (IMF 2001a, p.8).

Areas that have a weaker law enforcement structure are vulnerable to money laundering and criminal activity (Moshi 2007, p.1). Conversely, where law enforcement agencies become more effective, criminals and money launderers take greater care to hide their activities (Moshi 2007, p.2). The easy movement of money across global markets and borders is not always supported by a similar willingness between law enforcement agencies of different countries to share information. There is evidence that investigations have been hampered or curtailed by national governments in the interests of political gain or cooperation (Kochan 2007, p.46).

The FATF recommendations include several that address the broad ambit of law enforcement. There are three broad groupings in this respect, including the criminalisation of money laundering in recommendations 1, 4, 5 and 6; allowing for the seizure and confiscation of the proceeds of money laundering in recommendations 7, 35 and 38; and enabling international cooperation in the investigation, prosecution and extradition of suspects in recommendations 3, 31 to 33 and 36 to 40 (IMF 2001a, p.37).

In South Africa specific legislation criminalises money laundering. This was achieved with the promulgation of the Prevention of Organised Crime Act (POCA), No. 121 of 1998. The preamble to the POCA states that the aim of the Act is to combat organised crime and money laundering, and to prohibit money laundering. The POCA does not identify specific crimes as being associated with money laundering, but adopts a broad approach which involves identifying all unlawful activities as being crimes that could be involved in money laundering.

2.2.1.2 The impact of money laundering on the economy

Money laundering is of great concern to governments as it has a number of adverse effects on a country's economy. There are various reasons for paying attention to anti-money laundering (AML) efforts at a national level, as AML efforts enhance the fight against drugs, drug trafficking and other serious crimes. Such efforts also protect the stability and trustworthiness of the financial systems and disrupt terrorist financing activities. In addition, the country's economy is protected against the impact of freely available laundered funds on the financial environment (Richards 1999, p.45; Tsingou 2005, p.4).

In countries or regions where money laundering is rife, a demand for goods and services can be created that does not reflect the true economic situation in the country. The distortion of the supply and demand chain can negatively affect a market, thereby creating the impression that there is a higher demand for an item than really exists. In instances where money launderers cease their activities in a specific region, the false impression of supply and demand can negatively influence the market (Howell 2006, pp.30, 31).

The adverse impact that money laundering can exert on the economies of poor or developing countries should not be underestimated, as it can result in increased crime, reduced governance and increased corruption (Moshi 2007, p.2). Unchecked money laundering will detract from the functioning of financial institutions and ensure that a country is less attractive to potential foreign investments (Moshi 2007, p.2). Investors and trade partners may decide to disinvest or cease trading with a country or region that is rumoured or known to be a safe haven for money launderers (Howell 2006, p.31). It is

generally accepted that crime is high in countries or regions known to have a high incidence of money laundering (Howell 2006, p.31).

2.2.1.3 The impact of money laundering on good governance

In 2001, the IMF Board issued a public information notice (PIN) in which it stated that money laundering is a global problem that undermines the financial integrity, financial stability and good governance of a country (IMF 2001b, para.4). Corruption in government as a result of money laundering further weakens good governance (Schroeder 2001, p.5). Transparency International (2009, p.2) reports that, globally, the civil service is regarded as being highly corrupt; it further reports that most governments globally are regarded as being ineffective in dealing with corruption (Transparency International 2009, p.3). The problem of corruption is critical in developing countries, as criminal organisations use corruption to enhance their power base and decrease the effectiveness of the public sector (Tsingou 2005, pp.10, 16).

2.2.2 The process of money laundering

Money laundering is seen as a process rather than an event, which means that it is seldom a single activity, but rather a series of related activities that have as their ultimate goal the ability to access, through seemingly legitimate means, money that has illegal origins. Money laundering starts when there is a need to hide the fact that the money originated from an illegal activity (Gup 2007, p.6).

There are typically three stages in money laundering, which include placement, layering and integration (Thornhill & Hyland 2000, pp.6, 7; Buchanan 2004, p.117; Commonwealth Secretariat 2006, pp.8-10). Placement refers to those activities that place the illegal money in the financial system. Various actions, such as “smurfing” or structuring, can be used during this stage (Gup 2007, p.6). This often means that large amounts are broken up into smaller amounts which are then placed in the financial system (Sartip 2008, p.69). The greatest risk of detection for the money launderer is during the placement stage, as this is where the fact that the transaction is not entirely legitimate could be detected (Lyden 2003, p.208; Gup 2007, p.6). This is mainly as a result of the generation of large volumes of cash that need to be placed in the financial system without detection (Buchanan 2004, p.117).

The purpose of layering is to create distance between the source of the funds and the actual funds (Sartip 2008, p.69). During the layering stage money is often placed in various financial instruments such as cheques, money orders, shares or insurance policies. The use of more than one instrument and more than one financial institution can help to hide the fact that money is being laundered (Gup 2007, p.6). Launderers often use multiple accounts across a wide area in jurisdictions where there are less strict money laundering controls in place (Sartip 2008, p.69).

The last stage is integration, where the purpose is to integrate the laundered funds into the financial systems to ensure that they appear legitimate. The funds can then be used to purchase items such as property or vehicles, or to pay for expenses. Thereafter the funds can be used for further illegal activities (Gup 2007, pp.6, 7). There is evidence of new trends in money laundering at the integration stage, including trade finance and securitisation. Trade finance involves short-term financing with the aim of enabling the import and export of goods, and usually involves many parties on either side of the transaction (Sartip 2008, p.70). Securitisation involves creating new financial instruments (often called special purpose vehicles) by pooling financial assets and marketing them to investors. Money laundering can take place when these vehicles are sold to “qualified investors”, which can include illicitly funded offshore funds (Sartip 2008, p.69).

It is often hard to differentiate between “clean” and “dirty” money, as it is quite feasible that a launderer could mix legitimate (clean) money and illegal (dirty) money in one transaction (Richards 1999, p.47; Unger 2007, p.190). Gup (2007, p.7) identifies a number of concerns that impact on the decision of what money laundering process should be followed. The decision about the money laundering process to be adopted is influenced by issues such as the amount to be laundered and whether it is a once-off or a regular event. The money launderers also have to consider the number of people who are involved and how trustworthy they are. The effectiveness of the local law enforcement at detecting money laundering and investigating it is also an important consideration.

2.2.3 Money laundering trends

The ESAAMLG has identified three trends in money laundering which are worth taking cognisance of; these include internal money laundering, incoming money laundering and outgoing money laundering (Goredema 2003a, p.183).

Internal money laundering refers to a situation where laundering the proceeds of crime takes place in the same country as the original crime occurred (Goredema 2003a, p.184). Crimes that are closely associated with internal money laundering in South Africa and the member countries of the ESAAMLG include drug trafficking, trade in stolen vehicles, armed robberies, tax fraud, currency trading and defrauding government departments. All of these crimes generate substantial amounts of money that need to be laundered (Goredema 2003b, pp.2–9).

The terms “incoming” and “outgoing” money laundering describe the same process, but from different perspectives. Incoming money laundering refers to a situation where the money or assets that are laundered are derived from crime that took place outside the borders of the country in which the laundering is taking place (Goredema 2003a, p.184). Although there are various reasons why criminals would prefer to move the money from the country of origin to another country, two of the main reasons have to do with obscuring the money trail and moving the money to a country where law enforcement is less effective (Goredema 2003b, p.10). Typical crimes associated with incoming money laundering in the ESAAMLG member countries include the dagga trade (a popular narcotic in Africa) and transporting stolen vehicles across borders, such as the trade from South Africa to Namibia. The trade in stolen vehicles involves stealing vehicles in South Africa, transporting them across the border to Namibia, paying for them with money stolen in Namibia, and then selling the vehicles in Namibia (Goredema 2003b, p.11).

Outgoing money laundering is the flip side of incoming money laundering, as this occurs when the proceeds of the crime committed in one country are exported to another country or countries (Goredema 2003a, p.184). This method is often used to obscure the trail of money (Goredema 2003b, p.12). Research in South Africa, Kenya and Tanzania has shown that this is often achieved by carrying cash in bulk across borders (Goredema 2003b, p.12).

2.2.4 Indicators of money laundering

There are a number of indicators or red flags that can alert both banking and other financial institutions to the possibility of money laundering activities. These can include behaviour that does not fit the normal pattern of the business or individual, while other indicators include associations by parties with other parties that would not normally be associated with the business, or unusually high volumes of transactions without a clear business reason for the transactions or volumes (Gup 2007, pp.31, 32).

Money laundering typically occurs in areas where there are high rates of drug trafficking or financial crime, high volumes of currency flows, or financial interaction with countries where drug trafficking is rife (Gup 2007, p.32). The red flags can either relate to the customer or to the transaction. Customer-related red flags would include known affiliations to political groups or verbal statements and behaviour that give rise to the suspicion of money laundering (Ridley 2008, p.31). Transactional red flags would include transfers between accounts that would not normally have a reason to be associated with one another, as well as the transfer of unusual amounts, or transfers to unusual or suspect recipients (Ridley 2008, p.31). Red flags merely alert an official to the possibility of illicit activity and do not provide conclusive evidence of money laundering (Ridley 2008, p.31).

2.2.5 The development of an anti-money laundering framework

AML frameworks tend to have two focus areas, namely prevention and enforcement. The focus of preventative AML frameworks is to develop regulations, codes and rules and to enforce them through sanctions. The focus of enforcement is the deterrent effect of actions, such as investigating possible criminal activity, prosecuting offenders and confiscating the proceeds of crime (Tsingou 2005, p.4).

The development of regulations and regulatory approaches is described as having both a “download” and an “upload” effect (Tsingou 2005, p.4). The download of regulations occurs when regulatory frameworks are developed at a global level, such as the 40 + 9 FATF recommendations, and then adapted and implemented at a national level (Tsingou 2005, p.4). The upload of regulations occurs when regulatory frameworks are developed at

a national level and accepted at a global level (Tsingou 2005, pp.4, 5). National regulators often provide the impetus for the international or global adoption of regulatory standards or frameworks in order to avoid a domestic or international problem (Lutz 2004, pp.186□188).

Governments adopt AML strategies as a result of various considerations. The integrity of the economy and financial systems of a country can be undermined if the national government is suspected of supporting money laundering. In instances where large sums of laundered money can enter the formal financial systems, the additional inflow of money can distort the data on the actual financial growth of the economy. This distorted data then creates an impression of greater stability or actual growth than the true situation warrants. Laundered money can also be used by criminals to consolidate their position in a society or country, and to corrupt the political system. Criminal activities that are linked to money laundering include drug smuggling, human trafficking, the arms trade, and other serious crimes. The costs of combating these crimes and the impact of the crimes on society are high, especially if combating is done on a reactive level (after the crime has taken place). It is important for governments to be aware that the proactive combating of crimes is often more effective than reactive policing (Tsingou 2005, pp.9, 10; Moshi 2007, pp.2, 3).

2.3 TERRORIST FINANCING

It is very difficult to find a single globally accepted definition of terrorism. There are some common denominators that are found in the literature, describing the actions that could be regarded as acts of terror. Terrorist groups are usually motivated by extreme political, social or religious beliefs and direct their acts of violence at non-combatants in order to achieve their aims or publicise their cause. They generally function in a clandestine manner (Ruby 2002, pp.10, 11; Gup 2007, p.35).

Based on the above, it can be concluded that terrorist financing is the provision of funds for the purpose of funding, directly or indirectly, acts of terror. The term “terrorist financing” is used to describe two activities: firstly, it describes the financing of the terrorist cell, where the funds are used for logistical and support purposes, and secondly, it describes the raising of funds that will finance terrorist activities (Roth, Greenburg, Wille 2004, p.52).

A list of international terrorist actions that have taken place since 2001 include the attacks on the World Trade Centre in New York in 2001, attacks on a military housing compound in Riyadh, Saudi Arabia in 2003, and the train explosions in Madrid in 2004 and London in 2005 (Gup 2007, p.36). Terrorist attacks are considered to be domestic if the perpetrator and victims are from the same country, or international if the perpetrator and victims of the attacks are from more than one country (Gup 2007, p.36).

There is evidence that the main bases of terrorist groups are often situated in countries with low income levels, large unemployed populations, and strict governments with little democratic involvement (Gup 2007, p.37). Terrorist organisations may operate from a base in a safe haven, but may also have a network of cells in other locations, not necessarily in the same country as their main bases. Terrorists are often based in centres with frequent criminal activity (Gup 2007, p.37).

The view expressed that terrorism is more prevalent in countries with lower income levels is not necessarily the only view to be considered. The degree of political freedom in a country often influences the propensity for terrorism more than the level of poverty experienced, with lower levels of political freedom often leading to higher levels of terrorist activity (Abadie 2004, p.1). Conversely, in areas where political freedom is equal, more affluent countries are often the target of terrorist action (Abadie 2004, p.1). Another issue is that richer countries or their citizens tend to be favoured targets of terrorist attacks, as such attacks generate more attention than when similar attacks occur in smaller or poorer countries (Abadie 2004, p.2).

2.3.1 The difference between terrorist financing and money laundering

Different motives drive terrorist financing and money laundering. Financial gain is the main driver of money laundering, whilst considerations such as political or religious beliefs drive terrorist actions (Alexander 2005, p.66). The funding for terrorist activities may be obtained from legal sources, whereas the funds involved in money laundering are not derived from legitimate sources (Clark & Russel 2003, p.310; Moshi 2007, p.3). Terrorist finance can be derived from both legal sources, such as funds channelled via charitable organisations,

and illegal sources, such as funds derived from criminal activities (Bantekas 2003, p.316; FATF 2008c, p.8).

There are different stages involved in money laundering and terrorist financing. The typical money laundering stages are the placement, layering and integration of funds into the financial systems (FATF 2005, p.90). The purpose of money laundering is to accumulate wealth in such a manner that it appears legitimate. By contrast, the typical stages involved in terrorist financing are the collection of funds, the dissemination of funds to the terrorist cells and the use of funds (FATF 2005, p.90). The purpose of terrorist financing is not to accumulate wealth, but to fund actions designed to make a statement of importance, such as drawing attention to a political viewpoint.

Terrorist funding can originate in fraudulent schemes and the illegal profits are then applied for terrorist financing (Alexander 2005, p.67). Although anti-terrorism legislation aims to limit the financing of terrorism, the ability of terrorists to adapt and change their funding model often defeats the purpose of such anti-terrorism legislation (Napoleoni 2007, p.13).

2.3.2 Indicators of terrorist financing

Although the use of funding and the sources of funding differ between money laundering and terrorist financing, there are some similarities in the detection of possible illicit activity. In one incidence, a bank in France became suspicious about the seeming inconsistency between a restaurant manager's accounts and the link to a company manufacturing wooden pallets (FATF 2008c, p.14). Further investigation revealed that the people involved were linked to Salafist (radical) movements. In a similar incident, French bank officials became suspicious of a locksmith, who had high volumes of financial activity that were inconsistent with that type of business. Further investigation identified links between the locksmith and radical movements (FATF 2008c, p.14). This type of account monitoring could also have identified money laundering activities.

Another instance of identifying acts related to the financing of terror was reported in Russia, where a charitable organisation's stated objectives and account activities did not

match up. Investigation by the authorities uncovered the fact that the charity had links to militant organisations and made the funds intended for the charity available to them (FATF 2008c, p.13).

2.3.3 The need of terrorists for financing

Terrorist organisations come in many shapes and sizes, ranging from small, loosely organised groups to large, formal organisations (FATF 2008c, pp.4, 7). In addition, there are different types of terrorist who operate in different ways. The professional terrorist earns a livelihood from terrorism (Ganor 2005, p.190), while there are also individuals who carry out acts of terrorism on their own initiative, usually motivated by revenge or in protest against an issue (Ganor 2000, p.6). As a case in point, German officials found two suitcases packed with incendiary devices on a train. Further investigation established that this was the action of an individual, who had obtained the instructions for creating the devices from an Al Q'aida website and used funding aimed at furthering his studies, which he had obtained from his family, to purchase the required items. The total cost of this exercise was roughly EUR 250 (FATF 2008c, p.15).

Organised terrorism requires support and administrative structures, as numerous people and activities have to be housed, fed, trained, paid for and supplied with resources (Ganor 2005, pp.190, 191; Goredema 2005, p.5). The costs associated with such activities can be high, requiring infrastructure and funding (Howell 2006, p.21). The FATF (2008, p.10) reports that prior to 9/11 Al Q'aida needed an estimated USD 30 million per year to fund its operations and networks.

Recent research suggests that terrorist networks are largely fragmented, with terrorists operating in small groups or cells at a local level and organising their own funding. The self-funding of such local cells means that there is both less reliance on central funding and less impact on the overall network should such a cell be discovered by law enforcement agencies (Acharya 2009, p.286).

Research on terrorist attacks and the funding required for such attacks indicates that the amounts needed to fund these are not necessarily large. Estimates range from GBP 8 000

required for the London train system attacks in 2005, USD 10 000 for the 2004 Madrid train bombings and USD 50 000 for the bombings in Bali in 2002 (FATF 2008c, p.7). These estimates include items such as the cost of explosives and vehicles used during the attacks. The costs associated with the 2007 explosion of two bombs in Hyderabad, India, amounted to about 1 000 Rupees (USD 25) for each bomb, but claimed 42 lives and injured another 50 (Acharya 2009, p.285). The low costs associated with the explosions in India are attributed to the fact that terrorist cells are largely self-funded, and that they use easily obtainable materials to manufacture the explosive devices. These facts contribute to the difficulties that law enforcement agencies experience when trying to trace terrorist financing activities (Acharya 2009, p.286).

The financing of terrorism reflects the size of the operation that requires financing (FATF 2008c, pp.4, 7). Terrorist organisations can raise their own funds and much of their funds are obtained from members who are employed and who use part of their wages or salaries to fund the terrorist activities (FATF 2008c, p.11). Funds can also be obtained from well-organised sources such as charities, governments and companies (FATF 2008c, p.11). Such financing can either be obtained in multiple small amounts or in a few large payments; however, whatever the size of the transaction, it has to be obscured so as to ensure that the purpose for which it is to be used cannot be easily ascertained (Howell 2006, pp.21, 22). There are many examples of terrorist organisations raising funds through drug trafficking, extortion, credit card fraud and cheque fraud (FATF 2008c, pp.15□18).

It seems logical to surmise that interrupting or stopping the funding of terrorist organisations would have an impact on their ability to function, both immediately and in the future (Levitt 2003; Ganor 2005, p.191; Gardner 2007, p.326; Moshi 2007, p.3; Marron 2008, p.443). This argument is countered to some extent by the development of more localised terrorist cells. These cells are able to raise funds at grassroots (local) level, which means that less money or value needs to be remitted across borders, which reduces their vulnerability to detection and the subsequent interruption of the flow of finance (Acharya 2009, p.286).

2.3.4 Reasons for taking action against terrorist financing

The war on terrorism gained momentum after the 9/11 attacks, and many countries around the world have given their wholehearted support to this global initiative. Internationally, there is now a greater understanding of terrorist financing and actions that would disrupt the activities of terrorists (Gardner 2007, p.326) and there is evidence that even the USA did not take CFT initiatives seriously before the 9/11 attack (Levitt & Jacobson 2008, p.67). After these attacks, the USA law enforcement agencies were instrumental in forcing international cooperation to establish the source of funding for Al Q'aida and other terrorist organisations (Kochan 2007, p.47).

Passas (2006, p.282) convincingly states the case for monitoring terrorist finance, citing four reasons why it is important to conduct CFT activities. These include the fact that the impact of terrorist activities can be reduced, preventative actions are enabled and those involved in terrorist attacks can be found and prosecuted. The latter reason makes a strong case for publicising the investigation of financial affairs; the mere announcement of CFT investigations ensures that terrorist or militant groups have to change their activities, which allows intelligence services to gather new or additional information (Passas 2006, p.282).

The FATF, the UN and the Egmont Group have been instrumental in driving initiatives aimed at improving international CFT efforts (Levitt & Jacobson 2008, pp.67 - 70). In addition, many African countries have joined in the CFT fight, supporting the American-led efforts in this regard (Dagne 2002, p.62). There is also support for the belief that many terrorist organisations originate from or have ties to Africa (Dagne 2002, p.62; Gardner 2007, p.325). In support of this supposition is evidence of the link between organised crime, such as drug trafficking and the smuggling of diamonds, tanzanite and gold, in the funding and support of terrorism in Africa (Goredema 2005, pp.2-4).

CFT or, stated differently, the war on terrorism, includes an array of laws, directives and regulations (Amoore & De Goede 2005, p.151). The addition of CFT to global AML efforts means that the processes used to capture money launderers after the fact are now used to capture the terrorist before the act of terrorism has taken place (Amoore & De Goede 2005, p.152). This combination of two divergent purposes based on similar processes may

still prove to be ambitious (Amoore & De Goede 2005, p.152). According to Passas (2006, p.282), it is essential to target terrorist finance as it inhibits their activities, enables their actions to be monitored and helps to identify supporters. Another advantage of targeting terrorist financing is that enhanced regulations and better regulation of transactions provide more data for analysis (Amoore & De Goede 2005, p.182; Passas 2006, p.252).

There is a great amount of pressure applied to countries by external parties, including other countries and regulators, to act visibly to counter terrorism and all related activities. The European Union has warned member countries, including Britain, that failure to take visible action could lead to less financial support (Bascombe 2004, p.4). To illustrate the far-reaching warnings issued to member states, in 2004, the South African port authorities were warned either to adhere to the International Shipping and Ports Security Code with regard to the safeguarding of ports against terrorism or to face the possibility of "blacklisting and isolation from world trade" (Bascombe 2004, p.8).

2.4 SUMMARY

Money laundering and terrorist financing are global crimes and successful action against such crimes has to be taken on an international level. Countries that fail to recognise this and that also fail to take the necessary legal and regulatory action could find themselves in financial purgatory, where reputable industries and countries avoid doing business with them, or may even take action against them (Goredema 2003a, p.182; Bascombe 2004, p.4). Apart from the pressure exerted on countries to be seen to take action, strong arguments have been made that, regardless of the relative inexpensiveness of terrorist action, preventing any amounts from reaching the terrorist group helps to avoid another terrorist attack (Acharya 2009, p.294). Migrant populations and ARSs are linked, migrant populations have been linked to the financing of terrorist action, and ARSs have been linked to money laundering activities (De Montclos 2005, p.43).

CHAPTER 3: WHAT IS AN ALTERNATIVE REMITTANCE SYSTEM?

3.1 INTRODUCTION

Remittances provide an important form of funding for countries with large migrant populations living and working in other countries (Van Hear 2003, para.1). Migration for economic and political reasons has increased over the last two decades and these migrants have a significant impact on the economy of their originating country, as they send money home in the form of remittances (Van Hear 2003, para.3). It is possible to compare the impact of migrant remittances on developing countries with that of more formal forms of assistance, such as foreign aid programmes and foreign investments (Ashraf et al. 2009, p.2).

To illustrate the impact of migrant remittances, consider that by 2006 remittances to India accounted for 3,1% of the country's gross domestic product (GDP). This is significant, especially if one takes into account that this figure reflects only those remittances sent via formal remittance systems (Chisti 2007, p.3). This impact is further demonstrated by the fact that in 2004–5 funding from remittances accounted for 18,97% of the total government expenditure on education, compared to 3,8% in the period 1990–91 (Chisti 2007, p.4).

The significance of remittances is illustrated by the World Bank estimate that 190 million migrants sent remittances to the value of USD 397 billion in 2008, of which USD 305 billion was sent to developing countries (The World Bank Group 2009b, para.1). Data on the annual amounts sent via remittances reflect the value of remittances sent through formal banking channels (Adams 2003, p.5). Remittances sent to developing countries can be seen as even more significant when it is considered that the value of the remittances exceeds the value of international aid (Van Hear 2003, 3; Yujuico 2009, p.63) and such remittances can improve the quality of life for households in the receiving countries (Acosta et al. 2009, p.1). Remittances that are sent via formal channels are recorded as transfers and thus count towards the balance of payment of the receiving countries (Yujuico 2009, p.63).

In recent years the G8 countries have attempted to bring all remittance systems into the regulatory ambit (Pieke et al. 2007, p.349). However, it is not necessarily desirable to attempt to curtail this type of remittance, as there is evidence that suggests that informal remittance systems are often cheaper and easier to use by migrant communities (Pieke et al. 2007, p.349).

The flow of remittances between the USA and Latin America during 2003 and 2004 was studied extensively by Orozco (2004, p.3). The countries in Latin America that formed part of this study included Mexico, Jamaica, Haiti, Nicaragua, Costa Rico, Ecuador, Peru, El Salvador, Colombo, Guatemala, Honduras, Bolivia, Venezuela and the Dominican Republic (Orozco 2004, p.19). It was found that there was a significant difference between the regulatory requirements that remitters had to adhere to in the USA compared to those of remitters in Latin America, with the bulk of the regulatory requirements occurring in the USA (Orozco 2004, p.7). This study seems to suggest that remitters operating in developed countries face a more onerous regulatory regime than that faced by remitters operating in developing countries. There is a significant monetary implication for businesses that are required to adhere to regulatory requirements Orozco (2004, p.8) and the additional costs that apply to compliant business can increase the cost of remittances sent via formal remitters (Orozco 2004, p.14).

3.2 ALTERNATIVE REMITTANCE SYSTEM PROVIDERS

ARS providers can be individuals or groups, and can provide ARS services on a regular or ad hoc basis (FinCEN 2003, p.1). A number of typical businesses that provide ARS services in addition to their normal business activities have been identified, including travel agents, dealers in jewellery and gems, car hire companies, foreign exchange dealers, rug and carpet merchants and providers of telephone services. These are typically businesses with ethnic roots in a specific community that also have links to counterparts in other countries (Jost & Sandhu 2000, 8; Passas 2001, p.10).

Some of the ARS businesses are legitimate, merely offering ARS services in addition to other services, whereas some businesses can serve as “front-offices”, creating the impression of legitimate business whilst their primary function is to provide ARS services

(Passas 2001, p.20). ARS providers can make a profit from the ARS transactions, charging amounts cited as ranging between 0,5 and 20% of the value of the remittance (Carroll 2005, chap.II).

Remitters (those sending the remittance) have to consider the situation in the country or region to which they are remitting. Access to bank accounts and the banking infrastructure in a country is sometimes limited (Howell 2006, p.15). In such instances the money transfer businesses and the ARSs offer viable options for sending and receiving money (Howell 2006, p.15). Often an informal ARS is the only service provider in countries such as Somalia that can allow access to funds sent from other countries (Passas 2006, p.48). This situation could serve to explain why informal ARS systems are used by remitters sending remittances to certain countries.

The advantage of ARS services for their users is that it is very difficult to monitor who uses the services and why they are being used (Butler & Boyle 2003, p.10). The underground banker (informal ARS provider) is typically an entrenched and trusted member of a local ethnic community (Passas 2001, p.21; Carroll 2005, I; Casey 2007, p.12). This trust relationship means that very little paperwork is concluded between the underground banker and the remitter. The underground banker is also connected to many similar ethnic underground bankers in other parts of the world, enabling him or her to provide remittances across many jurisdictions (Carroll 2005, ch. I; Casey 2007, p.10). The development of global networks and a strong global financial infrastructure means that ARS providers can move funds or value across the world (Razavy 2005, p.279).

3.3 TYPES OF REMITTANCE

The definition of an ARS is broad, and includes large companies that operate in many countries, as well as small, localised service providers. These companies can be broadly divided into formal and informal ARS providers.

3.3.1 Formal alternative remittance systems

A formal ARS uses formal financial institutions such as banks to provide the platform for moving or transmitting money or value from the sender to the receiver. This refers thus both to ARSs that are themselves regulated, and to areas where ARSs may not be regulated but where the formal financial institutions used may be subject to regulation (Hernandez-Coss 2006, p.6).

The most formal and therefore also the most likely channel to be subject to regulation is the money transfer services offered by banks (African Development Bank 2007, p.7). The African Development Bank has identified a number of formal remittance systems that are commonly used by migrants. These include banks, money transfer companies such as Moneygram, microfinance institutions and the postal services (African Development Bank 2007, pp.27–31). The two biggest money transfer operators (formal remittance providers) are Moneygram and Western Union (Yujuico 2009, p.72). These companies are regarded as formal and regulated, as they are subject to some type of governmental oversight. In South Africa both Moneygram and Western Union have agency agreements with banks, through which they offer their services (Genesis Analytics (Pty) Ltd 2003, p.vii; Bester et al. 2008, p.18).

3.3.2 Informal alternative remittance system typologies

An informal ARS is any system or network where money or value is transferred from one area to another using businesses or networks that do not as their main purpose deal with the transmission of money (FinCEN 2003, p.1). Informal ARSs are also described as “any informal banking arrangement which run parallel to, but generally independent of, the formal banking systems” (McCusker 2005, p.1). This type of alternative remittance services is completely unregulated (Ballard 2005, p.321).

A variety of terms is used to describe informal ARSs. The best-known term is “hawala”, which originated in India. Other forms of informal ARS are known as “hundi” (from Bangladesh), “fei chien” (from China), “phoe kuan” (Thailand) and “padala” (the Philippines) (Passas 2006, p.48). Although there is a practice in the literature to use the

term “hawala” as a catch-all descriptor for any informal remittance system, this is not accurate, as hawala refers to a specific form of remittance. Hawala means the transfer of money or value from one area to another and differs from hundi, which was one of the first credit instruments created in India, and includes remittances, credit notes and bills of exchange (Passas 2003, pp.50, 51). The term “underground banking” is often used to refer to informal ARS transactions (FATF 2005, p.5). The meaning ascribed to this term is that the transfer of money is obscured and occurs in an unregulated manner (Passas 2001, p.7). The term “underground banking” is misleading as banking is not involved in the activity (Passas 2006, p.48).

Informal ARSs occur when a service provider in one country has a partner in another, and can arrange for money or value to be made available through the partner without making use of the formal banking system to transfer the value or funds (Butler & Boyle 2003, p.10). The money is not physically transmitted, but the partners settle the amounts transmitted through various means, including trade and smuggling (Butler & Boyle 2003, p.10; Carroll 2005, I; Casey 2007, pp.10, 11). It is important to understand that it is not always money that is remitted, but can include other items of value such as gold and diamonds (Passas 2001, p.10). The sale of commodities can often generate a significant profit for the underground banker (Passas 2001, p.15)

Passas (2006, p.48) contends that even using the word “alternative” in the context of informal remittance systems is incorrect, as the traditional systems of remittance provision, such as hawala, predate formal banking systems, and are still more prevalent than formal remittance providers in large parts of the world. The argument is thus that, as hawala predates formal banking systems, it cannot be regarded as an alternative system.

These remittance systems are regarded as informal, as the transfers they facilitate are either not recorded in the balance of payments of a country or they are not subject to international or national regulatory oversight (Yujuico 2009, p.71). The informal nature of this type of remittance means that it is more vulnerable to being used for purposes of money laundering or terrorist financing (Yujuico 2009, p.72).

Informal methods of transmitting value vary and can be as simple as sending money home with friends or relatives (Hougaard et al. 2008, p.2). Other informal methods include using

businesses that are not normally associated with money services to transmit money home (Hougaard et al. 2008, p.2). According to Lindley (2009, p.531) “informality” refers to “economic activity occurring outside state regulation”. Informal remittance providers can be described as functioning out of sight or without monitoring and supervision taking place (Yujuico 2009, p.71).

Informal remittance service providers operate in various ways. For example, they can use cash couriers to transport money. Such couriers can involve either an informal arrangement with an individual returning to the originating country or a more formal arrangement with a professional cash courier. A second method for remitting money is to use transfers in kind, which involves setting up a system where money is sent to a trader, who then distributes the money in the form of goods, such as groceries, to the beneficiaries. A third method is to send small amounts of cash via the postal services (African Development Bank 2007, pp.35-37; Yujuico 2009, p.71).

The question of when the remittance activity is formal or informal depends on whether a state chooses not to govern a specific financial activity such as remittances, or it could happen that regulations change, bringing an informal ARS into the regulatory ambit (Anna Lindley 2009, p.531).

Passas (2006, pp.48, 49) differentiates between informal funds transfer systems (IFTS) and informal value transfer methods (IVTM). IFTS refers to those systems originating in India and China, but which have spread throughout the world as a result of migration. These systems have ethnic origins, are well known in their communities and tend to be subject to the regulations designed for money transfer businesses. In contrast, IVTM involves small networks of people who transfer money or value illegally, using formal financial networks to move the funds, but without leaving a trail that can be followed. IVTM is criminal in nature, and involves more than one type of fraudulent transaction, providing perpetrators with the ability to move large sums.

3.4 METHODS USED FOR INFORMAL ALTERNATIVE REMITTANCE SYSTEM TRANSACTIONS

Alternative remittances refer to remittances sent by alternative remittance providers, often using the formal banking system to send the money. Such transactions can be structured in ways designed to hide the fact that money laundering or terrorist financing is taking place (Butler & Boyle 2003, p.10).

3.4.1 The structure of a typical alternative remittance transaction

A typical informal or underground transaction will involve at least four parties: the remitter, the receiver, the ARS provider in the remitting country and the ARS provider in the receiving country (Jost & Sandhu 2000, 3; Passas 2001, p.14; FATF 2005, pp.6-10). Normally, the remitter will approach an ARS provider and arrange to have a certain sum of money made available to a receiver in a specific location. There is thus an implicit understanding that ARS transactions occur across borders and that more than one currency is involved (Wilson 2002, p.2).

For the purpose of this research it will be assumed that the sender and the receiver are located in different countries, although such a remittance could also take place on a domestic level. The sending or remitting ARS provider will issue the remitter with a code, which could be based on the serial number of a bank note, and details of the receiving ARS provider. The remitter pays the remitting ARS the amount to be sent and an agreed fee for the service. The remitter then contacts the receiver and provides the code and contact details of the receiving ARS provider. The remitting ARS provider contacts the receiving ARS provider and provides the code and the amount to be paid out. The receiving ARS provider will pay out when provided with the correct code (FinCEN 2003, pp.3, 4; FATF 2005, pp.6-9).

3.4.2 Settlement of alternative remittance transactions

Settlement between two informal or underground ARS providers can occur in a number of ways. One recorded settlement involved a remitting ARS provider depositing money

received for remittances in various bank accounts, and then arranging with an importer to import goods from the country where the remittances had been sent. The imported goods were undervalued, and the ARS provider paid the difference in price to the importer. The importer then paid the exporter, the exporter paid the local ARS provider, and the ARS provider paid the recipients (Gup 2007, p.67). Another method is to overstate the value of goods exported to another country, allowing the ARS providers to receive and retain value on both sides. Alternatively, ARS providers can also arrange to settle debts between themselves (Gup 2007, p.67). Banks and bank accounts are often used in the settlement process and can include the use of wire transfers (FATF 2005, p.4).

Although ARS systems have historically not kept records or documentation of transactions, it is generally accepted that the number and complexity of transactions now require more record keeping, although this could still be obscure and vague (Carroll 2005, chapter II; Howell 2006, p.108). There are clearing firms in many parts of the world, including Asia and Europe, whose purpose is to enable the settlement of accounts involved with ARS transactions (Howell 2006, p.108). Remittances are seldom settled per transaction, but are rather settled on an account basis (FATF 2005, p.10).

3.5 UNDERSTANDING THE POPULARITY OF ALTERNATIVE REMITTANCE SYSTEMS

There are various reasons why ARSs are so popular (Casey 2007, p.12). Many remitters find that ARSs are convenient to use and ARS providers or underground bankers are rooted in the ethnic community, are easy to find and often have longer operating hours than formal remittance providers (El-Qorchi 2004, p.23). These informal providers are also often cheaper to use, which means that less money is used for transaction fees and more money is available to send to the intended recipient (Butler & Boyle 2003, p.10; Casey 2007, p.12; Beck & Demirguc¸-Kunt 2008, p.391).

The cost factor is critical, as the cost of formal remittances can vary from USD 6,93 per USD 500 remitted (from Singapore to Bangladesh) to USD 57,85 per USD 500 remitted (from Australia to Papua New Guinea) (The World Bank Group 2009e, p.1). The cost of remittances to Africa is high, with the cost of sending remittances from South Africa to

neighbouring countries being among the highest in the world (The World Bank Group 2009e, pt.2). Recent studies have shown that the cost of formal remittances can range between “2.5 percent to 26 percent of the amount sent” (Beck & Pería 2009, p.2).

There is evidence that highly skilled migrants tend to send less money home than their less skilled countrymen, which also indicates why it is so important that the cost of remittances should be kept low (Yujuico 2009, p.64). Another reason for the importance of the cost factor is that it is less expensive to send larger amounts via formal remittance channels; however, lower-income migrants tend to send smaller amounts more frequently (Yujuico 2009, p.64). Informal remittance providers (hawaladars) often charge substantially lower figures for remittances, even charging less than 1% of the value of the transmission, whilst at the same time offering very good exchange rates, sometimes 20% higher than the official exchange rate (Ballard 2003, p.6).

Other reasons for the popularity of ARSs include the fact that almost no paperwork is involved in such transactions. This is often very important as it protects the identity of the sender and the recipient, and in some countries there are good reasons to ensure that the authorities do not know who is receiving the funds, as it can protect the recipient against extortion and blackmail (FinCEN 2003, pp.2, 3). It should be noted that migrants do not always have access to the identification documentation required by formal financial institutions when sending money home. The lack of paperwork required by the underground banker is an attractive factor when selecting the remittance provider and the system used (Butler & Boyle 2003, p.10; Casey 2007, p.12).

Access to formal financial institutions is a critical determinant in the use of ARSs (FinCEN 2003, p.2). Estimates show that many African households do not have access to formal financial institutions (Beck et al. 2009, p.119). Developing countries (emerging economies) often do not have well-developed financial infrastructures, which means that access to formal financial institutions in rural areas is limited (Razavy 2005, p.287; Gup 2007, p.59). The sender could have access to formal remittance channels in the originating country, but the receiver could be “unbanked” (have no access to banking facilities) or “underbanked” (have limited access to banking or financial systems). The receiver’s financial situation could thus be a factor that determines the choice of remittance channel by the sender (Yujuico 2009, p.66).

As stated previously, research has shown that migrants who are less educated tend to remit money home more than those who are educated (Amuedo-Dorantes 2006, p.189). Illegal migrants also tend to remit more than legal migrants (Amuedo-Dorantes 2006, p.189). One supposition could thus be that informal ARSs are more popular because the remitter is an illegal migrant, and thus unable to provide the identification documentation required by a formal remittance provider. This is, however, not the topic of this research and will not be explored further in this report.

The increased regulation of formal financial institutions and the resultant stringent AML processes have seen a movement away from the formal financial institutions to the informal or ARSs for the purposes of money laundering or terrorist financing (Butler & Boyle 2003, p.4). As stated previously, ARSs are often used for legitimate purposes, but the lack of regulation and AML procedures increase their attractiveness for people who wish to launder money or finance terrorists (Butler & Boyle 2003, pp.4, 5).

3.6 IDENTIFYING ALTERNATIVE REMITTANCE PROVIDERS

There are a number of ways that regulators or investigative bodies can use to identify informal ARS providers. These include scrutinising the bank accounts of suspected remitters (Jost & Sandhu 2000, sec.8). As ARS providers' business activities grow, there is a good chance that they will need a bank account of their own (Passas 2004, p.168). Other indicators of suspicious activities could include unusually large cash deposits for the professed type of business, or transfers to businesses not normally associated with the remitting business (Passas 2004, p.168; Howell 2006, p.110).

Another method of identifying ARS providers is to trace the couriers of cash and establish on whose orders they are operating (Passas 2004, p.169). Another is to identify accounts with regular outgoing transactions to countries associated with ARS clearing houses, such as the UK and the United Arab Emirates (UAE) (Howell 2006, p.110).

Other ways to uncover informal ARS providers include the detection of multiple phone lines installed at a residence or small business, and records of short incoming calls but long calls to numbers in other countries (Olson 2007, p.4). Further signs of such activity

can include businesses with more than one set of financial records. It is not unusual for at least three sets of financial records to be uncovered, which include the official records, the account settling records and the set that details the criminal activity. An alternative indicator may be where a person or business has more than one bank account with different financial institutions (Olson 2007, p.4). Although not an exhaustive list, these indicators can help authorities to identify possible informal ARS operators.

3.7 REMITTANCE CORRIDORS

Although people can migrate from any country and have multiple options as to their destination country, a number of remittance corridors have been identified. A remittance corridor exists where there is a clear flow of money or value from one country to another (IMF 2005, p.20). Although the FATF (2005, pp.5, 6) acknowledges that most of the money or value transmitted via ARSs are “of legal origin and intended for legal purposes”, there remains a valid concern that formal and informal ARSs can be easily misused for money laundering or terrorist financing purposes.

It is possible to identify clear patterns of migration from certain countries to specific other countries. Such patterns can be seen in the high volumes of remittances sent between specific countries (Payment Systems Development Group 2008, p.62). The pattern of remittances between specific sending and receiving countries is known as a remittance corridor (Yujuico 2009, p.73). The World Bank has identified 167 country corridors, where money is sent regularly from 23 key remitting countries to 83 receiving countries (The World Bank Group 2009b, para.1). South Africa is regarded as one of the key remitting countries, with the regularly receiving countries being identified as Lesotho, Swaziland, Zimbabwe, Angola, Botswana, Malawi, Mozambique and Zambia (The World Bank Group 2009a, para.12).

The cost of sending remittances via formal providers, such as Money Transfer Operators (MTOs), plays a significant role in some of the established remittance corridors. Certain MTOs dominate specific corridors and, as a result, do not face fee-based competition, thus allowing them to charge high remittance fees (Yujuico 2009, p.73). The costs of remittances are also influenced by certain considerations, such as whether there are high

volumes of remittances in a corridor and whether the receiving country has a strong financial sector (Beck & Pería 2009, p.13). A recent study found that the costs of remittances are lower in corridors where there are more migrants, the income of the migrants is at a lower level and there is competition between the remittance providers (Beck & Pería 2009, p.15).

Formal, regulated remittance service providers do not always remit via their own branches or agents. This means that the remittance provider at the point of origin is not necessarily also the remittance provider at the point of receipt. Remittance providers are thus linked to a network of other remittance providers which enables them to provide remittance services to a wider spectrum of clients. One of the results of using a network is that the sending remitter does not always know how long the process will take, or even whether the receiving remitter will charge the recipient a fee (CPSS & The World Bank 2007, p.2). The advantage of such a network is that it enables services to be offered across a wide variety of remittance corridors, both large and small (CPSS & The World Bank 2007, p.2).

It is not always possible for a remittance to proceed directly from the remitting country to the receiving country (FATF 2005, p.13). Some remittances intended for South Asia tend to be routed via the United Arab Emirates (FATF 2005, p.13). The capital, Dubai, is regarded as the central point where remittances come together (Berkowitz, Woodward and Woodward, 2006, p.14). There is evidence of four big remittance networks that join up in Dubai. These include the Arab network, with links from Saudi Arabia, Syria, Jordan, Lebanon and Palestine; the Pakistani network with links from across the world, including the USA, UK and Europe; the South Asian network, which includes the Philippines; and the Lebanese Diaspora network, which includes links from Lebanon, the USA, South Africa, Kenya and Ghana (Berkowitz et al. 2006, p.14).

3.8 SUMMARY

It is clear that ARS providers have existed for many centuries. Although various authors have claimed that ARS providers came into existence in an effort to elude formal financial systems, there is sufficient evidence to disprove this viewpoint (Passas 2003, p.50). Although ARS providers are not allowed in some countries, it would seem that in many

countries informal ARS providers are so embedded in ethnic communities that they continue to exist with relative freedom (Carroll 2004, p.19).

It has been established that many people who use ARS providers do so with legal money and for legal purposes; in essence these are mainly migrant workers sending money home (Ratha 2007, p.1). There are good reasons why informal ARSs remain popular. These include ease of use, speed of transactions and the relatively low costs, which mean that migrants and low-income earners feel comfortable with this means for remitting money (Wheatley 2005, pp.354, 355). The strong element of trust that often exists between the migrant (remitter) and the ARS provider is also important, especially in ethnic communities. In addition, the recipients of such remittances often do not have access to banking services, and this is where informal ARS providers play an important role. Furthermore, the remitter is frequently challenged by a lack of formal documentation, which means that they are unable to use formal financial services (Wheatley 2005, p.355).

On the other hand, however, it is also true that many remittances are used to launder money or finance acts of terror and the lack of paperwork and audit trails means that informal ARS providers are vulnerable to money laundering, terrorist financing and other crimes such as tax evasion (Wheatley 2005, p.356).

CHAPTER 4: THE USE OF ALTERNATIVE REMITTANCE SYSTEMS FOR MONEY LAUNDERING AND TERRORIST FINANCING

4.1 INTRODUCTION

Remittances take place for various reasons, many of which are legal. In addition, the funds remitted usually have a legal origin, even if the method chosen for remitting them may not necessarily be legal. The question that thus arises is when and how are funds or the value remitted intended for money laundering or terrorist financing.

Informal ARSs are ideal vehicles for laundering money or financing terrorist activities (Schramm & Taube 2003, p.418; Looney 2003, p.166). Research has shown that ARSs have been directly linked to terrorism in India, the United Kingdom and America (Jost & Sandhu 2000, Appendix E; Gup 2007, pp.66, 67). ARS providers, especially informal ARS providers, are vulnerable to money laundering abuse because they tend not to have the basic AML procedures in place. The absence of such procedures, including customer information verification or identifying suspicious or unusual transactions, increases this vulnerability (Zagaris 2007b, p.160). The lack of procedures and the request for or verification of identification means that informal ARS providers can be used for terrorist financing, often without their knowledge. Typically, informal ARS providers do not retain records of transactions, and this lack of a paper trail may make their services attractive for financing terrorism (Zagaris 2007a, p.160).

As a result of the potential for informal ARS to be used for money laundering or terrorist financing, governments have become more interested in requiring remittances to be sent via formal channels (Ruiz & Vargas-Silva 2009, p.73). The rapid development of new technologies makes it easier for funds to be transferred across borders, thereby supporting the concept of a global flow of capital. However, the same technological advances also enable the transactions to be traced – in other words there is a greater chance that an audit trail can be found (Amicelle 2008, pp.3–5).

4.2 LAUNDERING MONEY AND FINANCING TERRORISM THROUGH FORMAL REMITTANCE SYSTEMS

Formal ARS providers include organisations such as Moneygram and Western Union (Beck & Pería 2009, p.2). Moneygram is a US-based money service business, and as such is registered and licensed in the USA (Milne 2006, p.2). Some of the other well-known US-based money service businesses are Western Union, American Express Travel Services, Travelex Americas and Sigue Corporation (Milne 2006, p.2). Moneygram and Western Union also operate in South Africa, although they do so via agency agreements with banks (Genesis Analytics (Pty) Ltd 2003, p.vii; Bester et al. 2008, p.18).

The Asia Pacific Group on Money Laundering (APG) reports that various methods have been identified where formal remitters or providers of designated remittance services (PoDRS), as they are referred to, have been used or been involved in money laundering and terrorist financing activities (APG 2009, p.17).

Some of the typologies described by the APG include examples where money launderers have used PoDRS for laundering the proceeds of drug trafficking (APG 2009, pp.16, 17). Similarly, PoDRS have been used by people in a country (Australia) on a short-term visa, sending bulk cash transactions offshore, trying to transfer as much money as possible before being detected (APG 2009, p.17). Other examples include terrorists in Sri Lanka receiving off-shore remittances that were used for terrorist financing and sending structured remittances via Western Union in the Cook Islands (APG 2009, p.17).

4.2.1 Laundering money

Formal ARS providers can knowingly be party to money laundering. In the USA, four suspicious transaction reports were filed by a bank about the activities engaged in by a formal, registered ARS provider who remitted more than USD 100 million to the Middle East over 30 months, although it only had a limited number of clients. Subsequent investigations established that the formal ARS provider had colluded with four unlicensed ARS providers who were cash couriers. The formal ARS provider received cash from the couriers and deposited it into its own bank accounts, and then remitted this onwards to the Middle East (FATF 2005, p.17).

4.2.2 Funding terrorism

Often formal transfer systems are used to finance terrorist activities. The case of Richard David Hupper is an example of funding an international terrorist organisation via an ARS. In 2008 Hupper, a citizen of the USA, was convicted in the Southern District of Florida of funding Hamas, a terrorist organisation. During 2004 and 2006 he provided money both by means of Western Union money transfers and in person, knowing that this would be used to fund Hamas (United States Department of State 2009, p.48).

In a case reported by the FATF (2008c, p.22), an FIU detected the leader of a terrorist organisation who was hiding in a country as a result of unusual remittance patterns. The person's friends had been sending remittances via a third country, and this created an unusual remittance pattern between the countries. He was arrested for suspected terrorism, and evidence of the money transfers was used in the court proceedings (FATF 2008c, p.22).

In another reported case, wire transfers were used to transfer money from a terrorist organisation in one country to another. The recipients used the money to fund terrorist activities that included building explosive devices. The sending and receiving accounts were opened in the names of people who had no known or visible links to any terrorist organisation, but they did have familial ties. These familial ties were used to obscure the real reason for their actions (FATF 2008c, p.22).

4.3 LAUNDERING MONEY AND FINANCING TERRORISM THROUGH INFORMAL REMITTANCE SYSTEMS

Many criminal activities generate large amounts of money, and this creates a need to launder it (Carroll 2004, p.4; Carroll 2005, p.1). The ability to handle large amounts of cash, the informal nature of the transactions and the lack of records (and subsequent lack of a paper trail) increases the attractiveness of ARS for money launderers (Carroll 2005, 1; Passas 2006, pp.57, 59). ARSs are often used to "provide a gateway" to finance terrorism (FATF 2008c, p.23). The ability of an ARS provider to remit money to a remote location is useful for a drug smuggler, as it means that drug money can also be remitted from those

remote areas (Carroll 2004, p.4). These aspects of informal ARS providers enhance their usefulness to the criminal element.

A study undertaken on behalf of Interpol reports that out of 21 countries surveyed, all had established some type of link between ARS providers and money laundering. The study found that 12 countries, including China and India, had established that ARS providers were involved with laundering drug profits, while India, Sri Lanka and Pakistan found that there were links between laundered funds and the arms trade. In addition, in five countries there were instances of laundering related to illegal gambling. The countries that had established ARS links to terrorist financing were India and Sri Lanka. Finally, five countries established evidence linking money laundering to the proceeds of human trafficking, including smuggling and kidnap ransoms (Carroll 2004, p.20)

The size of the laundering problem, in other words how much money is laundered through ARSs, remains unknown. The IMF tracks the amounts of money or value sent via formal ARSs, but there is no accurate tracking of the value of remittances sent via informal ARSs (Ballard 2005, p.322). There is evidence that ARSs can provide a vehicle for engaging in large-scale money laundering and tax evasion (Carroll 2005, chap.1).

4.3.1 Using an alternative remittance system to launder money

Interpol reports that ARSs can be used during any of the stages of money laundering, that is, placement, layering or integration (Jost & Sandhu 2000, pt.6). At the placement stage, many people who operate ARS providers have businesses that generate cash, and can develop a pattern of cash deposits that will not necessarily arouse undue suspicion at their banks (Jost & Sandhu 2000, pt.6). During the layering stage, the lack of paper trails created by ARS transactions, and the intermingling of legitimate and illicit funds, conspire to confuse matters to the extent that it is hard for investigators to determine whether a transaction is illegal (Jost & Sandhu 2000, pt.6). Illicit funds laundered via ARS systems are almost impossible to trace during the integration stage. The co-mingling of legitimate business funds and illicit laundered funds ensures that it is hard to differentiate between legitimate business funds and laundered funds (Jost & Sandhu 2000, pt.6).

4.3.2 Using an Alternative Remittance System to fund terrorists

ARS providers in both Afghanistan and Pakistan are known to have links to terrorist finance. The House of Lords in the UK have been informed that the financing of terrorists in Afghanistan and Pakistan has been done via informal remitters, specifically mentioning the hawala system (House of Lords 2009, p.43). In both countries, the informal financial systems, which include informal ARS providers, are well-established. The links to drug trafficking and the subsequent use of the funds generated for terrorist finance have also been established (Winer 2008, pp.117, 118). The United Nations sanctions list, published under the Security Council Resolution 1267, lists 479 institutions and individuals known to be associated with Al Q'aida (Winer 2008, p.122).

Evidence has been found that links Al Q'aida to informal ARS transactions used to move money from Afghanistan ahead of the USA military action during 2001. Al Q'aida was also linked to informal ARS (hawala) transactions for funding the bombings of the American Embassies in Kenya and Tanzania in 1998 (Wheatley 2005, p.358).

In 2008 in the District of Maryland, USA, Saifullah Anjum Ranjha, a Pakistani citizen, was sentenced to ten years imprisonment (United States Department of State 2009, p.47). Ranjha operated a money service business, Hamza Inc., in the District of Columbia. He was convicted of, among other things, drug trafficking and the financing of terrorism (Al-Q'aida). The evidence of a cooperating witness enabled the authorities to prove that Ranjha had transmitted $2, 2 million between 2003 and 2007, using the hawala system of informal alternative remittances. The transactions involved twenty-one hawala transactions, with destinations including Australia, Japan, Canada, Spain, Pakistan and England. The amounts per transaction ranged from USD 13 000 to USD 300 000. The recipients included designated third-parties, the cooperating witness and designated bank accounts. Ranjha retained about 5% of each transaction as his fee, and other parties involved retained between 3 and 5% as their fee (United States Department of State 2009, p.47).

4.3.3 Extortion, alternative remittance systems providers and terrorist financing

Although there is a perception that all terrorist financing is done voluntarily, this assumption is incorrect. Investigators in the USA have found evidence that informal ARS providers are sometimes victims of extortion, where they are "forced" to remit funds to organisations such as Hamas or Al Q'aida (Berkowitz et al. 2006, p.11). A typical example occurs where a group of men visit a shop or small business, reminding the owner that its existence depends on the goodwill of the community. The men then indicate to the shopkeeper that a small weekly donation to a specified cause will ensure the shop's continued existence. The shopkeeper then allocates a portion of the weekly income to be paid to the specified group. This becomes problematic, however, as the shopkeeper does not purchase goods, and thus has to find alternative ways to remit the money (Berkowitz et al. 2006, p.11).

In the US city of Detroit, funds were transmitted to terrorists via currency smuggling across the Canadian border and selling this currency on the black market. The funds involved in these transactions amounted to several million dollars (Berkowitz et al. 2006, pp.11, 12).

4.4 CONSEQUENCES FOR ALTERNATIVE REMITTANCE SYSTEMS PROVIDERS

As a result of 9/11 and the subsequent actions to curb money laundering and terrorist financing, many legitimate businesses have experienced severe difficulties. The bank discontinuation drive in the USA, where banks either stopped doing business with money service businesses or refused to open new accounts for them, is a case in point. This situation created major business problems for legitimate, formal ARS providers such as Moneygram (Milne 2006, pp.1–3). In the USA this affected the numerous small businesses such as small convenience stores that had an agency agreement with a formal ARS provider such as Moneygram. Their banks would inform them that they were unable to provide them with banking services whilst they were providing ARS services. The reasons provided for this action usually related to the fact that the bank's regulator regarded money service business as high-risk, and had instructed the bank to cease providing banking services to such businesses (Milne 2006, p.3).

Whilst the action was initially aimed at the smaller agents, it spread to include global relationships. During 2006 the Bank of America informed Moneygram that it would have to

curtail its business relationship. This business relationship had a global reach and generated millions of dollars in revenue for the Bank of America (Milne 2006, pp.3, 4). Other banks in the USA also decided to cease doing business with formal ARS providers, including such banks as the Bank of New York, HSBC and Chase (Milne 2006, p.4).

FinCen (2009, p.22129) stresses that it is not the intent of the authorities and the law enforcement agencies to drive ARS providers underground as a result of punitive action. In 2009, FinCen drafted a proposal on new rules for money service businesses (ARS providers) which was intended to assist both ARS providers and those institutions that conducted business with them. The proposed rules were developed in part as a result of the feedback that was received from organisations such as Moneygram (FinCEN 2009, pp.22129-22140).

In the UK action has been taken against hawaladars (informal ARS providers). Between 1999 and 2001 Customs and Excise arrested a number of hawaladars for laundering more than GBP 600 million (Ballard 2003, p.4). In 2005 the USA reported that 140 individuals engaged in illegal ARS activities had been arrested, resulting in 138 indictments and the confiscation of more than USD 25,5 million (Ballard 2005, p.323).

4.5 ACTIONS TAKEN BY FORMAL ALTERNATIVE REMITTANCE SYSTEMS PROVIDERS

In response to the increased focus of regulatory authorities, ARS providers have taken a number of different actions in an effort to comply with the regulatory requirements. Formal ARS providers, such as Dahabashiil Financial Services, which provides services to Somalia, have hired software engineers from Bangladore to develop comprehensive internet-based customer record-keeping programmes. The UAE Exchange in Dubai provides visible proof of their AML/CFT compliant record-keeping system by setting up their computers to be visible to passersby. Both of these institutions have ensured that they remain compliant with AML/CFT requirements by changing the way they operate (Ballard 2003, p.22).

It is clear, however, that the ARS providers that endeavour to be compliant have concentrated on the “know your customer” (KYC) requirements. The back-office record-

keeping does not provide clear paper trails regarding consolidation, settlement or distribution (Ballard 2003, p.22).

The inherent rivalry between the formal and informal financial systems finds a regulatory champion for the formal financial sector. The approach from the regulatory perspective is to distrust informal financial activities and suspect that it is more prone to engaging in criminal activity. Conversely, where systems are regulated it would be much harder to be abused by criminals (Ballard 2003, p.23). The effect of this regulatory approach favours the formal financial sector, as the informal ARS provider will either adapt and become a formal ARS provider, with all the accompanying rules and thus associated regulatory or compliance costs, or they will cease to exist. Once informal ARS providers formalise their systems, their operating costs increase and the profit discrepancy (and thus user-cost) between them and other formal ARS providers disappears (Ballard 2003, p.24).

4.6 SUMMARY

It is clear from the above discussion that there are links between ARS providers and systems, money laundering and terrorist financing. These links have been established by various law enforcement agencies. It is also apparent that although there are cases where informal ARS providers (hawaladars) have been linked to money laundering and terrorist financing; there is a lack of evidence to support all such suspicions. The 9/11 situation is a case in point. Although the law enforcement agencies in the USA were concerned that the attacks were partially funded by remittances sent via formal and informal ARSs, the 9/11 Commission was unable to establish such links (Roth et al. 2004, p.13). The case studies cited in the APG Typologies Report of 2009 indicate that there have been a number of instances where remittances were used to launder money or fund terrorists (APG 2009, pp.16-18). Although the international regulatory and law enforcement community has built up a comprehensive body of knowledge on the way ARSs can be used for money laundering and terrorist financing, there is still a large gap in the accrual of actual evidence. This gap will only be closed as more cases are investigated and offenders are prosecuted. This will remain a work in action for authorities and regulators.

CHAPTER 5: INTERNATIONAL AND REGIONAL REGULATORY REQUIREMENTS REGARDING ALTERNATIVE REMITTANCE SYSTEMS

5.1 INTRODUCTION

Money laundering and terrorist financing have an international impact. There are various organisations, some voluntary and others linked to national governments, which have as their aim the combating of money laundering and the financing of terrorism. The 9/11 attacks resulted in a greater focus on money laundering and terrorist financing (Amicelle 2008, p.6), and the focus on terrorist financing has broadened to include both the prosecution (previous focus) and the prevention thereof (Amicelle 2008, p.6).

According to Tsingou (2007, p.4) AML requirements include prevention and enforcement, and are addressed at the international, regional and national levels. This chapter will consider the role of the regulatory authorities in AML and CFT at the international and regional levels. The national role will be discussed in terms of the South African context in the next chapter.

5.2 THE ROLE OF REGULATORY AUTHORITIES

Regulatory authorities have to address both the prevention of AML and CFT, and enable the enforcement of the sanctions provided for in law. Prevention measures include rules and regulations which can be published as subordinate legislation, and provide for the supervision of institutions to ensure that the rules and sanctions are adhered to. Enforcement refers to actions such as “investigations, confiscation, prosecution and punishment” (Tsingou 2007, p.4).

According to Pratt (2005, p.20) financial services regulators are required to “develop and enforce regulations” aimed at financial institutions to make certain that money laundering and terrorist financing are guarded against. It should be recognised that regulatory authorities are “agents of governments” and thus of the citizens of a country, as

government is elected by the citizens, especially in countries where governments are elected democratically (Goodhart et al. 1998, p.52).

The enabling factors for a financial regulator include the need for primary legislation that empowers it to act in respect of certain issues, subordinate legislation that expands on the primary legislation, rules, guidelines or codes of conduct issued by the regulator and even policy statements (Mwenda 2006, p.5). Regulators do not necessarily perform all of the following functions, but a combination of one or more is quite typical. Regulators can determine the legal requirements that financial institutions must adhere to in order to function, approve financial institutions, provide rules of conduct, supervise compliance with the primary and subordinate legislation, investigate suspected non-compliance, and also share information or investigations with other regulatory authorities (Mwenda 2006, p.7).

There are different types of financial sector regulation. Prudential regulation is concerned with limiting the risk of financial failures, and uses capital and liquidity requirements, on-site supervision, and regulatory powers to intervene or intercede in the institution in order to achieve this (Carvajal et al. 2009, p.3).

The events of 9/11 have meant that there is a greater focus on the flow of financial activity. Regulatory authorities are not only concentrating on the formal flow of finance but also on the informal flow of finance, such as the flow of money or value via ARS providers (Amicelle 2008, p.8). One of the key problems regulatory authorities have with informal ARS providers is the fact that it is very difficult to establish the audit trail of transactions (Amicelle 2008, p.8). Although informal ARS providers do establish rudimentary information regarding their customers, their customer identification procedures and record-keeping do not meet the requirements of most regulatory authorities (Amicelle 2008, p.8).

The literature on remittances presents two different viewpoints. It is either a tool for money launderers and terrorist financiers or regarded as a necessary aid to provide relief against poverty and humanitarian aid (Amicelle 2008, p.9). As stated previously, the events of 9/11 renewed the regulatory interest in AML and CFT efforts and it is in this context that the role of the regulatory authorities will be reviewed.

5.3 INTERNATIONAL AND REGIONAL REGULATORY AUTHORITIES

It is important to establish cooperation between governments and regulatory authorities to ensure that cross-border investigations can take place. To facilitate this cooperation, it is necessary to have a legal framework that establishes similar definitions of crimes such as money laundering and terrorist financing (Thornhill & Hyland 2000, p.15). Further developments that enhance cross-border investigations and cooperation include the signing of multilateral agreements of mutual cooperation (Thornhill & Hyland 2000, p.15). The development of the 40 FATF recommendations and the 9 FATF special recommendations has also assisted in this regard.

A number of international and regional initiatives were undertaken with the intention to foster cooperation between countries in the fight against money laundering and terrorist financing. These include the following:

- the issuing of a statement of principles on the "Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering" by the Basel Committee on Banking Regulation and Supervisory Practices in 1988
- the holding of the United Nations (UN) Convention against illicit traffic in narcotic drugs and psychotropic substances in 1988 (also known as the Vienna Convention)
- the creation of the Financial Action Task Force (FATF) in 1989
- the holding of the Council of Europe Convention on laundering, search, seizure and confiscation from the proceeds of crime in 1990
- the issuing of the European Council (EC) Money Laundering Directive in 1991
- holding the UN Transnational Organised Crime Convention in 2000 (Clark & Russel 2003, pp.15-27)

The European Council Directive was updated twice, and currently the third Directive that was published in 2006 applies (European Parliament and the Council of the European Union 2005, p.15).

The signing of the Abu Dhabi Declaration on Hawala in 2002 was also an important step in the further development of principles on which the regulation of money laundering and combating of terrorist financing would be based (Butler & Boyle 2003, p.9).

5.3.1 The Financial Action Task Force

The Financial Action Task Force (FATF) was created in 1989 by the heads of states of the G7 nations and the President of the European Commission (Haynes 2003, p.21). By 2009 the membership of the FATF had grown to thirty-four (FATF 2008b, p.1). The aim of the FATF is "the development and promotion of policies to combat money laundering" (Clark & Russel 2003, p.21). South Africa became a member of FATF in 2003 (FATF/OECD. 2009b, p.1).

5.3.1.1 *Background to the Financial Action Task Force*

The FATF was initially created to combat money laundering and this mandate was subsequently expanded to include terrorist financing after 9/11. The task force relies on the assessments completed by participating countries and a series of mutual assessments to establish whether countries are implementing measures to combat money laundering and terrorist financing. The FATF is based at the offices of the Organisation for Economic Cooperation and Development (OECD) in Paris (Jackson 2005, pp.CRS-2) and it does not have a formal structure contained in a treaty or convention, but exists in terms of a mandate provided as a result of mutual agreement and cooperation between the participating countries' governments (House of Lords 2009, pp.11, 12).

Initially, the FATF was created under a five-year mandate, which has been renewed many times, with the last renewal being in 2004 for a period of eight years (FATF n.d., p.1; Jackson 2005, pp.CRS-2). The original mandate of the FATF was to address anti-money laundering by identifying how it occurred and establishing ways to prohibit it from occurring.

The attacks on America in 2001 led to the development of additional requirements to establish ways to combat the financing of terrorists and terrorist actions (Jackson 2005, pp.CRS-2; FATF n.d., p.1). The FATF also published a list of non-cooperative countries, essentially "naming and shaming" those countries that did not take effective action to implement AML procedures (FATF 2000, p.1; Winer 2008, p.114). This list has been updated with the removal of those countries that have taken action to meet the FATF recommendations. By 2008 no countries remained on the list (Winer 2008, p.114). FATF

started with a process to review high-risk jurisdictions in 2008, and by 2009 had issued a number of statements regarding high-risk and non-cooperative jurisdictions, including Iran and Uzbekistan (FATF 2009b, p.1).

5.3.1.2 *Financial Action Task Force recommendations*

The FATF has issued two sets of recommendations, which form the basis of the requirements that are set for member countries and other countries to be regarded as actively involved in the battle against money laundering and terror financing (The House of Lords 2009, p.12). The first set of recommendations is known as "The Forty Recommendations", and was published for the first time in 1990 (Jackson 2005, pp.CRS-2). This set of recommendations was revised in 1996 and again in 2003 (The House of Lords 2009, p.12).

In 2001, the FATF published an additional set of eight Special Recommendations on terrorist financing (Jackson 2005, pp.CRS-2). This was revised in 2004 and an additional recommendation was included. This is now known as the Nine Special Recommendations on Terror Financing (FATF/OECD. 2009a, p.1). The full set of recommendations is often referred to as the 40 + 9 Recommendations.

There are a number of commonalities in terms of the deterrence of money laundering that can be found in the legislation of many countries. The commonalities are based on one or more of the 40 + 9 FATF recommendations (Thornhill & Hyland 2000, pp.7, 8; Commonwealth Secretariat 2006, pp.10, 11). The recommendations apply to financial institutions and designated non-financial institutions and professions. Money remitters are regarded as financial institutions and are subject to the requirements of the 40 + 9 Recommendations (FATF 2003, p.13). The FATF recommendations are adopted by more than 180 countries and a number of international institutions, including the IMF, the World Bank and the United Nations (The House of Lords 2009, p.12).

The FATF monitors compliance with the 40 + 9 Recommendations through a process of mutual evaluation. Evaluation is conducted by a team of experts from other countries who

evaluate the extent to which the country being reviewed meets the standards. It then issues a report on its findings. The country under review must report within two years on the actions undertaken to rectify any shortcomings (House of Lords 2009, p.12).

5.3.1.3 *Financial Action Task Force recommendations regarding alternative remittance providers*

Although all the FATF recommendations are important, there are some recommendations that specifically address ARS providers (Maimbo 2003, p.21). In 2003 the FATF recommended that all institutions that transmit money or value are to be regarded as financial institutions and that the 40 + 9 Recommendations apply to them (IMF 2005, p.37).

Although the 40+9 Recommendations apply equally, there are some that have a greater impact on ARS providers. These include recommendations 4 to 16, which address customer identification, due diligence, record-keeping and reporting suspicious transactions. Recommendations 21 to 25 address matters of regulation and supervision that are also very relevant to ARS providers (IMF 2005, p.37).

Special Recommendation 6 requires countries to ensure that any business, whether formal or informal, that provides services regarding the transmission of money or value, should be licensed or registered. It also requires that such businesses should be subject to the same FATF requirements that apply to banks and other financial institutions. The FATF indicates that countries should take action, whether administratively, civilly or criminally, against businesses that do not comply with these requirements (Maimbo 2003, p.35).

Special Recommendation 7 addresses wire transfers, and also applies to ARS providers. This recommendation requires that remitters should identify the originator of the transmission, and this information should accompany the transmission to its destination. Businesses that provide such services should be aware of suspicious transactions and report them to the necessary authorities (Maimbo 2003, p.35).

In addition to adhering to the FATF Recommendations, many countries have also undertaken to adhere to the Abu Dhabi Declaration. The Abu Dhabi Declaration on Hawala, drawn up during the first International Conference on Hawala that was hosted by

the UAE in 2002, sets out five extra principles regarding ARS, money laundering and terrorist financing (MENAFATF 2005, p.5). These include the agreement that the FATF recommendations should apply to hawala and other ARS providers; countries would subject ARS providers to regulatory supervision and that the rules they were required to adhere to would be effective but not too restrictive. The Declaration also provides for international cooperation in the AML/CFT efforts, and that they would regulate ARS providers to ensure that they cannot be misused for AML/CFT purposes (Maimbo 2003, p.36).

5.3.1.4 *Financial Action Task Force styled regional bodies*

The FATF-styled regional bodies (FSRBs) extend the money laundering discourse and process of mutual evaluation beyond the thirty-four FATF members (House of Lords 2009, p.13). The FSRBs comprise

- the Asia/Pacific Group on Money Laundering (APG)
- the Caribbean Financial Action Task Force (CFATF)
- the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG)
- the Eurasian Group on Money Laundering (EAG)
- the Grupo de Acción Financiera de Sudamérica (GAFISUD)
- the Intergovernmental Task Force against Money Laundering in Africa (GIABA)
- the Middle Eastern and North African FATF (MENAFATF)
- the Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL) (Hernandez-Coss et al. 2005, p.3; The House of Lords 2009, p.13)

The FSRBs are involved in conducting their own research and publishing reports on their findings. The FSRBs also conduct joint “mutual evaluation” reviews with the FATF on their member countries. The 2008 mutual evaluation review of South Africa was a joint effort between the FATF and the ESAAMLG (FATF & ESAAMLG 2009b, p.2).

5.3.2 The European Union

The European Union (EU) had 26 member countries by 2009 and published a number of Money Laundering Directives, providing guidance for their member countries (Financial Services Authority 2009, pp.1, 2). The EU published their third Money Laundering Directive in November 2006, replacing the first Money Laundering Directive that was amended by the second Directive (Financial Services Authority 2009, pp.1, 2).

The EU directives aims to mirror the FATF recommendations and to "provide a common EU basis for implementing" it (Financial Services Authority 2009, p.2). This Directive includes both anti-money laundering and terrorist financing in its scope (Parlour 2005, p.204). The EU Directive impacts on more countries than merely the EU member states, including countries that want to join the EU, and other jurisdictions that are associated with EU member states (Parlour 2005, p.204).

5.3.2.1 *Requirements*

The Directive provides clear guidelines on a number of relevant issues regarding the combating of money laundering and terrorist financing. The Directive applies to a number of defined institutions, including financial institutions. The definition of financial institutions includes currency exchange offices, and money transmission or remittance offices (European Parliament and the Council of the European Union 2005, p.7). Chapter II, Article 6 addresses issues regarding "customer due diligence", which includes verifying the identity of the customer, and deals with both high and low risk customers (European Parliament and the Council of the European Union 2005, p.11). There are a number of legally binding issues, including the identification of politically exposed persons, enhanced customer due diligence, and the identification of third countries that do not meet the requirements of the Directive (European Parliament and the Council of the European Union 2005, pp.20, 21; Financial Services Authority 2009, p.2). The requirements to have systems for training, suspicious transaction reporting, and the registration of certain types of financial firm are addressed in chapter V, articles 34 and 35 (European Parliament and the Council of the European Union 2005, pp.20, 21; Financial Services Authority 2009, p.2).

The EU Commission, and thus the Directives, lack serious power, as has been proven with the case of the EU member states that failed to adopt the Third Directive in national legislation by the end of 2007. The EU Commission referred six countries (Sweden, France, Poland, Spain, Belgium and Ireland) to the European Court of Justice in 2008 for failure to adopt the legislation. To date no action has been taken, as the EU Commission itself points out that pecuniary action can only be taken after the second referral to the Court (House of Lords 2009, p.16).

5.3.3 The United Nations

It is worth discussing the United Nations (UN) briefly, as the Palermo Convention, adopted by General Assembly Resolution 55/25 of 15 November 2000, is "the main international instrument in the fight against transnational organised crime" (House of Lords 2009, p.20). Most of the UN members have adopted this Convention, which requires them to criminalise money laundering, take action against money laundering, and implement measures that allow them to confiscate the proceeds of crime (House of Lords 2009, p.20).

The UN Sanctions Committee was created in accordance with Resolution 1267 of 1999 (The House of Lords 2009, p.20). In accordance with Resolution 1333 of 2000 it can list a person or organisation on the request of a member state upon providing proof that the person or organisation is linked to Al-Q'aida, the Taliban or Osama Bin Laden (House of Lords 2009, p.20).

A recent example of such a listing, as well as the response to the listing, is the case of Al-Barakaat, an ARS based in the USA with its main aim to remit to Somalia. After Al-Barakaat was listed, it was given an opportunity to respond. However, the listing was upheld by the Sanctions Committee of the United Nations (The House of Lords 2009, p.21).

Another important UN resolution is the UN Security Council Resolution 1373 of 2001 that requires all member states to "put in place comprehensive measures against terrorist finance" (Winer 2008, p.122).

5.3.4 Eastern and Southern African Anti-Money Laundering Group

The ESAAMLG is a FATF-styled regional body consisting of fourteen member countries based in Eastern and Southern Africa, committed to the combating of money laundering and financing of terrorism (ESAAMLG 2004, p.1). This body was created by the governments of the countries in Eastern and Southern Africa (Goredema 2003b, p.1). South Africa is one of the founder members of ESAAMLG (ESAAMLG 2004, p.1)., which has fourteen member countries, namely Botswana, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe (Zagaris 2007, p.164).

This association's memorandum of understanding was drawn up in 1999, and spells out the objectives of the member countries in this regard (ESAAMLG 1999, p.1). These objectives include the commitment of the member countries to implement the 40 + 9 FATF Recommendations, to apply anti-money laundering measures, to combat terrorist financing, and to implement other measures such as multilateral agreements to combat money laundering and terrorist financing (ESAAMLG 1999, p.1). The ESAAMLG faces some challenges in implementing stringent AML/CFT requirements, as the economy of the region is still largely cash-based. An approach that does not take the realities of the region's situation into account could drive more informal ARS providers underground (Zagaris 2007, p.160).

5.3.5 The Egmont Group

The Egmont Group creates opportunities for FIUs to discuss and share valuable insights and standards regarding AML and CFT (Gup 2007, p.17). The Egmont Group was created in 1995 to promote international cooperation regarding money laundering. The Egmont Group also addresses CFT measures taken by its members.

The membership of the Egmont Group comprises of the FIUs of 116 countries (The House of Lords 2009, p.22) and membership of this organisation is voluntary. The Egmont Group enables member FIUs to share information about AML/CFT efforts, and also to cooperate in cross-border AML/CFT investigations (Gup 2007, pp.17, 18).

5.4 REGULATORY LIMITATIONS AND CHALLENGES

Regulators should acknowledge that it is ambitious to assume that there can be complete success in the efforts to combat money laundering and terrorist financing (Pratt 2005, p.20). Regulators face the twin dilemmas that the media will be quick to highlight any gaps in regulatory requirements should there be a money laundering case, whereas financial institutions and their customers also chafe against the regulations that are aimed at combating money laundering (Pratt 2005, p.20). The financial environment is ever changing, and as law enforcement agencies and regulators act and create new, enhanced regulations and laws, money launderers also change their behaviour (Unger 2007, p.107). Regulators are challenged by the problem of terrorist financing, as it is political advantage rather than financial advantage that drives the crime of money laundering (Alexander 2005, p.66). The money launderer does not necessarily want to disrupt society, but rather to be able to access funds within the normal financial environment (Alexander 2005, p.66). Regulators have established that “recognised charities and non-profit organisations” are often the sources of terrorist financing, but it is difficult to identify the activity, as the amounts are often negligible (Alexander 2005, pp.66, 67).

It has become apparent that as regulators focus more on formal financial systems, the use of informal financial systems becomes more attractive for activities such as terrorist financing (Alexander 2005, pp.67, 68).

It is important for regulators to understand the concept of anti-money laundering in real terms in order to add value to the financial systems and to avoid adherence to the rules as a matter of form rather than substance (Owen 2005, p.100). This requires regulators to avoid creating systems that are so prescriptive that a “tick-box” approach is followed that satisfies the rules but which does not deliver the expected results (Goodhart et al. 1998, p.3). It can be argued that the most effective AML/CFT systems will be aimed at cooperation between different regulators across borders, ensuring that information is gathered and shared in such a way that cooperation can occur (Carrington & Shams 2006, p.1).

5.5 LAW ENFORCEMENT

There is a difference in approach between the regulatory environment and that of the law enforcement agencies. The regulatory environment focus on prevention and uses approaches such as self-regulation, cooperation and risk-based supervision. In contrast, the approach of law enforcement agencies is to pursue prosecutions and convictions (Tsingou 2005, p.12).

It is apparent that international cooperation regarding law enforcement exists, but that it is slower to develop than the international regulatory cooperation. According to Tsingou (2007, p.6) there is limited cooperation at country level, and this largely occurs within the framework of Interpol and Europol. As recently as 2009 there were reports that jurisdictional issues often hamper cooperation in law enforcement cases (United States Department of State 2009, p.5).

Tsingou (2005, p.12) reports that tension exists between the regulatory and supervisory bodies, on the one hand, and the law enforcement agencies on the other. This could be ascribed to the way in which success is measured, as law enforcement agencies measure success in quantifiable ways such as confiscations and convictions, whereas the financial sector often measures in terms such as reduced occurrences of a specific issue (Tsingou 2005, p.12).

However, there are also other initiatives that support greater cooperation between the law enforcement agencies of different countries. As an example, the United States law enforcement and regulatory authorities conduct workshops where they share their knowledge and expertise with their counterparts of other countries (United States Department of State 2009, p.9). In a similar manner, EUROPOL provides training for law enforcement agencies of member states and other parties (Brown 2009, p.33).

5.6 SUMMARY

The development of the AML/CFT environment gained momentum after 9/11, and as a result a plethora of related rules and regulations were created (Ballard 2003, pp.20, 21).

Various regulatory bodies at international, regional and national levels have set standards for ARS providers. These standards aim to bring about a measure of formality and, correspondingly, a paper trail of transactions (Amicelle 2008, p.14).

There is no uniform international approach to ARS providers. The current situation is that in some countries ARS providers are required to be licensed and registered. In others, informal ARS providers are not allowed to operate at all and are considered unlawful. Countries that adopt this approach include Japan, India and the Netherlands (Shah 2007, p.208).

Some of the strategies that countries can adopt to deal with informal ARS providers include improving their investigative ability and providing viable alternatives to informal ARS providers (Wheatley 2005, p.373). Improving their investigative abilities may continue to be challenging, however, as informal ARSs by their very nature do not keep many records, and the lack of records will continue to make investigation processes difficult (Wheatley 2005, p.374). The toolkit for addressing terrorist financing includes information (intelligence), law enforcement, freezing of assets, and cooperation between governments and law enforcement agencies (Wayne 2004, pp.6, 7). The ability to list natural and legal persons as terrorists or the supporters of terrorists, and to freeze their assets, is an important tool for countries and law enforcement agencies (Wayne 2004, p.7). By 2004 more than USD 142 million in assets belonging to people who appeared on the UN consolidated list had been frozen by various governments (Wayne 2004, p.7).

Governments could consider allowing the development of alternatives to informal ARSs, as this would make it much harder for money launderers or terrorist financiers to abuse the systems (Wheatley 2005, pp.375, 376). Alternatives can include the postal services, providers such as Western Union, and banks (Wheatley 2005, p.377).

It is clear that on the preventative front (regulations, sanctions) there is continued cooperation and support on an international and regional level. Action is being taken on the law enforcement side, with support and cooperation from organisations such as Interpol and Europol; however, the success of these initiatives is compromised by jurisdictional issues (Tsingou 2007, pp.5, 6) .

In certain countries such as the USA and the UK, any business that intends to remit money has to register as a money service business (House of Lords 2009, p.43). The UK authorities have tried not to differentiate between different types of transmission, but treat all remittances in the same way, requiring all remitters to be registered, regulated and supervised (House of Lords 2009, p.43). In the USA, all money service businesses have to meet some form of licensing requirement (Zagaris 2007, p.166). Such businesses also have to meet other requirements, such as reporting suspicious transactions and being available for on-site inspections (Zagaris 2007, p.166).

International strategy regarding money laundering and the financing of terrorism involves a number of actions. These include criminalising money laundering and ensuring that there are legislative measures that allow action such as investigation and seizure of the proceeds of crime to be taken. The strategy also co-opts the private sector by requiring it to take certain action such as customer identification and the reporting of suspicious activities. Finally, international strategy involves the development and support of international cooperation in activities relating to the combating of money laundering (House of Lords 2009, p.11).

CHAPTER 6: ALTERNATIVE REMITTANCE SYSTEMS AND THE SOUTH AFRICAN REGULATORY REGIME

6.1 INTRODUCTION

South Africa is a key player in the economy of the Southern African region. Although its economy is still largely cash-based, the banking and financial sector is well developed. These factors make it vulnerable to crime, money laundering and terrorist finance (United States Department of State 2009, p.457).

South Africa has taken various actions to address AML and CFT, both on a national and an international level. On 14 December 1998, it acceded to the Vienna Convention, on 1 May 2003 it ratified the Terrorist Financing Convention and on 20 February 2004 it ratified the Palermo Convention (FATF & ESAAMLG 2009a, p.13). South Africa has implemented the majority of the provisions of these Conventions (FATF & ESAAMLG 2009a, p.13). In addition, South Africa became a member of the FATF in 2003, and held its presidency in 2005/2006 (Bester, Chamberlain, De Koker, Hougaard, Short, Smith, Walker, Harinowo, Kashangaki, Financieros, Khan 2008, p.42).

South Africa criminalised money laundering from drug-related crimes in 1992 and expanded this to include any type of offence in 1996 (Bester et al. 2008, p.16). In its pursuit of developing a strong AML/CFT strategy, South Africa has established cooperation between a number of governmental departments and agencies. This strategy attempts to incorporate the UN conventions and the FATF recommendations (FATF & ESAAMLG 2009a, p.24). The South African government has implemented a comprehensive legal framework for AML/CFT. However, no domestic typology exercise has been undertaken to date (FATF & ESAAMLG 2009a, p.16). The implementation of the AML/CFT laws and regulations has been successful in South Africa because it has a strong financial sector; however, the compliance requirements have brought about greater costs for the banks and financial institutions (Bester et al. 2008, p.16).

The FATF mutual evaluation report on South Africa, published in 2009, highlights the fact that, in South Africa, formal remittance providers that provide cross-border remittances are

regulated in terms of the Exchange Control Regulations, but that there are no registration or licensing requirements for similar services provided on a domestic level (FATF & ESAAMLG 2009a, p.11). This means that ARS providers are only regulated to the extent that they provide cross-border remittances, as that involves exchange control. ARS providers that provide domestic remittance services are not regulated, even when the remittance is conducted in part or completely via formal financial methods.

6.2 THE LEGAL FRAMEWORK IN SOUTH AFRICA

The legal framework that addresses AML and CFT is based on a combination of three different laws. The two main pieces of legislation regulating money laundering are the Prevention of Organised Crime Act (POCA), Act 121 of 1998, and the Financial Intelligence Centre Act (FICA), Act 38 of 2001 (De Koker 2003, p.83; De Koker 2008, p.13). The third piece of legislation is the Protection of Constitutional Democracy against Terrorist and Related Activities Act (POCDATARA), Act 33 of 2004, which addresses terrorist financing.

6.2.1 Money laundering

In terms of the POCA, money laundering is criminalised by three different provisions, thereby creating more than twenty different offences (FATF & ESAAMLG 2009a, pp.6, 7). The POCA addresses elements such as conversion or transfer, concealment, acquisition, transfer and possession of property in a similar manner as described in the Vienna Convention of 1988 and the Palermo Convention of 2000 (FATF & ESAAMLG 2009b, p.3).

South Africa has taken the stance that all crimes are predicate offences for money laundering and, as such, can fall into any of the 20 categories of offences. There are also additional categories of money laundering offences, which can apply to either a natural or a legal person, and the charges can be proven on the basis of factual circumstantial evidence (FATF & ESAAMLG 2009b, p.4). The POCA allows for both criminal and civil forfeiture of assets (FATF & ESAAMLG 2009b, p.4) and this forfeiture is managed by the Asset Forfeiture Unit of the National Prosecution Authority. The Criminal Procedure Act

(PCA), Act 51 of 1977, allows for the search, seizure, forfeiture and disposal of the instrumentalities of crime (FATF & ESAAMLG 2009b, p.4).

In South African law, money laundering is described in section 4 of the POCA, and includes elements such as indicating that a person is guilty of an offence if he knows or "ought reasonably" to have known that the property is part of an offence, and either concealed or assisted to conceal the nature of the property, or assisted a person who committed the offence to hide the nature of the offence (FATF & ESAAMLG 2009a, p.30). Section 5 of the POCA addresses the issue that a person is guilty of an offence if he assisted another to benefit from the proceeds of unlawful activity (FATF & ESAAMLG 2009a, p.30). Section 6 of the POCA describes the situation where a person is guilty of an offence if he acquires, possesses or uses the proceeds of unlawful activity (FATF & ESAAMLG 2009a, p.31).

Section 4 of the POCA refers to self and third-party money laundering. Sections 5 and 6 refer to third-party money laundering (FATF & ESAAMLG 2009a, p.32). Section 6 of the POCA does not criminalise money laundering, but is an additional offence that can be used in conjunction with offences under section 4 of the POCA to strengthen a case against a third-party, if the case made under section 4 on its own is not strong enough to warrant a conviction (FATF & ESAAMLG 2009a, p.33). It is useful to note that South African law does not require a conviction for the predicate offences before a conviction can be secured in relation to the money laundering offences described in sections 4 to 6 of the POCA (FATF & ESAAMLG 2009a, p.33). An example of how these offences are applied can be found in the case of the *State vs Maddock, Case SH7/17/08*, where Maddock was convicted of money laundering of ZAR 421 million of proceeds, under sections 5 and 6 of the POCA. Maddock was subsequently sentenced to eight years imprisonment (FATF & ESAAMLG 2009a, p.36).

FICA is largely based on the 40 FATF requirements, but also includes elements of the Basel Committee on Banking Supervision (Genesis Analytics 2006, p.10). FICA provides for the creation of a Financial Intelligence Centre (FIC), which is the South African FIU. FICA also imposes administrative and reporting obligations on financial and other institutions (Burger 2008, p.221). The money laundering penalties that can be imposed by a court include a fine not exceeding ZAR 100 million, or imprisonment of not more than 30

years (FATF & ESAAMLG 2009b, p.3). FICA was amended by the Financial Intelligence Centre Amendment Act, Act 11 of 2008.

6.2.2 Terrorist financing

Terrorism is described in the POCDATARA. Section 2 of the POCDATARA describes the offence of terrorism as the offence of engaging in terrorist activity. Terrorist activity is defined in section 1(1) of the POCDATARA, and includes three elements, namely the commission of harmful elements, the intent to achieve certain outcomes and the motive to pursue certain outcomes (FATF & ESAAMLG 2009a, p.42).

FICA does not define terrorist financing but it does define an "offence relating to the financing of terrorist and related financing", which refers back to section 4 of the POCDATARA. Terrorist financing is criminalised in section 4 of POCDATARA (FATF & ESAAMLG 2009a, p.7). Terrorist financing is also regarded as a predicate offence for money laundering (FATF & ESAAMLG 2009a, p.7). The nine special recommendations on terrorist financing, as issued by the FATF, are incorporated into the POCDATARA (Genesis Analytics 2006, p.11).

Section 28A of FICA requires an accountable institution that possesses or controls any property associated with an entity regarded as a terrorist organisation, as defined in the POCDATARA, to report this to the FIC. This requirement also applies to a situation where the property belongs to a person listed under section 25 of the POCDATARA. The FIC may then instruct the accountable institution to provide it with further reports in respect of the property.

The POCDATARA provides a comprehensive set of offences relating to terrorist financing, and includes their criminalisation. These offences include instances where the funds were used to finance a terrorist activity, were used by a terrorist organisation, or were used by an individual terrorist (FATF & ESAAMLG 2009a, p.43). The Act also allows for the seizure of property connected to the financing of terrorism. The term "property" is defined broadly and allows for the property to be seized, even if it was not used for the act of terrorism itself (FATF & ESAAMLG 2009b, p.4). The penalties for terrorist financing include a fine

not exceeding ZAR 100 million or imprisonment of not more than 15 years (FATF & ESAAMLG 2009b, p.4).

The provisions of the United Nations Conventions and others, and the provisions of the United Nations Security Council Resolutions and others do not automatically apply in South Africa. They can only be implemented if domestic legislation is enacted to give effect to them (FATF & ESAAMLG 2009a, p.40).

The POCDATARA allows for the freezing of assets in line with the UN Security Council Resolutions S/RES/1267(1999) and S/RES/1373(2001) (FATF & ESAAMLG 2009b, p.4). The UN Security Council Resolution S/RES/1267(1999) can be implemented by a proclamation by the President. Although 63 proclamations had been made by 2008, no assets had been found, thus no action was taken in relation to these Resolutions (FATF & ESAAMLG 2009b, p.4). The UN Security Council Resolution S/RES/1373(2001) can be implemented on the request of a foreign country, but by 2008 no such request had been received (FATF & ESAAMLG 2009b, p.4). The South African authorities are of the opinion that the threat of terrorist activities, both international and domestic, is low. This assessment of a low threat also applies to terrorist financing (FATF & ESAAMLG 2009a, p.17). The US State Department has listed two South African organisations, namely Qibla and People Against Gangsterism and Drugs (Pagad), as terrorist groups (De Koker 2003, p.113).

6.2.3 Accountable institutions and their responsibilities

FICA identifies three types of institution that have specific obligations under the Act And these are identified in Schedule 1 of the Act. Currently, nineteen different accountable institutions are listed in schedule 1 of FICA, with money remitters identified as number nineteen on the list. Accountable institutions are also required to keep a record of specific information. FICA does not describe what type of business is regarded as “a person who carries on the business of a money remitter”, as listed in schedule 1 of FICA. For the purposes of cross-border remittances, it is necessary to consider the exchange control legislation, which states that only authorised dealers in foreign exchange can remit funds (Truen, Ketley, Bester, Davis, Hutcheson, Kwakwa, and Mogapi 2005, p.67). This means

that for the purpose of this research, a money remitter in South Africa is an authorised dealer who is allowed to remit funds across borders. To identify whether a remittance is allowed under the Exchange Control Regulations, issued in terms of section 9 of the Currency and Exchanges Act, No. 9 of 1933, the identity of the remitter and the nature of the transactions must be identified (Truen et al. 2005, pp.68, 69). The FIC issued a number of exemptions relating to the FIC Act in 2002, amending them again in 2004. Exemption 17 specifically exempts money remitters from having to comply with certain sections of the Act and specific Regulations published in terms of FICA provided the sender and receiver are resident in South Africa. This does not apply to cross-border remittances.

Reporting institutions are identified in Schedule 3, and are required to report suspicious and unusual transactions, as well as cash transactions of amounts greater than a prescribed amount. The duty to report transactions above a set threshold, imposed in section 28, is not yet effective.

Other businesses that are obliged to report suspicious and unusual transactions are described in section 29 of the Act. The reporting duty imposed by section 29 also applies to accountable institutions and reporting institutions.

Accountable institutions are required to perform a wide range of activities, including customer identification procedures. FICA provides the requirements for the customer identification or “know-your-customer” (KYC) procedures that must be followed. It also provides the details for lodging suspicious transaction reports (STRs). The requirements for customer identification in FICA and the POCDATARA are similar (Genesis Analytics 2006, pp.10, 11).

Accountable institutions have found that many people, especially those in the lower income groups, find it hard to provide the documentary proof required. Some of the reasons include the fact that many informal settlements in South Africa do not have formal residential addresses or utility bills. Many people also use pre-paid services, and do not have bills that substantiate residential addresses (Genesis Analytics 2006, p.11). In 2002, the Minister of Finance published an exemption (exemption 17) under FICA to assist people in lower income groups to open bank accounts, even in the absence of formal proof

of residential address, but they still have to provide proof of identity (Genesis Analytics (Pty) Ltd 2006, p.11; De Koker 2009b, p.323).

Implementing the KYC requirements has proven to be problematic in South Africa. The basic documentation required includes an identity document or valid passport, and proof of residential address. Only certain documents, such as rates and taxes statement (municipal account), are accepted as valid proof of residential address (Genesis Analytics 2006, p.11). Many people, especially those in the lower income groups, have found it difficult to provide all the required documentation (Genesis Analytics 2006, p.11).

6.3 THE REGULATORY AUTHORITIES

The regulatory oversight structure in South Africa is divided between various entities. One of these is the FIU in South Africa, the Financial Intelligence Centre (FIC), which is an administrative centre created under the auspices of the Ministry of Finance (FATF & ESAAMLG 2009a, p.7); however, the primary investigative responsibility for money laundering and terrorist financing lies with the South African Police Service (FATF & ESAAMLG 2009a, p.8).

In terms of FICA, supervisory powers are delegated in terms of Schedule 2, which lists eight supervisory bodies, including the Registrar of Banks, the Financial Services Board (FSB) and the Johannesburg Securities Exchange (JSE). These supervisory bodies are tasked with monitoring the institutions they regulate in terms of adherence to the relevant AML and CFT legislation. The Registrar of Banks forms part of the South African Reserve Bank and supervises banks and the exchange control regulations (FATF & ESAAMLG 2009a, p.10). Most of the non-banking financial institutions are supervised by the Financial Services Board (Itzikowitz 2003, pp.433, 434). The JSE is a self-regulating organisation (SRO) and supervises the members of the Exchange (FATF & ESAAMLG 2009a, p.10).

6.3.1 The Financial Intelligence Centre

According to its mandate, the Financial Intelligence Centre (FIC) has a number of responsibilities. With regard to money laundering and terrorist financing, it is required to

identify the proceeds thereof, formulate and implement policy, prevent and reduce money laundering and terror financing-related activities, and advise the Minister of Finance on this and related issues (Burger 2008, p.221).

In addition, the FIC is mandated with monitoring supervisory bodies and accountable institutions that do not have an assigned supervisory body with regard to the extent to which they are carrying out their duties in terms of AML and CTF (Burger 2008, p.221; FIC 2009, p.15). Accordingly, during 2008/09 the FIC undertook 199 joint reviews with supervisory bodies and also conducted 30 independent reviews of the Postbank (FIC 2009, p.5). The FIC acts as the supervisory body for the Postbank , which is not a registered bank, and is exempt from the Banks Act. Furthermore, it is allowed to provide international and domestic remittances via money/postal orders (FATF & ESAAMLG 2009a, p.21).

The FIC is also responsible for meeting the international AML/CFT obligations that impact on the government and the country (Burger 2008, p.221). In 2008, South Africa's AML/CFT processes were subject to a full mutual evaluation process, jointly executed by the FATF and ESAAMLG. The FIC acted as the contact point for all South African institutions during this evaluation process (FIC 2009, p.3).

From its inception up to 2009 the FIC had received 112 829 suspicious transaction reports (STRs). In the 2008/09 financial year the FIC received 22 762 suspicious transaction reports, and referred 1 221 more of these to various law enforcement and investigating authorities than in previous years (FIC 2009, pp.4–6).

The FIC became a member of the Egmont Group in 2003 (FATF & ESAAMLG 2009b, p.4), resulting in access to more administrative and law enforcement information. As a result of this information, the FIC has issued a number of guidelines to accountable and reporting institutions (FATF & ESAAMLG 2009b, p.4).

The FIC Act was amended in 2008, expanding the powers of the supervisory bodies relating to compliance with the provisions of the Act. The FIC's powers were increased under the Act, allowing it to deal with deficiencies in the supervision of accountable

institutions. The administrative actions and sanctions that can be imposed in instances of non-compliance were also addressed in the amendments (Burger 2008, p.222).

6.3.2 The South African Reserve Bank

The South African Reserve Bank (SARB), South Africa's central bank, and the Minister of Finance form the monetary authority in South Africa (Burger 2008, p.228, 229; Rossouw 2009, p.1). In order to ensure its independence, the SARB is responsible to Parliament (Rossouw 2009, p.13).

The SARB is responsible for the regulation and supervision of banks in South Africa (Rossouw 2009, p.32), as well as setting the limits and conditions under which authorised dealers are allowed to provide foreign exchange services (Rossouw 2009, p.25). The only institutions that are allowed to remit money in South Africa are banks and the South African Post Office (The World Bank Group 2009d, p.2; Genesis Analytics (Pty) Ltd 2006, p.10).

The remitting institutions are registered as authorised dealers in foreign exchange by the SARB in terms of the Exchange Control Regulations (SARB 1961, p.1; SARB 2009, p.1). Currently, 22 banks are registered as authorised dealers and nine institutions are registered to act as authorised dealers with limited authority (SARB 2009, p.1). An authorised dealer with limited authority (ADLA) is allowed to act as a dealer in foreign exchange, but only in respect of travel-related transactions (FATF & ESAAMLG 2009a, p.20).

The Bank Supervision Department (BSD) of the SARB is the regulatory and supervisory body for the registered banks (FATF & ESAAMLG 2009a, p.18). The Exchange Control Department (ExCon) is the regulatory and supervisory body for the authorised dealers with limited authority regarding compliance with FICA (FATF & ESAAMLG 2009a, p.27). The authorised dealers and ADLAs are required to implement the same AML/CFT procedures as registered banks (FATF & ESAAMLG 2009a, p.21). In 2008/09, the ExCon of the SARB conducted 43 reviews of ADLAs (FIC 2009, p.26).

6.3.3 The Financial Services Board

The Financial Services Board (FSB) is an independent regulatory authority with a number of regulatory functions, including acting as the Registrar of long-term insurance, short-term insurance, friendly societies, pension funds, financial services providers, collective investment schemes, financial markets and exchanges (Burger 2008, p.230).

The FSB is also appointed as a supervisory body in terms of schedule 2 of FICA. As part of the execution of its supervisory obligations, the FSB's Financial Advisory and Intermediary Services (FAIS) department, which is tasked with the supervision of financial services providers, undertook 212 on-site supervisory reviews during 2008/09. These reviews included a review of the FICA compliance of these financial service providers. Each financial services provider was provided with a report on the findings, and recommended dates on which to report back to the Registrar of Financial Services providers regarding their remedial actions (FSB 2009, pp.26–28). In a similar exercise the Insurance department reviewed 12 long-term insurers, finding that they were largely compliant (FSB 2009, p.47).

6.4 THE REMITTANCE SECTOR IN SOUTH AFRICA

The provision of remittances in South Africa is tightly regulated. No cross-border transfers may take place through an institution that does not have a valid bank licence (Bester et al. 2008, p.18). Two of the largest formal remittance providers in the world, Western Union and MoneyGram, maintain a presence in South Africa via agency agreements.

Although Western Union is still cited as a money transfer agent by the FinMark Trust reports of 2003 and 2005, it exited South Africa in 2001, and only provides services via agent agreements (Genesis Analytics 2003, p.vii). These agreements include one with a local bank (ABSA) and two with bureaux de change (American Express and Travelex) (Western Union 2009, p.1).

MoneyGram has an agreement in place with two licensed banks, but affordability remains an issue (Bester et al. 2008, p.18). Matters are further complicated because foreign exchange can only be purchased by legal residents, which excludes the high number of

illegal migrants. There are no affordable formal (legal) remittance mechanisms available to the illegal migrants or low-income earners (Bester et al. 2008, p.18).

In contrast with the strict cross-border control of remittances, there is no requirement to report informal ARS providers or the participants thereof in South Africa (United States Department of State 2009, p.458). Domestic remittances are not subject to the tight exchange control regulations and there are no requirements for domestic remittance providers that provide money/value transfer services only to be registered or licensed (FATF & ESAAMLG 2009a, p.147).

Very little data exists on the remittances environment in South Africa (Truen et al. 2005, p.6). The 2006 FinMark Trust Report highlights the fact that SADC countries do not separate remittances from other payments in their balance of payments reports (Genesis Analytics 2006, p.2). According to the FinMark Trust report the known destinations for remittances are Botswana, Malawi, Lesotho, Mozambique and Swaziland (Genesis Analytics 2006, p.2). However, according to World Bank data on remittance corridors, the South African remittance corridor consists of Angola, Botswana, Lesotho, Malawi, Mozambique, Swaziland, Zambia and Zimbabwe (The World Bank Group 2009d, p.1). FinMark Trust (Truen et al. 2005, p.xiii) estimates that in 2005 the value of cross-border remittances from migrants based in South Africa to SADC was R6,1 billion.

According to World Bank data on the cost of sending remittances from South Africa to other countries in the South Africa corridor, the most expensive country corridor is between South Africa and Zambia, and the least expensive is between South Africa and Lesotho (The World Bank Group 2009a, p.1). World Bank data reflect that remittances from South Africa to Zambia and Malawi are the two most expensive country corridors in the world (The World Bank Group 2009c, p.1).

It is relevant to recognise that although the actual value of remittances sent from South Africa may not be high, these remittances are often more than the official funding or assistance that the receiving countries obtain from other sources (Genesis Analytics 2006, p.3).

6.4.1 The use of formal and informal remittance providers

Research indicates that although only formal remittance channels (banks) are allowed to operate in South Africa, other informal methods exist and are used (Genesis Analytics 2006, pp.5, 6). Migrant workers often use the transportation networks (bus and taxi drivers) to send money home, rather than using the formal financial sector, and have done so for more than a century (FATF & ESAAMLG 2009a, pp.16, 17).

Little evidence was found of hawala-type ARSs in South Africa, although there is some evidence of hawala/hundi-type transactions taking place in ethnic communities in South Africa (De Koker 2003, p.93). One suggestion for this lack of evidence is that the lack of commodity trading networks means that the environment is not conducive to hawala transactions (Genesis Analytics 2003, p.41).

Studies have found that 33% of adults in South Africa do not make use of formal bank accounts, as the costs of such are too high in relation to their income (Bester et al. 2008, p.viii). To help alleviate the problem, certain bank accounts may be opened for low-income earners. These use Exemption 17 of FICA, and are known as Mzansi accounts. Mzansi accounts are limited in terms of functionality, that is, the total amount held in the account may not exceed R25 000 per month, and the maximum daily transactions may not exceed R5 000 (De Koker 2008, p.18; De Koker 2009b, p.323). The Mzansi account has enabled the four major banks and the Postbank to assist in excess of 6 million people to open bank accounts, which has significantly reduced the number of unbanked adults in South Africa (De Koker 2008, p.18; De Koker 2009b, p.323).

Evidence has been found of a number of ways in which cross-border remittances are made from South Africa. Research conducted in 2003 established that the four most prevalent methods were informal transfers via friends or taxi drivers, money orders sent via the Post Office, using bank products such as bank drafts, and using money transfer agents (Genesis Analytics 2003, p.iv). In Table 3 of the FinMark Trust report of 2005 (Truen et al. 2005, p.xiv) a number of ARS methods that are used by migrants based in South Africa are described. These methods vary between those who are “banked” and those who are “unbanked”. The banked population uses ATM cards and internet transfers

to effect transfers, whilst the unbanked uses services such as Western Union transfers or prepaid cards (Truen et al. 2005, p.xiv).

The 2005 FinMark Trust report sheds some light on the preferred method of sending remittances from South Africa. Although some of the research results indicate that migrants use bank cards to transfer money, discussions with research subjects indicated a preference for sending cash with people such as taxi drivers, friends or relatives. The Post Office was the favoured formal ARS channel, as it was seen to be as safe as the banks, easier to access as it had many branches across the country, and was regarded as being cheaper (Truen et al. 2005, pp.25 - 28).

Using taxi drivers or bus drivers to remit money is popular because they provide an extensive transport system in Africa, as well as a relatively cheap and safe remittance service. There are reports that sending R500 to a neighbouring country with a taxi driver will only cost R50 (Bester et al. 2008, p.18).

It thus seems as if the most used informal ARS channel is to send money with a friend, a relative or a taxi driver. The most preferred formal ARS method is to purchase a money order from a Post Office.

6.5 THE REGULATORY IMPACT ON ARS

The strict regulatory environment in South Africa creates barriers to remittance services. Some of the regulations exclude people completely from using such services, whilst others make it expensive. There are three sets of legislation that create the major difficulties in this regard (Truen et al. 2005, pp.xv, xvi).

Firstly, the legislation regarding exchange control only allows authorised dealers to effect cross-border remittances. Although the monetary limits for transactions are reasonable, the requirement that they are only done via authorised dealers make this expensive for the users, and also means that there are few new entrants to the remittance market (Truen et al. 2005, p.xvi). South Africa is a member of a common monetary area (CMA) with Lesotho, Swaziland and Namibia (Van Zyl 2002, p.134) and, accordingly, there is no restriction on the movement of funds within the CMA (Van Zyl 2002, p.135). The exchange

control rulings do not inherently impose barriers for cross-border transactions; the problem lies rather in who the remitter is, the organisations that are allowed to act as remitters and the reporting obligations imposed on the ARS (Genesis Analytics 2006, p.7). Residents and temporary residents are allowed to purchase foreign exchange (Genesis Analytics 2006, p.8), but non-residents, which include illegal migrants, are not allowed to do so in South Africa (Genesis Analytics 2006, p.8). As stated previously, only institutions with authorised dealer licences are allowed to purchase foreign exchange, which is a prerequisite for enabling remittances beyond the CMA members (Genesis Analytics 2006, p.8). A major problem lies in the strict reporting requirements, which require all ARS providers to report all foreign exchange transactions, regardless of the amount involved, to the SARB's Cross Border Foreign Exchange Transaction Reporting System (Genesis Analytics 2006, p.9). The strict reporting obligations increase the administrative costs of all remittance transactions and result in a situation where many migrants are excluded from using formal remittances both because of documentary requirements (KYC regulations) and affordability issues (Genesis Analytics 2006, p.9).

Secondly, the AML/CFT and customer identification requirements are very difficult to adhere to for low-income people, as they often have great difficulty in providing the necessary documentation (Truen et al. 2005, p.xvi). As discussed previously, the strict KYC requirements encapsulated in FICA mean that many people are unable to provide the required documentation, and are thus excluded from using the formal remittance providers (Genesis Analytics 2006, p.11). Although Exemption 17 of FICA has allowed for residents to open Mzansi bank accounts, this type of account can only be used for cross-border transactions within the CMA. The strict limits that are placed on transactions from the Mzansi accounts also limit their usefulness for remittances within the CMA (Genesis Analytics 2006, p.12).

The third set of problems relates to the immigration laws, which make it very hard for undocumented migrants to legally obtain the necessary documentation (Truen et al. 2005, p.xvi). Immigration to South Africa is tightly controlled, and does not allow for unskilled domestic, hospitality or construction workers to obtain work permits. They, thus, have to enter the country illegally and are unable to obtain legal documentation (Genesis Analytics 2006, p.13).

Apart from the exchange control regulations, remittance providers also face some challenges regarding the FATF requirements. The majority of remittances from South Africa are sent to other countries in Africa. In 2006 South Africa was the only FATF member in Africa, and also the only FATF-compliant country in Africa (Genesis Analytics (Pty) Ltd 2006, pp.12, 13). Financial institutions are required to assess the level of compliance of the AML/CFT actions of business partners, which is much more difficult to do if the other party does not have corresponding levels of compliance (Genesis Analytics 2006, pp.12, 13).

Table 5 of the FinMark Trust report enumerates the regulatory barriers faced by ARS providers (Truen et al. 2005, p.xvi). According to this information, the Western Union model of remittances faces thirteen regulatory barriers, and the use of the internet faces eleven barriers (Truen et al. 2005, p.xvi).

The net effect of the three sets of legislation is that large numbers of unskilled migrants have no option but to use informal ARS providers, as they cannot access the formal ARS mechanisms (Genesis Analytics 2006, p.13).

The FATF recommendations on informal remittances include that governments should regulate informal remittances and establish whether funds are moved across border in an illegal manner (Bester et al. 2008, p.151). South Africa is a largely cash-based economy, and it is known that large volumes of cash are carried across the borders. This situation makes it very difficult for the South African government to adhere to these requirements (Bester et al. 2008, p.151).

6.6 SUMMARY

The South African government has taken a number of actions in their fight against money laundering and terrorist financing. These include creating a legal framework that criminalises money laundering and terrorist financing and creating a financial intelligence unit (the FIC). The legal framework allows for the identification of assets and property involved in money laundering and terrorist financing, and the freezing or seizure of such assets. The government has signed various treaties, ratified conventions, and joined

international and regional bodies such as the FATF, the Egmont Group and the ESAAMLG (United States Department of State 2009, pp.62, 458, 459).

There is little evidence that hawala-type networks exist in South Africa. There is, however, some evidence of covert hawala usage by ethnic communities such as Indians, Somalis and Pakistanis (Bester et al. 2008, p.138). The most preferred informal ARS methods involve either sending money with a friend or a relative, or sending it with a taxi driver (Kerzner 2009, p.15).

The formal ARS providers are the Post Office, banks or money service businesses that have agent agreements in place with banks in South Africa. The limitation placed on the creation of formal ARS providers in South Africa through the exchange control rules, further limits the use of such providers. The costs associated with sending remittances via formal ARS providers are high, and this can be too high for people who only want to remit small amounts (Bester et al. 2008, p.26).

There is little evidence of terrorist financing in the SADC region. After 9/11 there were rumours linking the gold and diamond trade to Al-Q'aida; however, this was not confirmed (Hübschle 2006, pp.100, 101). There is evidence of terrorist-related activity taking place within South Africa, notably action by PAGAD between 1999 and 2000 (Botha 2005, p.1).

There is little evidence of any action by law enforcement agencies regarding money laundering and terrorist financing in South Africa. The prosecutions and subsequent conviction for money laundering addressed crimes such as laundering the proceeds of armed robbery, negligent laundering and laundering the proceeds of illegal gambling (De Koker 2003, pp.94–96). There have also been a number of cases where cash couriers were used to smuggle funds into or out of South Africa. However, none of these cases involved ARS providers (ESAAMLG 2008b, pp.9, 10).

Although South Africa has clearly demonstrated its commitment to AML/CFT endeavours, there are still gaps. The FATF/ESAAMLG mutual evaluation of South Africa established that there are some gaps in the regulation of remittances, as some types of informal remittance can be made via the telephone, and this is not regulated (FATF & ESAAMLG 2009a, p.148). South Africa's FIC should continue to analyse STRs and refer cases to the

appropriate law enforcement agencies. Although the FIC referred 22% more cases to law enforcement agencies in 2008/09, this may continue to increase (FIC 2009, p.4).

CHAPTER 7: CONCLUSION AND RECOMMENDATIONS

After 9/11 various international regulatory authorities focused their attention on ARS providers. Although action was taken against hawaladars (mainly Pakistani) operating in the UK and they were subsequently imprisoned, it did not have a significant impact on the existence of informal ARS providers in the UK (Ballard 2003, p.21).

Remittances are a necessary part of the economic landscape. Migrant workers rely on their ability to send money home, and their families rely on their ability to receive it. Azam and Gubert (2006, p.459) estimate that migrant workers from Mali based in France send approximately 100 million Euros in remittances to Mali per annum, whilst the French government's aid to Mali is about 60 million Euros. This example shows clearly the significance of the remittances that are sent by migrant workers. Reducing the fees charged for remittances would encourage migrants to use more formal ARS providers (Ratha 2006, p.182).

7.1 DESIGNING RULES AND REGULATIONS

The regulatory environment, and specifically the requirements of AML/CFT regulations, should not make it impossible for ARS providers to set up arrangements with correspondent banks. Greater clarity and uniformity of requirements across countries should be a matter of concern to regulators (Ratha 2006, p.182). Ratha (2006, p.182) suggests that a shared payment system could assist in reducing the cost of remittances.

The Committee on Payment and Settlement Systems of the World Bank has issued a report that provides guidelines for international remittance systems. In this report a number of such guidelines are given. An important point that is raised is that although it is recommended that remittances take place within the formal network, rules and regulations should not be designed in such a manner that they are overly cumbersome. The rules governing remittances should be developed in proportion to the size of the problem it is intended to address (CPSS & The World Bank 2007, p.4).

The payment system project in the SADC region could be instrumental in reducing the cost of cross-border remittances, thereby bringing relief to an area that is known for the high costs of remittances (SADC Committee of Central Bank Governors 2007, pp.2, 4; Masela 2009, p.12).

7.2 RECOMMENDATIONS

The recommendations made by the 2005 FinMark Trust report (Truen et al. 2005, p.xvii) are worth repeating. The report makes four recommendations: The first is to introduce a reporting threshold limit for exchange control, requiring that only transactions of a value of more than R5 000 need to be reported. The second is to create an authorised dealer limited authority (ADLA) licence for the remittance market, to enable more remittance providers to enter this market. Thirdly, it recommends that Exemption 17 of FICA, which allows for the opening of accounts based on limited AML requirements, be extended to cross-border transactions with Africa or the SADC. The last recommendation is to allow people to make remittances even if they can only produce a passport, and simultaneously to guarantee that the information thus obtained by the remittance provider will not be used by the immigration authorities (Truen et al. 2005, p.xvii).

Ensuring that remittances are affordable and accessible is a key point for international remittance providers (CPSS & The World Bank 2007, p.4). The high costs of formal remittances in South Africa, resulting from the foreign exchange control requirements, strict AML/CFT requirements, and the fact that there is no reporting threshold for foreign exchange transactions, means that formal remittances remain unaffordable for many people (Bester et al. 2008, pp.141, 142). The strict AML/CFT requirements mean that many people are unable to provide the documentation required for sending remittances via formal remittance channels, which creates a situation in which people are by necessity “forced” to use informal remittance providers such as taxi drivers. Sending remittances is not a choice for most remitters but a necessity and they will resort to accessible channels that are accessible to them, even if it means using the informal networks (Bester et al. 2008, pp.141, 142).

It is important that the regulatory authorities retain their independence. The key regulatory authorities (the FIC, the SARB and the FSB) all have a measure of independence, which means that they can perform their regulatory and supervisory mandate. This continued implementation of financial controls will assist in combating the threat of terrorist finance. The UN Security Council Resolutions and the 40 + 9 FATF recommendations are important tools in this regard (Hübschle 2007, p.2), although there is no evidence that ARSs operating in South Africa have been linked to terrorist finance, despite the fact that it has been alleged that such links exist (Hübschle 2007, pp.8, 9).

The strict exchange control rules in South Africa, and the tight control exercised by the SARB mean that the formal cross-border remittance market is well regulated. However, as was proven with the withdrawal of Western Union, the South African remittance market's inability to meet these strict controls has meant that conditions are not always conducive to admitting new entrants into the market (Bester et al. 2008, p.18). One of the consequences is that remittance costs in South Africa are among the highest in the world (The World Bank Group 2009c, p.1).

As the alleged links between informal ARS providers, money laundering and terrorist finance have not been proven, it is recommended that the South African authorities focus their attention on strengthening the controls for formal and informal financial systems (Hübschle 2007, p.12). Although there is no evidence of money laundering or terrorist financing having resulted from ARS usage, it has been proven that high volumes of cross-border remittances take place via the informal channels (taxi drivers). South Africa has not taken any visible action to address the issue of cross-border remittances via informal ARS providers (FATF & ESAAMLG 2009a, p.158).

7.3 CONCLUSION

The South African government and the regulatory authorities have taken various actions to implement the international conventions South Africa is a signatory to (FATF & ESAAMLG 2009a, p.24). The 2008 mutual evaluation conducted by FATF and ESAAMLG found that South Africa does indeed meet many of the 40 + 9 Recommendations in respect of AML and CFT (FATF & ESAAMLG 2009b, pp.11 - 20).

In South Africa, cross-border remittance services can only be provided by authorised dealers in foreign exchange, the Postbank and ADLAs, provided the remittance is related to travel (FATF & ESAAMLG 2009a, p.158). As has been noted, this approach limits the enablement of a strong competitive remittance market. As a result, the cost of remittances is very high and drives many senders to search for alternative ways to send remittances.

The strict foreign exchange control regulations make it very hard for new providers to enter this market, and have even led to the withdrawal of alternative remittance providers. This is an area where further research could be useful, to establish what measures could be taken to encourage a more accessible ARS system in South Africa. Further research regarding the impact and necessity of the strict foreign exchange regulations, specifically aimed at identifying whether it is necessary to impose such strict foreign exchange control regulations could also be considered. This aspect could include considerations such as the effect of either lessening the exchange control regulations, or even discontinuing them completely.

It is of concern to note that cross-border remittances are only regulated in relation to the strict exchange control regulations (FATF & ESAAMLG 2009a, p.158). This potentially creates a regulatory gap, as should the exchange control regulations be amended, it may create a situation where cross-border remittances may not be regulated at all. The impact of amendments to the exchange control regulations on ARS providers have not been studied, and it would be useful to establish the impact of amendments to the exchange control regulations on ARS in the South African corridor, both in terms of costs imposed by formal ARS and whether it would lessen the use of informal ARS providers.

The Postbank is allowed to provide cross-border remittance services, but there is a gap in that the Postbank is not adequately supervised (FATF & ESAAMLG 2009a, p.158). The supervisory situation with regard to the Postbank is an area that should be addressed by the regulatory authorities. A possible area for future research regarding the Postbank includes identifying which organisation should act as regulator for the Postbank.

The government could consider instituting a licensing or registration requirement for all institutions that wish to offer remittance services, including domestic and cross-border remittance services. Such ARS providers should be required to adhere to AML and CFT

requirements and be placed under the regulatory supervision of a designated supervisor (FATF & ESAAMLG 2009a, p.158). The regulations governing ARS providers should include AML and CFT requirements, and provide for administrative and other sanctions to be imposed in cases of non-compliance (FATF & ESAAMLG 2009a, p.158). The recommendations offered in the 2005 FinMark Trust report could form the basis for further research by the relevant regulatory authorities.

An area for further study could consider the consequences for the remittance market in South Africa should the government decide to open the market for more ARS providers. Such action by the South African government could encourage informal ARS providers to become licensed and approved, bringing them into the ambit of the formal regulatory environment. This could limit the opportunity for criminal abuse and provide greater control over the flow of remittances from South Africa. There are various opportunities to consider, including a “licensing” amnesty that could be offered to informal ARS providers, in terms of which they could become licensed without sanctions being imposed on them. In addition, the South African government and the regulatory authorities could engage with the ARS industry to consider options, constraints and timelines in this regard.

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