

ASPECTS OF MONEY LAUNDERING IN SOUTH AFRICAN LAW

by

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I declare that **ASPECTS OF MONEY LAUNDERING IN SOUTH AFRICAN LAW** is my own work and that all sources that I have used or quoted have been indicated and acknowledged by means of complete references.

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3 April 2011

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Date

SYNOPSIS

Money laundering involves activities which are aimed at concealing benefits that were acquired through criminal means for the purpose of making them appear legitimately acquired. Money laundering promotes criminal activities in South Africa because it allows criminals to keep the benefits that they acquired through their criminal activities. It takes place through a variety of schemes which include the use of banks. In this sense money laundering control is based on the premise that banks must be protected from providing criminals with the means to launder the benefits of their criminal activities.

The Financial Intelligence Centre Act 38 of 2001 ('FICA') in aggregate with the Prevention of Organised Crime Act 121 of 1998 ('POCA') form the backbone of South Africa's anti-money laundering regime. Like its international counterparts FICA imposes onerous duties on banks seeing that they are most often used by criminals as conduits to launder the benefits of crime. In turn, POCA criminalises activities in relation to the benefits of crime and delineates civil proceedings aimed at forfeiting the benefits of crime to the state. This study identifies the idiosyncrasies of the South African anti-money laundering regime and forwards recommendations aimed at improving its structure.

To this end nine issues in relation to money laundering control and banks are investigated. The investigation fundamentally reveals that money laundering control holds unforeseen consequences for banks. In particular, a bank that receives the benefits of crimes such as fraud or theft faces prosecution if it fails to heed FICA's money laundering control duties, for example, the filing of a suspicious transaction report. However, if the bank files a suspicious transaction report, it may be sued in civil court by the customer for breach of contract. In addition, if the bank parted with the benefits of fraud or theft whilst suspecting that the account holder may not be entitled to payment thereof, it may be sued by the victim of fraud or theft who seeks to recover loss suffered at the hand of the fraudster or thief from the bank.

Ultimately, this study illustrates that amendment of some of the provisions of South Africa's anti-money laundering legislation should enable banks to manage the aforementioned and other unforeseen consequences of money laundering control whilst at the same time contribute to the South African anti-money laundering effort.

KEY TERMS – Money laundering control; banks; Financial Intelligence Centre Act of 2001;

Prevention of Organised Crime Act of 1998; Money Laundering and Terrorist Financing Control Regulations of 2002; globalisation of criminal activity; money; bank-customer relationship; bank confidentiality; safe-harbour provisions; ownership of deposited money; proceeds of crime; Basel Committee on Banking Regulations and Supervisory Practices; Statement of Principles; Financial Action Task Force on Money Laundering; Forty Recommendations; Council of Europe; Third Anti-Money Laundering Directive; KYC Standard; customer due diligence; Vienna Convention; Strasbourg Convention; Proceeds of Crime Act 2002; Bank Secrecy Act; Patriot Act; Financial Crimes Enforcement Network; common-law ownership remedies; constructive trust; tracing; *rei vindicatio*; quasi-vindictory action; *actio* Pauliana; interdicts; unjust enrichment *condictiones*; civil forfeiture; innocent owner defence

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THESIS PLAN

Aspects of Money Laundering in South African Law

CHAPTER 1

Introduction
Problem Statement

CHAPTER 2

Concepts of Money
Benefits of Crime

CHAPTER 3

Bank-Customer Relationship
Bank as Owner of Deposited
Benefits of Crime

CHAPTER 4

Definition of Money Laundering

Money Laundering Process

Consequences of Money Laundering

INTERNATIONAL POSITION

CHAPTER 5

International Institutions
Basel Committee
FATF
United Nations
Industry Measures
IMF & World Bank
Wolfsberg Principles
Egmont Group

CHAPTER 6

EU Position
2005 Directive
Civil Remedies
English Position
Proceeds of Crime Act

CHAPTER 7

US Position
Bank Secrecy Act
Money Laundering Control Act
Patriot Act

Civil Remedies

Civil Remedies

Constructive Trust
Tracing
Civil Forfeiture

SOUTH AFRICAN POSITION

CHAPTER 8

AML Legislation
Financial Intelligence Centre Act
Prevention of Organised Crime Act

Civil Remedies
Rei Vindicatio, Quasi-Vindictory Action, *Actio*
Pauliana, Interdict
Unjust Enrichment *Conditiones*
Civil Forfeiture

CHAPTER 9

Conclusions and Recommendations

LIST OF ACRONYMS

ALI	American Law Institute
AML	Anti-Money Laundering
BIS	Bank for International Settlements
CFR	Code of Federal Regulations (USA)
CHIPS	Clearing House Interbank Payment System
CTR	Currency Transaction Report
EC	European Commission
EFT	Electronic Fund Transfer
EU	Countries on the European Continent that are subject to EU Law
FATF	Financial Action Task Force on Money Laundering
FICA	Financial Intelligence Centre Act of 2001 (South Africa)
FIC	Financial Intelligence Centre
FIU	Financial Intelligence Unit
IMF	International Monetary Fund
KYC	Know Your Customer
MVT	Money Value Transfer
NDPP	National Director of Public Prosecutions
PCA	Proceeds of Crime Act 2002 (England)
POCA	Prevention of Organised Crime Act of 1998 (South Africa)
NPA	National Prosecuting Authority
STR	Suspicious Transaction Report
SWIFT	Society for Worldwide Interbank Financial Telecommunication
UCC	Uniform Commercial Code
UN	United Nations
US	United States of America
USC	United States Code

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CHAPTER 1

INTRODUCTION

At all times Chess has the will, the intent, the meaning of picturing a war between two parties: a war of extinction, conducted according to rules, laws in a cultured manner, yet without clemency. This becomes evident from the rules of the game almost at first sight.

LASKER *Chess* 1–2

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A. INTRODUCTION

1. Background

The last three decades witnessed the changing face of banking. Not only has banking been affected by technological advancement, but globalisation further left its mark on the banking industry. In the current era of globalisation where financial transactions are often conducted across borders, relevant banking laws should mirror international regulatory trends as well. South Africa as a developing country must be internationally competitive and should stay abreast of global trends. Unfortunately, this means that South Africa needs to address one of the dire consequences of globalisation, namely, the growth of financial crime¹ and one of its byproducts, money laundering.²

Money laundering involves activities which are aimed at concealing illegally acquired

¹ Which is any type of illegal activity that results in a financial loss (see ch 4.B.1).

² See ch 2.C.5.2.1; ch 4.B.2.1 as regards globalisation's role in promoting money laundering.

property³ for the purpose of making it appear legitimately obtained.⁴ Although money laundering was historically associated solely with the proceeds of drug trafficking,⁵ currently the need to legitimise all types of property that was acquired through illegal means is common to all criminal activities.

This study explores the consequences where criminals use banks as tool to launder money, one of which is a potential civil claim against a bank filed by either a customer or a victim who suffered loss as a result of financial crime such as fraud or theft. By way of introduction, the following comment is significant because it encapsulates the reason for combating money laundering:⁶

[n]o country can ever say that it is free from money laundering or that opportunities for terrorist financing have been eradicated. We are shooting at a moving target with new methods, techniques and vehicles for money laundering ... being identified every day. That is why we need to remain vigilant ... I would like to remind everyone about what is at stake. Financial crime may appear to be discreet and non-violent, but appearances are often deceptive. Money laundering ... [is] a *direct* threat to the values which ... [we] defend - democracy, human rights and the rule of law.

Section 1 of the Financial Intelligence Centre Act,⁷ the primary money laundering control statute of South Africa, defines money laundering as:

[a]n activity which has or is likely to have the effect of concealing or disguising the nature, source, location, disposition or movement of the proceeds of unlawful activities or any interest which anyone has in such proceeds, and include any activity which

³ Section 1(xvi) of the Prevention of Organised Crime Act 121 of 1998, as amended ('POCA'), defines 'property' as '*money or any other movable, immovable, corporeal or incorporeal thing and includes any rights, privileges, claims and securities and interest thereon and all proceeds thereof*'. The 'proceeds' of unlawful activities are defined as '*any property or any service, advantage, benefit or reward which was derived, received or retained, directly or indirectly, in connection with or as a result of any unlawful activity carried on by any person*' (section 1(xv)). Of note, an 'unlawful activity' is *any* criminal conduct whether it occurred in the Republic or abroad (section 1(xv)(a)–(b) of POCA).

⁴ See ch 4.B.1 as regards the functional definition of money laundering. For the various legal definitions of the concept, see ch 6.B.3.6, par C.3.4; ch 7.C.2–3; ch 8.C.4.2, paras D.4.2.1–4.2.2.

⁵ See ch 4.B.2; ch 5.C.1, ch 6.B.3.4, par C.3.3; ch 8.C.1–2.

⁶ Davis *Council of Europe* 2007 2.

⁷ 38 of 2001, as amended ('FICA'), whose sections came into operation on various dates as announced in the government gazette.

constitutes an offence of section 64⁸ of this Act or section 4, 5 or 6⁹ of the Prevention Act.¹⁰

The aforementioned definition of money laundering is sufficiently wide that the acquisition, use or possession of illegally acquired money is a money laundering offence. In simple terms, a money laundering offence occurs where a person benefits from a criminal offence. Money laundering occurs through deals and bank transfers until the source of the illegally acquired money has been concealed and the money appears to be legally acquired.¹¹ The conversion of

⁸ Section 64 of FICA criminalises transactions conducted for the purpose of avoiding reporting obligations (see ch 8.C.4.2.3.3).

⁹ The sections read as follows: '**Money laundering**

4. Any person who knows or ought reasonably to have known that property is or forms part of the proceeds of unlawful activities and (a) enters into any agreement or engages in any arrangement or transaction with anyone in connection with that property, whether such agreement, arrangement or transaction is legally enforceable or not; or (b) performs any other act in connection with such property, whether it is performed independently or in concert with any other person, which has or is likely to have the effect (I) of concealing or disguising the nature, source, location, disposition or movement of the said property or its ownership or any interest which anyone may have in respect thereof; or (ii) of enabling or assisting any person who has committed or commits an offence, whether in the Republic or elsewhere— (aa) to avoid prosecution; or (bb) to remove or diminish any property acquired directly, or indirectly, as a result of the commission of an offence, shall be guilty of an offence.

Assisting another to benefit from proceeds of unlawful activities

5. Any person who knows or ought reasonably to have known that another person has obtained the proceeds of unlawful activities, and who enters into any agreement with anyone or engages in any arrangement or transaction whereby— (a) the retention or the control by or on behalf of the said other person of the proceeds of unlawful activities is facilitated; or (b) the said proceeds of unlawful activities are used to make funds available to the said other person or to acquire property on his or her behalf or to benefit him or her in any other way, shall be guilty of an offence.

Acquisition, possession or use of proceeds of unlawful activities

6. Any person who— (a) acquires; (b) uses; or (c) has possession of, property and who knows or ought reasonably to have known that it is or forms part of the proceeds of unlawful activities of another person, shall be guilty of an offence'.

¹⁰ Which references are made to POCA. The long title of POCA explains that the Act was enacted to introduce measures aimed at organised crime, prohibit activities relating to racketeering; criminalise money laundering and to provide for an obligation to report certain information, prohibit gang related activities, enable the recovery of the proceeds of unlawful activities, provide for civil forfeiture, cater for the creation of a Criminal Assets Recovery Account, amend the Drugs and Drug Trafficking Act of 1992 (see ch 8.C.1) and the International Cooperation in Criminal Matters Act of 1996 (see ch 8.D.4.4), repeal the Proceeds of Crime Act of 1996 (see ch 8.C.2) and to provide for matters connected with the above mentioned.

¹¹ There is a wealth of material available which discusses the nature and purpose of the money laundering process. For a South African perspective, see in general De Koker *ABLU-2002* 7–8; Itzikowitz (1999) *THRHR* 89; ICA *AML Manual* 73; Smit *Clean Money* 9;

illegally acquired money into seemingly legally acquired money can take place through a number of schemes which include the use of banks.

A money laundering scheme may commence with a deposit into a bank account of illegally acquired money.¹² The funds can then be converted into monetary instruments through the use of banker's drafts and money orders, or they can be withdrawn and used to buy expensive items such as property and diamonds to make it difficult for the authorities to ascertain exactly where the money came from in the first place. As a final stage in the money laundering process the property or diamonds are sold and the proceeds are again deposited into a bank account where they re-enter the economy as seemingly legally acquired funds. It follows that any effective anti-money laundering¹³ regime should provide for an early warning system that includes efficient risk management and compliance to money laundering control laws which are aimed at preventing the criminal use of the banking system as a whole. It was recently estimated that the value of illegally acquired money laundered in South Africa may be as high as 80 billion rand annually.¹⁴ Money laundering promotes criminal activities in South Africa because it allows criminals to profit from their illegal conduct.¹⁵ It further damages the integrity of society and undermines the rule of the law because it protects the benefits of crime against discovery.¹⁶ From a prevention point of view money laundering is the Achilles heel of criminal activities and, therefore, must be combated. The idea is that by targeting the money laundering aspect of criminal activities, criminals will be deprived of their illegally acquired benefits which will leave them profitless and as a consequence, the criminal activity should cease.

Goredema *Overview of the Threat* 1; De Koker (1997) *J for Juridical S* 18; Itzikowitz (1999) *THRHR* 89; Bourne (2002) *SA Merc LJ* 475–476; Itzikowitz (2000) *J of Fin Crime* 185; Smit (2001) *Crime & Conflict* 25; De Koker *Money Laundering* 2-8; Goredema & Montsi (2002) *African Security R* 8; Itzikowitz *ABLU-2005* 1; De Koker *South Africa* 97–110.

¹² Which constitutes the first stage in the money laundering process known as 'placement' (see ch 4.B.5). For example, in *Gainsford NNO v Gulliver's Travel (Bruma) Pty (Ltd)* 07/5121 [2009] ZAGPJHC 20 (7 April 2009) a fraudster deposited the proceeds of misappropriated shares with a bank for money laundering purposes (see ch 3.B.2.1.2 for the facts of the case; ch 4.C–D where various money laundering schemes are discussed).

¹³ Or 'AML'.

¹⁴ Goredema *South Africa* 86. For money laundering trends in South Africa, see De Koker *ABLU-2002* 29–44; Goredema *Overview of the Threat* 6, 11.

¹⁵ Moodley *SA Strategic Review* 79. See also ch 4.E.1–5 where the negative consequences that money laundering has for a country are considered.

¹⁶ See Moodley *op cit* 68–75; UNDCP *Ten Laws*; ch 4.E.1–5 as regards the dire consequences of money laundering.

POCA is based on the premise that by combating money laundering criminals will be prevented from using banks as tool to launder their illegal gains.¹⁵ If illegally acquired money can be easily processed through a bank because an employee either has been bribed or because it turns a blind eye to the potential criminal nexus of the deposited money, the bank can become part of the organised crime syndicate itself. Banks must therefore be protected from inadvertently providing criminals with the means to launder the benefits of crime. To this end, FICA imposes onerous duties on banks¹⁶ and other sectors of persons¹⁷ that may be used by criminals as tools to launder the benefits of crime. In turn, POCA criminalises activities in relation to the benefits of crime and set-out proceedings aimed at forfeiting the benefits to the state.

Money laundering is further characterised by its international nature. In recent years the international community¹⁸ has been confronted by the growing problem of preventing the growth in organised crime and money laundering.¹⁹ The failure of the Bank of Credit and Commerce International²⁰ is a case in point. The BCCI was a bank that laundered money for both terrorists and intelligence agencies.²¹ More than one million US dollars were transferred by the BCCI from

¹⁵ See the long title of POCA.

¹⁶ Schedule 1 of FICA defines a bank in terms of section 1 of the Banks Act 94 of 1990, as amended ('Banks Act'). Section 1 of the Banks Act defines a bank in terms of two concepts, namely 'deposit-taking' and 'business of a bank', both which are delineated in much detail. The concept 'business of a bank' has different meanings for various purposes and in terms of different legislation (Malan & Pretorius *Malan on Bills* 254; Itzikowitz *Banking* 170; Malan *Banking Law Influences* 18–29; Itzikowitz (1992) *SA Merc LJ* 176; Schulze (2001) *SA Merc LJ* 79). In short, a person that receives money as a deposit is conducting the business of a bank (see ch 3.B.1).

¹⁷ See Schedule 1 of FICA for a list of designated persons to which the Act applies; ch 8.C.4.1. It is important to emphasise that although this study is concerned solely with banks in relation to money laundering control, FICA applies to various designated institutions. It follows that while the ambit of this study is restricted to banks the law is not so restricted.

¹⁸ Which concept is used to denote countries, transnational bodies and forums that are involved in the fight against money laundering on a collective basis (see ch 5.B–D).

¹⁹ For an analysis of the nexus between organised crime, the benefits of crime and money laundering, see ch 2.C.5.

²⁰ Or 'BCCI'.

²¹ The BCCI was a joint venture between the Bank of America and a Pakistani banker, Aga Hassan Abedi (Bosworth-Davies & Saltmarsh *Money Laundering* 102–103; *United States v BCCI Holdings (Luxembourg), S.A.* 69 F Supp 2d 36 (1999) 37–38 [*BCCI*]). It was incorporated in both Luxemburg and the Cayman Islands to prevent nationalisation. Since its main office was situated in London, the bank was regulated nowhere and was a fraud from the beginning because it did not have legitimate capital (Blum *Offshore Money* 71–75). With its corporate structures created to evade banking laws, the BCCI was used to fund, *inter alia*,

Libyan companies incorporated in the United States. Subsequent investigations revealed that massive fraud and rumours about money laundering, which led to a run on bank deposits, contributed largely to the demise of the bank. In its wake followed unprecedented activity aimed at combating criminal activity and money laundering within the banking industry. In essence, the BCCI's failure emphasises both the vulnerability of banks to criminal infiltration and the need for stringent measures to combat money laundering.

In this study money laundering control is compared to a chess match. The enemies combating each other on the chessboard are the police authorities and a criminal seeking to launder the benefits of crime. The authorities are represented by White whilst a member of an organised crime syndicate is represented by Black on the chessboard. The analogy can be illustrated as follows:

the transfer of military nuclear technologies from Europe to Third World leaders (Hemraj (2005) *J of Money LC* 346–347). It also became a vehicle for about one billion US dollars of Islamic deposits which were employed for commodity investments. Services provided by the bank included dishonest auditing for illegal businesses (i.e. fraud), money laundering and secret transfers for terrorist organisations (Ehrenfeld *Evil Money* 183; Lilley *Dirty Dealing* 5; Hemraj *op cit* 348–350; *BCCI* 39). Documents were falsified and shell company transactions created to manipulate officials in different countries. By the time the BCCI was shut down in 1991 it had 430 branches in 73 countries (Bosworth-Davies & Saltmarsh *Money Laundering* 103 ev; Passas (1993) *Crime, Law & Social Change* 294–295).

Figure 1.1

WHITE

ROOK Bank- Cust. Relation- ship	KNIGHT Internat. AML Efforts	BISHOP AML Statutes	QUEEN KYC Standard	KING Banks	BISHOP Civil Forfeiture	KNIGHT AML Treaties	ROOK Bank- Cust. Relation- ship
PAWN Individual AML Measures	PAWN Individual AML Measures	PAWN Individual AML Measures	PAWN Individual AML Measures	PAWN Individual AML Measures	PAWN Individual AML Measures	PAWN Individual AML Measures	PAWN Individual AML Measures
PAWN Variety of Schemes	PAWN Variety of Schemes	PAWN Variety of Schemes	PAWN Variety of Schemes	PAWN Variety of Schemes	PAWN Variety of Schemes	PAWN Variety of Schemes	PAWN Variety of Schemes
ROOK Internet Banking	KNIGHT Bank Confiden- tiality	BISHOP Use of Legal Persons	QUEEN Money Launder- ing	KING Benefits of Crime	BISHOP Other Money Launder Tools	KNIGHT Electronic Money	ROOK Internet Banking

BLACK

Black and White have equal power in the form of sixteen pieces until the pieces are captured. The objective of the two players are similar: to defend the life of the King. The player who cannot save his King is 'checkmate' and loses the match. Who wins the game is determined by the stealth and foreseeability of the players.

For the police authorities the White King on the chess board signifies banks that must be protected against criminal infiltration and money laundering. For the criminals the Black King signifies the benefits of crime that must be protected from detection, identification, confiscation and subsequent civil forfeiture. The other White pieces on the board represent various money laundering control strategies aimed at identifying the benefits of crime whilst the Black pieces represent elements that act in support of money laundering. Throughout this study the analogy of a chess match between the police authorities and members of an organised crime syndicate is referred to. Like a chess match the outcome of crime prevention through money laundering control is fraught with uncertainty. Since strategies vary, the two players must outwit each other to attain checkmate and win the match.

Ultimately, this study is an attempt to distil some general principles out of various money laundering control issues in as far as they impact on banks. In particular, the study sets out to establish that whilst compliance with statutory AML obligations may assist a bank to avoid prosecution for a money laundering offence, it may also expose the bank to civil liability despite the fact that its conduct may have been above reproach.²²

2. Money Laundering Control Legislation

Money laundering control legislation is part of the arsenal used by the police authorities to combat criminal activities by keeping the benefits of crime out of the financial system. The idea is that an effective money laundering control regime should render it impossible for criminals to use the benefits of their criminal activities without fear of prosecution and, or civil forfeiture of the funds. The reason for a bank's inevitable participation in money laundering control is rooted in the reality that regardless of the type of institution involved in executing a financial transaction, illegally acquired money by and large ends-up in a bank account from where the funds are dispersed as part of the final stage of the money laundering process.²³

Since the early 1990s, the Know Your Customer²⁴ standard has been promoted by the international community as a crucial measure to identify both criminals and the benefits of crime before the funds can enter the financial system. The KYC standard which is the crux of international AML legislation²⁵ comprises four key obligations, namely:

1. customer identification;
2. suspicious transaction reporting;
3. record-keeping; and
4. training.

²² Which liability is known as 'facilitator liability' (Rider (1999) *J of Money Laundering Control* 208; Reid *Civil Law and Money Laundering* D2).

²³ The alternative is to keep the benefits of crime in the form of cash under a bed mattress as quipped by the court in *Alley Cat Clothing v De Lisle Weare Racing* [2002] 1 All SA 123 (D) [*Alley Cat*] 131A. However, due to modern banking practices and the fact that cash is seldom used in the place of electronic money (as to which, see ch 2.B.2) it is fair to assume that banks will always assume a key role in money laundering schemes.

²⁴ Or 'KYC standard' (see ch 5.B.3).

²⁵ See ch 5.B.3, paras C–D; ch 6.B.3.4–3.6, par C.3.4; ch 7.C.2–3, par C.8.3.2.

Collectively the four obligations above are aimed at reducing the vulnerability of banks to criminal infiltration and preventing their prosecution for money laundering offences as well. FICA follows a path that was paved by international AML legislation. As a result, the KYC standard obligations have been incorporated in full in the Act.²⁶

As mentioned above, POCA criminalises activities which are aimed at concealing the nature, source, location, disposition or movement of the benefits of crime, and provides for the confiscation and civil forfeiture thereof.²⁷ In turn, FICA imposes stringent obligations on banks and creates money laundering offences when these obligations are neglected. For example, section 21 of FICA requires that a bank establishes the identity of customers whilst section 29 stipulates that a bank reports suspicious or unusual account activity to the Financial Intelligence Centre.²⁸ Banks must further keep records of their customers' transactions and train employees to comply with FICA and their internal AML measures.²⁹ Failure to observe FICA's provisions incriminates a bank and leads to its prosecution for a money laundering offence.

Two important points as regards the benefits of crime must be emphasised. First, both FICA and POCA fail to distinguish between money as the object of crime and money as the proceeds of crime. Instead, both Acts use the concept 'proceeds of unlawful activities' to denote in general terms property that was acquired through criminal means.³⁰ POCA further provides for the civil forfeiture of an 'instrumentality of an offence' which offences are listed in Schedule 1 of the Act.³¹ By using some of the offences listed in Schedule 1 of POCA as examples the distinction between money as the object of criminal conduct and money as the proceeds of criminal conduct can best be illustrated as follows:

²⁶ See ch 8.C.4–5, par E.1.

²⁷ See ch 8.C.3, par D.4.

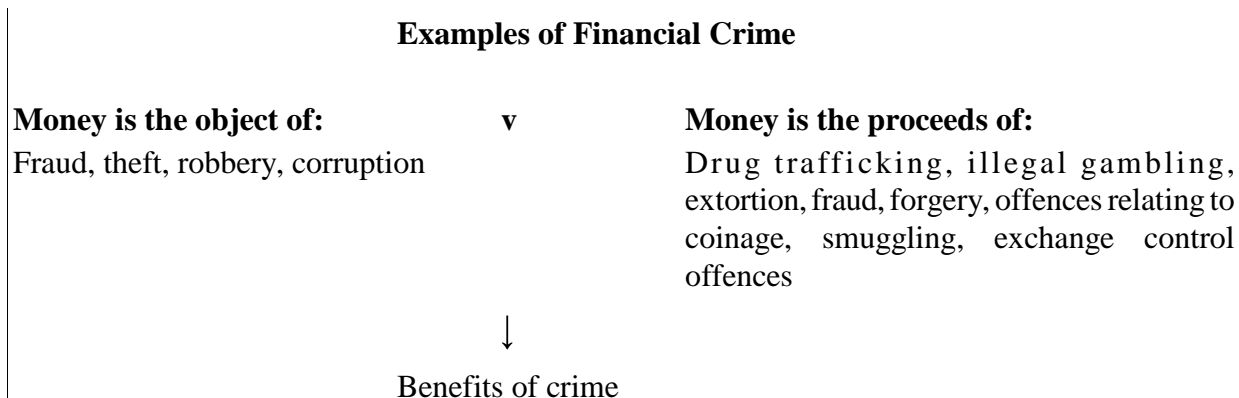
²⁸ Or 'FIC' whose objectives are considered elsewhere in the study (see ch 8.E.1).

²⁹ Sections 25, 43 of FICA (see ch 8.C.4.2.3.4–4.2.3.5).

³⁰ See section 1(xv) of POCA as referred to by section 1 of FICA.

³¹ See ch 8.C.3.2, par D.4.2.1.2 for the 34 offences listed in Schedule 1 of POCA.

Figure 1.2



Money is the object of crimes such as fraud or theft where it was acquired from the victim through criminal means. Consider the scenario where money was stolen by an employee of a consulting firm. The money is the object of the theft and the firm's clients remain the legal owners of the funds.³² In contrast, money is the proceeds of criminal activities such as drug trafficking or illegal gambling because it was generated by the criminal activities. The criminal further acquires ownership of the funds. In this study the concept 'benefits of crime' is used as an umbrella term to denote both money as the object and money as the proceeds of crime.

In most instances where money is the proceeds of the criminal activities listed in Figure 1.2 above there are no obvious victims who have suffered loss. For example, when the proceeds of drug trafficking or corruption are deposited into a bank account the funds legally belong to the (criminal) account holder. The state may also instigate civil forfeiture proceedings against the account holder pursuant to POCA's provisions.

However, sometimes depending on the nature of the criminal activity money can either be the object of a crime or the proceeds of a crime, for example, where it was acquired through fraud. Illegally acquired money constitutes the object of fraud where a person, for example, was fraudulently induced to pay money to secure an interest in property which never existed. But illegally acquired money can also constitute the proceeds of fraud where an investor, for example, was fraudulently induced to invest in property which was subsequently sold to a third-party without the investor's knowledge. In the latter case the profits made from selling the property

³² This is on account of the *nemo plus iuris ad alium transfere potest, quam ipse habet* rule which provides that no one can transfer more rights in property to some other than the person himself has (as to which, see ch 3.C.2.2; ch 8.D.2.1.1)

constitute the proceeds of fraud as opposed to the object of fraud. However, regardless of whether the benefits acquired by the fraudster are the object or the proceeds of fraud in both examples there is a victim of fraud who seeks to recover his loss. The position can best be illustrated as follows:

Figure 1.3

Examples of Financial Crimes	
<p>Obvious victim: Theft, robbery, fraud, forgery, extortion</p> <p style="text-align: center;">↓</p> <p>Civil claim by the victim against the account holder</p>	<p>No identifiable victim: Drug trafficking, corruption, smuggling, offences relating to coinage or exchange control</p> <p style="text-align: center;">↓</p> <p>Civil forfeiture proceedings by the state against the account holder</p>
Remedies	

Where the benefits of crime were acquired through theft, robbery, extortion, forgery or certain types of fraud a money laundering investigation may point the way to locate the funds and restore them to the victims. The victim of the aforementioned crimes may further be able to follow his loss to a bank account where the illegally acquired money was deposited. If the funds were not withdrawn by the criminal account holder the victim can claim from him.³³ However, the victim will be left out of pocket if the funds were withdrawn by the criminal who either absconded with the money or who proves to be a proverbial man of straw. In this study fraud and theft are used as examples of criminal activity which left a victim who suffered loss and is seeking to recover it.³⁴ In turn, drug trafficking is used in this study as an example of criminal activity which left no obvious victim who suffered loss.³⁵

Secondly, the distinction between money as the object of crime and money as the proceeds of crime is important in relation to civil forfeiture proceedings. The running argument is that only the proceeds of drug trafficking which left no obvious victims should be forfeited to the state

³³ For the *causa* of the claim, see par B below; ch 8.D.1.

³⁴ This is due to a report by the Financial Action Task Force on Money Laundering (see par B below) which recognised fraud and theft as major profit-generating crimes in South Africa (FATF SA Report-2009 3).

³⁵ This is because drug trafficking presents a tremendous problem for the South African police authorities (ibid).

otherwise a victim of fraud or theft may be left out of pocket where fraudulently acquired or stolen money is the subject of a civil forfeiture application. Consider again the scenario above where an employee stole money from a consultancy firm and deposited it with a bank. The clients followed the money to the bank account of the thieving employee only to discover that although the money was not withdrawn by the thief, the account is the subject of civil forfeiture proceedings. In this case the court should not grant the state a civil forfeiture order without having to establish first that there are no persons with a valid claim to the money in the account. The reason is that the employee, who is a thief, did not obtain a legal title to the stolen money.³⁶ Therefore, the clients of the consulting firm should be allowed first to recover that part of the funds in the account which represents the amount that was stolen from them before the court can grant the state's civil forfeiture application in respect of the money.

This study shows that POCA fails to recognise this distinction. Instead, it sanctions civil forfeiture of all the benefits of crime to the state irrespective of whether the funds belong to a victim of crime who has a valid claim to the money.³⁷

3. Dilemma of Banks

A bank may become embroiled in civil litigation due to the fact that it receives deposits from the public.³⁸ There are two potential causes of action³⁹ against a bank as recipient of the benefits of crime. First, the bank may be sued by a customer for breach of bank confidentiality. The concept 'bank confidentiality' refers to a bank's common-law duty to observe the confidentiality of customers in relation to their bank affairs.⁴⁰ Bank confidentiality is dated back to the Code of Hammourabi.⁴¹ A bank as an accountable institution⁴² must heed FICA's provisions in order to avoid prosecution for a money laundering offence. Pursuant to section 29 of FICA a bank must file

³⁶ See above.

³⁷ See ch 8.D.4.2.1, par D.4.3.

³⁸ See ch 3.C.3.1 as regards the purpose of banking.

³⁹ See Lambiris (*Restitution* 2–3) who denotes a cause of action as 'the legal ground which entitles a plaintiff to ask a court for relief or to avail himself of relief.'

⁴⁰ See ch 3.B.2.3; ch 6.B.2.2, par C.2.2; ch 7.B.2.

⁴¹ Chambost *Bank Accounts* 3.

⁴² See Schedule 1 of FICA; ch 8.C.4.1.

a suspicious transaction report⁴³ to the FIC when it knows or suspects that a transaction is conducted for the purpose of laundering the benefits of crime. This obligation conflicts directly with the bank's obligation to treat the customer's affairs with confidentiality. As a result, the customer may claim damages from the bank based on breach of contract.⁴⁴

Secondly, English common-law provides a remedy to victims of fraud or theft who followed their loss to a bank account only to discover that the benefits of the fraud or theft were withdrawn by the (criminal) account holder whose whereabouts are either unknown, or who is the proverbial man of straw.⁴⁵ At English common-law the victim may claim his loss from the bank which parted with the suspected benefits of fraud or theft provided that he can establish that the bank knew that the deposited funds were the benefits of fraud or theft.⁴⁶ The ability of the victim to establish such knowledge on the side of the bank is crucial to the outcome of the claim. A bank that filed a STR to the authorities as required by the English Proceeds of Crime Act 2002⁴⁷ inadvertently may have assisted the victim-claimant to establish the required degree of knowledge in order to impose liability on it.

Consider the scenario where a person paid a deposit of 10,000 rand to a fraudster for the renting of a fictitious holiday home. The fraudster eventually broke all contact with the victim leaving him without a holiday home and his deposit. Some time later the holidaymaker learned that the fraudster was caught and charged with various charges of fraud. Due to the investigation into the affairs of the fraudster the victim of fraud was able to follow the 10,000 rand to the bank account where the fraudster had deposited it. Whilst on bail the fraudster closed his bank account and absconded with the money. As a result the victim of the fraud is unable to claim his loss directly from the fraudster.⁴⁸ At English law the victim may pursue civil action against the bank that received and parted with the suspected benefits of fraud and claim loss suffered at the hand of the fraudster from it.⁴⁹

⁴³ Or 'STR' (see ch 8.C.4.2.3.3).

⁴⁴ See ch 3.B.2.1; ch 6.B.2.1, par C.2.1; ch 7.B.1.

⁴⁵ See ch 6.C.4.2–4.3.

⁴⁶ See par A.3 below.

⁴⁷ See ch 6.C.3.4.2.

⁴⁸ Note that it stands to reason that the victim of fraud will instigate action against the fraudster for repayment of the amount if he can find him or the bank account where the benefits of fraud were deposited (see ch 8.D.1).

⁴⁹ See ch 6.C.4.2–4.3. See also ch 7.D.2–3 for the US position.

At South African common-law the extent to which similar civil liability can be imposed on a bank that parted with the benefits of fraud or theft which left an identifiable victim is unclear. By comparison to English courts South African courts have had limited opportunities to consider the potential civil liability of a bank as former recipient of the benefits of fraud or theft. In *First National Bank of Southern Africa Ltd v Perry and others*⁵⁰ the court remarked as follows:

[o]ne must enquire, as a matter of substantive and not merely procedural law, what cause of action may lie against the bank.

This study therefore sets out to establish, *inter alia*, which potential causes of action may be used by a victim of fraud or theft to call a bank which parted with the benefits of fraud or theft to answer in court.

Sometimes there are no obvious victims who have suffered loss as a result of criminal activities, for example, where the benefits of crime derive from drug trafficking.⁵¹ If a drug trafficker deposits the proceeds of drug trafficking with a bank, the court will order that the money be declared forfeited to the state. POCA introduced civil forfeiture as a method to combat, *inter alia*, money laundering.⁵² It is an apposite remedy to consider in relation to banks and the benefits of crime deposited into a bank account because it establishes a civil cause of action against such money and allows the state to instigate civil forfeiture proceedings against the account holder. Ultimately, civil forfeiture redresses criminal conduct by removing the profits from the criminal.

Civil forfeiture is further a controversial remedy because it operates in violation of the notion that ownership is an absolute right.⁵³ However, ownership under Roman law was never absolute because it tolerated restrictions.⁵⁴ In similar fashion it is accepted today that POCA has

⁵⁰ 2001 (3) SA 960 (SCA) par 19.

⁵¹ See par A.2 above.

⁵² See the Preamble of POCA which acknowledges that: '[m]oney laundering ... present[s] a danger to public order and safety and economic stability, and have the potential to inflict social damage; and whereas the South African common-law and statutory law fail to deal effectively with ... money laundering ... legislation is necessary to provide for a *civil remedy for the restraint and seizure, and confiscation of property which forms the benefits derived from such offence*; and whereas no person should benefit from the fruits of unlawful activities, nor is any person entitled to use property for the commission of an offence ... legislation is necessary to provide for a *civil remedy for the preservation and seizure, and forfeiture of property which is derived from unlawful activities or is concerned in the commission or suspected commission of an offence.*'

⁵³ See ch 3.C.1–2.

⁵⁴ Van der Walt (1992) *De Jure* 446; Hahlo & Kahn *Union of SA* 579.

limited the traditional notion of ownership;⁵⁵ it allows for the civil forfeiture of the benefits of crime without the state needing to obtain a criminal conviction first.⁵⁶ Section 25(1) of the Bills of Rights of the Constitution of the Republic of South Africa⁵⁷ provides that:

[n]o one may be deprived of property except in terms of law of general application, and no law may permit arbitrary deprivation of property.

It follows that section 25(1) protects all rights held as regards property, including ownership. For this reason POCA provides that property may be forfeited to the state only where it is the proceeds of unlawful activities or the instrumentality of an offence.⁵⁸ In addition, notice must be served on holders of an interest in the property that is earmarked for civil forfeiture.⁵⁹ The latter provision is crucial to a person such as a bank which as mortgagee holds an interest in a residence that has been earmarked for civil forfeiture because it was used, for example, as a brothel.⁶⁰ But, this study illustrates that POCA fails to distinguish between the civil forfeiture of the proceeds of drug trafficking where there is no victim who suffered loss, and the civil forfeiture of the benefits of fraud or theft where there is a victim who followed his loss to the fraudster or thief's bank account. In contrast to the bank above which may recover its interest in the residence earmarked for civil forfeiture, the victim of fraud or theft is likely to experience difficulty to establish his interest in the deposited money if the fraudster or thief's account is the subject of civil forfeiture proceedings.

In the end, this study establishes that similar to a chess match where White (the police authorities) allows the Black King (the benefits of crime) to infiltrate its last line of defence, money laundering control carries unforeseen consequences for any bank where the benefits of crime are deposited into a bank account. However, a bank that is able to identify a criminal and, or the benefits of crime before the funds can be introduced into the banking system may be able to circumvent and even protect itself against potential civil litigation as spelt out above. This outcome not only affords credence to money laundering control but also returns credibility to statutory AML obligations.

⁵⁵ Van der Walt & Kleyn *Divided Ownership* 258; Reid & Van der Merwe *Property Law* 648–651.

⁵⁶ See ch 8.D.4.

⁵⁷ 108 of 1996 ('the Constitution').

⁵⁸ See section 50(1) of POCA; ch 8.D.4.2.1.1–4.2.1.2.

⁵⁹ See section 51 of POCA; ch 8.D.4.3.

⁶⁰ Which is an offence in terms of section 2 of the Sexual Offences Act 23 of 1957.

B. PROBLEM STATEMENT

The principal purpose of the study and research, which is entitled ‘Aspects of Money Laundering in South African Law’, is to illustrate that money laundering control carries unforeseen consequences for banks. Therefore, nine research objectives are examined in this study within the context of money laundering and banks. This is done by comparing the position of other jurisdictions which have had more experience in matters relating to money laundering control to the current legal position in South Africa. Having explored the characteristics of money and the benefits of crime, the consequences that money laundering control carries for the bank-customer relationship and the jurisprudence of money laundering and money laundering control, civil remedies which may address the consequences for criminals who use banks as tool for money laundering will fall under the spotlight.

Money laundering per definition concerns a process to conceal the nexus that money has to criminal activities.⁶¹ However, it must be emphasised that not all the benefits associated with money laundering were necessarily acquired through illegal means. Consider, for example, the offence of tax evasion.⁶² The benefits acquired as a result of tax evasion are not judged as having being laundered because money which a person lawfully receives cannot be laundered. If X receives 10,000 rand as remuneration, he must pay 40 per cent income tax on it. X fails to declare the income. As a result the 4,000 rand is considered as being stolen from the Treasury. The 4,000 rand is therefore the object of theft. X therefore does not launder the 10,000 rand, only 4,000 rand must be laundered to conceal that the funds were acquired through theft. However, in order to retain the 4,000 rand X needs to put the whole amount of 10,000 rand through the money laundering process because he needs to demonstrate that he received 10,000 rand legitimately in order to evade a payment of 4,000 rand to the Treasury. As once reasoned:⁶³

[t]he perception of irregularity or use of ‘dirty money’ can vary greatly over time and from country to country. Clearly, the test cannot be based merely on moral precepts or on doubts about illegality in some foreign country.

⁶¹ See par A.1 above.

⁶² See ch 8.C.3.2, paras C.4.2.3.3, D.2.2.1, D.4.2.1.1.

⁶³ Hirsch (1986) *J of Comparative B & CMLaw* 378.

The correctness of the statement above is evident in the distinction that the literature draws among two concepts that are commonly associated with money laundering, namely ‘dirty money’ and ‘benefits of crime’.⁶⁴ POCA criminalises any activity associated with property such as money that was acquired through illegal means.⁶⁵ But how the criminal conduct of an individual can be linked to money is unclear. Since this study sought answers to various money laundering related issues, it is deemed important to commence the investigation by considering:

1. the characteristics of money in general and in particular, money that was acquired through criminal means.

Having established that while money in itself is a neutral medium, its designation is influenced by the criminal intention of its owner or possessor, the second issue to consider is whether:

2. a bank as recipient of the benefits of crime acquires ownership of the funds following their deposit into a bank account.

As a result of the business of banking and contemporary methods of payment a bank indeed becomes owner of the benefits of crime whether the funds commingle with other funds in the bank account or not, and despite their nexus to criminal activities. The bank as owner of the benefits of crime may also face prosecution for a money laundering offence.⁶⁶ For this reason money laundering control strategies are aimed at a bank’s prudent identification of customers and the filing of STRs if necessary.⁶⁷ It follows that the third issue to consider concerns:

3. the consequences that money laundering control carries for the bank-customer relationship.

A bank that fulfills its obligations pursuant to FICA should avoid prosecution for a money laundering offence. However, as stated above, research illustrates that the bank nevertheless may be exposed to civil litigation instigated by a customer of it. This is in part due to the conflict that exists between the reporting obligation of banks and ancient bank confidentiality rules. A bank is

⁶⁴ See ch 2.C.5.3 as regards the different concepts used to denote property that was acquired through criminal means.

⁶⁵ See ch 8.C.3.2 as regards the AML provisions of POCA.

⁶⁶ See section 2(1)–(4) of POCA; ch 8.C.3.2.

⁶⁷ See ch 5.B–D; ch 6.B.3.6, par B.5, par C.3.4, par C.5; ch 7.C.2–9, par E; ch 8.C.3–4, par E.

namely confronted with two conflicting obligations. On the one hand, it must preserve the confidentiality of customers whilst on the other hand, it has an obligation to disclose suspicious transactions to the FIC and to render assistance with any subsequent investigation.⁶⁸ If it is established that FICA disregards the confidentiality duty of banks on account of money laundering control, research must be done to establish why such a drastic imposition is required to combat a crime that appears to be innocuous. However, elaborate global AML efforts⁶⁹ contradict the ostensible innocuousness of money laundering. Therefore, the fourth issue to investigate concerns:

4. the characteristics and consequences of money laundering to ascertain whether the imposition of stringent AML measures is warranted.

Since money laundering is aimed at concealing the criminal nexus of the benefits of crime, stringent enforcement of measures aimed at combating money laundering is warranted if the reputation of the banking system is to be protected. In addition, the idea is that by depriving criminals of the ability to launder the benefits of crime, the incentive to commit crime likewise will be reduced.⁷⁰ This calls into question the effectiveness of existing AML measures. Internationally and in South Africa the KYC standard takes centre stage in all AML legislation and programmes.⁷¹

The KYC standard has been heralded by the international community⁷² as an indispensable tool to combat money laundering for the following reasons:

- compliance with the KYC standard should assist banks to avoid a conviction for a money laundering offence;
- information gathered in the course of compliance with the KYC standard is likely to assist the authorities in a money laundering investigation; and
- the success of a civil forfeiture application hinges on the state establishing a nexus between funds deposited with a bank and criminal activities which could be established under the KYC standard.

However, considerable doubt exists about the effectiveness of the KYC standard as tool to identify the benefits of crime before a criminal deposits the money with a bank. The fact that money

⁶⁸ See sections 29 and 32 of FICA respectively.

⁶⁹ See ch 5.B–D.

⁷⁰ See ch 4.E.1 as regards the purpose of money laundering control.

⁷¹ See ch 5.B–C; ch 6.C.3.6; ch 7.C.2–9; ch 8.C.4–5.

⁷² See ch 5.B.3.

laundering still sustains whole economies⁷³ further discredits international efforts to combat the crime.⁷⁴ Moreover, it has yet to be established that the KYC standard assists banks with the practical difficulties they experience with money laundering control in general, and in particular, identifying both criminals and the benefits of crime. Even so, South Africa is following the path caved by the international community by implementing legislation that features the KYC standard as primary defence against the use of banks for money laundering purposes. Therefore, it should fifthly be examined whether:

5. the KYC standard has evolved for the purpose of identifying contemporary money laundering schemes and thereby combating the use of banks by criminals for money laundering purposes.

Internationally, the pre-eminent authoritative body in the field of money laundering prevention is the Financial Action Task Force on Money Laundering.⁷⁵ In its efforts aimed at the formulation of a comprehensive anti-money laundering program the FATF developed a set of forty recommendations⁷⁶ which advocate the use of the KYC standard to effectively identify suspicious transactions and consequently, money laundering schemes. The Forty Recommendations constitute, and are intended to serve as, as a basic reference for the identification of money laundering.⁷⁷

The FIC in its capacity as the official AML authority in South Africa⁷⁸ endorses the FATF's forty recommendations and has endeavoured to do so since FICA's enactment in 2001. However, it is unclear if the provisions of FICA and POCA are in accordance with the AML legislation of countries which have more experience in money laundering control, and whether they expedite actual money laundering control. Consequently, the sixth issue to determine is whether:

6. the provisions of FICA and POCA conform with contemporary foreign money laundering control measures.

⁷³ See ch 2.C.5.2.2.

⁷⁴ See ch 5.B–D as regards the AML efforts of the international community.

⁷⁵ Or 'FATF'. See in general Sherman *International Efforts* 20; ch 5.B.3.3.

⁷⁶ See FATF *Forty Recommendations 2001*; FATF *Revised Forty Recommendations 2003*; ch 5.B.3.3.2–3.3.3.

⁷⁷ See ch 5.B.3.3.2.

⁷⁸ South Africa joined the organisation in June 2003 (see ch 8.B.1, par E.1).

If need be, recommendations must be made how additional measures can be introduced to improve South Africa's AML legislation. AML legislation, however, may be insufficient by itself to combat money laundering. The research revealed that the countries used in this study for comparative purposes have taken additional measures which supplement their AML legislation in an effort to expedite efforts aimed at money laundering control. It follows that the seventh issue to investigate is whether:

7. AML measures other than legislation are likely to expedite the money laundering control efforts of a country.

Having established that a country's AML regime needs to comprise both statutory and other measures in order to combat money laundering with efficacy, the next issue that should be investigated concerns the potential civil liability of a bank as recipient of the benefits of fraud or theft.

FICA is concerned with money laundering and the benefits of crime from the position of identifying, investigating and prosecuting those who contravene its provisions. It does not aim to compensate victims of fraud or theft who followed their loss to a bank account only to find that the bank parted with the money. That is the function of the civil courts. While a large portion of the benefits of crime is generated by crimes such as corruption and drug trafficking and therefore is unlikely to have victims who suffered loss, there are cases where the benefits of crime have been acquired through crimes such as fraud and theft. In these cases there are obvious victims who suffered loss which they seek to recover.

Consider the scenario where X was fraudulently induced by Y to deposit 10,000 rand with C Bank for the renting of a holiday home. Y absconded with the money leaving X without his deposit and a holiday home. Subsequent investigations by the authorities reveal that Y transferred 5,000 rand to an account held at B Bank, withdrew the balance at C Bank and closed the account. It soon becomes evident that Y's account at C Bank also has been closed. Since the whereabouts of Y are unknown, the question arises whether X can look to one of the banks to recover his loss.⁷⁹

⁷⁹ The means of *directly* recovering money from the criminal, for example, by way of the English doctrine of conversion or the *actio furtiva* (see ch 8.D.1) falls beyond the scope of this investigation whose focus is solely on banks, and is, therefore, not considered in this study. In addition, in most instances the criminal would have either disappeared or, if traceable, would no longer have funds available which renders any civil action against him

In recent years English civil courts have extended the restitution remedy of constructive trust to assist victims in cases such as the aforementioned.⁸⁰ The root principle of the remedy is that where a bank holds funds in circumstances in which in equity the funds should be held by some other, it will be compelled to hold the property on trust for that other. If the bank parts with the money to the prejudice of its rightful owner who is the victim of fraud or theft, it may be liable for breach of that trust and consequently for loss suffered by the victim. In fact, at English common-law X above as the victim of fraud may recover loss suffered at the hand of Y from both B Bank and C Bank to the extent of the amount of the benefits of fraud that each of the banks received. What then is the nexus between the constructive trust remedy and money laundering? The answer is straightforward: if B Bank or C Bank filed a STR about Y's transactions they inevitably may have assisted X to establish the required degree of knowledge⁸¹ to impose civil liability on either of them as former recipients of the benefits of fraud.

However, caution should be exercised when applying concepts of civil liability to cases of money laundering. Burrell and Cogman⁸² explain the reason for the caveat as follows:

[a] recent decision of the Commercial Court considers the position of institutions which suspect that funds in their possession are the proceeds of crime. [The decision] is a warning of the pitfalls of adopting the wrong procedural route when attempting to resolve the conflicts between the money laundering regime and the imposition of civil liability. It also adopts the theme, notable in the earlier Bank of Scotland decision,⁸³ that institutions must bear some of the commercial risks that arise when money laundering is suspected There are a number of options open to financial institutions when faced with a dilemma regarding possible money laundering. It is easier to deal with the criminal issues and avoid liability for tipping off than it is to avoid possible civil liability and legal costs. It is therefore important that in any such situation, a clear strategy is identified from the outset, so that costs are not wasted on unnecessary court applications.

useless (see, for example, in ch 8.C.4.1 where the antics of controversial fraudster Arthur Brown, once chief executive officer of Fidentia Asset Management, are outlined). This outcome alone renders an analysis of the *actio furtiva* redundant in the present context. Moreover, there is no consensus on whether conversion forms part of South African law (see *John Bell & Co Ltd v Esselea* 1954 (1) SA 147 (AD) 152B–153E; Sonnekus (2001) *J for Juridical S* 113–114).

⁸⁰ See ch 6.C.4.2–4.3.

⁸¹ See ch 6.C.4.2.2 as regards the degree of knowledge required to establish the potential civil liability of the bank.

⁸² *Money Laundering Dilemmas* paras 1, 13, available at <<http://www.spr-consilio.com/artmoney1.htm>> (2011.03.10). Although lengthy, due to the nature of the remark is it important to quote it in full.

⁸³ See ch 6.C.2.1 where the case is analysed.

This warning also rings true for South African banks. With this in mind, the eighth issue to investigate is whether:

8. traditional common-law ownership remedies are adequate for the purpose of availing a victim of fraud or theft to claim loss from the bank that received and parted with the benefits of the fraud or theft.

In the event that South Africa's traditional ownership remedies fell short of availing a victim of fraud or theft against the bank, it may be necessary to consider one of two options to remedy the situation, namely:

1. introduction of an English restitution remedy to South African law; or
2. codification of a general remedy similar to the United States' restatements of the common-law.⁸⁴

Most notably, a common-law remedy that addresses the consequences of using banks as tools for money laundering has already been codified in South African law. Civil forfeiture which was codified in POCA is aimed at preventing criminals from enjoying the fruit of their illegal activities.⁸⁵ It is a civil remedy used by the state as representative of the general public to redress criminal conduct.

Civil forfeiture as remedy differs in two salient ways from the potential remedies that a victim of fraud or theft may have against a bank. First, civil forfeiture is a remedy that operates in favour of the state as opposed to the remedy claimed by a victim of fraud or theft which operates in favour of the claimant. Civil forfeiture should therefore be used by the state only to recover the benefits of crime in cases where there are no obvious victims who suffered loss and, therefore, have a claim to the deposited funds. For example, the proceeds of drug trafficking belong to the drug trafficker as opposed to stolen money which belongs to the victim of theft because a thief cannot acquire ownership of the stolen money.⁸⁶ Secondly, in the event that the fraudster or thief has withdrawn the benefits of fraud or theft from his account or transferred the funds to an unknown bank account and thereafter absconded, the claim of the victim of fraud or theft will be against the bank. In contrast, civil forfeiture proceedings are instigated by the state against the

⁸⁴ See ch 7.D.2–3.

⁸⁵ See ch 8.D.4.

⁸⁶ See par A.2 above.

account holder and are, therefore, aimed at forfeiting the (criminal) account holder's property to the state.⁸⁷

Civil forfeiture is further of two-fold importance to a bank. First, the bank must pay the money in the account of the defendant to the state following a civil forfeiture order to the effect. Secondly, the bank may be the mortgagee of property that is the instrumentality of an offence⁸⁸ because it is used, for example, as a brothel or for the illegal manufacture of drugs. If the property becomes the subject of a civil forfeiture application the bank will have to approach the court to prevent forfeiture of its interest therein.⁸⁹ However, whether a victim of fraud or theft likewise can rely on the so-called 'innocent owner defence'⁹⁰ is questionable. Consequently, the ninth issue to investigate in this study is whether:

9. POCA offers adequate protection to a victim of fraud or theft where the deposited benefits of theft or fraud are earmarked for civil forfeiture.

If need be, recommendations must be made on how POCA can be amended to assist innocent owners to recover deposited benefits of theft or fraud where the funds are the subject of civil forfeiture proceedings.⁹¹

Research in the field of money laundering is particularly relevant nowadays. Internationally, much has been done to combat money laundering. Due to globalisation⁹² South Africa is not immune against the activities of crime syndicates. In addition, South African banks cannot ignore the reality of money laundering and the potential two-fold civil liability which money laundering control could impart. To recap, a bank that receives the benefits of crime into a bank account potentially faces a two-fold liability. First, if the bank files a STR, it may be sued by the account holder for breach of bank confidentiality. Secondly, if the bank parted with the benefits of fraud or theft it may be sued by the victim of fraud or theft who endeavours to recover the loss he

⁸⁷ See ch 3.C.3.

⁸⁸ See Schedule 1 of POCA which lists 34 offences; ch 8.C.3.2.

⁸⁹ See ch 8.D.4.3 as regards the so-called 'innocent owner' defence.

⁹⁰ See ch 6.B.4.2.1, paras B.4.2.2, C.4.4.3; ch 7.D.4.3.

⁹¹ Consider the scenario where a bank discovered that one of its employees has been stealing money from it. The bank as the victim of theft followed its loss to the employee's bank account at some other bank only to discover that the account is the subject of civil forfeiture proceedings. The bank must therefore establish its claim to part of the funds in the thief's account in order to prevent civil forfeiture thereof.

⁹² See ch 4.B.1–2, par D.4.3.

suffered at the hand of the fraudster or thief from the bank. Prudent regulation of money laundering is naturally important and not only in the interest of banks, but also in the interest of the financial system and the reputation of the country.

Moreover, research in this area may also assist in ensuring that South African law does not fall behind internationally accepted methods of money laundering control and holding those accountable that facilitate the crime and thereby assist criminals in enjoying their illegal gains. At the same time it may lead to the introduction in South African law of international trends with regard to the detection, identification, freezing and civil forfeiture of the benefits of crime, all which collectively may have deterrence value as regards financial crime in general, and in particular, the use of banks by criminals as tool to launder the benefits of crime.

C. RESEARCH METHODOLOGY

In order to reduce the topic to manageable proportions I have chosen to restrict myself to establish the nine research objectives above within the context of the following critical aspects:

- the nature of money in general, and in particular, money acquired through illegal means;
- the consequences that money laundering control carries for the bank-customer relationship;
- the phenomenon of money laundering;
- legislative measures and programmes aimed at money laundering control; and
- civil remedies which may prevent the use of banks as tools to launder the benefits of crime.

While it is inevitable that a number of related issues will be touched upon under these broad headings, this study makes no claim to deal comprehensively with the topic of money laundering control as a whole. Most obviously, nothing is said about the role of AML legislation as an effective tool to combat crime, the investigation of potential money laundering schemes or the enforcement of AML obligations.

The main premise in the study is straightforward: besides keeping the benefits of crime under a mattress as once facetiously observed by the court,⁹³ they are most likely to end-up in a bank account as part of a money laundering scheme. This reality renders a study of the position of

⁹³ See *Alley Cat* where the court remarked as follows (131A): '[i]t will be of some comfort to those who keep their money under their mattresses to know that they maintain ownership of their coins and notes while those who deposit their money in banks lose their ownership and retain only a personal right against the bank.'

banks in relation to money laundering control a necessary and important endeavour. Hinterseer⁹⁴ recognises a fundamental limitation in examining issues pertaining to money laundering, namely that one deals with a world of unreality. This is due to the illegality of the activities used to acquire and conceal the benefits of crime. This limitation is likewise relevant to this study and is therefore acknowledged in this setting. What follows is an attempt to evaluate literature that relates both directly to banks and in a broader analytical context to money laundering.

Due to the scope of the literature on money laundering control and related issues it was necessary to set certain limits. First, the focus of this study is banks which as accountable institutions pursuant to FICA are required to partake in money laundering control.⁹⁵ Secondly, although criminals use various schemes to launder the benefits of crime,⁹⁶ this study does not pretend to analyse the mechanics of all of them. The point of departure here is the position of a bank that received a deposit of money which turns out to be the benefits of crime. Thirdly, as pointed out above one of the research objectives of the study concerns the impact of money laundering control on the bank-customer relationship. Although the bank-customer relationship is based on contract,⁹⁷ due to the scope of the study it was necessary to exclude an analysis of the ramifications of breach of contract.

Since South Africa is affected by globalisation and money laundering control is still in an early stage in comparison to other jurisdictions, the approach of this study is comparative. For this purpose three jurisdictions were elected with which the South African AML regime was compared. They are the European Union⁹⁸ as region, England as member state of the EU and the United States.⁹⁹ The principle objective is to ascertain whether the AML regimes of these jurisdictions hold any recommendations for improvement, if necessary, of the South African AML regime and whether such systems offer possible solutions in situations where there is a lack of clarity in the South African AML regime.¹⁰⁰ More specifically, some of the issues that must be clarified include the efficacy of the manner in which the provisions of FICA and POCA were arranged and the

⁹⁴ *Criminal Finance* 10.

⁹⁵ See Schedule 1 of the Act where 19 persons are listed; ch 8.C.4.3.1.

⁹⁶ See ch 2.B.2.

⁹⁷ See ch 3.B.1.

⁹⁸ Or 'EU'. The meaning attributed in this study to the acronym 'EU' is explained elsewhere in the study (see ch 6.B.1).

⁹⁹ Or 'US'.

¹⁰⁰ Van Zyl *Regsvergelyking* 17ff.

relevancy of the Money Laundering and Terrorist Financing Control Regulations¹⁰¹ and the FIC's guidelines to money laundering control in South Africa. Whether Schedule 1 of FICA, which lists 19 'accountable persons', and Schedule 1 of POCA, which lists 34 offences, are in fact necessary to promote money laundering control are further explored.

It is submitted that comparison with other countries may prove invaluable at this early stage of implementation of AML control in South Africa to assist with judging the overall adequacy of South Africa's AML regime. The Constitution further authorises courts, when interpreting the Bill of Rights, to consider foreign law.¹⁰² It has been held that the best that the Constitutional Court could do was:¹⁰³

[t]o create an approach that was valid for ... South Africa, interpreting our constitutional text in light of our reality, yet picking up from other constitutions those transportable ideas that were most valuable and accepted internationally.

In the end it may be necessary to incorporate ideas from the jurisprudence of other countries in order to strengthen South Africa's AML regime. However, heavy reliance will have to be placed on South Africa's unique circumstances and the Constitution will have to be used as the main form of guidance.

Various reasons exist why the EU, England and the US have been identified as a region and countries respectively with which to compare the South African position. AML measures which are in place in the EU are relevant because its member states despite their diversity are compelled to consider the directives and conventions of the EU legislature when debating individualised legislation.¹⁰⁴ South Africa has a key role to play as regards money laundering control in Southern Africa.¹⁰⁵ The country is also an active member of the Eastern and Southern Africa Anti-Money Laundering Group, a group whose objective is to combat money laundering in the region.¹⁰⁶ Therefore, the position of the EU as regards money laundering control in the EU region is considered with one objective in mind. It is namely to determine the extent of the influence of

¹⁰¹ GNR 1595 of 20 December 2002, as amended by GNR 465 of 20 May 2005 ('AML Regulations') - see ch 8.C.5.

¹⁰² Section 39(1)(c) of the Constitution.

¹⁰³ Sachs (1999) *R of Constitutional S* 81.

¹⁰⁴ See Council Treaty Establishing the European Economic Community of 1957 which entered into force on 1 January 1958; ch 6.B.1.

¹⁰⁵ Sithole *Money Laundering* 6; De Koker *South Africa* 120.

¹⁰⁶ Or 'ESAAMLG' (see ch 8.E.3).

regional measures such as those of the EU legislature on the national AML legislation of a member state such as England. Therefore, the AML regimes of the EU as region and England as a member state are evaluated.

Further in this regard, South Africa's banking laws are rooted in English banking practices hence strong resemblances continue to exist as regards, for example, the bank-customer relationship.¹⁰⁷ South African courts have further on occasion referred to English cases in litigation pertaining to banking practices.¹⁰⁸ Moreover, the judiciary should not hesitate to adopt a principle which may be in line with current developments of a particular branch of the law.¹⁰⁹ It follows that the benefit of looking at English law for legal comparison purposes, especially to determine the best application of, or extension of legal principles¹¹⁰ cannot be denied. In this study English common-law remedies are explored in an effort to ascertain whether traditional South African remedies for the protection of ownership are adequate to assist a victim of fraud or theft in claiming loss from the bank as former recipient of the benefits of fraud or theft. If not, it may be necessary to consider importation of certain English restitution remedies to augment our common-law.

Other reasons for electing England pertain to its historic influence over the laws of its former colonies. The influence of English law is noticeable in both the common-law and in the statutory provisions of the US although the country has given its own particular perspective on the

¹⁰⁷ See Olivier (*ABLU-2002 2*) explaining the importance of English law *vis-à-vis* South African banking law principles; Willis (*Banking in SA Law* 18–21) who asserts that our courts applied English decisions when judging matters for which no precedent or clarity in our law exists; Du Toit *Dematerialisatie van Geld* 5; Stassen (1983) *MBL* 80. Note further the influence of *Tournier v National Provincial & Union Bank of England* ([1924] 1 KB 461 CA) on South African bank confidentiality principles (see ch 3.B.2.3.2).

¹⁰⁸ For example, in *Standard Bank of SA Ltd v Minister of Bantu Education* 1966 (1) SA 229 (N) 240–241 the court referred to English cases to determine whom can be regarded as a bank's customer. The cases include *The Great Western Railway Co v London and County Banking Co Ltd* [1901] AC 414 and *Importers Company v Westminster Bank Ltd* [1927] 2 KB 297.

¹⁰⁹ See *Blower v Van Noorden* 1909 TS 890 where the court observed as follows (905): '[t]here come times in the growth of every living system of law when old practice ... must be modified in order to keep in touch with the expansion of legal ideas, and to keep pace with the requirements of changing conditions ... [I]s for the Courts to decide when the modifications ... are of a nature to be effected by judicial decision, and when they are so important ... that they should be left to the Legislature.'

¹¹⁰ See ch 6.C.4.2 where the constructive trust remedy is explored.

law as it is currently applied in England.¹¹¹ On occasion English law has been described as ‘an ongoing, modern legal system, rich in case law and detailed rules’.¹¹² Since English common-law was exported to the US and other British colonies, common-law developments also found their way to South Africa.¹¹³ Therefore, English law broadened Roman law principles in the South African legal system.¹¹⁴ It follows that a study of the English law as it currently presents, and in its hybrid form as incorporated in South Africa’s common-law, is desirable to determine suitable remedies to address the consequences when banks are used as tools for money laundering.

The importance of considering US law in the context of money laundering control and the civil forfeiture of the benefits of crime was recognised by the our courts.¹¹⁵ In *National Director of Public Prosecutions v Prophet*¹¹⁶ the court explained as follows:

[c]ivil forfeiture in South Africa is largely based on statutory provisions in the USA ... The US in particular has had extensive experience with civil forfeiture. American case law may therefore be usefully studied comparatively. [Civil] forfeiture in the US has traditionally been based on the [English] theory that the property is guilty of an offence.

In *National Director of Public Prosecutions v Cole and others*¹¹⁷ the court importantly declared that:

I shall dwell briefly upon the [American] cases ... because they provide some contextual colour to the issues with which the South African Courts are having to grapple in dealing with the interpretation and the application of the Act.

Moreover, the AML regime of the US is arguably the most comprehensive AML regime globally.¹¹⁸ South Africa as newcomer in money laundering control matters needs to evaluate the AML measures of other jurisdictions in an effort to improve and to streamline its own effort. It follows that an analysis of US AML measures is likely not only to impart wisdom in relation to money laundering control, but may also demonstrate which measures to exclude from the South African AML control model. It is therefore important to consider US law in this study.

¹¹¹ See ch 7.D.2-3.

¹¹² Morice *English Law* 246.

¹¹³ Spiller *Law of Delict* 341.

¹¹⁴ Schreiner *Contribution of English Law* 56–57.

¹¹⁵ POCA is based on the US Racketeer Influenced Corrupt Organisations Act of 1970 (18 U.S.C. chapter 96) - see ch 7.C.4; Redpath (2000) *African Security R* 16.

¹¹⁶ 2003 (8) BCLR 906 (C) par 23.

¹¹⁷ [2004] 3 All SA 745 (W) par 9.

¹¹⁸ See ch 7.C.2–9.

England and the US have been elected for other reasons as well. They have in common with South Africa a commitment to the rule of law and the quest for rooting out money laundering.¹¹⁹ They are multicultural democracies. Finally, England and the US share a history of being vulnerable to organised crime in general and in particular, money laundering. In this sense, England and the US are part of the global struggle against organised crime and ultimately, money laundering. In addition, both countries are members of the UN and the FATF and are, therefore, bound by the same international laws and principles respectively on money laundering control. Moreover, in England and the US organised crime and money laundering continue to pose challenges and have been afforded the highest attention from individual and internationally active policing authorities.¹²⁰

Although South Africa is not as developed as the countries with which the comparisons are made, it nevertheless promulgated AML legislation which incorporated some of the provisions of international AML legislation.¹²¹ However, unfortunately in its quest to combat money laundering Parliament overlooked the core purpose of banking law, namely, the protection of banks. As a result, meagre protection was afforded to banks against the negative consequences of money laundering control.

D. OVERVIEW OF STUDY

In overview, the study is divided into nine chapters and conducted in the broader context of international law. The research presented in the following nine chapters entails:

Chapter 1: The *Introduction* sets out the foundation on which this research was conducted. This covers the background to this study, the problem statement, research methodology and an overview of the nine research objectives.

Chapter 2: The evolution and *Concepts of Money* will be outlined. At the outset, attention is given to the concept of money against the background of internationally accepted legal principles. A short historical analysis will illustrate why the characteristics of money are still relevant in an age where paper money is steadily being replaced by its electronic counterparts. An

¹¹⁹ As evident from their detailed AML measures (see ch 6.C.3.4–3.5, par C.5; ch 7.C.2–9, par E).

¹²⁰ See ch 5.D.2–5; ch 6.C.5.2–5.3; ch 7.E.1–3.

¹²¹ See ch 8.C.3–4, par C.5.

understanding of the forces that drive money and create the need for it assists in investigating the effectiveness of contemporary money laundering control measures. Some contemporary methods of payment and their mechanics are considered. Divergent theories aimed at clarifying the value of money are analysed. It will be evident that they fail to impart much to delineate the concept of money. The differences between legitimately earned money and money that were required through criminal means are further explored. It will soon become evident that money is a concept of unlimited complexities. The chapter will conclude with two divergent approaches to the nature of money and the benefits of crime that are finally crystallised:

- G the nature of money is determined by two forces: one, the state which designates a particular thing as legal tender and two, society which attaches different meanings to money;
- G whilst money in itself is a neutral medium, its designation is influenced by the criminal conduct or intention of its owner or possessor. Following its connection with criminal activity money may be designated as the benefits of crime.

Chapter 3: Having established that money is a concept of unlimited complexity, this chapter explores *Aspects of the Bank and Customer Relationship*. Chapter 3 elaborates on the theme of money with a review of the bank-customer relationship at South African common-law. Three aspects are significant in this regard, namely the nature of the relationship between a bank and customer, the bank's obligation to observe the confidentiality of customers and ownership of the benefits of crime after the funds have been deposited with a bank.

The bank's common-law obligation to observe customer confidentiality is investigated against the background of FICA's provisions. This is followed by a short evaluation of the concept 'ownership'. It will be shown that banks due to the business of banking must acquire ownership of funds deposited into a bank account in order to transact with the money as owner. Deposited money further becomes the property of the bank when it commingles with other funds in the bank account. Whether this is also the case where the benefits of crime are deposited into a bank account is considered. Ultimately, the research will illustrate that a bank acquires ownership of money deposited with it irrespective of whether the money was legally earned by the account holder, or whether it was acquired through criminal means. It will also be shown that the account holder acquires a personal claim against the bank for repayment of the deposited amount unless there is evidence that the money was acquired through criminal means. In that case the bank is precluded

from paying the deposited amount to the customer on demand and will hold the money on behalf of the victim of the fraud or theft.

It will be evident that various issues as regards the bank-customer relationship and money laundering control have been left unaddressed by FICA and POCA alike. The chapter will conclude with the following syntheses:

- G the bank-customer relationship is one of debtor and creditor deriving from a contract of mandate;
- G FICA fails to adequately resolve the tension that exists between bank confidentiality and the reporting duty of banks;
- G the benefits of crime deposited into a bank account become the property of the bank;
- G FICA and POCA intrude on key aspects of the bank-customer relationship.

Chapter 4: This chapter, entitled *The Jurisprudence of Money Laundering*, deals with the characteristics of money laundering and explains how the money laundering process is orchestrated. The focus moves from the nature of money, the benefits of crime and the bank-customer relationship under South African law to the functional¹²² definition of money laundering and the money laundering process with all its ramifications. The role of banks in facilitating money laundering will be explored. The chapter then continues to examine the vulnerability of Internet banking as a tool in the money laundering process. It will be indicated that the availability of electronic banking has presented yet another money laundering opportunity for criminals to exploit. The chapter concludes with commentary on the consequences of money laundering. Three realities of money laundering will subsequently be emphasised:

- G criminals use banks most commonly to facilitate the money laundering process;
- G money laundering techniques are infinite and criminals are cunning enough to use the newest technology available to their advantage;
- G money laundering carries various negative consequences for the banking industry.

Ultimately, it is resolved that money laundering influences every aspect of the financial system and, therefore, combating it is a matter of utmost urgency.

Chapter 5: In this chapter, entitled *International Codes, Conventions and Proposals*, the focus shifts from the money laundering process to the efforts of the international community and

¹²² As opposed to the legal concept of money laundering which is evaluated elsewhere in the study (see ch 6.B.3.4–3.6, par C.3.4; ch 7.C.2; ch 8.C.3.2, par C.4.2.1).

its determination to combat money laundering. The chapter assesses the content of the international AML regime as regards the KYC standard protocols that it advocates. The KYC standard has been at the heart of the international community's AML measures. It follows that the content of the KYC standard is examined in order to establish whether it has kept abreast with the ever changing face of money laundering. South Africa is a member of the FATF and co-signatory of the UN Convention Against the Illicit Traffic in Narcotic Drugs and Psychotropic Substances of 1988.¹²³ The efforts of the FATF and the AML treaties of the United Nations¹²⁴ are consequently evaluated. Attention is further paid to the guidelines of the Basel Committee on Banking Regulation and Supervisory Practices.¹²⁵ Auxiliary measures which international organisations have taken to combat money laundering are explored. The soft-law initiatives which are pursued by the Basel Committee, the FATF and certain private banks are considered against the backdrop of more formal statutory arrangements.

Initiatives of the Basel Committee and the FATF are analysed only in relation to the KYC standard. An overview of the UN' conventions and other industry measures will ensue. The Basel Committee and the FATF provide important guidelines on money laundering prevention and forfeiting the benefits of crime to the state. It will be submitted that in its effort to control money laundering the international community has disregarded the confidentiality duty of banks. This left banks in the unenviably position of having to decide when to observe bank confidentiality rules and when to disclose transaction information to the AML authorities. It will further be submitted that with the exception of the FATF the AML measures of the international community have thus far failed to resolve the tension between bank confidentiality and suspicious transaction reporting. Moreover, it will be indicated that irrespective of the evolvement of the KYC standard into intricate AML protocols the goals of reducing crime, protecting the integrity of the financial system and controlling corruption have not been completely achieved. The chapter will conclude with the following synthesis:

G the KYC standard has evolved into intricate AML protocols yet the goals of reducing crime, protecting the integrity of the financial system and controlling corruption have not been completely achieved.

¹²³ See ch 5.C.1.

¹²⁴ Or 'UN'.

¹²⁵ Or 'Basel Committee'.

This outcome is attributed to the complexity of global money laundering which renders it impossible for an AML regime to single handedly make a significant contribution to combat money laundering. The international AML regime, however, may be deemed reasonably effective in protecting the core financial system.

Chapter 6: The comparative position as regards money laundering and money laundering control is considered in two chapters. The first is Chapter 6, entitled *Comparative Position Re Money Laundering I - The European Perspective*, which evaluates the AML initiatives of the EU and England. Thereafter, the US position is evaluated in Chapter 7. The comparative study of the laws of the EU, England and the US entails a brief overview of the legislative framework in each country and region. AML legislation is covered. Case law and academic opinion is included where relevant. This is followed by an analysis of two distinct remedies that may address the consequences of using banks as tools for money laundering. First, the chapters will examine potential remedies which a victim of fraud or theft may use to claim loss from the bank that received and parted with the benefits of the fraud or theft. Secondly, civil forfeiture as codified remedy that is used by the state to confiscate and forfeit the benefits of crime will be explored. In addition, each of the comparative chapters considers measures other than legislation which countries have taken to counteract money laundering.

Chapter 6 commences with an examination of the AML initiatives of the EU's legislature. This is followed by an evaluation of the AML measures of England. A brief discussion of the EU's AML legislation ensues. It will be shown that the EU's AML legislation introduces innovative measures which not only replaced the KYC standard measure of money laundering control, but which are also likely to assist banks with the identification of the benefits of crime. Similar measures were subsequently inserted into English AML legislation. The first part of Chapter 6 will reveal that in the absence of an EU common-law a claimant, whether a customer of a bank or a victim of fraud or theft, must use the rules that govern certain aspects of jurisdiction and conflict of laws when claiming loss from a bank. It will further be revealed that the Strasbourg Convention provides widely for across-border assistance in civil forfeiture matters.

Following an analysis of English AML legislation, the civil remedies of constructive trust, tracing and civil forfeiture are explored. At English common-law the operation of remedial constructive trust means that the judiciary may use their discretion and allow an extension of traditional constructive trust principles to assist a victim of fraud or theft in recovering loss from the bank that parted with deposited benefits of fraud of theft. It, however, will become evident that

despite the suitability of constructive trust to claim loss from an English bank as former recipient of the benefits of fraud or theft, it does not present a perfect remedy to address criminals' use of banks as tool for money laundering. In contrast, civil forfeiture as codified remedy presents few shortcomings in as far as recovering the benefits of crime from criminals and forfeiting the funds to the state.

The chapter will conclude with following syntheses:

- G both EU and English AML legislation provides safe-harbour protection to banks that is aimed at resolving the tension between the confidentiality duty of banks and their reporting duty;
- G both jurisdictions follow the Subjective Model of Money Laundering Control;
- G both jurisdictions have replaced erstwhile KYC standard obligations with advanced customer due diligence measures;
- G at English common-law a civil claim instigated by a victim of fraud or theft based on constructive trust is likely to succeed against the bank that paid the benefits of fraud or theft to the fraudster or thief who absconded with the money;
- G the remedy of tracing in equity may be used by a victim of fraud or theft against a bank provided that the benefits of fraud or theft remain under the bank's control;
- G in contrast to EU law which emphasises transborder cooperation in relation to civil forfeiture orders, English civil forfeiture law emphasises the forfeiture of different types of benefits of crime.

Chapter 7: Chapter 7, entitled *Comparative Position Re Money Laundering II - The United States of America*, is the second of the two comparative chapters in this study. It follows that the sequence of Chapter 6 will be followed throughout Chapter 7 as well. Since the US AML framework bears out the influences of English law, the US AML measures will be considered in this chapter which follows after the English position, dealt with in Chapter 6. First, the bank-customer relationship and related issues fall under the spotlight. Thereafter the statutory AML regime of the US will be discussed. The chapter will illustrate that the US AML regime constitutes a fragmented and disorganised system which ultimately undermines its efficacy. It will be submitted that this outcome is overshadowed by the conciseness of its codified constructive trust and tracing remedies.

Two civil remedies that are likely to address the consequences of using banks as tools for money laundering are then explored. It will crystallise that in contrast to its fragmented statutory

AML provisions, the US constructive trust and tracing remedies are characterised by concise principles which due to codification have none of the discretionary application of their English counterparts. However, codified US common-law seems to need the security of set principles rather than allowing the judiciary to use its discretion and extend constructive trust principles to cases where they normally would not find application. It therefore will be illustrated that US courts unlike their English counterparts have not yet fix a bank with constructive trust liability where it parted with the benefits of fraud or theft. However, the constructive trust remedy present few problems where the bank continues to exercise control over the deposited benefits of fraud or theft. Finally, it will be submitted that like the US AML measures the effectiveness of civil forfeiture as codified remedy has been detrimentally influenced by the fragmented nature of its relevant legislation.

Chapter 7 will conclude with the following syntheses:

- G the US adopted a hybrid model of money laundering control;
- G the civil liability of a bank that discloses information about a customer and is sued by the customer in response remains unlimited;
- G claiming loss from a bank as recipient of the benefits of fraud or theft is a much more straightforward exercise under US codified law than at English common-law. However, a victim of fraud or theft in order to succeed against the bank must establish that the benefits of fraud or theft remained under the control of the bank at the time of *litis contestatio*.

The greatest contribution of the US AML regime to money laundering control crystallised in its sober codification of restitution principles which under certain circumstances can address the ramifications of using banks to launder the benefits of fraud or theft.

Chapter 8 considers at great length *The Money Laundering Control Framework of South Africa* and its evolution. It is designed to compare and evaluate South Africa's AML regime with others analysed elsewhere in the study with the focus being cast on the position of the bank as recipient of the benefits of crime. Chapter 8 is the second of two chapters on South African law, the other being Chapter 3. It follows that reference to Chapter 3 will be made throughout Chapter 8. At the outset the historical development of money laundering is considered whereafter the focus shifts to the salient provisions of the country's AML laws. It is subsequently demonstrated that with the exception of its customer identification obligations, South Africa's AML framework in general compares favourably with models in place in the EU and in England. However, at present,

there is a need to screen and refine current AML legislative measures to combat money laundering more effectively. In doing so the tension between money laundering control measures and the potential civil liability that banks are exposed to in light of the suspicious transaction reporting obligation may be resolved.

The chapter further investigates the efficacy of traditional common-law ownership remedies to address the consequences for criminals who use banks as tools for money laundering. In particular, the *rei vindicatio*, quasi-vindictory action and the *actio* Pauliana are considered against the background of recovering the benefits of fraud or theft from the bank where the funds were deposited. Interdicts also fall under the spotlight. This is followed by an evaluation of the unjust enrichment *condictiones* as potential remedies used by a victim of fraud or theft against a bank as recipient of the benefits of fraud or theft. Ultimately, the question is answered whether the remedies mentioned above can avail a victim of fraud or theft to claim loss from a bank that parted with the benefits of the fraud or theft. It will be submitted that a victim of fraud or theft is likely to experience substantial problems with using any of the remedies above to recover loss from a bank in scenarios where the bank parted with the benefits of fraud or theft. These problems are highlighted and evaluated. Recommendations on how to remedy this lacuna in the law are forwarded.

Further still, civil forfeiture as a codified common-law remedy is studied with a view of determining whether POCA offers innocent owner protection to a victim of fraud or theft where the benefits of the fraud or theft have been deposited into a bank account which is the subject of civil forfeiture proceedings. Ultimately, Chapter 8 illustrates that civil forfeiture as codified remedy has been widely and successfully applied by the state to confiscate and forfeit the benefits of crime. However, it will be shown that POCA provides protection only to innocent owners that acquired an *interest* in confiscated property as opposed to having a vested interest in deposited benefits of fraud or theft that are the subject of civil forfeiture proceedings. Recommendations on improving POCA's innocent owner remedy are forwarded. The evaluation of South Africa's AML regime concludes with a summary of the main issues as regards money laundering control in relation to banks.

The chapter will conclude with the following syntheses:

G like the US and unlike the EU and England South Africa adopted a hybrid model of money laundering control comprising both elements of the Objective Model and the Subjective Models for Money Laundering Control;

- G FICA fails to conform with international AML legislation due to the absence of simplified and enhanced due diligence measures;
- G traditional common-law remedies for the protection of ownership and the unjust enrichment *condictiones* are inadequate where a victim of fraud or theft endeavours to claim loss from the bank that parted with the deposited benefits of fraud or theft;
- G POCA's innocent owner defence fails to protect a victim of fraud or theft who followed the benefits of fraud or theft to the fraudster or thief's bank account only to discover that the funds are the subject of civil forfeiture proceedings.

It will be submitted that the contribution that South Africa's AML regime could make to money laundering control should not be underestimated. However, some amendments to improve the country's AML regime are necessary. It will further be illustrated that if FICA and POCA are amended as suggested, the South African AML regime potentially may constitute the most innovative and comprehensive AML regime globally.

Chapter 9: Finally, this study concludes with Chapter 9, entitled *Research Conclusions and Recommendations*. It concludes the research by revisiting the nine research objectives.¹²⁶ On the strength of the current position in South Africa as contrasted with the other systems investigated some recommendations are made to promote amendments to FICA, POCA and the AML Regulations. The chapter will conclude with three key propositions:

- G FICA's safe-harbour provision fails to resolve the tension between the confidentiality duty of banks and their reporting duty.

In addition, a refinement and reconsideration of some of the AML measures are required to elevate South Africa's AML legislation to the standard of its international counterparts. This should not only give credence to the AML regime of the country, but will also serve as testimony of the serious commitment of South Africa to control money laundering.

- G Traditional ownership protection remedies are inadequate for the purpose of availing a victim of fraud or theft to claim loss from a bank that parted with the benefits of fraud or theft.

A quasi-vindictory action, however, may assist the victim to recover loss from the bank provided that the benefits of fraud or theft remain under its control. Ultimately, the research shows that there is little that a victim of fraud or theft can do to recover loss if the bank parted with the benefits of

¹²⁶ See par B above.

fraud or theft as instructed by fraudster or thief who either absconded with the funds, or who is a pauper. This outcome can be rectified by either importing the English civil remedy of constructive trust, or by inserting similar to POCA's civil forfeiture provisions and the US restatements a general civil remedy in FICA. Codification of a general civil remedy in FICA will render the Act globally the most comprehensive and progressive AML piece of legislation to date.

G POCA's innocent owner protection provision is defective because it offers protection to an innocent owner of property earmarked for civil forfeiture only in limited circumstances, namely, where he acquired an interest in the property as opposed to having a vested interest in deposited benefits of fraud or theft that are the subject of civil forfeiture proceedings. Suitable amendments to address this lacuna in POCA will therefore be forwarded which should widen the scope of the Act's innocent owner remedy.

Some other recommendations are further made to promote legal certainty and to ensure that AML measures are effective to control and prevent money laundering as intended by FICA. Finally, some projections will be made to indicate the way forward for the fight against money laundering in South Africa.

(Chapter 2 to follow)

PTO

CHAPTER 2

CONCEPTS OF MONEY

At the start of the game the pieces are placed in a determined position [A] struggle of chess pieces takes places according to determinate rules, until the King of a party is captured by force or the contestants agree upon a drawn issue.

LASKER *Chess* 4

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A. INTRODUCTION

If not for the lure of money, the need to launder it would not exist.¹²⁷ It is therefore necessary to commence this study with a reflection on the history of money, its origins and the influence it exerted throughout the ages. The evolution of bartering to money occurred due to the need to simplify payment. Paper money originated by virtue of the practical demands and technical developments of certain periods. Custom likewise accommodated the functions of money, hence the need to study the roles money played, and continues to play, in a post-millennium society.

¹²⁷ As once remarked: '[s]ome worship heroes, some worship power, some worship God, and over these ideals they dispute - but they all worship money' (Twain *Notebook* 343). Most people are motivated by money and will do anything to accumulate more (Laming *Understanding Human Motivation* 245). This may explain the increase of financial crimes such as fraud and theft and methods to launder the benefits thereof (see also ch 1.A.2).

Following the general methodology and purpose of this study in Chapter 1 this chapter explores the origins of money, its development and the characteristics of the concept ‘benefits of crime’. The nature of money is examined within the context of the following critical aspects: (I) the functions of money; (II) the evolution of various payment methods; (III) the contemporary concepts of money; and (IV) the characteristics of the benefits of crime. The chapter concludes with a summary and some comments about the nature of money in general, and in particular, the benefits of crime.

My overriding argument guiding this chapter is the idea that changes in the form of money and human conventions have transformed the nature of money. As will be seen below, economists offer limited help in clarifying the nature of money. However, before turning to the historic aspects of money, it is important to first consider three concepts which are generally used to denote the functions of money, namely, ‘chattel’, ‘medium of exchange’ and ‘legal tender’.¹

1. Money as Chattel

Legally, money² is a chattel³ issued under the authority of the law, denominated with reference to a unit or account which is intended to serve as a medium of exchange in the state of issue.⁴ This definition employs the three key functions of money.

Money as a chattel consists of concrete, movable objects and has value attached to it which is capable of discharging legal obligations for a specific amount.⁵ Objectively regarded money is something that is negotiable, portable and spendable in the form of currency.⁶ It is also accepted

¹ See also paras B.1–2 below where the meaning of money is evaluated in terms of these concepts and historic developments.

² See Lockhart (*Coins* 18–20) who analyses the literal meaning of the concept ‘money’ in full. In short, the English word ‘money’ comes from the Middle English word *monoie* which derived from an old French noun *monie*. This in turn developed from the Latin word *moneta* which is the Latin name for the mother of the Muses who in Greek was called Mnemosyne, the goddess of memory.

³ As an English legal concept, ‘chattel’ is defined as follows: ‘[a]n item of movable personal property’ (Collins *Dictionary* sv ‘chattel’).

⁴ Mann *Legal Aspects of Money* 8; Goode *Payment Obligations* 1.

⁵ Akindemowo (1998) *UNSWLJ* 472; Stathopoulos *Introduction* 10. Mann (*Legal Aspects of Money* 24) regards this as money’s function of setting a unit of account.

⁶ Which in an economic context refers to coins and notes (as opposed to cash) (Akindemowo (1998) *UNSWLJ* 472).

as legal tender.⁷ Ownership of money is key because its transfer follows the rules of transfer of ownership over things.⁸ Of note, cheques,⁹ credit cards and other forms of ‘plastic money’ are mere means of transferring money.¹⁰ This view contrasts directly with the economic definitions of money that explain money in terms of banknotes and coins.¹¹

2. Money as Medium of Exchange

People use money to purchase goods and services and therefore, it serves as a medium of exchange.¹² It is an alternative to barter. Mann¹³ defines this quality of money as something which:

[i]s to be attributed to all chattels which ... are meant to serve as [a]... means of exchange in the State of issue.

Money creates the global economic activity in terms of real US dollars which bounds together different countries regardless of politics, religion and technology.¹⁴ Its key role is establishing

⁷ See par A.3 below.

⁸ See Stathopoulos *Introduction* 10; par C.3 below.

⁹ Which is a bill drawn on a bank and payable on demand (see section 1 of the Bills of Exchange Act 34 of 1964, as amended (‘BEA of 1964’)).

¹⁰ *Tjollo Ateljees (Edms) Bpk v Small* 1949 (1) SA 856 (A). Akindemowo ((1998) UNSWLJ 472) points out that debts are incurred in terms of monetary units. Credit is not money, but the *right* to a sum of money (Loubser *Theft of Money* 68). Instruments of payment such as bills of exchange and promissory notes must be made out for ‘a sum certain in money’ (section 2(1) of the BEA of 1964), which amount may be influenced by interest (section 7(1)). It follows that other things which were historically used as payment such as gold or feathers (see par B.1 below) were not money for two reasons: one, no specific value was attributed to them (see Malan and Pretorius (*Malan on Bills* 40) and Schulze (*ABLU-2004* 1) who list various objects that were employed as money), and two, they were not designated by the state as legal tender (see par A.3 below).

¹¹ See par C.2 below.

¹² Which is how the commodity-exchange theory explains money (Ingram *Monetary Spaces* 125; Good *Face of Money* 12), a view that is also accepted by Thomas and Boraine ((1994) *THRHR* 683). The authors believe that contemporary money serves only as a medium of exchange because it possesses no intrinsic value. In contrast, Loubser (*Theft of Money* 56) argues that money’s intrinsic value lies in its purchasing power which is expressed as a sum of monetary units.

¹³ *Legal Aspects of Money* 8.

¹⁴ Cloete *Teorie van Geld* 9–10; Stathopoulos *Introduction* 4. Regardless of whether money is denoted as dollars; rubles; yen; marks; francs; pounds; pesos, bahts; ringits; kronas; kwansas; levs; escudos; liras; biplwelles; rials; drachmas; shekels; yuans; quetzals; pa’angas; ngultrums; ouguiyas; rupees; schullings; rand or afghanis, it operates as part of a global monetary system (Weatherford *History of Money* 7).

value, facilitating exchange and creating commerce. Money's medium of exchange function transforms money into a representative of income. Once an object is accepted as a medium of exchange, it also becomes the standard unit for quoting prices, and therefore, establishes the first key role of money, namely as a unit of account.¹⁵

Money as a medium of exchange must be durable, transferable and widely accepted.¹⁶ Historically, this function of money evolved from barter;¹⁷ money originated as a tradeable commodity held by merchants to increase profits.¹⁸ Three problems have been identified with this view of money.¹⁹ First, money as exchange medium disregards the value of money.²⁰ Secondly, money possesses a social relationship²¹ because it holds the promise to pay for something, a factor which is ignored by the money as medium of exchange description. Thirdly, different forms of money²² became money only when they were expressed in a specific value.

3. Money as Legal Tender

¹⁵ Guttman *Cybercash* 16; Mann *Legal Aspects of Money* 24; Nussbaum *Money* 15–16.

¹⁶ Good *Face of Money* 12. The requirements also render credit or bank money a medium of exchange by virtue of its role in discharging monetary obligations (Loubser & Swart (1999) *Stell LR* 357). Bank money, called 'deposit money', *monnaie scripturale* or *buchgeld* (Stathopoulos *Introduction* 4; Mann *Legal Nature of Money* 56), suggests that the existence of a bank account can discharge an obligation without the intervention of a bank as opposed to cash or paper money (known as *monnaie fiduciaire* or *papiergeld*).

¹⁷ Goods that were initially traded with were later replaced by metal pieces which had specific values attributed to them. These afforded to the commodity the characteristic and function of legal tender (see par B.1 below).

¹⁸ Ingram *Monetary Spaces* 125–126; Smithin *Money* 34.

¹⁹ Ingram *op cit* 126–127.

²⁰ See Keynes *Theory of Employment* 215–216; par C.2 below.

²¹ See par C.2 below where money's value as viewed by society is evaluated.

²² See par B.1 below where the evolution of money is discussed.

Legal tender is currency as defined by the legislature of a particular country in legislation.²³ Not everything that is money is legal tender,²⁴ and not all legal tender is money.²⁵ Under the Reserve Bank Act all notes and coins²⁶ issued by the bank are recognised as legal tender.²⁷ Money which is legal tender may not be refused in the payment of a debt.²⁸

It is unclear if the definition of money is limited to the definition of legal tender which excludes some instruments of payment such as digital cash.²⁹ Legal tender have two key attributes: state recognition and acceptability. Whether these two qualities can be attributed to electronic money remains a matter of opinion.

²³ See section 16 (a bank may '[m]ake ... coins of the denominations and with the mass set out in Schedule 2, ... which are made of gold ... of the standard fineness so set out') and section 17(2)(a) (which provides that payment by legal tender means employing gold and other coins) of the Reserve Bank Act 90 of 1989 ('Reserve Bank Act'); Fox *Property Rights* 8,10, 28–29; Mann *Legal Aspects of Money* 42.

²⁴ See par B.2.3 below.

²⁵ For example, Nussbaum (*Money* 54–55) lists plots of land and grains as examples of legal tender.

²⁶ Not all South African coins are regarded as legal tender. Oelofse ((1985) *MBL* 126–127) argued that a Krugerrand is not legal tender because it does not have a nominal value whilst Pretorius ((2004) *SA Merc LJ* 468) submits that Krugerrands in the form of golden coins, are legal tender regardless of the fact that they do not have a nominal value. The South African Mint Company issues gold coins which are legal currency for settling any amount (Falkena *SA Financial System* 56). The value of the coins equals the net amount for which the Reserve bank is willing to purchase them on the day presented.

²⁷ See section 11(1) of the Act; Falkena *SA Financial System* 55–56. The South African Mint Company was established in 1989 to manage the functions of the Reserve Bank to issue notes and coins.

²⁸ Debt is not synonymous to money (Akindemowo (1998) *UNSWLJ* 472; Nussbaum *Money* 45–48). Legally, money can be stolen whilst a debt cannot be the subject of theft (but see Loubser (*Theft of Money* 85) who reasons as follows: '[t]he object of [theft] ... can be an incorporeal sum of money in respect of which an obligation to repay exists').

²⁹ Various arguments exists in favour of, and against, the recognition of electronic money as legal tender (see, for example, Schulze (*ABLU-2004* 2) who regards electronic money as 'money', but not as legal tender; Loubser (*Theft of Money* 85) who argues that a credit transfer is a sum of money). Due to the state theory (see par C.1 below) it, however, does not constitute a new form of money (Loubser & Swart (1999) *Stell LR* 368)). It is submitted that whether electronic money is legal tender depends on the legislation of the country used (see par B.2.4 below).

Cash is legal tender when defined as coins and notes issued on state authority.³⁰ It has various advantages for the person possessing it, for example, acceptability, guaranteed payment, no transaction charges and anonymity.³¹ A customer may demand payment of the amount that was deposited with the bank which cannot charge a customer for providing it.³² In the context of the acceptability of a dollar deposit made at an English bank in London, the court reasoned that:³³

[e]very obligation in monetary terms is to be fulfilled, either by the delivery of cash, or by some other operation which the creditor demands and which the debtor is either obliged to, or is content to, perform.

If money is used as legal tender to pay for goods or services, the discharge of the debt using legal tender constitutes an absolute form of payment.³⁴ Legal tender thus operates independently from a third-party performing an obligation.³⁵ In this sense payment cards are not legal tender regardless

³⁰ See above. A creditor may demand payment in cash in absence of an agreement to the contrary or where no trade usage exists (*Cowen Negotiable Instruments* 7, 56–57). However, the right of a customer to demand payment of deposited money in cash depends on the terms of contract between the parties (*Guest Contracts* 21–55; *Burg Trailers SA (Pty) Ltd and another v Absa Bank Ltd and others* 2004 (1) SA 284 (SCA) [*Burg Trailers*] 289B; *Nissan South Africa (Pty) Ltd v Marnitz NO and others (Stand 186 Aeroport (Pty) Ltd Intervening)* 2005 (1) SA 441 (SCA) [*Nissan*] paras 24–26 - see ch 3.C.3).

³¹ *Reid E-Money* 297; Chinoy (1997) *BFLR* 17. Anonymity likewise is a feature of electronic money (see par B.2.4 below) and crucial to money launderers (see ch 4.D.4.3).

³² *Libyan Arab Foreign Bank v Bankers Trust Co* [1989] QB 728 [*Libyan Foreign Bank*] 755.

³³ *Idem* 764.

³⁴ *Loubser & Swart* (1999) *Stell LR* 356. Payment is legally distinguished according to whether it is absolute or conditional (*Stathopoulos Introduction* 4–5). Absolute payment cannot be countermanded and remains irrevocable whereas conditional payment may be recounted up to a certain point in the payment process (see also par B.2.3.5 below).

³⁵ Which situation differs from the one where a cheque is offered as payment. A cheque is a conditional form of payment since payment depends on the cheque being honoured by a third party, the bank, on which it is drawn (*Stassen* (1979) *BML* 183–185; *Commissioner, South African Revenue Service, and another v Absa Bank Ltd and another* 2003 (2) SA 96 (W) 129E–131G; *Malan & Pretorius Malan on Bills* 299 ev). Payment by cheque is viewed as a conditional payment until the cheque is paid (see *Eriksen Motors (Welkom) Ltd v Protea Motors, Warrenton* 1973 (3) SA 685 (A) where the court observed that: ‘[p]ayment by cheque is ... regarded as immediate payment subject to a condition ... that the cheque be honoured on presentation’ (693)). When a cheque is sent by mail on request of the payee and gets lost, the debt will also be considered paid provided that the drawer took due care in delivering the cheque to the payee (*Mannesman Demag (Pty) Ltd v Romatex (Pty) Ltd* 1988 (4) SA 383 (D). In *Greenfield Engineering Works (Pty) Ltd v NKR Construction (Pty)*

of the fact that payment with a credit card is an absolute form of payment.³⁶ Payment with a credit card is viewed as final as soon as the cardholder signed the voucher at the point of sale.³⁷ The distinctive features of a credit card substantiate this point.³⁸

Ltd 1978 (4) SA 901 (N) the drawer had to pay the amount on the cheque twice). Incidentally, this view is criticised by Mann (*Legal Aspects of Money* 78n75) who reasons that the intervention of the post office does not change the fact that payment with a cheque remains conditional.

³⁶ The nature of payment with a credit card was considered in *Re Charge Card Services Ltd* [1989] Ch 497 [*Charge Card Services*] and *Diners Club SA (Pty) Ltd v Singh and another* 2004 (3) SA 630 (D) [*Diners Club*]. In *Charge Card Services* a charge card, which could be used to buy goods from various garages, was issued to a cardholder. The card issuer had an agreement with another company, C, whereby debts owed by its cardholders to C were assigned to C. When the card issuer became insolvent, the court had to decide whether debts owed by cardholders represented debts due to the garages, or debts due to C (704–705). Two key submissions were made by the garages (706): one, payment with a credit card is conditional upon reimbursement by the card issuer, and two, a presumption that payment is conditional exists in law when a risk is involved in a specific method of payment. The court disagreed (see below).

³⁷ By signing the voucher in a credit card transaction, the cardholder agrees to both the transaction and resumes liability for payment of the amount (Jones *Credit Cards* 190–192; *Diners Club* 659).

³⁸ For example, a supplier cannot trace a cardholder and, therefore, must have intended that payment was effective at the moment when the voucher was signed, payment mechanics do not require disclosure of a cardholder's address to the supplier, the availability of a credit card method of payment is beneficial to both the supplier and the cardholder (see *Charge Card Services* 513–514; Stassen (1978) *BML III* 12–13; Schulze (2005) *SA Merc LJ* 203–210 and the authorities quoted there). In *Diners Club* the court had to pronounced whether a clause in the credit card contract, which holds the cardholder liable for fraudulent payments with the card, is *contra bonos mores*. The court found that the clause intended to protect the card issuer (658I–659B). A cardholder is not obligated to accept a credit card, but when he does so, he should apprise himself of the terms applicable to the use of the personal identification number (659E). It follows that the clause which holds a cardholder liable for fraudulent use of the card was not against public policy (659E–F).

Letters of credit likewise are not legal tender.³⁹ A bank has a contractual obligation to pay the seller only if the documents presented to it conform with the credit.⁴⁰ Where a letter of credit is used as payment, the seller selects the bank issuing the letter whilst as mentioned already, in a credit card transaction the seller has no say as to whom the card issuer is.⁴¹ In a credit card transaction the seller pays commission for the transaction, whilst with a letter of credit it is the buyer who pays for the facility.⁴²

In summary, it is evident from the aforementioned that money as legal tender has four characteristics: it is a medium of exchange, it constitutes final payment, it is transferred by delivery and it needs no clearing or settlement. An object constituting money must function as a chattel, a medium of exchange and legal tender, the latter which is determined according to the characteristics of the particular object. However, it should be evident from the following discussion that money is a concept of unlimited complexities.⁴³

B. HISTORICAL DEVELOPMENT OF MONEY

1. The Origin of Banknotes and Coins

³⁹ See *Phillips and another v Standard Bank of South Africa Ltd and others* 1985 (3) 286 (TPD) [*Phillips*]; *Ex parte Sapan Trading (Pty) Ltd* 1995 (1) SA 218 (W) [*Sapan Trading*]; *Loomcraft Fabrics CC v Nedbank Ltd and another* 1996 (1) SA 812 (AD) [*Loomcraft*]; articles 5-101–118 of the UCC (Cooper *Portable UCC* 168–176); Oelofse *Letters of Credit* 1–5, 83–94; Schulze (2000) *THRHR* 672 as regards letters of credit. For a discussion of the legal issues regarding electronic letters of credit, see Johnson *Electronic Letters of Credit* 271.

⁴⁰ *Phillips* 303E, 304B; *Sapan Trading* 227D–E; *Loomcraft* 816C; Oelofse *Letters of Credit* 85, 91–92; Malan (1994) *TSAR* 152.

⁴¹ *Phillips* 303B–F; *Sapan Trading* 223I–224G.

⁴² *Phillips* 303B–F; Oelofse (1996) *SA Merc LJ* 296.

⁴³ This characteristic of money was recognised already in 1934 by Ellis (*Monetary Theory* 3) when he quoted Schumpeter who reasoned that: ‘[t]here are only two theories of money which deserve the name ... the commodity theory and the claim theory. From their vary nature they are incompatible.’

Money survived history and today continues to accommodate desires. In the process it has united society more effectively than dictatorship.⁴⁴ Money evolved from a commodity to currency, its acceptance influenced by commerce⁴⁵ and governments. Moreover, it is the heart of banking.

Numismatists disagree about the origin of coins.⁴⁶ Most theories of the origin of money in the West, the Muslim world and China are founded on a division of labour.⁴⁷ Sheikh Abu al-Fadl Jaafar al-Dimishqi, who wrote an Arabic treatise on commerce dated 860 AD, imagined that money was invented by a super-race of early men whom he called *awail*,⁴⁸ to create a system of equivalences. But money may be older than writing.⁴⁹ It goes back further than cuneiform writings to Hagiographa from the Sumerian civilisation, found at UR in 3 BC, which referred to silver struck with the head of Ishtar.⁵⁰ It follows that money has since the beginning of time reflected the ambiguity of its social function, namely an instrument of cohesion and a source of violence.

Initially, the function of determining the cost of various goods which were used as barter was performed by goods that were scarce.⁵¹ These commodities were gradually replaced by gold

⁴⁴ Buchan *Meaning of Money* 20.

⁴⁵ Vakhitov & Vakhitov (2002/2003) *RCEEL* 103; Guttman *Cyberman* 18–19.

⁴⁶ Engelbrecht *Geld in SA* 2; Davies *History of Money* 111.

⁴⁷ Buchan *Meaning of Money* 22.

⁴⁸ Or ‘the first ones’ (Buchan *Meaning of Money* 22-23). The *Awail* sought something to which they could apply the price of everything and used what was near: plants, animals or living property.

⁴⁹ Davies *History of Money* 24, 36; Weatherford *History of Money* 18. Cuneiform inscriptions from Mesopotamia, dated to 3 BC, recorded the weighing-out of barley for taxes and restitutions. The Chinese writing system, developed in the next millennium, used symbols of shellfish shells, cowries which are shellfish shells found in the shallower waters of the Indian and Pacific Oceans, in characters relating to payment (Schulze *ABLU-2004* 1; Schulze (2004) *SA Merc LJ* 50).

⁵⁰ Aglietta *Whither Money* 31. Ishtar was both the mother-goddess, a symbol of fertility, and the goddess of death.

⁵¹ Weatherford *History of Money* 17–18; Engelbrecht *Geld in SA* 1; Burnett *Roman World* 15; Davies *History of Money* 9–18; 27. Scarce commodities, such as butter (used by the Norwegians) and salt (used in China, North Africa and the Mediterranean), from which the word ‘salary’ derives (*salrius* in Latin), were employed as money. Plants and living things were rejected because they were not durable. From minerals hard stones were chosen that could be smelted. Iron and copper were passed up because they rusted, lead turned black. Gold and silver were elected since they were easily cast in forms, were odourless, shone and took on surface signs as protection. The Aztec of Tenochtitlán used chocolate beans for money, which bought them fruit, vegetables, jewellery and slaves.

and silver pieces.⁵² Gold and silver were minted and made a means of payment for everything. Gold was used for payment because it was durable, could survive burial and repeated smelting.⁵³ The view of money's invention as 'spontaneous and careful'⁵⁴ came from classical antiquity. Sima Qian, a Chinese author writing in the early first century, who argued⁵⁵ that money had come into being 'long ago and far away' once commerce had been established.

Further, the Old and New Testaments in the Bible contain numerous references to payments of silver.⁵⁶ Early European written records do not mention money.⁵⁷ The first book of Herodotus,⁵⁸ called *Histories*, concerned money and referred to coins, value, gifts, payment of soldiers and commerce. One of the first international banks was the Knights of the Templar, a religious order founded by the Crusaders in Jerusalem around 1118 AD.⁵⁹ They built castles all over Europe which were used to store gold and silver. Deposits and withdrawals could be made at the castles and loan agents were using them as a basis for their activities. These castle banks led to the establishment of banks elsewhere in Europe. Coined money survived the collapse of the Roman Empire.⁶⁰ During the next century trade revived and rulers, in memory of Roman civility, minted silver coins called *denarii*. In 8 AD a money standard based on weighted silver became entrenched in Western Europe.⁶¹ Coinages were often inseparable from the Christian religion and a monarchical state.⁶²

⁵² Davies *History of Money* 106–108; Weatherford *History of Money* 25–26; Engelbrecht *Geld in SA* 1–2; Vakhitov & Vakhitov (2002/2003) *RCEEL* 103. Minted coins were invented in the Lydian cities of Aegean in 7 BC (Broom & Markham *Bank Activities* 1).

⁵³ Nussbaum *Money* 4; Engelbrecht *Geld in SA* 2–3; Guttman *Cybercash* 18–19.

⁵⁴ Buchan *Meaning of Money* 22.

⁵⁵ Buchan *op cit* 24; Weatherford *History of Money* 63–79.

⁵⁶ For example, Genesis 37: 28 (Joseph being sold by his brothers to Midianite merchants) and Matthews 17:27 (Jesus instructed about the payment of taxes).

⁵⁷ Buchan *Meaning of Money* 24. Clay tablets unearthed at the beginning of the century in the Greek Peloponnese and in Crete were partially deciphered in the 1950s and revealed as inventories. They listed women, children, tradesmen, troops, flocks of sheep and goats, grain, oil, spices, land leases and yields, ritual offerings, cloth, vessels, furniture, bronze and chariots, but no payment in silver or gold for services rendered.

⁵⁸ Herodotus was born in 490 BC and known as the father of history (Burnett *Roman World* 17; Davies *History of Money* 88). Herodotus lived on the east coast of Aegean (where the Mediterranean met Asia) where the first likeness of coins were struck in 7 BC.

⁵⁹ Broom & Markham *Bank Activities* 9.

⁶⁰ Burnett *Roman World* 16, 33; Davis *History of Money* 106–112; Buchan *Meaning of Money* 50. See Aglietta *Whither Money* 54–56 as regards the dysfunctions of the Roman payment system.

⁶¹ Davies *History of Money* 12; Weatherford *History of Money* 56–57. Silver coins gradually appeared and circulated beyond the Roman Empire of the West, in Bavaria,

The Muslims who inherited Constantine's Roman Empire in the East minted gold dinars and silver dirhams, which were carried to Africa and all over Europe.⁶³ The availability of money in Europe depended on the supply of silver and golds from the mines of the Harz Mountains and Freiburg in Saxony.⁶⁴

Paper money was invented in China in the 9th century.⁶⁵ By the 15th century, shortages of money drove men to metal workshops.⁶⁶ Europe had a modern monetary regime at the time comprising⁶⁷ a hierarchy of gold, silver and metal-based coins, various kinds of money, such as, bills of exchange,⁶⁸ local cheques, travellers' cheques, securities and deposit certificates, public credit, municipal bonds and private banks. At the beginning of the 18th century the state stepped in and first banished the production of money in coin form and then continued to abolish gold as payment medium.⁶⁹ From the middle of the 20th century bank debts, intended for settling accounts, were employed as the first non-cash forms of money.⁷⁰ The high cost of conducting banking

Bohemia and Saxony in 10 AD. They were subsequently transplanted to Denmark, Norway, Hungary, Poland, Baltic Russia, the Ukraine, Sweden, Scotland, Ireland and finally to the Americas.

⁶² Buchan *Meaning of Money* 51–52.

⁶³ Nussbaum *Money* 59–6. Muslim money collided with the money of the Chinese, who first used knives and spades as money and later strings of cast bronze coins.

⁶⁴ Buchan *Meaning of Money* 53.

⁶⁵ Nussbaum *Money* 72; Weatherford *History of Money* 126–129. The use of paper as money allowed the Chinese government a monopoly over gold and silver. Yet, money was first printed in 1690 in Northern America due to a shortage of coins (Weatherford *History of Money* 132–135). Benjamin Franklin printed the first paper money used in the US.

⁶⁶ Davies *History of Money* 169–173; Weatherford *History of Money* 93–105.

⁶⁷ Broom & Markham *Bank Activities* 2. For the history of banking, see Miller & Van Hoose *Money* 184–186; Cecchetti *Banking* 264.

⁶⁸ Bills of exchange were brought into circulation by 13th century Italian bankers (Aglietta *Whither Money* 44–45). They were trading with Islamic merchants who were already using them as payment mediums. Due to the Crusades, monarchs needed to transfer considerable means of payment from one end of Europe to the other.

⁶⁹ Vakhitov & Vakhitov (2002/2003) *RCEEL* 104. This initiative marked the transition from commodity money such as gold to credit (Guttman *Cybercash* 20).

⁷⁰ Known as 'plastic money', for example, credit cards which are used as substitutes for cash payment (Vakhitov & Vakhitov (2002/2003) *RCEEL* 104; Stathopolous *Introduction* 5). The idea of a credit card was mentioned in 1888 already in an American novel (Weatherford *History of Money* 225). Diners Club created the first charge card in 1950 whilst in Europe, the first bank card was issued by the English Barclays Bank in 1966 (Weatherford *op cit* 227). In 1977, the Society for Worldwide Interbank Financial Telecommunication, SWIFT, went into operation in Brussels to coordinate the movement of electronic money (see Weatherford *op cit* 236; Wyrsh (1992) *Denver J of Internat L& P* 517–520; par B.2.3.2

operations by non-cash payments led to the creation of electronic transfers and electronic, or digital, money.⁷¹

A final comment as regards the history of money as payment medium concerns the evolution of the payment system which has not been discussed in this paragraph. Money's evolution also influenced the development of the payment system. The development of the payment system is best illustrated in terms of four main monetary groups:⁷² one, money as an object group comprising trade by barter and trade with valuable objects, two, money as a currency group consisting of coins and notes,⁷³ three, money as a claims group that includes deposit accounts, plastic and electronic money, and electronic fund transfers and four, money as an electronic impulses group, consisting of smart cards and digital coins. Thus, objects employed as barter evolved into coins and notes which are generally known as money. They function as mediums of exchange and legal tender.⁷⁴ The third group, called 'near money'⁷⁵ is neither legal tender nor cash. The fourth group contains some features of money although they are also not legal tender.⁷⁶

Clearly the payment system had to develop for the purpose of accommodating contemporary forms of payment such as electronic money. Whether these payment forms use traditional money are considered next.

2. Electronic-Banking⁷⁷

below). During 2002 more than 193,170 million credit card transactions were conducted in South Africa, totalling 62,942 billion rand (Schulze *ABLU-2004* 3).

⁷¹ Note that 'plastic money' and 'electronic money' are not identical. With plastic money the buyer undertakes to pay the sum for the transaction to the card issuer so that the seller has a claim against the issuer for the amount (see *Charge Card; Diners Club*; par A.3 above). Conversely, electronic money denotes an immediate transfer of monetary value from the buyer to a seller (see par B.2.4 below).

⁷² Akindemowo (1998) *UNSWLJ* 469–470. Generally, money takes on only two forms: cash comprising of coins and paper money, and bank deposits maintained in banks which are transferred in various ways such as by cheque, credit cards, credit transfers and interbank transfers (David (1986) *Canadian BR* 193). See also Stathopoulos *Introduction* 3–11.

⁷³ Which is known as 'cash' (see par B.2.4 below) and constitutes legal tender (see par A.3 above).

⁷⁴ See paras A.2–3 above.

⁷⁵ Akindemowo (1998) *UNSWLJ* 470.

⁷⁶ See par B.2 below.

⁷⁷ Or 'e-banking'. See also ch 4.D.4 where online money remittance services are considered.

2.1 Electronic-Banking as Part of Electronic Commerce⁷⁸

E-commerce has revolutionised international banking and created vast opportunities for generating money.⁷⁹ E-banking, which is defined⁸⁰ as the conduct of banking business with the assistance of telecommunication tools, is a special form of e-commerce. The removal of legal barriers to e-banking was brought about by legislation and contractual arrangements.⁸¹ In 1996, UNCITRAL⁸² established a model law on e-commerce⁸³ and since then various other international rules have been adopted for the protection of consumers.

It was initially assumed that e-commerce operated in a legal hyperspace where national rules do not apply. This is no longer the case, because e-commerce businesses are subject to the laws of each country where they have customers or where their website can be accessed,⁸⁴ a situation which presents several difficulties.⁸⁵

2.2 Specific Problems of Electronic Banking⁸⁶

⁷⁸ Or ‘e-commerce’.

⁷⁹ Reid *E-Money* 1. E-commerce revolutionised business operating systems and processes. The Organisation for Economic Cooperation and Development recognised that (Suddard *OECD Report* 300): ‘[t]he potential for electronic commerce is vast and its ability to promote a truly global village is unparalleled.’

⁸⁰ Horn *Banking* 3.

⁸¹ Reed *Cross-Border Electronic Banking* 6–8; Tan (2002) *J of Fin Crime* 281. The history of banking via the Internet is recent with the Bank of America being first to offer an online service in 1995 (Munro (2001) *J of Fin Crime* 142). Internet banking is popular due to the lower costs, remote access, speed of transacting and enhanced customer service that it offers (see also ch 4.D.4).

⁸² Which is an acronym for the United Nations’ Commission on International Trade Law which was established in 1966. It is tasked to promote the harmonisation and unification of international trade (see in general Malan & Pretorius *Malan on Bills* 26).

⁸³ UNCITRAL Model Law on Electronic Commerce of 1996 (see in this regard, Wiegang *Electronic Banking* 168–173; Malan & Pretorius *Malan on Bills* 26–28).

⁸⁴ Reid *E-Money* 1; Munro (2001) *J of Fin Crime* 146–147.

⁸⁵ For example, dealing with financial product restrictions and obtaining information concerning delivering of banking services in a specific country (Reid *E-Money* 2).

⁸⁶ Note that this section is not an attempt to address all the contemporary issues as regards electronic payment. Such an endeavour falls beyond the scope of this study (see ch 1.D). Instead, key principles underpinning electronic payment are considered in as far as they relate to money laundering (see also ch 4.C.1, par D.4). See Malan & Pretorius (2006) *THRHR* 594; (2007) *THRHR* 1 as regards the nature of and problems involving credit transfers.

In 1995 1.8 billion bank cards were in use globally representing 14 billion monetary transactions.⁸⁷ At present, banks are challenged to stay abreast with technological developments. Globalisation coupled with specialisation in financial products have forced banks to reconsider which products they offer and how they are offered.⁸⁸ The resulted development of e-banking influenced key areas of banking business, for example, the bank-customer relationship, transactions conducted and the bank's compliance functions.⁸⁹

Data protection and communication safety are two problems of e-banking within the sphere of e-commerce.⁹⁰ Bank confidentiality⁹¹ further poses a significant problem for banks, particularly in respect of electronic transactions.

2.3 Electronic Transfers⁹²

2.3.1 Overview and Primary Concepts

As indicated above, economic developments necessitated payment⁹³ systems⁹⁴ to accommodate both the needs of society and the trends of the times. Current payment systems facilitate a move away from physical money towards electronic money.⁹⁵

⁸⁷ Davies *History of Money* 240.

⁸⁸ Breuer *Banking in the Electronic Age* 32–34.

⁸⁹ See ch 6.B.3.6, par C.3.4; ch 7.C.2–9; and ch 8.C.3–4 as regards AML legislation.

⁹⁰ Wiegand *Electronic Banking* 173; Tan (2002) *J of Fin Crime* 281–282.

⁹¹ See ch 3.B.2.3. For an international perspective, see ch 6.B.2.2, par C.2.2; ch 7.B.2.

⁹² Or 'EFTs'. Note that the following analysis considered EFTs only in as far as they assist in establishing the nature of money. See in general Hooley & Taylor *Payment by Fund Transfers*; Hapgood *Paget's Law of Banking*; Geva *Bank Collections*; Stathopoulos *Financial Transactions*; Malan & Pretorius (2006) *THRHR* 594; (2007) *THRHR* 1; Schulze (2008) *SA Merc LJ* 290; Schulze (2007) *SA Merc LJ* 379; *Pestana v Nedbank Ltd* 2008 (3) SA 466 (W); *Take and Save Trading CC and others v Standard Bank of SA Ltd* 2004 (4) SA 1 (SCA) as regards the obligations of the different parties involved in fund transfers and other aspects.

⁹³ The word 'payment' refers to various ways in which a monetary obligation can be discharged (Mann *Legal Aspects of Money* 75; Guest *Contracts* par 21-083). Payment has been described as: '[a] bilateral juristic act requiring the meeting of two minds' (*Burg Trailers* 289B).

⁹⁴ A payment system is: '[a]ny machinery facilitating the transmission of money which bypasses the transportation of money and its physical delivery' (Geva (1986) *Osgoode Hall LJ* 1).

⁹⁵ Or 'e-money'. Van Tonder ((1989) *SA Bankier* 130) suggests that coins would continue to be of importance regardless of developments in presented in electronic transfer

Electronic payment systems ease the flow of value from customers to businesses, or vice versa, depending on the type of payment conducted.⁹⁶ Two kinds of electronic payments may be distinguished, namely, remote access payment systems⁹⁷ and e-money⁹⁸ mediums. Remote access instruments include credit and debit cards, phone, home and Internet banking applications.

EFTs⁹⁹ followed in the footsteps of coins and notes and paper-based payments with bills of exchange and cheques.¹⁰⁰ Two main kinds of EFTs exist, namely cross-border¹⁰¹ and domestic transfers,¹⁰² but other kinds of bank transfers are also possible, for example, in-house transfers,¹⁰³ interbank-transfers,¹⁰⁴ and transfers in cash.¹⁰⁵ EFTs¹⁰⁶ are electronic transactions carried out on

systems. It is submitted that this opinion is no longer valid in light of the current tendency to pursue various electronic methods of payments in the place of coins and notes. Electronic money are used much more frequently than paper money and coins because it is more efficient and secure (Aglietta *Whither Money* 51; Schulze *ABLU-2004* 3; Schulze (2004) *SA Merc LJ* 53; Visser (1989) *SA Merc LJ* 189).

⁹⁶ Schudelaro *Electronic Payments* 141–142; Kreitszheim (2003) *JBFLP* 168–169; Stathopoulos *Introduction* 7–9.

⁹⁷ They allow instrument holders to access funds on their accounts at a bank (Schudelaro *Electronic Payments* 142; Ellinger *Modern Banking Law* 460).

⁹⁸ See par B.2.4 below.

⁹⁹ An EFT has been defined as: ‘[a] fund transfer in which one or more of the steps in the process that were previously done by paper-based techniques are now done by electronic techniques’ (UNCITRAL *Guide* par 6).

¹⁰⁰ This occurred due to deficiencies encountered when payment was made with cash, which are risky and inconvenient (Frazer *Plastic and Electronic Money* 3 - see par B.1 above).

¹⁰¹ Cross-border transfers are transfers where the originator and beneficiary institutions are located in different countries, or where any part of the transfer has at least one transnational element (Geva *International Fund Transfers* 4; Hooley & Taylor *Payment by Fund Transfer* 119).

¹⁰² Domestic electronic transfers are fund transfers where the originator and beneficiary institutions are located in the same country (Geva *International Fund Transfers* 1–4).

¹⁰³ In-house transfers take place when a creditor and debtor have accounts at the same branches of a specific bank. Payment occurs the moment when the bank decides to credit the creditor’s account and makes the transfer.

¹⁰⁴ Mere instructions from one bank to another bank do not affect payment and are revocable (Geva (1990) *BFLR* 122–125). Payment only occurs between two parties when the creditor’s bank accepts the instructions and acts on them, thus credits its customer’s account.

¹⁰⁵ Transfers in cash are usually specified in a contract and refer to any method of transferring funds with the result that the transferee is given immediate access to the transferred amount (*Libyan Foreign Bank* 750–751).

¹⁰⁶ Also known internationally as wire transfers (Geva (1990) *BFLR* 111). In an international transaction where the banks involved are distant from each other, the interbank

behalf of an originator through a bank with the purpose of making an amount of money available to a beneficiary at another bank¹⁰⁷ Funds are moved in seconds because what is being moved is not physical currency, but electronic messages. Chorafas explains as follows:¹⁰⁸

[m]oney itself is nothing but information. It represents the claims that individuals and institutions have for goods and services that exist within an economy. ... The movement of money is the movement of these claims through the accounting records of the financial, industrial and merchandising communities.

The essence of Chorafas explanation is threefold. First, ETFs comprise money in the incorporeal format of information. Secondly, the existence of this type of intangible money is found in the physical documents registering the claims to it. It follows that e-money is nothing more than claims of paper. Thirdly, currency is not physically transported in an EFT transaction; EFTs merely represent a series of messages intended to document the payment instructions between the parties to the transaction. Sometimes the paying party¹⁰⁹ and the payee are the same person.

There has not yet been legislation promulgated in South Africa to cover EFTs. The recently enacted Electronic Communications Transactions Act¹¹⁰ which provides a standard framework for electronic communications, applies to electronic banking transactions but does not cover banking transactions in particular. The provisions of the Act are general in nature¹¹¹ and, therefore, bank-customer relationships are contractually determined.¹¹²

2.3.2 Legal Nature of a Fund Transfer Instruction

message is transmitted by cable or telex, hence the name ‘wire transfer’ (Geva *op cit* 112). See also ch 7.B where the bank-customer relationship pursuant to US law is considered

¹⁰⁷ FATF *Wire Transfers 2003* article 2(a)–(c).

¹⁰⁸ *Fund Transfers* 5. See also Maroldy (1990) *Notre Dame L R* 864; Wyrsh (1992) *Denver J of Internat L & P* 517–518.

¹⁰⁹ FATF *Wire Transfers 2003* article 2(e).

¹¹⁰ 25 of 2002 (‘the Act’). See in general Schulze (2004) *SA Merc LJ* 57; Schulze (2005) *SA Merc LJ* 210–211; Meiring *Electronic Transactions* 82–83.

¹¹¹ See Visser ((2002) *SA Merc LJ* 758) and Pistorius ((2002) *SA Merc LJ* 737) who discuss the Act in detail. Schulze ((2005) *SA Merc LJ* 210–211) suggests that e-money products due to the issues involved should be regulated by sector-specific legislation only.

¹¹² See ch 3.B.2.1 as regards the foundation of the bank-customer relationship.

In essence, modern financial systems consist of digital money transfers through telecommunications links among bank computers.¹¹³ Internationally, banks are connected by a computer messaging system that is operated by the Society for Worldwide Interbank Financial Telecommunication.¹¹⁴ Domestic banks within a country use systems similar to the New-York-based Clearing House Interbank Payment System.¹¹⁵ In South Africa, fund transfers are processed individually or in bulk. The relationship between the debtor and his bank, resulting from the transfer instruction, is governed by a contract of mandate.¹¹⁶

EFTs are brought about by the instructions of the originator to a bank. Such instructions may come in paper form, via the telephone or through a telecommunications network.¹¹⁷ Generally payment requires the physical delivery of money from the buyer to the seller. Any mechanism that facilitates the transfer of money by bypassing in whole or in part, its physical transport from the paying party to a payee is a payment mechanism.¹¹⁸ Due to the nature of e-money and electronic fund transfers no money passes through the bank system. It is merely a series of debits and credits which are linked to the transaction being conducted.¹¹⁹

2.3.3 Legal Nature of Credit and Debit Transfers

¹¹³ Geva *International Fund Transfers: Mechanisms and Laws* 6; Stathopoulos *Introduction* 7.

¹¹⁴ Or 'SWIFT'. SWIFT, a cooperative organised under Belgium law, was established in 1973 and is owned by its member banks and financial institutions (Lee & Zinnecker *Payment Systems - Problems* 297–298; *Paget's Law of Banking* 304–307; Geva (1990) *BFLR* 116–117). It supplies secure messaging services and software to over seven thousand financial institutions in 197 countries.

¹¹⁵ Or 'CHIPS', which is a New York based private sector clearing facility for large value transfers. It was created in 1970 when the New York Clearing House bought a computer that could receive and track dollar payments by New York banks (Weatherford *History of Money* 80–83; Geva (1990) *BFLR* 134–135; Lingl (1981) *Harvard Int LJ* 626–630; Wyrsh (1992) *Denver J of Internat L & P* 517–519). CHIPS is an example of a central switch network, whilst the English CHAPS is more a gateway system (Geva *International Fund Transfers: Mechanisms and Laws* 12). See par B.2.3.4 below as regards Internet banking.

¹¹⁶ Meiring *ABLU-1996* 4; Malan & Pretorius (2007) *THRHR* 8; ch 3.B.2.1

¹¹⁷ Mackenzie (1998) *J of Money Laundering Control* 29; Munro (2001) *J of Financial Crime* 139–140.

¹¹⁸ Geva *International Fund Transfers* 1–2; Meiring *ABLU-1996* 2; Fox *Property Rights* 166–167.

¹¹⁹ *Foskett v McKeown* [2001] 1 AC 102 (HL) 128 (see ch 6.C.4.3.4 where the facts of the case and the court's decision are discussed). For a detailed analysis of the operation of e-money as payment mechanism, see Schulze (2004) *SA Merc LJ* 56–57.

Point-of-sale payments can be made in shops, or to withdraw cash from automatic teller machines.¹²⁰ With a debit transfer, the paying party's instructions are sent to his bank by the payee through the payee's bank.¹²¹ When the instructions are first received by the payee's bank, his account is credited. In a debit transfer, funds credit to the payee's account are 'pulled' from the paying party's account imitating the process of cheque collection.¹²²

When the instruction to pay reaches the paying party's bank, his account is debited. It follows that in a debit transfer the credit to the payee's account precedes the debit to the paying party's account. The credit to the payee's account is provisional and can be reversed if the paying party's bank dishonours his instruction due to, for example, a lack of funds. Payment will only be final when the debit to the paying party's account becomes irreversible.¹²³

With a credit transfer, the paying party's instructions are sent to his bank directly by him without the intervention of a credit to the payee's account at the latter's bank.¹²⁴ As soon as the instructions are sent, the paying party's account is debited. It follows that the first impact of the paying party's instruction on the banking system is a debit to his account. In a credit transfer, the debit to the paying party's account precedes the credit to the payee's account and cannot be reversed. Funds debited to the paying party's account are 'pushed' to that of the payee. Where the accounts of both parties are at the same bank, no interbank communication is needed.

2.3.4 Internet Transfers

At present, the banking industry is largely dependant on the availability of electronic information. Within the e-banking domain banking products and services are electronically delivered and on

¹²⁰ They are also known as 'smart cards' because of the information that is contained in the cards (Solomon *Virtual Money* 68–69; Schulze *ABLU-2002* 4; Stathopoulos *Introduction* 9–10). Since smart cards store money in themselves in the form of value, no account at a bank, or anywhere else is needed (Schudelaro *Electronic Payments* 181–182; Guttman *Cybercash* 81–82).

¹²¹ Hapgood *Paget's Law of Banking* 292–293; Stathopoulos *Introduction* 13–15. For a detailed analysis of the nature of and problems involving credit transfers, see Malan & Pretorius (2006) *THRHR* 594; (2007) *THRHR* 1.

¹²² Geva (1990) *BFLR* 112, 121–123; Kreitszheim (2003) *JBFLP* 168.

¹²³ See also par B.2.3.5 below.

¹²⁴ Geva *Bank Collections* 186–188; Smith & Robertson *Plastic Money* 200–202; Malan & Pretorius (2006) *THRHR* 596 ev.

offer through the Internet.¹²⁵ Before considering to the importance of the Internet with respect to e-banking, it is necessary to understand some of the linguistics of the cyberworld.¹²⁶

The Internet is a global network of computers that speak the same language.¹²⁷ A network, consisting of a group of computers connected together to use the same protocols, enables computers to share the same information with absolute accuracy.¹²⁸ One aspect of the Internet is the World Wide Web. The basic technology of the Web was created to assist physicists tracking data produced by field experiments.¹²⁹ A programming language, HTML, enables phrase or word linkage in documents anywhere on the global Internet. The Web is therefore merely a common language permitting computers to communicate with one another. Internet banking continues to change traditional banking, and is driven by three factors:¹³⁰ one, it is cost-effective, two, it is convenient and three, a large choice of products is easily accessible.

The importance of the Internet to e-banking lies in the fact that it facilitates payment. Three principal systems facilitate payment on the Internet, namely e-money, EFT systems and online-chequing.¹³¹ Before encryption techniques were used, electronic shopping malls created substantial security risks when payment for goods bought over the Internet was effected with a credit card. On-line transmission of encrypted credit cards is a useful payment system. Payment over the Internet with a credit card works as follows: a buyer opens an account with a facilitator, usually a bank and provides his credit card number. A record of the sale is transmitted from the supplier to the bank which confirms the purchase with the buyer.¹³²

¹²⁵ The origins of the Internet is traced back to the early 1960s when L Kleinrock of the Massachusetts Institute of Technology published a paper on how messages can be sent over computer networks (Schudelaro *Electronic Payments* 9–11; Guttman *Cybercash* 57–58). In 1969, the first Wide Area Network ARPANET, which stands for the network of the Advanced Research Projects Agency, was created (Munro (2001) *J of Financial Crime* 139).

¹²⁶ Gringras *Laws of the Internet* 453–460; Solomon *Virtual Money* 72–74.

¹²⁷ Schudelaro *Electronic Payment* 7; Gringras *Laws of the Internet* 2–4; Munro (2001) *J of Financial Crime* 139. This is important because to connect computers to receive and sent data, similar modes of communication must be used.

¹²⁸ Currently, more than 150 million computers are permanently connected to serve more than 500 million individuals (Gringras *Laws of the Internet* 4).

¹²⁹ Schudelaro *Electronic Payments* 23; Gringras *Laws of the Internet* 460. The total number of websites has since 1993 when only 130 sites existed, multiplied to the more than 38 million websites existing today.

¹³⁰ Breuer *Banking in the Electronic Age* 31; Tan (2002) *J of Fin Crime* 281–282.

¹³¹ Konvisser (1997) *Harvard JLT* 324–325; Lawack-Davids (2001) *Obiter* 319–320.

¹³² See also par A.3 above.

2.3.5 Completion of Payment

In general, time of payment depends on the instrument used to facilitate payment and the particular payment system.¹³³ The time for completion of payment is not fixed, but subjected to various variables such as the parties involved in transaction,¹³⁴ the particular transactional stage and the contractual arrangements regulating the transfer.¹³⁵

At present, the concept of time of payment is open to interpretation. Banks generally accept any one of the following four alternatives as time of payment: one, the time at which a message is released by the sending bank, two, the time at which the receiving bank receives the message, three, the time at which the receiving bank enters the credit to the payee's account or four, the time at which the payee receives notice of the credit.¹³⁶ As soon as payment has been received by the bank it becomes owner of the amount of money that has been transferred. The bank acquired ownership of the transferred amount, *inter alia*, as a result of commingling¹³⁷ which occurs in the bank account as soon as payment is completed.

2.4 Electronic Money

A variety of systems exist that involve digital money, electronic cash or e-money.¹³⁸ E-money has been denoted as 'an electronic surrogate for coins and bank notes.'¹³⁹ Generally, e-money is a monetary value represented by a claim against the issuer which is stored on an electronic device,

¹³³ See par A.3 above.

¹³⁴ For various examples, see Stathopoulos *Introduction* 32–35; Hooley & Taylor *Payment By Fund Transfer* 86–87.

¹³⁵ Malan (1990) *Stell LR* 166–167. For example, the CHIPS payment system fixes time of payment at a specific point in the transfer. Parties may also contractually agree when a transfer will be irrevocable.

¹³⁶ Lingl (1981) *Harvard Intern LJ* 651–652; Hooley & Taylor *Payment by Fund Transfer* 86.

¹³⁷ See par C.4 below as regards commingling; ch 3.C.2–3 as regards the bank's ownership of deposited money.

¹³⁸ The concept 'e-money' is used in this paragraph to denote various kinds of money which is not chattel or cash.

¹³⁹ Edgar *Electronic Money* 202. Kurtzman (*Death of Money* 11) describes e-money as 'megabyte money' because it consists of symbols shown on a computer screen. The concept 'e-money' was used for the first time in 1995 in the US by an encryption specialist, David Chaum.

issued on the receipt of funds which are not less in value than that issued, and accepted as a means of payment by undertakings other than the issuer.¹⁴⁰ It has two distinct features, namely, a programming system which produces identification numbers and the possibility of transferring these numbers from one person to another without registering the transaction with the issuer of the money.¹⁴¹ The possession of an identification number allows the holder to exchange it for ordinary money.

E-money shares three characteristics with cash:¹⁴² anonymity, little or no transaction charges and the transfer of value to an electronic purse owed by a third party. However, there are two fundamental differences between e-money and traditional cash.¹⁴³ First, flows of digital bits represent payment amounts as opposed to cash presented as payment, and secondly, the physical delivery of the e-money is impossible. E-money generally has two main species:¹⁴⁴ stored value cards and third-party digital cash. A customer, for example, may have an agreement with a cash provider (usually an e-money institution) which allows him to send encrypted messages to a vendor which can use them without going to a bank to exchange them into cash. Stored value cards include automatic teller machines cards.

Of note, not all stored value cards can be described as e-money.¹⁴⁵ Sometimes the instruction to debit an account linked to the card is given when the card is used by the holder to make a payment. Payment made to the issuer will then amount to a traditional deposit unless the scheme is so arranged that it falls within the definition of e-money. However, depending on the agreement between the vendor issuing the card and the card holder, some types of e-money products may fall within the definition of deposit-taking.

¹⁴⁰ See in general Goldfinger *Intangible Economy* 106–107; Kobrin (1997) *Foreign Policy* 67–70; Stathopoulos *Introduction* 13–12, 27; Schulze *ABLU-2004* 4–5; Schulze (2004) *SA Merc LJ* 53–54. Vakhitov and Vakhitov ((2002/2003) *RCEEL* 110) observe that there is no fixed legal definition of digital money. Only by looking at the characteristics of a payment medium can one determine whether it embodies digital money.

¹⁴¹ Vakhitov & Vakhitov (2002/2003) *RCEEL* 110; Horn *Electronic Banking* 18–19.

¹⁴² See par C.3 below.

¹⁴³ Reid *E-Money* 299; Solomon *Virtual Money* 66–67; Kurtzman *Death of Money* 11–15.

¹⁴⁴ Gringras *Laws of the Internet* 43–44; Struber *Electronic Purse* 40–46. But note the six different forms of e-money that have been suggested (Loubser & Swart (1999) *Stell LR* 359–361; Lawack-Davids (2001) *Obiter* 315).

¹⁴⁵ Johnstone (1999) *J of Money Laundering Control* 254; Guttman *Cybercash* 133–135.

Mondex¹⁴⁶ is an example of an electronic monetary system which does not amount to deposit-taking. It functions as a payment mechanism instead of a product used to deposit and repay a deposited amount.¹⁴⁷ Mondex operates similar to a smart card which stores information on a microchip, including a 'purse' which holds value. The purse can hold up to five different currencies at one time on the card. It allows for the instant transfer of value between a supplier and its customers without the need for payment authorisation. Both public key¹⁴⁸ cryptography¹⁴⁹ and the Certification Authority¹⁵⁰ are employed to protect the stored values.

At present, the legal relationship between e-money issuers and buyers is governed by contract.¹⁵¹ Whether e-money is legal tender depends on the relevant legislation of a country.¹⁵² Even if e-money is permitted as legal tender, a payee may refuse to accept digital money as payment. If a seller display at the point of sale the logo of a specific type of electronic cash it would be holding itself out as accepting such digital payments as payment for goods or services.¹⁵³ Whether monetary value¹⁵⁴ represents a deposit at a bank depends on the relevant legislation. It is submitted that e-money usually is not legal tender because it is not a universally accepted medium of exchange.¹⁵⁵

¹⁴⁶ Which was created in 1990 and allows users to make secure on-line purchases without giving personal details (Reid *E-Money* 29; Loubser & Swart (1999) *Stell LR* 361).

¹⁴⁷ See ch 3.B.2 as regards 'deposit-taking'. Loubser and Swart ((1999) *Stell LR* 362–364) argue that the Mondex stored value card when issued with the agreement that the customer must repay the stored value, will qualify as a deposit.

¹⁴⁸ Or asymmetric encryption systems which are based on the use of two keys for each cryptographic operation: one which is used to encrypt data, another key to decrypt it (Reid *E-Money* 414). See also ch 4.D.4.2 as regards encryptions keys.

¹⁴⁹ Cryptography is used for two purposes: one, to encrypt data sent from one person to another, and two, to encrypted information stored electronically to prevent unauthorised access to it (Reid *E-Money* 415; Schudelaro *Electronic Payments* 154–155).

¹⁵⁰ Which is technology to protect chips from the point of manufacture and at every stage as they pass from issuer to user (Reid *E-Money* 300).

¹⁵¹ Effros *Electronic Payment Systems* 203; Konvisser (1997) *Harvard JLT* 328.

¹⁵² See par A.3 above.

¹⁵³ Reid *E-money* 297; Solomon *Virtual Money* 66–68.

¹⁵⁴ The value bought by the user is stored in two ways (Reid *E-Money* 298; Good *Face of Money* 28–34; Kreitzheim (2003) *JBFLP* 173–174): one, on a device that contains a microchip, or two, on a card linked to an account which is maintained by the issuer and records the balance loaded on the card.

¹⁵⁵ See also par C.1.2 below as regards the role of society in recognising a specific medium as legal tender.

The nature of a bank's obligation to the account holder following a deposit into a bank account is explored elsewhere in this study.¹⁵⁶ Suffice it to mention here that a deposit of traditional money into a bank account gives rise to an undertaking by the bank to pay the deposited amount to the account holder on demand.

The foregoing analysis illustrates that money has evolved over time to keep abreast with societal needs. Does e-money differ substantially from ordinary money? Before dealing with this vexed question it is necessary to establish what the contemporary concept of money entails.

C. MODERN CONCEPTUALISATION OF MONEY

1. Theoretical Approach

1.1 State Theory of Money

As mentioned already,¹⁵⁷ money issued by the state is regarded as legal tender. Likewise are only movables that are issued by, or with the permission of, the state accepted as legal tender.¹⁵⁸ This theory is known as the state theory of money which also explains the origins of money.

Since money is a necessity, society adopts the idea of state money. Money is therefore a creation of the state, not because it is regulated by the state but because it is only what the state recognises it to be.¹⁵⁹ Mann¹⁶⁰ accepts this definition of money as a concept which is identical to legal tender.¹⁶¹ According to this approach, non-cash money cannot be regarded as money.¹⁶²

¹⁵⁶ See par C.4 below; ch 3.B.3.

¹⁵⁷ See par A.3 above.

¹⁵⁸ Mann *Legal Aspects of Money* 14–16; Vakhitov & Vakhitov (2002/3) *RCEEL* 106.

¹⁵⁹ Vakhitov & Vakhitov (2002/3) *RCEEL* 107; Guttmann *Cybercash* 31, 35–36.

¹⁶⁰ *Legal Aspects of Money* 23. Money is produced by the state and denominated in national units to be employed as a way to measure value (Guttmann *Cybercash* 15).

¹⁶¹ See also par A.3 above.

¹⁶² The reason is that non-cash money is not distributed by a central bank. In the context of EFTs Goode (*Commercial Law* 503) suggests that the transfer of funds to the account of a payee is a payment between the payer and the payee, but not a payment between a bank and the payee. This is because paying with one's own debt (i.e. non-cash money which is the debt of the bank- see par C.4.2 below; ch 3.C) is prohibited.

The state theory of money applies in South Africa by virtue of the fact that the national monetary system is regulated in terms of various pieces of legislation that refer to money.¹⁶³ Consequently, circulating mediums of exchange can be considered money only when issued under governmental authority.¹⁶⁴

1.2 Societal Theory of Money

Consider for a moment the well-known proverb that money is the root of all evil. Literally regarded, money may be used to facilitate crimes such as terrorism.¹⁶⁵ Money also has the power to corrupt honest people due to the value society places on wealth whether real or assumed. This power renders money a dangerous yet coveted commodity. The societal theory evidently comprises two dimensions. The first dimension of the societal theory of money explores the role of society in the origins of money, its acceptance of money as value, income and capital. A second dimension, however, should also be considered.¹⁶⁶ It concerns society's influence on designating a specific commodity as legal tender. This dimension will be discussed next with reference to both its relationship to money and those values that are inherent and transferred to money.

The societal theory discards the role of the state in determining which commodity should constitute legal tender in favour of society's choice to accept a particular commodity as a valid payment medium.¹⁶⁷ Supporters of the theory argue that the role of the state in creating money is overemphasised.¹⁶⁸ Instead, commodities which constitute legal tender should be chosen by the

¹⁶³ Joubert (1990) *SA Merc LJ* 231.

¹⁶⁴ Mann *Legal Aspects of Money* 17–18; Joubert (1990) *SA Merc LJ* 231–232.

¹⁶⁵ The practice of using legally derived money for criminal purposes is known as reversed money laundering (see ch 4.D.4.3.2).

¹⁶⁶ The two roles are described as the objective impact and subjective impact that society has in the choice of the commodity that is issued as legal tender.

¹⁶⁷ Von Mises *Money and Credit* 70. This theory would explain the use of various convenient methods of payment such as credit cards by society at large in the place of coins.

¹⁶⁸ See Guttman (*Cybercash* 14, 16–17) arguing that money organises society in terms of the different social relations that it engages in; Von Mises (*Money and Credit* 74) observing: '[e]ven nowadays, it is only the practice of the individuals who take part in business that can make a commodity into a medium of exchange ... the choice of a medium of exchange ... belongs to those engaged in business.' Loubser and Swart ((1999) *Stell LR* 357) also agree that credit as money is a medium of exchange merely because of its practical role in discharging monetary obligations.

individuals who engage in business. The societal theory of money further postulates that society's core values are channeled to money. The well-known proverb that money makes the world go round captures the theory's core.¹⁶⁹ This view is accepted by Buchan who discusses the influence of money on society in detail.¹⁷⁰ Buchan argues that money has a deep, unbreakable, social relation. It is the greatest invention and contributed more to shape civilisation than letters.¹⁷¹ Although hard to comprehend,¹⁷² money is a language that is universally understood.¹⁷³

Through history people have identified money with gold, silver, coins, banknotes. Even though money is of no particular substance,¹⁷⁴ it may be embodied in various substances such as coins, shells, knives, in persons, in words or in gestures.¹⁷⁵ Money therefore contributes to the idea of value. In the words of Buchan:¹⁷⁶

[t]he value of money has been settled by general consent to express our wants and our property, as letters were invented to express our ideas; and both these institutions, by giving more active energy to the powers and passions of human nature, have contributed to multiply the objects they were designed to represent.

¹⁶⁹ A suggestion which Davies (*History of Money* 1) finds exaggerated. He compares it with a biblical warning that 'the love of money is the root of all evil' and argues that the latter emphasises the personal and moral significance of money in society. Guggenbuhl-Craig (*Soul and Money* 88) supports the view of Davies: money is evil in as far as it provides an incentive for crime.

¹⁷⁰ *Meaning of Money* 7. The author observes that: '[o]nly money could measure success or failure, happiness or misery ... States and governments must just stand back and money - which reconciles all clashes of human will - would see us right. Money was good.' This position is widely accepted (see, for example, Ingram *Monetary Spaces* 127; Guttman *Cybercash* 14; Nussbaum *Money* 5–10; Dodd *Sociology of Money* 59; Guggenbuhl-Craig *Soul and Money* 87–88).

¹⁷¹ See Buchan (*Meaning of Money* 14) who suggests that money is: '[e]nthroned as the God of our times.' Verbruggen ((1997) *European J of Crime, Crim L & Crim J* 340) likewise agrees that: '[m]oney ... is to our capitalist society, what rain is to the earth.'

¹⁷² Buchan *Meaning of Money* 17. Others agree that money is society's relation to purpose, end and goal (Lockhart *Coins* 18; Perry *Wealth and Poverty* 59–60).

¹⁷³ Buchan *Meaning of Money* 17.

¹⁷⁴ See par B.1 above.

¹⁷⁵ People have a clear idea of what money is because 'it arises in their innermost nature, their sense of self as nurtured by possession' (Buchan *Meaning of Money* 16). Marx (*Capital* 101) argued that although gold and silver are not by nature money, money is by nature gold and silver.

¹⁷⁶ *Meaning of Money* 20. This opinion is accepted by Guttman (*Cybercash* 14).

Money further serves two primary purposes: first, to acquire the necessities of life, and secondly, to generate more money through trade or lending.¹⁷⁷ The political economy acknowledges the dual nature of money under the concepts ‘currency’ and ‘capital’.¹⁷⁸ At a historic level money is the social element that stood in the way of Jewish emancipation.¹⁷⁹ Buchan is confident that money by virtue of its lethality leads to counter productivity,¹⁸⁰ an opinion that is supported by Keynes.¹⁸¹ Money embodies the history and values of society and, therefore, it constitutes a projection of society.¹⁸²

In summary, it is evident that neither historical explanations nor governmental or societal theories offer satisfactory explanations for how money came into being or how it evolved to the

¹⁷⁷ Guttman *Cybercash* 22–24; Buchan *Meaning of Money* 29–30. Crime, one may add, also generates money (see par C.5 below).

¹⁷⁸ Buchan *Meaning of Money* 30; Wardrop (1999) *BFLR* 108–109). Guttman (*Cybercash* 23) suggests that the two sides of money, which he identifies as the public and private roles of money, are incompatible with each other. Whereas money in a private commodity serves individual interests only, money as a public commodity benefits society in general, a role which is undermined by the former.

¹⁷⁹ Guggenbuhl-Craig *Soul and Money* 88; Buchan *Meaning of Money* 198. This is a controversial, racist and unfair view. The love for money is universal and not solely attributable to the Jewish people.

¹⁸⁰ Buchan *Meaning of Money* 281.

¹⁸¹ The reason for Keynes’s conclusion differs from the view of Karl Marx (see also par C.3 below). Keynes suggested that the superabundance of money resulted in counter productivity and stagnancy (Buchan *Meaning of Money* 272; Weatherford *History of Money* 44–45). To understand why this view is mentioned in this context, some biographical information of John Keynes is necessary. John Keynes was born in England in 1883. An economist who distinguished money from property, he saw cash as a purified form of life’s uncertainties. Keynes thought that money personified the future: ‘[t]he importance of money essentially flows from its being a link between the present and the future.’ Keynesianism, a monetary theory, was founded on Keynes work and sought to combine work for all with profits for all. The theory nearly destroyed sterling money between 1948 and 1996 when the pound sterling lost most of its buying power to Germany (Buchan *Meaning of Money* 274). Although disliking the idea that money leads to productively, Keynes nevertheless believed that money was the only commodity whose increase had no negative consequences (Meyer *Bankers* 55; Rudiger *Macroeconomics* 370–371). Possessing money literally soothes unease (Keynes *Theory of Employment* 215–216). Moreover, Keynes, considered usury the key to understanding the nature of both money and modern society. As proof for this belief Keynes denoted money lending as a ‘charge on humanity’ and capital increases, which by virtue of the ensuing decrease of interest rates on borrowed money, as having negative influences on investors.

¹⁸² Guggenbuhl-Craig (*Soul and Money* 86–87) asserts that everything society respects can be projected on money including power, security, relationships and reality.

medium of exchange that it is today. It is therefore submitted that a compounded theory such as the one forwarded by Joubert should be used when delimiting money.¹⁸³ Joubert advocates a theory that acknowledges the role of the state in both issuing a specific commodity as a medium of exchange and in affirming society's choice of legal tender.¹⁸⁴

1.3 *Res Corporalis and Res Fungibiles*

Roman law defines physical things or *corporeals* as things that could be felt or touched.¹⁸⁵ The determination of a thing as corporeal or incorporeal depends on the convictions of society instead of what is proved by science.¹⁸⁶ Hahlo and Kahn¹⁸⁷ define *res corporalis* as whatever could be assessed in terms of money and has a cash value placed upon it. Bank notes and coins are corporeal things.¹⁸⁸ Various other opinions exist as to which characteristics should be attributed to a commodity for it to constitute money.¹⁸⁹

Generally, even though the material composition of a commodity is irrelevant,¹⁹⁰ it must nevertheless be exchangeable, destined for transfer and it should not be consumed. But, money is also a *res fungibilis* or a fungible thing implying that its value cannot be individually determined, but must be determined in terms of numbers or dimensions.¹⁹¹

¹⁸³ (1990) *SA Merc LJ* 233. Nothing can function as legal tender if not for society's cooperation and support in the matter.

¹⁸⁴ Joubert *op cit*.

¹⁸⁵ Fox *Property Rights* 35–36; Badenhorst *Law of Property* 14–15. Common-law authors such as Grotius and Van Leeuwen saw *res corporalis* as a thing which could be perceived by external senses, ideas that were incorporated into South African law (Badenhorst *op cit* 29–30).

¹⁸⁶ Van der Merwe *Sakereg* 24.

¹⁸⁷ *Union of SA* 571.

¹⁸⁸ Loubser *Theft of Money* 56.

¹⁸⁹ See Mann *Legal Aspect of Money* 8–13; Joubert (1990) *SA Merc LJ* 228–229.

¹⁹⁰ For example, whether money is represented by feathers, metal, precious metal or mere paper, its value is determined by the number in a specific denomination printed on it (see also par C.2 below).

¹⁹¹ Fox *Property Rights* 24–26; Badenhorst *Law of Property* 38. This is known as the 'nominalism theory' in terms of which the value of debts is calculated with reference to a particular denomination as opposed to in terms of the money's inherent value or its buying power (Barker (1989) *SALJ* 53).

Ownership in money is acquired by delivery¹⁹² and mixing.¹⁹³ Mere delivery is insufficient to transfer ownership of property: a mental element or intention to transfer rights must be present.¹⁹⁴ The delivery of ownership in money further occurs independently from the existence of a valid underlying contract.¹⁹⁵ This point is important with regards to the protection that is available to the transferor. In general, the transferor will have a personal action for the return of a delivered thing if ownership was invalidly transferred to some other.¹⁹⁶ Most notably, however, is the exception that exists in the context of money that is mixed with other funds in a bank account.¹⁹⁷

¹⁹² Or ‘*traditio*’, a concept that denotes the acquisition of a thing such as money as a result of a bilateral act or a legal fact (see Hugo (1989) *SA Merc LJ* 4–5; Fox *Property Rights* 79–85; Carey Miller *Ownership* 121–123; *Air-Kel (Edms) Bpk h/a Merkel Motors v Bodenstein* 1980 (3) SA 917 (A) [*Air-Kel*] where the court asserted that: ‘[o]m eiendomsreg van ’n roerende saak oor te dra moet daar dus die nodige saaklike ooreenkoms wees ... en ook *traditio*.’ (923H)). The transfer of ownership of money usually occurs with the physical handing over of the funds, *traditio vera* (see the discussion in Carey *Ownership* 142; Badenhorst *Law of Property* 250–251). Badenhorst (*Law of Property* 75–76) discusses various requirements for the legal transfer of ownership. They include a delivery which is subject to ownership and transferable, the transferor must be legally competent, the transfer must be effected subject to the *nemo plus iuris ad alium transfere potest, quam ipse habet* rule (‘*nemo plus iuris* rule’ which means that ‘nobody can transfer a greater right than he himself has’ - see below; ch 3.B.2.1.2), the receiver of the property must also be legally competent, transfer must be conducted by means of a recognised form of delivery, a legal cause for the transfer should exist and both parties should have corresponding intentions in relation to the transfer and obtainment of ownership in the money.

¹⁹³ Or ‘*commixtio*’ (see par C.4 below). See in general Malan & Pretorius *Malan on Bills* 43–44; Vakhitov & Vakhitov (2002/3) *RCEEL* 116–118; ch 3.C.3.

¹⁹⁴ Fox *Property Rights* 83–85; Carey Miller *Ownership* 120–123; Badenhorst *Law of Property* 80. In *Air-Kel* the court observed that: ‘[o]rhandiging] moet gepaart gaan met ’n ooreenkoms tussen oorhandiger en ontvanger dat daarmee eiendomsreg gegee en geneem word. Hier kan van ’n saaklike ooreenkoms gepraat word’ (992F).

¹⁹⁵ Van der Merwe *Sakereg* 308–310. In *Trust Bank van Africa Bpk v Western Bank Bpk* 1978 (4) SA 281 (A) the court reasoned as follows: ‘[v]olgens ons reg gaan die eiendomsreg op ’n roerende saak op ’n ander oor waar die eienaar daarvan dit aan ’n ander lewer, met die bedoeling om eiendomsreg aan hom oor te dra, en die ander die saak neem met die bedoeling om eiendomsreg daarvan te verkry. Die geldigheid van die eiendomsoordrag staan los van die geldigheid van enige onderliggende kontrak’ (301H–302A).

¹⁹⁶ Badenhorst *Law of Property* 83. If valid transfer did not occur, the transferor has a real right against the transferee. This is by virtue of the *nemo plus iuris* rule (see in this regard Van der Merwe (1964) *THRHR* 300; Malan *Collective Securities* 218–219; Vermaas *Dematerialisasie van Aandele* 125).

¹⁹⁷ See paras C.4.1–4.2 below as regards the mixing of money deposited with a bank.

In general a person who is not the owner of property is unable to transfer ownership to another person regardless of whether he gave value for it and acted in good faith or bad faith.¹⁹⁸ Money, however, is the exception to this rule.¹⁹⁹ Money acquired for value by a *bona fide* person cannot be reclaimed.²⁰⁰ In fact, the *bona fide* acquirer is the owner of the money.²⁰¹

2. Value of Money

Money certainly represents a quality that society values, because it affords respect to its owner or possessor.²⁰² It also attracts particular societal values which have the ability to alter its nature.²⁰³ Two kinds of monetary values can be distinguished, namely an objective and a subjective value.²⁰⁴ The objective value of money determines its various denominations as opposed to the a subjective value which describes society's attitude towards, and appreciation of, money.²⁰⁵ It is submitted that both values are relevant to establish the nature of money.

There are furthermore two monetary theories which describe the objective and subjective value of money.²⁰⁶ First, the realist theory of money which asserts that money acquires its value from the intrinsic value of the metal.²⁰⁷ The realist theory subscribe to the conventional notion that

¹⁹⁸ Badenhorst *Law of Property* 76; Vermaas *Dematerialisasie van Aandele* 125–126; *Chetty v Naidoo* 1974 (3) SA 13 (A) 20A–C; *Hefer v Van Greuning* 1979 (4) SA 952 (A) 959.

¹⁹⁹ Malan and Pretorius (*Malan on Bills* 44) argue that this outcome is not a limitation of the *rei vindicatio*, but due to the currency element of money (see also par C.1.3 above; ch 8.D.2.1).

²⁰⁰ The reason for the deviation of the *nemo plus iuris* rule is based on the fact that a *bona fide* acquirer of money obtains ownership in the physical notes and coins (Malan & Pretorius *Malan on Bills* 51; Hugo (1989) *SA Merc LJ* 3–5; *Adams v Mocke* (1906) 23 SC 782 788; Malan (1977) *SALJ* 249; Oelofse (1982) *MBL* 93–94; Pretorius (2004) *SA Merc LJ* 469).

²⁰¹ See par C.4.2 below; ch 3.C.3 as regards a bank's ownership of deposited money.

²⁰² See paras B.1, C.1.2 above.

²⁰³ See Covitz *Money* 64; Lockhart (*Coins* 14) who observes that: '[m]oney is the most powerful, practical and experienced form of transformation.'

²⁰⁴ Vakhitov & Vakhitov (2002/3) *RCEEL* 105–107.

²⁰⁵ See also par C.1.2 above.

²⁰⁶ Vakhitov & Vakhitov (2002/3) *RCEEL* 107.

²⁰⁷ According to Cloete (*Teorie van Geld* 12–13), banknotes and coins do not have an intrinsic value but are accepted as mediums of exchange only because the recipient understood its buying value. This viewpoint is in contrast to Loubser's explanation that money's intrinsic value is found in its purchasing power (Loubser *Theft of Money* 56).

barter initially existed which evolved into money due to the need to overcome high the high transaction costs of barter. Secondly, in contrast, the institutional theory promotes that value is not intrinsic but results from the organisation of commodity exchange by money.²⁰⁸ Some economists accept both theories²⁰⁹ whilst some, for example Simmel,²¹⁰ regard trade as a social link and money as a form of trade.²¹¹ It is submitted that a combination of both theories coupled with the values of society may best explain the value of money. It is evident that money's value is neither simply determined by its intrinsic value as posited under the realist theory nor can its value be set by world markets. The value that society attributes to wealth in general and in particular, money at any given time should be considered as well because this is what feed the desire for money.

The value of money as represented by various denominations can further be determined by various economical theories whereas the value of debts in terms of denominations is determined by various theories which concern contractual obligations.²¹² Which ever theory one accepts, it is evident that the link between money's objective value and its subjective value cannot be denied. Nussbaum²¹³ succinctly phrases the position as regards the value of money as follows:

[t]he existence of a monetary unit is apparently a phenomenon of *social psychology* which can be traced historically for each unit, yet is impossible to decompose analytically into simpler logical elements.

To conclude, Samuelson²¹⁴ states the paradox of money, namely money is accepted because it is accepted. It follows that money attracts and personifies certain values. It is submitted that society which places great value on money attracts those negative elements which are associated with

²⁰⁸ Vakhitov & Vakhitov (2002/3) *RCEEL* 106–107.

²⁰⁹ For example, Von Mises (*Money and Credit* 74); Keynes (*Theory of Employment* 215–216); and Meyer (*Bankers* 55).

²¹⁰ 198–203. Simmel (*Philosophy* 201) observes that: '[m]oney has value not on account of what it is, but one account of the ends that it serves; and although an original intrinsic value of money made possible its later functions, it acquires its value subsequently from these functions'.

²¹¹ Which he calls 'good money' (Simmel *Philosophy* 192). Money is 'good' only because it is a reliable measure of value.

²¹² See Barker ((1989) *SALJ* 53) highlighting the plight of debtors when inflation rate changes occur; Van Jaarsveld ((2001) *CILSA* 17) who discusses interest and exchange rate changes *vis-à-vis* the provision of financial services. Barker suggests ((1989) *SALJ* 54) that the impact of inflation rate changes can be contractually minimalised by the inclusion of specific terms to provide for such fluctuations.

²¹³ *Money* 14.

²¹⁴ *Economics* 54. See also Weenink ((2003) *JBLR* 438 explaining why Euro banknotes and coins are only viewed as legal tender in the member countries of the EU.

generating money. One of these elements is crime which has endless potential to generate an abundance of wealth.²¹⁵

3. Proposed Definition

The foregoing paragraphs considered different views aimed at resolving the enigma of money. Various theories afford different answers to primary questions about money such as its functions, origins, how it maintains value or lose it and its impact on society.²¹⁶ Yet a concise definition of money is hard to find, probably because money has no fixed meaning assigned to it. This fact has been recognised by the judiciary²¹⁷ and legislation²¹⁸ alike.

Available definitions of money further contribute to the uncertainty.²¹⁹ For example, the narrow definition of money describes money in terms of its functions as chattel, medium of exchange and legal tender.²²⁰ The broad definition of money describes money's use²²¹ in various legal areas²²² as the equivalent to the legal concepts of 'payment', 'debt', 'value',²²³ a substitute for cash payments and to confuse different types of money.²²⁴ It is submitted that none of the

²¹⁵ See par C.5 below.

²¹⁶ See paras C.1.1–1.2, C.2 above.

²¹⁷ See, for example, *Perrin & Others v Morgan & others* ([1943] AC 399 (HL) [*Perrin*]) where the court asserted that the meaning of money should be established in light of the relevant circumstances (406–407).

²¹⁸ See, for example, section 1 (defining 'proceeds of unlawful activities', 'property'), section 20 (value of money); section 31 (sums of money) and section 57 (deposit of moneys) of POCA where the term 'money' is used whilst the concept is left undefined by the Act; sections 1 (money laundering), section 14 (funds of the FIC) and section 31 (electronic transfers) of FICA which likewise fails to define money; and section 2(1), section 7(1), section 87(1) of the BEA where the phrase 'a sum certain in money' is used whilst the concept 'money' is not defined.

²¹⁹ Contextually, the nature of money can be explained from economic, historic, legal, scientific, educational and philosophical perspectives, each which furthermore caters for different approaches. As seen above (see par B.1) some authors explain money in terms the historic purposes it served (for example, Davies *History of Money*; Weatherford *History of Money*), others have a more philosophical approach (for example, Buchan *Meaning of Money*), whilst jurists usually consult a variety of sources when pronouncing on the issue (for example, Fox *Property Rights*; Mann *Legal Nature of Money*).

²²⁰ See paras A.1–3 above.

²²¹ Joubert (1990) *SA Merc LJ* 226–227; David (1986) *Canadian BR* 206.

²²² For example, the law of contracts and the law of succession.

²²³ *Good Face of Money* 11.

²²⁴ For example, e-money and the different kinds of credit facilities on offer.

theories on the nature of money attribute much to delineate the concept.²²⁵ This is because money is not an one dimensional thing, but instead, consists of a concrete form and an abstract form.²²⁶ Adding to the confusion are the various methods used to measure money's value.²²⁷ In *Woodhead Plant & Co v Gunn*²²⁸ the court reasoned as follows:

[in ancient times] the real nature of money was not clearly understood, but even then it was found impossible to place money on the same footing as ordinary items of merchandise.

For a legal viewpoint money is a movable thing with specific characteristics which distinguish it from other commodities.²²⁹ Some academics have identified five requirements which must be met before money can be regarded as a payment medium.²³⁰ It must one, be commonly accepted as a medium of exchange, two, be accepted as final payment of a debt, three, be transferred by mere delivery, four, require no clearing or settlement and five, it should be taken free from claims of prior owners. It is submitted that whilst the latter requirement serves to narrow the concept of money, it fails to take all the various forms of money into consideration.

In an economical context²³¹ money is something that is accepted as a means of payment or a medium of exchange.²³² Its buying power is equivalent to its exchange value. In terms of

²²⁵ See, for example, the theories advanced by Joubert (1990) *SA Merc LJ* 227–228; Simmel *Philosophy* 142; Samuelson *Economics* 54–55; Von Mises *Money and Credit* 61–63; Davies *History of Money* 9.

²²⁶ Mann *Legal Aspects of Money* 5.

²²⁷ See, for example, Felmington and Coleman (*Money & Finance* 12–15) describing measurements to establish the 'degree of moneyness' or the ability of assets to substitute cash.

²²⁸ (1984) 11 SC 4 [*Woodhead*] 8.

²²⁹ Mann *Legal Aspects of Money* 8–13, 24; Nussbaum *Money* 11. Both authors concur that money as a medium of exchange is not an object of exchange and, therefore, money is not a commodity (Mann *op cit* 24).

²³⁰ Crawford (1997) *BFLR* 402–403; Tumin *Technology of Money* 77–78; Kianieff (2002) *BFLR* 217–218; Meiring *ABLU-2004* 1–2.

²³¹ For example, Felmington & Coleman *Money and Finance* 7; Cloete *Teorie van Geld* 13; David (1986) *Canadian BR* 203.

²³² Or as '[a]n accounting unit' which Silard (quoted in Mann *Legal Aspects of Money* 6n17) judges as '[w]hatever else can be said about such as definition, it is certain that lawyers will not find it helpful.'

payment money means cash²³³ although a creditor may accept another means of payment.²³⁴ Money is a generally accepted exchange medium.²³⁵ The UCC acknowledges this role of money as follows:²³⁶

[money is] a medium of exchange authorised or adopted by a domestic or foreign government as part of its currency.

The definition fits the commonly accepted description of money as a chattel and a medium of exchange issued in terms of the authority of the state.²³⁷ However, it is incomplete for two reasons: one, it ignores the role of society in the adoption of a specific commodity as legal tender, and two, it does not recognise social values²³⁸ embodied in the chattel. It follows that whilst money in itself as paper or coins is a neutral medium,²³⁹ its designation is affected by societal values. It is submitted that Schopenhauer²⁴⁰ gives money the best definition: '[m]oney is human happiness in abstract.' Ancient philosophers were appalled by this conclusion.²⁴¹ Aristotle questioned why humanity invented money.²⁴² The answer, he found, was that men invented money and coinage to make an international division of labour possible.

²³³ Which are notes and coins (see, for example, section 1 of FICA which defines 'cash' as: '[c]oin and paper money of the Republic or of another country that is designed as legal tender and that circulates as, and is customary used and accepted as, a medium of exchange in the country of issue; (b) travellers' cheques ...').

²³⁴ Tumin *Technology of Money* 78–80; Goode *Payment Obligations* 11.

²³⁵ See *Moss v Hancock* [1899] 2 QB 111 (QBD) where the court defined money as (116): '[money is] that which passes freely from hand to hand throughout the community in final discharge of debts and full payment of commodities, being accepted equally without reference to the character or credit of the person who offers it and without the intention of the person who receives it to consume it or apply it to any other use than in turn to tender it to others in discharge of debts or payment for commodities.' In this case, a servant stole a five pound note from his employer, Hancock, and asked Moss to change it for him into five sovereign coins. The servant was convicted for theft and the court had to pronounce on the question whether restitution can be made to Hancock. Since the coins were money, restitution could be made in pursuance to the Larceny Act of 1861. The fact that a *bona fide* purchaser for value of a negotiable instrument was protected against restitution (see par C.4.2 below), meant that this protection possibly also extended to money as currency. The court therefore had to decide whether the coins were in fact currency. It found that the coins were not sold as currency, but as a work of art.

²³⁶ UCC section 1-201(24) (*Cooper Portable UCC* 3).

²³⁷ See paras A.1–3 above.

²³⁸ See par C.1.2 above.

²³⁹ A view that is also held by Davies (*History of Money* 1–2).

²⁴⁰ Buchan *Meaning of Money* 31–33; Simmel *Philosophy* 241–242, 289.

²⁴¹ For example, Plato and Aristotle proposed that money has the power to destroy governments (Simmel *Philosophy* 156–157).

²⁴² Simmel *Philosophy* 169, 409–411; Buchan *Meaning of Money* 23.

Not even academics are in agreement about the characteristics of money. For example, in contrast to Mann who views money as an object that serves as a medium of exchange,²⁴³ Nussbaum regarded money as a measurement or standard of value. More recently, it was suggested²⁴⁴ that recent theories on e-money and virtual money are based upon a misunderstanding of the nature of money. It is submitted that there is a tendency to confuse different forms of money with the properties of money as measure of value. Verbruggen²⁴⁵ simply proposes that money, like all goods, is itself morally neutral. Its ‘immoral’ character or description as ‘dirty’ derives from the criminal intention of its owner or possessor.²⁴⁶ This view matches the contention that money should be delineated according to people’s intentions.²⁴⁷ In this sense, it is possible to describe money as ‘legitimate’ or ‘dirty’ because the adjectives refer to the manner in which it was acquired.

Ultimately, it is evident that contemporary concepts of money recognise society’s influence and choices in the commodity which constitutes money.²⁴⁸ Therefore, any definition of money should include a reference to society’s viewpoint and the manner in which it was acquired.²⁴⁹ In *Perrin* the court appositely articulated the different meanings of money²⁵⁰ and came to the

²⁴³ See paras A.1–2 above.

²⁴⁴ Ingram *Monetary Spaces* 124.

²⁴⁵ (1997) *European J of Crime, Crim L & Crim J* 340.

²⁴⁶ It is therefore confusing to distinguish between ‘good’ or legally earned money and ‘bad’ or criminally acquired money (ibid). See also par C.5.3 below.

²⁴⁷ Ehrenfeld *Evil Money* xx.

²⁴⁸ See par C.1.2 above.

²⁴⁹ To this end Guttmann (*Cybercash* 13) observes: ‘[m]oney is best defined as a man-made social institution at the centre of our cash-flow economy.’

²⁵⁰ Simon V-C’s evaluation of the meaning of money is so apposite that despite its length, it should be quoted in full (*Perrin* 406–407): ‘I agree ... that, if a word has only one natural meaning, it is right to attributed that meaning to the word when used in a will unless the context or other circumstances which may be properly considered show that an unusual meaning is intended, but the word ‘money’ has not got one natural or usual meaning. It has several meanings, each of which in appropriate circumstances may be regarded as natural. In its original sense, which is also its narrowest sense, the word mean “coin”. Moneta was an appellation of Juno, and the Temple of Moneta at Rome was the mint. Phrases like “false money” or “clipped money” show the original use in English, but the conception very quickly broadens into the equivalent of “cash” of any sort. The question: “Have you any money in your purse?” refers presumably to bank notes or Treasury notes, as well as shillings and pence. A further extension would include not only coin and currency in the possession of an individual, but debts owing to him, and cheques which he could pay into his banking account, or postal orders, or the like. Again, going further, it is a matter of common speech to refer to one’s “money at the bank”, although in a stricter sense the bank is not holding one’s own money ... Sums on deposit, whether with a bank or otherwise, may be included by a further extension, but this is by no means the limit to the senses in which the word “money” is frequently and quite

conclusion that although money has several meanings, its ‘popular’ meaning - that is the meaning attributed to it by society - in contrast to its legal meaning, is key. It is submitted that the latter description of the nature of the definition of money presents the best summation of the nature of money. Money’s nature is found in public opinion which ultimately varies according to societal values.

4. Commingled Money

4.1 Criterion of Mixing

Mixing or *commixtio*²⁵¹ is an original method of acquiring ownership.²⁵² *Commixtio* is constituted by a unilateral act²⁵³ whereby one thing of an owner becomes another’s property because it is more of the one than of the other.²⁵⁴ As ownership is acquired by a unilateral act, the title of the acquirer is not derived from any predecessor which renders the intention of the predecessor irrelevant.²⁵⁵

naturally used in English speech ... The word may be used to cover the whole of an individual’s personal property- sometimes, indeed, all of a person’s property, whether real or personal. “What has he done with his money?” may well be an inquiry as to the general contents of a rich man’s will. Horace’s satire at the expense of the fortune-hunter who attached himself to childless Roman matrons, has its modern equivalent in the saying: “It’s her money he’s after.” When St Paul wrote to Timothy that the love of money is the root of all evil, he was not warning him of the risks attaching to one particular kind of wealth, but was pointing to the dangers of avarice in general. When Tennyson’s Northern Farmer counselled his son not to marry for money, but to go where money is, he was not excluding the attractiveness of private property in land. These wider meanings of “money” are referred to in some of the reported cases as “popular” meanings, in contrast to the “legal” meaning of the term, but for the purpose of construing a will, and especially a home-made will, a popular meaning may be the more important of the two.’

²⁵¹ Which is defined as: ‘[t]he mingling of liquids or metals so that they become inseparable’ (Hutchinson *Wille’s SA Law* 285), or: ‘[a process] whereby two articles belonging to different persons become inextricably mixed’ (Hall & Maasdorp *Institutes* 38).

²⁵² See in general Hahlo & Kahn *Union of SA* 571; Fox *Property Rights* 40–42; Maasdorp *Institutes of South African Law* 10–11; Hutchinson *Wille’s SA Law* 259.

²⁵³ Badenhorst *Law of Property* 68; *Unimark Distributors (Pty) Ltd v Erf 94 Silvertondale (Pty) Ltd* 1999 (2) SA 986 (T) [*Unimark*] 998H–999A.

²⁵⁴ Badenhorst *Law of Property* 199. It is, however, suggested (Sonnekus (1991) *TSAR* 707; Van der Merwe *Sakereg* 230) that ownership cannot be acquired of the accessory thing because it has become so much part of the principal thing that it is indistinguishable from the latter.

²⁵⁵ *Unimark* 995I–996D, 998H–999A.

Badenhorst²⁵⁶ identified a particular kind of mixing, one where things which are mixed together become fused in such a way that no distinction between a principal and an accessory is possible. This kind of mixing comprises a commingling of solids.²⁵⁷ Generally, when two solids are mixed with the permission of the owners and a distinction between the two forms is impossible, the mixture will belong to both the owners.²⁵⁸

4.2 Money in a Bank Account

Money deposited into a bank account usually commingles with other moneys in the account and becomes an undistinguishable thereof.²⁵⁹ However, the bank becomes owner²⁶⁰ of the deposited money irrespective of whether commingling has occurred in the account.²⁶¹ Money *in specie* paid into a bank account is rendered unidentifiable from other moneys in the account by virtue of the mixing that has transpired.²⁶² This fact was accepted in *First National Bank of Southern Africa Ltd v Perry NO and others* where the court asserted as follows:²⁶³

²⁵⁶ *Law of Property* 221. The distinction is also recognised by Van der Merwe (*Sakereg* 263–64; *Law of Things* 133) and Carey-Miller (*Ownership* 46–48).

²⁵⁷ Ownership of the mixed form depends on two factors, namely consent by the owners of the solids that were blended together and whether separation of the two solids is possible (Badenhorst *Law of Property* 221–222).

²⁵⁸ See, for example, *Andrews v Rosenbaum & Co* (1908 EDC 419) where feathers belonging to different persons were mixed. The court referred to the common-law and found that when a mixing of two things took place without consent of one of the owners and a distinction between the mixed things were impossible, one of the owners would have retained the mixture, whilst the other had an action for the recovery of the amount of the feathers belonging to him (425).

²⁵⁹ See par C.4.1 above.

²⁶⁰ A bank acquires ownership of money *in specie* as a result of delivery or *traditio*. It needs to be owner of deposited moneys because of the nature of banking (see ch 3.C.3).

²⁶¹ See *McEwen NO v Hansa* 1968 (1) SA 465 (A) 469H–470A; *Commissioner of Customs and Excise v Bank of Lisbon International Ltd* 1994 (1) SA 205 (N) 208I where the court confirmed that ownership of money as *res fungibiles* passed to the bank after it was deposited into a bank account; *Nissan* paras 13–19. See also ch 3.B.2.1.2, par C.3.1; ch 8.C.4.2.3.3, paras D.2.2.1–2.2.2, par D.2.3 as regards ownership of deposited money.

²⁶² *Woodhead* 4; *Nissan* par 23; Joubert (1990) SA *Merc LJ* 229–230. Note, however, a bank becomes owner of deposited funds regardless of the fact that they are kept in a separate account (*Barnard Jacobs Mellet Securities (Pty) Ltd v Matuson* 2005 CLR 1 (W) par 26. For the facts of the matter, see ch 3.C.3.2.1).

²⁶³ 2001(3) SA 960 (SCA) 967H–I. In this matter money paid in terms of a stolen cheque was reclaimed from the bank (see also ch 8.D.2.1). The court found that if the money

[t]he rule in our law, an inevitable rule it seems to me, flowing from physical reality, that, once money is mixed with other money without the owner's consent, ownership in it passes by operation of law.

More recently, in *Alley Cat Clothing v De Lisle Weare Racing*²⁶⁴ the court agreed that money paid into a bank account becomes unidentifiable from, and part of the bank's funds. Mixing where two combined forms became indistinguishable from each another therefore presents one way to explain a bank's ownership of the deposited money.²⁶⁵ It follows that money *in specie* cannot be recovered following its deposit into a bank account where it mixes with other moneys in the bank account.²⁶⁶ However, the account holder acquires a personal right to claim from a bank the same amount of money he deposited into his bank account.²⁶⁷

In general, the owner of stolen property such as a vehicle or cattle may enforce his right of ownership²⁶⁸ against anyone who has the property under his control.²⁶⁹ The exception to the

was identifiable, the owner could have claimed it back from any person who had it in his possession, even if the latter obtained the money in good faith (967J–968B). This finding of the court is correctly criticised by Pretorius ((2004) *SA Merc LJ* 472) who suggests that money acquired in good faith and for value cannot be recovered (see below; ch 8.D.2.1.1 as regards the *bona fide* purchaser for value defence).

²⁶⁴ [2002] 1 All SA 123 [*Alley Cat*] 131J–132A (see par C.5.3.3 below). The court referred (132B) to of *Amalgamated Society of Woodworkers of South Africa and another v 1963 Ambagsaalvereniging* (1967 (1) SA 586 (T)) where it was confirmed that money paid into a bank account has three consequences. First, it becomes unidentifiable from other money in the account. Secondly, the customer loses its right of ownership and thirdly, it cannot be vindicated (596B–C). See also Malan (1977) *SALJ* 249; ch 8.D.2.1 as regards the *rei vindicatio*.

²⁶⁵ The transfer of ownership transfer did not occur by virtue of some kind of a real obligation, but because of the merging of money which transpired. It is important to point out that a bank needs to acquire ownership of deposited funds in order to conduct the business of banking (see in this regard ch 3.C.3.1).

²⁶⁶ The reason for this outcome is twofold: first, co-ownership of the commingled money cannot be determined according to each customer's contribution thereof (see par C.4.1 above). According to Carey-Miller (*Ownership* 48) 'no re-allocation' of rights took place. Secondly, as a result of the business of banking, a bank needs to acquire ownership of deposited money so that it can be, for example, invested, loaned and used by the bank as it pleases (see ch 3.C.3.2.1 where the reasons for a bank's ownership of deposited funds are considered).

²⁶⁷ Unless the bank knows that the money is the benefits of crime in which case it will pay it to the account holder at its own peril (see below; ch 3.B.2.1.2.2 as regards the bank's right to refuse payment of deposited moneys to the account holder).

²⁶⁸ See ch 3.C.2 as regards the concept of ownership.

²⁶⁹ See ch 8.D.2.1.1. The protection of the money's receiver is crucial (Nussbaum *Money* 23). Mann (*Legal Aspects of Money* 10) and Carey-Miller (*Ownership* 262) explain

general rule is where a person acquired property such as stolen money in good faith and for value, the so-called ‘*bona fide* purchaser for value defence’.²⁷⁰ Stolen or fraudulently acquired money that is deposited by the fraudster or thief with a bank is another exception to the general rule above.²⁷¹ A bank that receives the benefits of fraud or theft becomes owner thereof irrespective of the fact that the money does not belong to the thief or the fraudster who deposited it with the bank.²⁷² If the bank in the course of its relationship with the fraudster or thief comes to suspect that the deposited money may have been acquired through criminal means,²⁷³ it will be precluded from paying the deposited amount to the fraudster or thief until the issue of ownership has been resolved.²⁷⁴

This point connects with the crux of the following section, namely, the nature of money acquired through criminal means. Two vexed issues will be considered. First, why the stigma of crime can be attached to money in order to designate it the benefits of crime.²⁷⁵ Secondly, whether criminally acquired money remains the benefits of crime after it has commingled in a bank account with legitimately derived funds.

5. Concept of ‘Benefits of Crime’

5.1 Introduction

the basis for this rule in terms of the function of money; it promotes commerce.

²⁷⁰ See ch 8.D.2.1.1. In *Woodhead* the court remarked that the currency of money renders it incompatible with the right of a person to claim stolen money back from a *bona fide* possessor who received it in good faith and for value (7–8). This is the position regardless of whether mixing occurred in the account (*Woodhead* 10).

²⁷¹ For a detailed evaluation of the potential common-law remedies that a victim of fraud or theft who followed his money to the fraudster or thief’s bank account may have, see ch 8.D.2–3.

²⁷² See *Joint Stock Varvarinskoye v Absa Bank Ltd* 2008 (4) SA 287 (SCA) where the court reasoned that although a bank becomes owner of deposited money, it does not have a right to it (par 33); ch 3.C.3.2.2.3 where the latter decision is analysed and criticised.

²⁷³ For example, by virtue of its internal customer due diligence rules (see ch 8.C.4.2.3.2).

²⁷⁴ See *Gainsford NNO v Gulliver’s Travel (Bruma) Pty (Ltd)* 07/5121 [2009] ZAGPJHC 20 (7 April 2009); ch 3.B.2.1.2.2.

²⁷⁵ Cf par C.5.3 below.

This section considers the concept ‘benefits of crime’ to ascertain why criminal conduct can be attached to money in such a way that its possession is criminalised. Seeing that the concept ‘dirty money’ which depicts money that was acquired through criminal means was initially coined in reference to organised crime syndicates, it is deemed important to consider first the nexus among organised crime, the benefits of crime and money laundering.

Pecunia non olet,³³¹ money does not stink. This is still the general attitude of society towards the benefits of crime. However, there is no gainsaying that society’s love of money coupled with the reality that crime seems to pay have resulted in an unprecedented increase in criminal activities as well as in the amount of criminally acquired money.³³²

5.2 Historical Aspects

5.2.1 Drugs and Organised Crime

The largest pool of cash available in the world today is generated through drug trafficking.³³³ The ability of criminals to move and conceal the benefits of their criminal activities is crucial for the success of organised crime.³³⁴ Money is the main goal of organised crime syndicates because they need it to plan criminal activity and to convince professionals to assist in the money laundering process.³³⁵ In turn, money laundering is needed to conceal the money’s connection to criminal activities.

³³¹ *Oxford Dictionary* sv ‘*pecunia non olet*’. The statement is attributed to Emperor Vespasianus on raising taxes on public toilets.

³³² See ch 4.B.3 as regards the scale of money laundering.

³³³ Schelling *Economics and Criminal Enterprises* 377; Ehrenfeld *Evil Money* 242.

³³⁴ Woodiwiss *Organised Crime - American Concept* 14; Woodiwiss *Transnational Organised Crime* 7.

³³⁵ See ch 4.C.3 as regards the involvement of professional persons in money laundering.

Any definition of organised crime causes controversy, because it usually refers to all types of illegal activities.³³⁶ However, the core of an organised crime syndicate or *mafioso*³³⁷ is a closed organisation with a hierarchical structure aimed at increasing its power and profits. Technological advancements in communications and banking coupled with free trade have advanced the globalisation of organised crime.³³⁸ In turn, globalisation assists organised crime to prosper.³³⁹

Whilst disagreement may exist on the types of transnational criminal activity that deserves international attention, consensus exists on which criminal organisations operate across borders.³⁴⁰ The Chinese Triads, Colombian cartels and Sicilian mafia are some of the crime groups which are actively involved in illegal drug trafficking and money laundering. The two riskiest parts of a cartel's operation are the transportation of drugs and laundering the proceeds.³⁴¹ This nexus between organised crime and the benefits of crime led to the imposition on banks of identification and reporting duties.³⁴² The initial lack-lustre implementation of AML measures by banks saw the enactment of AML legislation that is endorsed by penalties and black-listing.

5.2.2 Organised Crime and the Benefits of Crime

³³⁶ See in general Rider *War on Terror and Crime* 63; Clutterbuck *Drugs, Crime & Corruption* 5; Reuvid *Focus on Laundering* 178–179; Rider *Taking the Profit Out of Crime* 1; Stessen *Money Laundering - Enforcement Model* 83; Savona *Money Trails* 2; Abadinsky *Organised Crime* 6; Gambetta *Sicilian Mafia* 101; McIntosh *Organisation of Crime* 56.

³³⁷ Different meanings have been attributed to the word 'mafia'. Its origins is traced to 15th century Spain and a secret organisation called the *Garduna* (Santino (1988) *Contemporary Issues* 204–205; Abadinsky *Organised Crime* 36–37). An Italian activist, Guiseppe Mazzini, brought it to Sicily in the form of a secret society. The word 'mafia' is an acronym derived from the slogan *Mazzini Autorizza Furti, Incedi, Avvelenamenti* which translated means 'Mazzini authorises theft, arson, poisoning'.

³³⁸ Lilley *Dirty Dealing* xiii, 3. Tanzi *Money Laundering and the Financial System* 1–2. Note that globalisation is an ambiguous concept carrying various meanings. In short, it may describe modern facts or mere policy programs and therefore, its use in relation to money laundering control has been challenged (Elvins *Transnational Organised Crime* 29).

³³⁹ See ch 4.B.2–3.

³⁴⁰ Savona & De Feo *International Money Laundering Trends* 13; Lilley *Dirty Dealing* 19–27; Einstein & Amir *Organised Crime* 469; Booth *Triads* 51; Farer *Fighting Organised Crime* 262–263.

³⁴¹ *Ibid.*

³⁴² See ch 5.C.1; ch 6.B.3.6, par C.3.4; ch 7.C.2–8; ch 8.C.4.

As suggested earlier,³⁴³ most people are largely motivated by money.³⁴⁴ Vast amounts of money can be acquired through organised criminal activities with the only barrier presented in the form of the authorities. Criminals are consequently continuously exploring new ways to escape incrimination. One way to sever the link between crime and the benefits thereof is through money laundering, money that appears legitimately derived cannot incriminate its owner or possessor. It follows that money laundering presents a sophisticated yet key activity for organised crime syndicates.

It is estimated that more than 200 billion US dollars of drug trafficking profits are laundered through financial institutions annually despite the fact that information about organised crime and money laundering is difficult to obtain, mostly based on guesstimates and often derives from questionable sources.³⁴⁵ The capacity of organised crime syndicates to launder money extends beyond the international justice system by virtue of their ability to conceal the benefits of crime in product export and financial products.³⁴⁶ National responses have been inadequate to deal with organised crime activities and money laundering which is largely due to ignorance, corruption and the guile of criminals.³⁴⁷ Ultimately, the factors have resulted in collective action by the international community to combat money laundering.³⁴⁸

5.3 Different Notions of the Concept ‘Benefits of Crime’

5.3.1 Criminal Connection

Money has been demonised by virtue of the criminal intention of its owner or possessor. For this reason Ehrenfeld³⁴⁹ suggests that evil money does not exist, only evil people who do evil things

³⁴³ See par C.5.2.1 above.

³⁴⁴ US (1996) *Fincen Advisory* 2.

³⁴⁵ Bosworth-Davies & Saltmarch *Money Laundering* 28; UN *Countering Money Laundering* 5; Thoumi *Transnational Crime* 120; FATF *Report 1989-1990* paras 4–5. See ch 4.B.3 as regards the global scale of money laundering.

³⁴⁶ Jordan *Drug Politics* 211; Schaap *Fighting Money Laundering* 23; Samuel (1992) *American Business Law* 174.

³⁴⁷ Williams *Crime & Money Laundering* 107; Levi (1991) *British J of Criminology* 117. See also ch 4.C–D as regards different money laundering schemes.

³⁴⁸ See ch 5.B–D.

³⁴⁹ *Evil Money* xx. Ehrenfeld fails to indicate what she means by the concept ‘evil’ in this context. However, it is inferred that the adjective ‘evil’ refers to the criminal intention of

with money. This view is supported by Verbruggen who asserts that the concept ‘benefits of crime derives its ‘immoral character’ from the intention of its users.³⁵⁰

As indicated above,³⁵¹ on its own money is a neutral concept; it is only a piece of paper, a coin or a medium used for trade. However, problems occur when states, organisations and individuals use it to promote and facilitate criminal activity.³⁵² People in general need money to sustain themselves. The irony is that without the necessary incentive crime will not exist, and without crime the benefits of crime will not need to be laundered. It follows that crime is the *raison d’être* for money laundering. Money laundering would be unnecessary if the nexus between the benefits of crime and the money’s owner can be kept secret from the law, for example, if the funds are spent in the form of anonymous cash. Money laundering is only successful where the benefits of crime have been given the appearance of legitimately derived funds.

Money that is acquired through criminal means, the so-called ‘benefits of crime’,³⁵³ may be divided into three categories,³⁵⁴ each depicting criminal activities which differ both in appearance and impingement on society. The first category consists of money that was obtained in a legal manner but subsequently became illegal. This category concerns crimes such as tax evasion and is known as legal-illegal money. The second category consists of money that was acquired through crime but is subsequently used in a legal manner. This money is known as illegal-legal money and refers, for example, to the benefits of fraud which have been employed for legitimate business activities.³⁵⁵ The third category of money that was acquired through crime comprises money that was illegally acquired and subsequently used for illegal purposes. It is known as illegal-illegal money and therefore, constitutes the benefits of crime or so-called ‘dirty’ money.³⁵⁶

the money’s owner. See also in this regard Naylor *Hot Money* 11.

³⁵⁰ (1997) *European J of Crime, Crim L & Crim J* 340–341.

³⁵¹ See par C above.

³⁵² Arlacchi *Corruption and Money Laundering* 101.

³⁵³ See figures 1.1 and 1.2 in chapter 1.A.2 which depict various criminal activities.

³⁵⁴ Schaap *Fighting Money Laundering* vii-viii.

³⁵⁵ These activities are known as organisational crime (Abadinsky *Organised Crime* 340–342; Naylor *Follow the Money* 268).

³⁵⁶ See par C.5.3.3 below.

It is submitted that this type of categorisation infers like Verbruggen³⁵⁷ that money in itself is a neutral concept. Its designation is, however, influenced by external factors such as the values of society³⁵⁸ and the (criminal) intention of its owner or possessor. As illustrated above,³⁵⁹ organised crime with its appalling characteristics made such an impression on the authorities that money connected with it has been designated as ‘dirty’. In the US the tainted theory, which in part also justifies civil forfeiture, is used to explain why criminal conduct can be link to property such as money to designate it the benefits of crime.

5.3.2 Tainted Theory

The tainted theory has been used in the US to rationalise civil forfeiture, a remedy which is aimed at depriving a criminal of property which he acquired through criminal means or which has a nexus to crime.³⁶⁰ It sanctions the attachment of an offender’s criminal conduct to a neutral medium such as money and holds it liable for its owner’s offences.³⁶¹

Legal fictions, however, may never be employed to the prejudice of an innocent person.³⁶² It was therefore recognised that by holding property such as money liable for its owner’s criminal conduct may result in unintended wrongs. Nevertheless, US courts continue to proceed against the property of offenders as if the property itself committed the offence and, therefore, should be punished with forfeiture.³⁶³ It follows that deposited benefits of crime are regarded as representing the criminal conduct of its owner, the offender, whose own liability is removed from the funds.³⁶⁴

³⁵⁷ See paras C.3, C.5.3.1 above.

³⁵⁸ See paras C.1.2, C.2 above.

³⁵⁹ See par C.5.2.2 above.

³⁶⁰ See ch 7.D.4 as regards civil forfeiture pursuant to US law.

³⁶¹ *Various Items of Personal Property v United States* 282 US 577 (1931) 581 quoted in *United States v Usury* 518 US 267 (1996) 281.

³⁶² *United States v 1960 Bags of Coffee* 12 US (8 Cranch) 398 (1814) 406 referred to by Williams & Whitney *Federal Money Laundering* 549.

³⁶³ See, for example, *J.W. Goldsmith, Jr-Grant Co v United States* 254 US 505 (1921) [*Goldsmith*] 510 where the court referred to the case of *The Palmyra* (12 Wheat. 1 (1827) where the court asserted that: ‘[t]he thing is here primarily considered as the offender (of the crime), or rather the offence is attached primarily to the thing.’ See also ch 7.D.4 where civil forfeiture pursuant to US law is considered.

³⁶⁴ *United States v Kemp* 690 F 2d 397 (4th Cir 1982) 401.

The tainted theory further maintains that the longevity of the benefits of crime's criminal taint is dependant on two factors.³⁶⁵ First, whether the benefits of crime remain the property of the offender and secondly, whether the provisions of statutes of limitations apply to the underlying crime. In combination, the factors above carry a two-fold consequence for the offender. First, as soon as he transfers the benefits of crime to a *bona fide* purchaser for value the money's taint is removed. Secondly, the benefits of crime further lose their criminal taint where the statutes of limitation apply to the crime through which the money was acquired.

It is submitted that if the tainted theory is accepted without reservation the foundations for money laundering control would require rethinking. This is because the state will be unable to prosecute an account holder for a money laundering offence if he deposits the benefits of crime with a bank. Since the criminal taint remains with the deposited money, the account holder's liability is removed as soon as the bank acquires ownership thereof. The state can hardly prosecute the account holder for a money laundering offence if the deposited benefits of crime lost their criminal taint when deposited with a bank. The practical effect is that the benefits of crime are laundered as soon as the funds are deposited with a bank, or used for a legitimate purpose such as an investment. It is therefore submitted that whilst the tainted theory may justify civil forfeiture of property, it should not be accepted without reservation.

5.3.3 *Alley Cat Clothing v De Lisle Weare Racing*

Although the tainted theory has not been used by South African judiciary to justify civil forfeiture applications,³⁶⁶ similar consequences have been attached by the courts to the benefits of crime. For example, when the benefits of crime are deposited into a bank account, the bank becomes owner thereof irrespective of the fact that the money was acquired through crime.³⁶⁷

This point was validated by the court in *Alley Cat*. In this case the court had no difficulty to answer the question of whether stolen money that is deposited into a bank account has lost its criminal taint.³⁶⁸ It implied, even if it failed to pronounce on the issue, that legitimately earned

³⁶⁵ Williams & Whitney *Federal Money Laundering* 374.

³⁶⁶ See ch 8.D.4.1

³⁶⁷ See ch 3.B.2.1.2.2, par C.3.1.

³⁶⁸ In this case an employee of Alley Cat, R, used money that was stolen from the company to settle gambling debts with De Lisle. Alley Cat alleged that De Lisle had a duty of care towards it and should have inquired as to the source of R's money (see also ch

money changes into stolen money as soon the crime is completed.³⁶⁹ When the stolen money is deposited into a bank account, it in turn loses the taint of the theft as soon as commingling occurs in the account.³⁷⁰ If the account holder subsequently withdraws the money from the account, the criminal taint will fail to attach to it again with the result that it remains legitimate.³⁷¹ It follows that the criminal taint is not permanently attached to the stolen money which converts back into legitimately earned money as soon as it becomes the property of a bank. Therefore, the benefits of crime lose their criminal taint as soon as the funds are deposited into a bank account which means that criminal taints do not attach permanently to money.

The conclusion above holds two consequences for an criminal account holder who deposits the benefits of crime into his bank account. First, he commits a money laundering offence as soon as he deposits the benefits of crime with a bank.³⁷² Secondly, since the criminal taint does not attach permanently to the benefits of crime, the state may experience difficulty to establish the required connection between the deposited money and his criminal conduct.³⁷³ This is because money that was acquired through criminal means can hardly be forfeited to the state if the criminal taint will be removed the moment that it is deposited with a bank.

A finer construction to explain what transpires when the benefits of crime are deposited into a bank account is found with reference to the personal claim of the account holder against the bank for payment of the deposited amount.³⁷⁴ When the deposited benefits of crime commingle with other funds in the account, the money cannot be identified *in specie*.³⁷⁵ For this reason, and also because the bank becomes owner of the deposited money,³⁷⁶ it is submitted that the criminal taint of the newly deposited money attaches to the account holder's *claim* against the bank for payment of a corresponding amount of money. This construction is supported by the mechanics

3.C.3.2.1). In the words of the court: '[t]he monies thereby become the bank's property and ... thereby loses its taint of being stolen property' (136I). The court ultimately found that Alley Cat failed to establish that De Lisle had a duty of care towards it to inquire about the source of the money it received from R (*Alley Cat* 137B).

³⁶⁹ *Alley Cat* 131C: '[t]he crime of theft was complete when the money was credited to Reddy's account.'

³⁷⁰ *Alley Cat* 131C.

³⁷¹ *Idem* 131D.

³⁷² See ch 1.A.1; ch 8.C.3.2, par C.4.2.1.

³⁷³ See ch 8.D.4.2.1.

³⁷⁴ See ch 3.B.2.1.1 as regards the bank-customer relationship.

³⁷⁵ See paras C.4.1–4.2 above.

³⁷⁶ See par C.4.2 above; ch 3.C.2–3.

of EFTs and e-money, both which provide for the transfer of monetary *values* instead of physical notes and coins to a bank account.³⁷⁷ The criminal taint remains with the personal claim of the account holder against the bank for the deposited value irrespective of how the money was deposited with the bank and whether or not commingling occurred. If one accepts that the criminal taint refers to the criminal conduct or intention of the account holder instead of to the money itself like the tainted theory maintains, it makes sense that money, a neutral medium,³⁷⁸ releases its criminal taint as soon as it is deposited with a bank.

To conclude, the aforementioned principles may be best illustrated by an actual example. Consider the scenario where fifty thousand rand in the form of notes and coins is found in the possession of a known drug trafficker. She is arrested, the money is confiscated and would subsequently be declared forfeited to the state if the latter can establish a connection between the notes and coins and the drug trafficker's criminal conduct.³⁷⁹ If established, the connection renders the money the proceeds of a drug offence. However, if the same drug trafficker deposits the money with the bank, the money will lose its criminal taint as soon as the bank acquires ownership thereof. But, the criminal taint will remain with the drug trafficker's claim against the bank for payment of the deposited amount, signifying the manner of its acquisition and representing her claim against the bank. For this reason the state may proceed against her for the purpose of obtaining a civil forfeiture order from the court.

D. CHAPTER COMMENTARY AND SUMMARY

This chapter explored the nature of the concept of money in general and in particular, the meaning and characteristics of money that was acquired through illegal means. Overall, it was demonstrated that money is a concept of unlimited complexities.

The investigation commenced with an overview of the functions of money as chattel, medium of exchange and legal tender, the latter which is determined according to the characteristics of the particular object. It soon became evident that the characteristics determine whether a new commodity constitutes money. The research pointed out that the needs of society resulted in a modernisation of current payment systems which facilitate a move away from

³⁷⁷ See par B.2.3.2 above.

³⁷⁸ See par C.5.3.1 above.

³⁷⁹ See ch 8.D.4 as regards civil forfeiture applications pursuant to POCA.

physical money towards EFTs and e-money. In this regard it was submitted that money's evolution also influenced the development of the payment system.

It further became evident that despite the availability of various theories which afford unlikely answers to questions about money such as the function of money and its impact on society, a concise definition of money is hard to find. An argument was made that money has no fixed meaning assigned to it. It was seen that the argument was eventually substantiated by the judiciary and legislation. In the end, the investigation revealed that contemporary definitions of money need to acknowledge society's influences in the choice of what constitutes money as a medium of exchange.

Closely related to the discussion was an examination of the connection between the benefits of crime, organised crime and money laundering. It was illustrated that on its own money is a neutral concept; it is only a piece of paper or a coin used for trade. However, problems occur when individuals use it to facilitate crime. The irony is that without an incentive whether personal or monetary, crime will not exist, and without crime the benefits of crime will not need to be laundered. It follows that crime is the *raison d'être* for the existence of money laundering.

The chapter further imparted that a can of worms is opened when the US tainted theory is accepted without reservation. To reiterate, in terms of the tainted theory the criminal conduct of the owner or possessor of money is transferred to the money and alters its acquisition from legitimate to criminal. The taint is, however, not permanent but is relinquished as soon as the money becomes the property of a *bona fide* person such as a bank. In *Alley Cat* the court found that the benefits of crime relinquish their criminal taint as soon as the funds are deposited with a bank. Of pressing importance is the fact that if it is accepted that the benefits of crime become legitimate when the funds are deposited with a bank, which is what the money laundering process attempts to bring about, it should be impossible to criminalise the process of money laundering. It follows that a reason is required to explain why an account holder can be prosecuted and why the money in his account will be forfeited to the state if the benefits of crime lost their criminal taint when deposited into a bank account as found in *Alley Cat*. A finer construction which explains what transpires when the benefits of crime are deposited with a bank was offered.

Ultimately, the chapter imparted three key facts about the nature of money and the benefits of crime. First, the nature of money is determined by two forces: one, the state which designates a particular thing as legal tender, and two, society which attaches different meanings to money. Secondly, since society determines the value attached to money, it is possible to link money with

criminal conduct or the intention of its owner or possessor in such a way that it changes from legitimately earned money to the benefits of crime. It is thirdly submitted that the criminal taint attaches to the claim of the account holder against the bank for payment of a deposited amount instead of to the physical money itself. This construction solves both the problem of the nature of deposited benefits of crime and explains how the bank can acquire ownership of deposited benefits of crime.

In conclusion, to draw from the chess analogy, this chapter attempted to introduce and emphasise key aspects of the concept of money as it relates to money acquired through criminal means. Now that the nature of the Black King as represented by the benefits of crime has been established, the focus can be turned to the White King as represented by banks. Chapter 3 therefore evaluates the nature of the bank-customer relationship pursuant to South African law. A key hypothesis is that the implementation of money laundering control legislation has had unforeseen consequences for banks because it impacts negatively on certain aspects of the bank-customer relationship. In particular, money laundering control disregards the duty of banks to observe the confidentiality of their customers' affairs.

[Chapter 3 to follow]

PTO

CHAPTER 3

ASPECTS OF THE BANK-CUSTOMER RELATIONSHIP

All pieces are subject to capture except the King. Its life is sacred, the player must defend it, it perishes only when no possible resource can save it from capture. Whenever that occurs the game is at an end.

LASKER Chess 5–6

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A. INTRODUCTION

Chapter 2 illustrated that the evolution of money was substantially influenced by the development of banking. Money launderers likewise benefit from advancements seen in banking.¹ But regardless of the changes that the banking sector have experienced over the last three decades, the legal nature of the relationship between a bank and a customer has for the most part remained unchanged - that is until the era of money laundering control has arrived.

South Africa signed the UN's 1988 Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances² in 1988 and joined the international community in combating money laundering. FICA was promulgated in 2001 as testimony of South Africa's commitment to the global AML effort.³ The running argument in this chapter is that FICA and POCA in aggregate intrude on salient aspects of the bank-customer relationship. It will be shown that FICA not only

¹ See in this regard ch 4.B.2, paras C.1, D where various money laundering techniques are considered.

² Or 'Vienna Convention' as it is generally known (see ch 5.C.1).

³ For a detailed analysis of the history of FICA, see ch 8.B, paras C.1–3.

encumbers a bank's duty of care with its stringent customer identification measures,⁴ but that its suspicious transaction reporting duty further operates in direct conflict with the bank's confidentiality duty to customers. In turn, POCA's civil forfeiture provisions ignores the bank's ownership of the benefits of fraud or theft following their deposit into a customer's bank account.⁵

The aforementioned issues are explored within the context of the following critical aspects: (I) the nature of the bank-customer relationship; (II) the foundation of bank confidentiality; (III) ownership of money deposited with a bank; and (IV) the impact of FICA and POCA on the bank-customer relationship. This chapter concludes with a summary and some comments about the bank-customer relationship and the other issues mentioned above.

In the main, the evaluation concentrates on banking jurisprudence in South Africa, drawing analogies from the common-law.⁶ English law is referred to where necessary.⁷ This chapter, together with Chapter 8 which explores the South African AML regime, provides the background for the evaluation of the current position that will follow in Chapter 9.

B. BANK-CUSTOMER RELATIONSHIP

1. Introduction

⁴ See par B.2.2 below; ch 8.C.4.2.3.3.

⁵ As to which, see ch 8.D.4.2.1.

⁶ The bank-customer relationship pursuant to EU, English and US law is analysed in ch 6.B.2, par C.2, and ch 7.B.1–3 respectively.

⁷ See ch 1.C as regards the importance of English law in a South African banking law context.

In general the concept ‘bank-customer relationship’ refers to a relationship that is created with the opening and operation of a bank account.⁸ The relationship entails mutual duties and obligations.⁹ It is a complex and confidential relationship which implies that banks are obliged to maintain a duty of confidentiality as regards the affairs of their customers.¹⁰ Following a deposit¹¹ into a bank¹² account a relationship of debtor and creditor¹³ is established between the bank and the

⁸ An account may be opened by any person or entity (Itzikowitz *Banking* 172). It follows that natural persons, companies, partnerships and close corporations may open accounts as determined by the relevant legislation (see, for example, section 34 of the Companies Act 61 of 1973, as amended, and section 2(4) of the Close Corporation Act 69 of 1984). A bank-customer relationship may further be formed before the actual opening of an account if the services of the bank is of a more formal nature (Lewis *Banking Law* 5). In *Hedley Byre and Co Ltd v Heller and Partners Ltd* [1964] AC 465 [*Hedley*] the court observed as follows (529): ‘[i]t is a relationship that is voluntarily accepted or undertaken, either generally where a general relationship, such as ... banker and customer, is created, or specifically in relation to a particular transaction.’

⁹ For the purpose of this study only the relationship between a bank and the customer in relation to money deposited into a bank account is evaluated.

¹⁰ Willis *Banking in SA Law* 41; Smith (1979) *MBL* 26; Fourie *The Banker* 51; Faul (1986) *TSAR* 182. Note that the relationship is nowhere defined in banking legislation and therefore its nature has been mostly described by the courts.

¹¹ See paras B.2.1, B.3.1. below.

¹² Section 1 of the BEA of 1964 defines a bank as a body of persons that carries on the business of banking. Included in the definition is a bank as provided for, *inter alia*, in the Banks Act 94 of 1990, as amended (‘Banks Act’). Section 1 of the Banks Act defines a bank in terms of two concepts, namely ‘deposit-taking’ and ‘business of a bank’, both which it delineates in much detail. The concept ‘business of a bank’ have different meanings for various purposes and in terms of different legislation (Malan & Pretorius *Malan on Bills* 254; Itzikowitz *Banking* 170; Malan *Banking Law Influences* 18–29; Itzikowitz (1992) *SA Merc L J* 176; Schulze (2001) *SA Merc LJ* 79). In short, a person that receives money that must be paid back as arranged is conducting the business of a bank (Green *Banking History* 11; Hefferman *Banking* 1). From an economic perspective, the primary function of a bank is to use deposited money for profited lending agreements, investments and to repay loans (see in general Falkena *SA Financial System* 7; Samuelson *Economics* 275; Hubbard *Money* 279; Cecchetti *Banking* 263–264; par C.3.1 below).

¹³ *Joint Stock Varvarinskoye v Absa Bank Ltd* 2008 (4) SA 287 (SCA) [*Joint Stock*] par 37 (for the facts of the case, see par C.3.2.2.1 below); Pretorius (2005) *SA Merc L J* 57. In *Standard Bank of SA v Oneanate Investments (Pty) Ltd* 1995 (4) SA 510 (C) [*Oneanate I*] the court analysed the bank-customer relationship and found its designation as one of *mutuum*, *depositum* or agency unsatisfactory. It therefore declared the relationship as one of debtor and creditor (531I–532D). Malan & Pretorius (1996) *SA Merc LJ* 401 described the decision as: ‘[t]ouching on practically all aspects of the current-account relationship between a bank and its customer.’

customer¹⁴ respectively. But, a bank also has a duty of care in respect of the money in the account of a customer.¹⁵

2. Legal Framework

2.1 Relationship of Debtor and Creditor

2.1.1 General Principles

The relationship that exists between a bank and customer is based on contract¹⁶, a principle that was recently confirmed by the Supreme Court of Appeal.¹⁷ In addition, special contracts such as borrowing or lending may be concluded between the parties.¹⁸ The bank becomes owner of the

¹⁴ Stassen ((1983) *MBL* 82) finds it unnecessary to limit terms such as ‘customer’, ‘bank’ and ‘relationship between bank and customer’ to one type of relationship only. In general, a person who uses the services of a bank could be regarded as a customer of the bank. In *Standard Bank of SA Ltd v Minister of Bantu Education* 1966 (1) SA 229 (N) [*Minister of Bantu Education*] the court referred to the following two English cases to an effort to determine who the customer of a bank may be (240–241); *The Great Western Railway Co v London and County Banking Co Ltd* [1901] AC 414 where the court observed that (420): ‘[t]here must be some sort of account, either a deposit or a current account ... to make a man a customer of a banker’; and *Importers Company v Westminster Bank Ltd* [1927] 2 KB 297 where the court questioned the meaning of ‘customer’ and found that (305): ‘[t]he most ordinary meaning ... is a person who keeps an account at the bank.’ According to Lewis (*Banking Law* 5) a customer is a person who applied to the bank to open an account and whose application was accepted.

¹⁵ In *Hedley* the court ruled that a bank owed a duty of care to a person seeking advice irrespective of whether or not a bank-customer relationship existed (529) - see par B.2.2 below.

¹⁶ See in general Willis *Banking in SA Law* 24; Cowen *Negotiable Instruments* 365, 367; Olivier *ABLU-2000* 1. In *Oeanate I* the court observed that (530G–H): ‘[t]he law treats the relationship between banker and customer as a contractual one. The reciprocal rights and duties included in the contract are to a great extent based upon custom and usage.’ This principle has been internationally accepted (cf Symons (1983) *Banking L J I* 220; (1983) *Banking L J II* 325; Crawford *Banking* 741; Hapgood *Paget’s Law of Banking* 116–125; Cranston *Introduction* 1). See also ch 6.B.1, par C.1; ch 7.B.1.

¹⁷ See the *Joint Stock* matter which is analysed in par C.3.2.2 below.

¹⁸ See, for example, *Minister of Bantu Education* 241; *The Godfather v Commissioner for Inland Revenue* 1993 (2) SA 426 (N) 432; *SAB Banking Code* paras 2.1–2.23.

deposited money¹⁹ with the customer holding a personal claim against the bank for payment of a similar amount.²⁰

Over the years, different opinions have been expressed about the nature of the bank-customer relationship, varying from one of debtor and creditor, a loan for consumption (*mutuum*) or some kind of a contractual agreement.²¹ In *In Re White v Brown (Standard Bank)*²² the court described the relationship between a bank and its customer as one of loan and not *depositum*.²³ Likewise in *Baylis's Trustee v Cape of Good Hope Bank*²⁴ the court asserted that when money is deposited with a bank, the bank becomes the debtor of the account holder.²⁵ In *Kearney NO v Standard Bank of South Africa Ltd* the court explained that:²⁶

[o]rdinarily the relationship of customer and bank is that the customer is the creditor and the bank the debtor who is obliged to pay the customer's cheques when the account is in credit. Any amount deposited to the credit of the customer immediately upon receipt becomes a loan to the bank and is not held in trust for the customer.

¹⁹ See par C.3.2 below; ch 2.C.4.2.

²⁰ But see par B.2.1.1 below as regards the bank's payment of the benefits of fraud or theft.

²¹ Pinpointing the nature of the contract between the parties is of importance because once it is established, obligations in terms of the contract can be ascertained (Joubert (1991) TSAR 250).

²² 1884 4 NLR 88.

²³ *Idem* 91–92. The concept of *depositum* must be distinguished from deposit-taking as provided for in the Banks Act (see in general Malan (1991) TSAR 576–568; Malan & Pretorius *Malan on Bills* 254; Itzikowitz (1992) SA Merc LJ 176–177; Itzikowitz *Banking* 171; Schulze (2001) SA Merc LJ 80–89; Willis *Banking in SA Law* 184–189; Newman *Law of Obligations* 130–132; *Mensky v Absa Bank Limited t/a Trust Bank* [1997] All SA 280 (W); *Transitional Local Council of Randfontein v Absa Bank (Ltd)* 2000 (2) All SA 134 (W)[*Transitional Local Council*] 146F–I). *Depositum* occurs when a customer leaves valuables with the bank for safe-keeping. The relationship is governed by a contract of deposit. Conversely, money deposited with a bank is borrowed by the bank from the customer (see below).

²⁴ (1886) 4 SC 439.

²⁵ 442. The debtor-creditor aspect of the relationship is likewise acknowledged by Olivier (*ABLU-2000* 1), Thomas & Boraine ((1994) *THRHR* 680–681) as well as by the courts in *Absa Bank v Janse van Rensburg* 2002 (3) SA 701 (SCA) [*Janse van Rensburg*] 709A–B and in *Commissioner of Customs and Excise v Bank of Lisbon International Ltd* 1994 (1) SA 205 (N) [*Bank of Lisbon*] 213I–J.

²⁶ 1961 (2) SA 647 (T) [*Kearney*] 650.

In *Langford v Moore*²⁷ the bank-customer relationship was aptly described as a contract of *mutuum*²⁸ whilst in *Bank of Lisbon*²⁹ the court asserted that a customer has a ‘special property or interest’ in the money in his bank account despite the fact that the bank is its debtor and it the creditor. The court further reasoned that when a customer deposits money with a bank, the bank is in no better position than a third-party who received money without giving anything in return for it.³⁰ It is submitted that the correctness of the court’s statement is questionable. Under ordinary circumstances a bank does not benefit from a deposit made into a bank account. Although the bank becomes owner of the money and may pay the customer interest for its use,³¹ the deposited funds do not alter the financial position of the bank.³² More accurately, a bank receives a deposit of money from a customer on an onerous title.³³

²⁷ (1899) 17 SC 1 18 per De Villiers CJ.

²⁸ Which means ‘loan for use’ (Willis *Banking Law in SA Law* 30; Stassen (1983) *MBL* 82–83)) or ‘[a] contract whereby one person, termed the lender, delivers to another, termed the borrower, money or some fungible thing, on the stipulation that the latter will return to the former a thing, of the same quantity, quality or kind at some specific future date or on demand after reasonable notice’ (Newman *Law of Obligations* 128; Gibson *Wille’s SA Law* 197–198). Cowen (*Negotiable Instruments* 366–367) disagrees that a bank-customer contract is based on *mutuum* because it is impossible to explain the bank’s confidentiality duty on that basis whilst Schulze ((2001) *SA Merc L J* 90) favours *mutuum* as explanation for a deposit of money with a bank.

²⁹ 213I–J. In this matter the commissioner appealed a ruling which dismissed his claim against the Bank of Lisbon for the payment of money that was fraudulently paid the bank account of one R (207C–208C). Part of the money was subsequently transferred to the accounts of other persons. Although the bank later repaid part of the stolen money to the commissioner, the action was for the balance of the money which the bank transferred to other accounts. For a detailed analysis of the matter, see Thomas & Boraine (1994) *THRHR* 678; Malan & Pretorius (1994) *TSAR* 387; ch 8.D.2.2.1–2.2.2.

³⁰ *Bank of Lisbon* 214A. See also par C.2 below.

³¹ Conversely, when the customer is granted an overdraft account, the bank becomes his creditor and he the bank’s debtor (see *Standard Bank of SA Ltd v Sarwan* [2002] 3 All SA 49 (W) [*Sarwan*]; *Oeanate I* 530G, 531 G–H; par C.3.3 below).

³² See *B & H Engineering v First National Bank of South Africa Ltd* 1995 (2) SA 279 (A) [*B & H Engineering*] 294I; *Nedcor Bank Ltd v ABSA Bank and another* 1995 (4) SA 727 (W) [*Nedcor Bank*] 730C–D; ch 8.D.3.1.

³³ See Malan and Pretorius (*Malan on Bills* 296; (1994) *TSAR* 388–389) who point out that a bank is obligated to render services to a customer and repay deposited funds on demand. It follows that a bank would seldom, if ever, accept a deposit of money with a lucrative title (or *ex titulo lucrativo*) as opposed to money received *ex titulo oneroso*.

Money that is not deposited with a bank in a traditional manner is also regarded as being deposited and should be treated as a contract of *mutuum*.³⁴ In *Transitional Local Council* the court considered whether a bank actually took possession of money that was given to its teller at the council's premises.³⁵ Absa Bank, the defendant bank, argued that the council accepted liability for the stolen amount since it later issued a cheque as substitution for the amount that was stolen. It therefore had a duty of care to safeguard the money whilst it was in the council's safe.³⁶ It was further alleged that a contract of *depositum* came into existence between the two parties in terms of which the bank deposited that bag with cash the council as depository. Absabank was therefore liable because it breached its duty to safeguard the money.³⁷

The court evaluated the conduct of the teller and confirmed that a deposit was made with the bank and that Absa Bank became the owner of the money deposited with its teller.³⁸ Once the deposit was lost, the onus was on the council as depository to demonstrate that it had exercise due diligence with regard to the money. Although the council was negligent, gross negligence was not established and therefore Absa Bank had to repay the council the amount of the stolen money.³⁹

In *GS George Consultants v Datasys*⁴⁰ the court found that the contract between a bank and customer is both *mutuum* and *sui generis*,⁴¹ the latter which is generally accepted.⁴² But, Malan and

³⁴ *Transitional Local Council of Randfontein v Absa Bank (Ltd)* 2000 (2) All SA 134 (W) [*Transitional Local Council*].

³⁵ 140D–142B, 144D–I. As arranged, Absa Bank sent a teller to the council's premises where cheques and cash intended for deposit into its account with the bank were collected by her. The teller issued, stamped and initialled deposit slips in respect of the amount tendered for deposit. The cash was placed into a bag, sealed and placed into the council's safe for later collection by a cash-in-transit security which collected the money for the bank. This money was stolen from the safe. Absa Bank consequently denied that the money was deposited with it as it never reached the bank whilst the council insisted that its account be credited with the amount of the stolen money.

³⁶ 138F–H.

³⁷ 146E–H.

³⁸ 145I–146A, 146E–G.

³⁹ 155B. See also par B.2.2 below.

⁴⁰ 1988 (3) SA 726 (W) [*George*] 735-736D.

⁴¹ The court explained: '[t]hat the contract is *sui generis* need not be doubted. Nevertheless, that conclusion does not exclude the proposition that the contract is fundamentally one of *mutuum* on various grounds' (736D). According to Willis (*Banking Law in SA Law* 31) a *sui generis* contract is one of a kind or in a class of itself.

⁴² See Willis *Banking in SA Law* 31; Cowen *Negotiable Instruments* 368; Smith (1979) *MBL* 25; Stassen (1980) *MBL* 79; *Bank of Lisbon* 213I–214C.

Pretorius⁴³ suggest that the contract between a bank and a customer is one of mandate⁴⁴ because the bank is required to render particular services⁴⁵ to the customer pursuant to the latter's instructions. The natural consequences of mandate becomes relevant if the contract between a bank and customer is classified as one of mandate.⁴⁶ The bank as mandatory undertakes to observe good faith in handling the business entrusted to him by his customer, the mandator.⁴⁷ The bank's duty of good faith is a general obligation and also the source of the bank's duty to keep the affairs of customers confidential.⁴⁸

In *Liebenberg v ABSA Bank Ltd t/a Volkskas Bank*⁴⁹ the court held that instructions given to a bank by a customer are governed by the law of agency. It is submitted that the use of agency

⁴³ See *Malan on Bills* 296 where the concept 'comprehensive mandate' is used in relation to the bank-customer relationship. Stassen ((1980) *MBL* 80) likewise agrees that the relationship is most likely based on a mandate. See also Schulze (2002) *SA Merc LJ* 459–460; *Volkskas Bpk v Johnson* 1979 (4) SA 775 (C) [*Johnson*] 777H–778A. In *Harding and others NNO v Standard Bank of South Africa* 2004 (6) SA 464 [*Harding*] the court explained that the consensus between a bank and its customer as regards services that should be rendered, emanates from a contract of mandate in terms of which the customer is the *mandator* and the bank is the *mandatory* (468B–C). Malan and Pretorius (*ABLU-1996* par 7) advocate that the mandate is governed by the *naturalia* of the contract which includes that both parties must act in good faith and without negligence in the performance of the mandate. Cf Faul (1986) *TSAR* 183.

⁴⁴ A mandate is a consensual undertaking in terms of which one person agrees to execute the specific instruction of another for remuneration (Joubert *Mandate* 3; Stassen (1980) *MBL* 79–80; De Wet *Kontraktereg* 386; Kerr *Agency* 52;78; Van der Merwe *Contract* 233), but without being subject to the control of the latter (Neethling *Delict* 374; Van der Merwe *Onregmatige Daad* 510). In *Rodrigues v Alves* (1978 (4) SA 834 (A)) the court explained that (842): '[t]he requirement is not that there should be actual control. The requirement relates to the power or the right to control.'

⁴⁵ For example, collecting and paying the cheques of the customer (Malan and Pretorius *ABLU-1996* par 7).

⁴⁶ Pretorius (2005) *SA Merc LJ* 57.

⁴⁷ Van der Merwe *Contract* 233; Malan & De Beer *Wisselreg* 299; *Di Giulio v First National Bank of SA Ltd* 2002 (6) SA 281 (C) 289H–290A; *George* 735E–G. The *mandator* (customer) must compensate the *mandatory* (bank) for services rendered and for losses suffered in the execution of its duties (Van der Merwe *Onregmatige Daad* 521–522; McKerron *Delict* 94; Joubert *Mandate* 5; Pretorius (2005) *SA Merc LJ* 57). Even where the bank extends an overdraft to a customer and becomes the customer's creditor, the nature of the contract between them remains one of mandate (*Sarwan* 54).

⁴⁸ See par B.2.3 below.

⁴⁹ [1998] 1 All SA 303 (C) [*Liebenberg*] 308B–309H. Conversely, in *B & H Engineering* 293A–B the court agreed that a bank acts as a customer's mandatory and not as its representative or agent.

in this context should be questioned because the relationship between the parties evidently was one of mandate and not agency.⁵⁰ For this reason the following description of the court in *Harding*⁵¹ of the nature of the bank-customer relationship is preferred:

[a] collection of a number of complex juristic relationships which may vary from customer to customer. In general, the relationship will exhibit features of debtor and creditor, of agency and mandate.

As stated above, the legal contract arises the moment the bank agrees to accept the person as a customer. The contract need not be in written form and its limits are undefined.⁵² The bank is the account holder's debtor for as long as the account's balance is in credit. The bank is, however, not an ordinary debtor who must seek his creditor and repay the debt because it is under no obligation to contact the customer and repay him. Instead, the customer as creditor must make a demand for payment of the deposited amount.

When cash is deposited in an autoteller payment of the amount to the bank occurs only when the contents of the envelope are removed by a bank official.⁵³ The contract between the bank and the customer in relation to autoteller deposits usually provides that the amount of the deposit be credited to the customer's account only when it has been checked and found to be correct. It follows that a contract of *depositum* as opposed to deposit-taking⁵⁴ exists while the envelope is in the autoteller. Usually, the bank as depositary is liable for the loss of the property deposited, unless

⁵⁰ Likewise in *Joint Stock* (par 36) the court used the word 'agent' to describe the relationship between Absa Bank and the appellant (see par C.3.2 below). Willis (*Banking in SA Law* 31) also employs the concept 'agency' in his argument that a bank acts as agent for its customer, but then agrees that the contract between them is not one of agency. Although the relationship between a bank and customer is not one of agency because the bank is not authorised by the customer to perform juristic acts in its name (Van der Merwe *Contract* 234–235; De Wet *Kontraktereg* 101–102), it is similar to agency in some respects (Van der Merwe *op cit* 233), for example, the bank owes a customer a duty of confidentiality (Cowen *Negotiable Instruments* 367). But De Wet (*Kontraktereg* 95, 386) suggests that mandate and agency can be regarded as 'siamese twins' because they are treated by most academics as sub-topics of each another. It is submitted that mandate and agency are not the same because a mandate implies authorisation to execute a certain order as opposed to agency where the agent is vested with wide authority to perform legal acts in the client's name.

⁵¹ 467J–468A.

⁵² *Janse van Rensburg* 709A–B; *Bank of Lisbon* 213I–J.

⁵³ See *Transitional Local Council* 146E–G where the court explained the nature of a *depositum* which takes place outside of a bank.

⁵⁴ See par B.1 above.

it could be proved that the loss was not its fault.⁵⁵ The bank, however, may also contractually exclude its liability as depositary toward the customer.

2.1.2 Bank's Receipt of the Benefits of Fraud or Theft

In view of the aforementioned, it is important to consider two questions that relate to the bank-customer relationship. First, may a bank terminate its relationship with a customer because it suspects him of illegal dealings and secondly, may the bank refuse to pay deposited money it suspects is the benefits of crime to the customer on demand? In answering the questions above it may be best to keep in mind a scenario where Y, a customer of B Bank, demands payment of deposited funds which B Bank suspects were stolen from the Y's employer, X..

2.1.2.1 Right to Terminate Contractual Relationship

Voidable Contract

At the outset, it is important to inquire whether the contract between B Bank and Y may be void as a result of B Bank's suspicions of Y. Literature reviewed suggests that the contract between the B Bank and Y would be void only where *both* parties were alive to the fact that they were concluding an illegal contract. This is due to the operation of the *ex turpi causa non oritur actio*⁵⁶ and the *in pari delicto potior est conditio defendentis*⁵⁷ rules⁵⁸ which are likely to find application

⁵⁵ Itzikowitz *Banking* 176; Pretorius *Deposit* 186–187; *Government of the RSA v Fibre Spinners and Weavers (Pty) Ltd* 1978 (2) SA 794 (A) 802E–H; *WJ Lineveldt (Edms) Bpk v Immelman* 1980 (2) SA 964 (O) 968C; *Havenga v De Lange* 1978 (3) SA 873 (O) 880.

⁵⁶ The maxim *ex turpi causa non oritur actio* ('*ex turpi causa*') means 'no action results from disgraceful cause' (*Minister van Justisie v Van Heerden* 1961 (3) SA 25 (O) par 28; Nagel *Business Law* 46). Consequently, if applied performance between a bank and the customer is rendered unenforceable.

⁵⁷ Or the '*par delictum*' rule which in essence means 'morally equally guilty' (*Klokow v Sullivan* 2006 (1) SA 259 (SCA) [*Klokow*] par 12; *Christie Contract* 393; *Visser Enrichment* 542–543. See also ch 8.D.3.3.4). In terms of the *par delictum* rule the court will not order performance in terms of an illegal contract unless the plaintiff acted in good faith. The *Klokow* matter illustrated the applicability of the *par delictum* rule and therefore, a brief examination of the court's decision is warranted. The facts in simple form are as follows: the appellant, one Hitler Adolf Klokow, sought to recover 250,000 rand from Sullivan which he

where both parties to a contract colluded⁵⁹ to conclude an illegal contract.⁶⁰ In *Jajbhay* the court in reference to the *par delictum* rule remarked as follows:⁶¹

[t]he moral principle which inspired the enunciation of those two maxims is obvious and has often been expounded. It is to discourage illegality and immorality and advance public policy.

It follows that unless an employee of B Bank colluded with Y and concluded a contract with him whilst aware that Y intends to use the account at B Bank to launder the stolen money, the contract between B Bank and Y would be perfectly legal.⁶² But, there is no gainsaying that their relationship is impacted by B Bank's suspicions. In a recently reported case the court dealt with the question of whether a bank may terminate its relationship with a customer on account of information it received about his dealings. The court's sobering decision is considered next.

Bredenkamp and others v Standard Bank of South Africa Ltd and another

paid as part of the purchase price for a liquor-licensed business. The agreement turned out to be illegal (paras 1-6). Sullivan relied on the *par delictum* rule to resist the claim of Klokow. The court *a quo* ruled that the *par delictum* rule did not arise in the given circumstance which ruling Sullivan successfully appealed (par 16). Cachalia AJA in reference to *Jajbhay v Cassim* 1939 AD 537 [*Jajbhay*] (see below) remarked that one should guard against adopting an 'overly technical approach to pleadings' (par 24). Instead, it is important to determine where the equities of a matter lie. In the present case Sullivan was left with both the money and the business concerned (par 26), an outcome which supported a return to the *status quo* (par 28). The court therefore allowed Klokow's claim.

⁵⁸ In *Jajbhay* the court distinguished between the two maxims as follows (542): '[t]he maxim *ex turpi causa non oritur actio*, however, may be distinguished from ... maxim *in pari delicto potior conditio defendentis*. The former maxim prohibits the enforcement of illegal contracts and the latter seeks to restrict the right of the offending parties to avoid the consequence of their performance.'

⁵⁹ Note that where a bank employee and a customer colluded to conclude a contract for an illegal purpose the rights of the bank as possessor of the deposited money will be stronger so that the customer will be unable to reclaim his performance (Nagel et al *Business Law* 46). Applied to B Bank above it means that Y would be unable to demand payment of an amount similar to the money deposited into his account pursuant to the illegal contract.

⁶⁰ See, for example, *Jajbhay*; *Bobrow v Meverowitz* 1947(2) SA 885 (T); *Venter v Vosloo* 1948 (1) SA 631(E); *Henry v Branfield* 1996 (1) SA 244 (D) 250C–D; *Klokow* par 17.

⁶¹ *Jajbhay* 542.

⁶² This is because all the requirements for a legal contract such as consensus, contractual capacity, legality, physical possibility and formalities are usually present when the contract is concluded between the bank and the customer in the ordinary course of business. See also Malan & Pretorius (1994) *TSAR* 388.

In the seminal matter of *Bredenkamp and others v Standard Bank of South Africa Ltd and another*⁶³ Standard Bank became embroiled in civil litigation as a result of its decision to terminate the contract between itself and a customer whom it suspected was involved in illegal business dealings.⁶⁴ Judge Lamont was confronted with the vexed question of whether Standard Bank may terminate its relationship with a customer based on information it received about his dealings. The court first examined the contract and the circumstances between the parties at the time it was concluded. Pursuant to the contract Standard Bank had the right to terminate its relationship with B provided that reasonable notice of the intention was given. It was therefore necessary to ascertain whether the parties had equal bargaining power in order to determine which weight should be given to the terms of the contract.⁶⁵ On the facts it was clear that B had equal bargaining power when the contract was concluded and contracted freely with the bank. For this reason the court found that the contract's termination clause was acceptable.

The court continued to point out that the nature of the contract between the parties was 'one in which contractual bonds of a personal nature' were established.⁶⁶ It recognised that certain characteristics of a customer such as his morality and integrity could impact on the bank-customer relationship. The court further disagreed with B's contention that Standard Bank's termination of the contract would render him unable to obtain other banking facilities.⁶⁷ It explained that banks consider independently the profiles of potential customers before accepting their business. There

⁶³ 2009 (6) SA 277 GSJ [*Bredenkamp*] which ruling was confirmed by Harms DP in *Bredenkamp and others v Standard Bank of South Africa Ltd and another* 2010 (4) SA 468 (SCA) par 64 ev.

⁶⁴ *Bredenkamp* ('B') was an international commodities trader and customer of Standard Bank ('Standard Bank'). Following a decision by the US Treasury's Office of Foreign Assets Control ('OFAC') to list B as a Specially Designated National, Standard Bank investigated B and concluded that he was suspected of involvement in illegal business dealings and fraud. Standard Bank had concerns, *inter alia*, about its reputation and that B's accounts could be used to facilitate unlawful activities (par 7). It therefore decided to terminate its relationship with B and gave reasonable notice of this intention to B. B consequently applied for, and was granted, an *interim* interdict which prohibited Standard Bank from closing his accounts. B further sought a declaratory order to the effect that Standard Bank did not have the right to terminate the contract (paras 19--20), because, so it was argued, such termination would render it impossible for him to obtain other banking facilities elsewhere.

⁶⁵ *Bredenkamp* paras 21--27.

⁶⁶ *Idem* par 32.

⁶⁷ *Bredenkamp* paras 35, 46.

was no evidence to suggest that Standard Bank's termination of the relationship would render B unable to obtain other banking facilities. Significantly, the court acknowledged that the Banks Act, FICA and POCA⁶⁸ influence the bank-customer relationship.⁶⁹

With reference to *Columbus Joint Venture v Absa Bank Limited*⁷⁰ the court agreed that banks must be vigilant about the potential criminal use of bank accounts by customers. A bank's failure to heed this duty could incriminate it. It found that OFAC's listing of B placed an onerous burden on Standard Bank to monitor B's account. This burden was increased by the international nature of B's business which made it impossible for Standard Bank to sufficiently monitor B's account activities.

The court further asserted that a bank is entitled to rely on information it received to decide whether or not the customer's character is such that it wishes to continue the relationship.⁷¹ In this matter Standard Bank perceived B as a person with which it did not wish to pursue a banker-customer relationship. The court therefore found that Standard Bank had exercised its right to terminate the contract fairly. Standard Bank terminated the contract as a result of the information that it had about B, the OFAC listing and its concerns that contracting with B may damage its reputation and cause it economic harm. The court therefore dismissed B's application and the interim order was set aside.

It is submitted that the *Bredenkamp* decision is of fivefold importance to banks. First, the court spelt out the boundaries of the bank-customer relationship and emphasised the importance of a customer's character to a bank. Secondly, it recognised that FICA and POCA hold specific consequences for banks, namely, that they must monitor the account activities of customers and file STRs where necessary. Failure by a bank to heed these obligations would lead to criminal and economic sanctions.⁷² Thirdly, the court advised banks to use their knowledge about a customer to alert them about possible illegal conduct. Fourthly, it admitted that a bank's ability to monitor a customer's account is influenced by the nature of the customer's business and the bank's ability to verify information proffered by the customer. Fifthly, the court gave banks the green light so to speak to terminate a relationship with a customer if the latter is likely to jeopardise their

⁶⁸ See paras B.2.2, B.2.3.1 below; ch 8.C.3.2, par C.4.2.3 as regards POCA and FICA.

⁶⁹ *Bredenkamp* paras 49–54.

⁷⁰ 2002 (1) SA 90 (SCA) [*Columbus II*] par 13. For the facts of the matter, see ch 8.C.4.2.3.2.

⁷¹ *Bredenkamp* paras 61–68.

⁷² See ch 8.C.4.3 as regards FICA's penal provisions.

reputation and international standing. The court implied that a bank that suspects a customer of illegal dealings, continues with the relationship at its own peril. In this sense FICA acts as a reminder to banks that they should be vigilant in as far as customers and the nature of their dealings are concerned.⁷³

2.1.2.2 Right to Refuse Payment of Deposited Moneys

General

Moving on to the second question above, namely whether a bank may refuse to pay deposited funds to a customer whom it suspects acquired the money through criminal means, recent case law is clear on the issue.⁷⁴ Since the customer is not entitled to the funds, the bank is under no obligation to repay it to him on demand.⁷⁵ In *Nissan South Africa (Pty) Ltd v Marnitz NO and others (Stand 186 Aeroport (Pty) Ltd Intervening)*⁷⁶ the court explained the position as follows:⁷⁷

[i]f stolen money is paid into a bank account to the credit of the thief, the thief has as little entitlement to the credit representing the money so paid into the bank account as he would have had in respect of the actual notes and coins paid into the bank account.

⁷³ See sections 21 and 22 of FICA; ch 8.C.4.2.3.2.

⁷⁴ See *First National Bank of Southern Africa Ltd v Perry No and others* 2001 (3) SA 960 (SCA) [*Perry*] par 32; *Joint Stock* par 42 (for the facts of the case, see par C.3.2.2.1 below); *McEwen NO v Hansa* 1968 (1) SA 465 (A) [*McEwen*] 472D–E.

⁷⁵ In fact, an account holder does not have exclusive rights to claim the money deposited with the bank (*McEwen* 472D–E; *Joint Stock* par 35).

⁷⁶ 2005 (1) SA 441 (SCA) [*Nissan*] (see also Malan & Pretorius *Malan on Bills* 349–350). In this matter Nissan's bank mistakenly transferred 12 million rand to Maple ('M') as payment which should have been made to a creditor, TSW Manufacturing. The funds were immediately withdrawn. M knew that the funds credited to its account were neither due nor owing to it. Ultimately M's account was frozen and liquidated. Nissan claimed that at least 9,750 000 rand of the transferred amount could be traced to M's account and, therefore, it did not form part of M's insolvent estate. In turn, M's liquidators contended that the money formed part of M's assets. The court rejected this contention and held that a bank that had credited its customer's account with an amount received was not liable to pay the amount to the customer on demand where the money was acquired through fraud or theft. In this case M clearly was not entitled to the funds that were credited to its account by mistake. The court thus ruled in Nissan's favour and ordered M's liquidators to pay the amount claimed (plus interest) to it. The *Nissan* decision was subsequently applied in other cases as well (see, for example, *Pestana v Nedbank Ltd* 2008 (3) SA 466 (W) par 15 - see Schulze (2008) *SA Merc LJ* 290 ev) and *Joint Stock* (paras 41–42)).

⁷⁷ *Nissan* par 23.

The court suggested that where a third-party claims ownership of deposited money the bank would be best served to ignore the customer's instructions as regards the deposit and to adopt the position of a 'stakeholder'.⁷⁸ Should the bank continue with the transaction, it would do so at its own 'peril'.⁷⁹

Sonnekus dismisses the *Nissan* court's reasoning and raises two points of criticism against the decision.⁸⁰ First, that the court failed to recognise that a bank as *bona fide* recipient⁸¹ of stolen money could have acquired an original right to the transferred funds. Secondly, Sonnekus argued that pursuant to the contractual agreement between the bank and M, the bank has a duty to receive and pay on demand the money that was deposited with the bank irrespective of how the customer acquired the funds.⁸² Thus, once the bank has been instructed by the customer to deal with the funds in the account in a certain manner, it will be contractually bound to heed the instruction unless otherwise interdicted by the court.⁸³

It is submitted that although correct in asserting that a bank is contractually bound to heed a customer's instructions, Sonnekus failed to consider the legal ramifications for a bank that heeded a customer's instructions and paid money that turns out to be the benefits of fraud or theft. Three potential consequences come to mind. First, a bank employee who pays money to a customer whilst knowing that it was acquired through fraud or theft will be prosecuted as an accomplice to fraud or theft.⁸⁴ Secondly, a bank that allows payment of the benefits of fraud or theft to a customer whilst suspecting that he may not be entitled to the funds will be prosecuted for a FICA-offence if it failed to file a STR to the FIC.⁸⁵ Thirdly, the bank may face civil action instigated against it by the victim of the fraud or theft for loss suffered because it parted with the suspected benefits of fraud or theft.⁸⁶

⁷⁸ *Nissan* par 28. The court reasoned that once a bank realised that it received stolen money, it was precluded from paying it to the customer on demand.

⁷⁹ *Nissan* par 28.

⁸⁰ *Ongegronde Verryking* 22; (2005) TSAR 426; Sonnekus (2008) TSAR 353.

⁸¹ See ch 8.D.2.1.1 as regards the *bona fide* purchaser for value defence.

⁸² Sonnekus *Ongegronde Verryking* 374–375.

⁸³ See ch 8.D.4.5 as regards interim recovery orders.

⁸⁴ See *R v Oelsen* 1950 (2) PH H 198; *S v Graham* 1975 (3) SA 569 (A) [*Graham*] 573E-H.

⁸⁵ See section 52 of FICA; ch 8.C.4.2.3.3, par C.4.3.

⁸⁶ For example, consider the dilemma of a victim of fraud who followed his loss to the bank account of the fraudster only to discover that the bank transferred the benefits of the

Intention of Account Holder

In *Gainsford NNO v Gulliver's Travel (Bruma) Pty (Ltd)*⁸⁷ two questions were put to Saldulker J as regards the deposited proceeds of stolen company shares. First, what was the intention of two fraudsters who transferred the proceeds of misappropriated shares into a bank account which they opened under false pretenses? Secondly, was the account holder entitled to the deposited proceeds of fraud and theft?

Turning to the first question above, Judge Saldulker reasoned that since the two fraudsters, Kebble and Poole, did not control Tuscan they could not be the lawful 'directing minds' of the company.⁸⁸ They were, however, controlling the bank account opened in Tuscan's name. The court accepted testimony that Tuscan never did anything to generate money. In fact, Tuscan's bank account was operated by Kebble and Poole as a 'conduit'⁸⁹ to channel the proceeds of misappropriated shares so that the funds could not be traced to them. Kebble and Poole therefore used Tuscan's name to open a so-called 'phantom'⁹⁰ bank account for money laundering purposes. The bank account was never intended to operate as Tuscan's account. Instead, Poole and Kebble intended to use it as a 'shelter' for their illegal activities. It follows that Tuscan was

fraud to an offshore account which the fraudster closed soon after the transfer. The fraudster is a man of straw and suing him would be a fruitless endeavour. Under these circumstances the victim of fraud is likely to consider the bank which parted with the benefits of fraud as a convenient target for litigation. Whether he will be successful in recovering loss from the bank as former recipient of the benefits of fraud is considered in great detail elsewhere in the study (see ch 8.D.2–3).

⁸⁷ 07/5121 [2009] ZAGPJHC 20 (7 April 2009) [*Gainsford*]. This case concerns a money laundering scheme of murdered businessman, Brett Kebble. He and one Poole opened a bank account in the name of Tuscan Ltd ('Tuscan') and used the account, *inter alia*, to launder the proceeds of misappropriated shares. Tuscan was eventually liquidated which brought Gainsford as one of Tuscan's liquidators into the picture. He contended that Tuscan as represented by Kebble and Poole made a number of payments to Gulliver's Travel ('G') that should be set aside as dispositions not made for value. This is because, so Gainsford claimed, the payments were made within two years of Tuscan's winding-up. G contested the claim and raised a number of defences, *inter alia*, that the assets of Tuscan did not exceed its liabilities following the alleged dispositions and that it acted in good faith when it used the moneys received from the Tuscan account for business expenses (paras 1–12).

⁸⁸ *Gainsford* paras 81, 88–89.

⁸⁹ *Idem* par 116.

⁹⁰ *Ibid.*

not a customer of the bank and could not claim a right to the moneys in the bank account because Kebble and Poole never intended the deposited money to be Tuscan's property.⁹¹ It was common course that most of the money deposited into the account (125 million rand) constituted the proceeds of misappropriated shares. The balance of approximately 45 million rand was from other sources. Tuscan therefore had no money to start with nor did it have any basis on which to receive money.

In answering the second question, namely whether Tuscan was entitled to the moneys in the bank account, the court considered⁹² the *Joint Stock, Nissan*⁹³ and *McEwen*⁹⁴ cases. In *Joint Stock* the Supreme Court of Appeal reasoned that an account holder is not the only one that could claim payment of money held to its credit by the bank.⁹⁵ The court further made it clear that it is irrelevant that the account is in the customer's name. The mere fact that a person is the account holder does not mean that he is entitled to demand payment of the money from the bank. The funds in an account may belong to someone other than the account holder. The court endorsed the approach followed in *Nissan*⁹⁶ and *McEwen*. In *McEwen*⁹⁷ the Court of Appeal found that payments made by a mortgage debtor into the bank account of one M were not paid into the bank account with the intention that M as account holder should be entitled to it. The money paid into M's bank account clearly did not belong to him. The court explained that an account holder who under similar circumstances withdrew money from the account whilst aware that he was not entitled to it, would be guilty of theft.⁹⁸

Judge Saldulker further confirmed that a bank becomes owner of money deposited in a customer's account, but reasoned that in the present case Tuscan must establish that it has a right of action against the bank for payment of the money standing to its credit.⁹⁹ The evidence

⁹¹ *Gainsford* paras 120–122, 125–126, 129–131.

⁹² *Idem* paras 93–99.

⁹³ See above.

⁹⁴ In this matter a mortgage bond debtor made monthly payments into a savings account with the Allied Building Society in the name of one Mortimer ('M'). There was never an intention that M would have acquired any rights in relation to the deposited money. When M was sequestrated the question arose whether the money in the account formed part of M's insolvent estate.

⁹⁵ *Joint Stock* paras 31–33 (see also par C.3.2.2 below).

⁹⁶ See below.

⁹⁷ 472D–E.

⁹⁸ 472E. See also par C.3.2.2.2 below as regards the *McEwen* decision.

⁹⁹ *Gainsford* paras 100–110.

indicated that Tuscan could not claim payment of the money deposited into its bank account because it failed to establish that the account in issue was its account to operate. In turn, Gainsford had to establish that Tuscan had debts when the action was instituted and failed to do so. The court further found that G, in using the money that was transferred to it from the Tuscan account, had no intention to prejudice Tuscan's creditors. There was no evidence from any creditors or from Gainsford that 'earmarked' or 'traceable'¹⁰⁰ funds existed in the Tuscan account to which they would have a claim. The court observed that the mere fact that the money was paid into its bank account does not make Tuscan liable to any person. Tuscan would only be liable if it knowingly participated in the receipt of stolen money or if the moneys could be 'earmarked' from an identifiable theft. In order for Tuscan to assert title to the moneys in the account there must have been an intention on someone's part that it be entitled to payment. The court gave two more reasons why Tuscan had no legal claim to the funds in the bank account opened in its name. First, Tuscan's name was merely used to open the account and secondly, the account was opened and used by Kebble and Poole as a money laundering tool. The account was therefore not opened for Tuscan's benefit. For this reason the court found that Gainsford failed to establish that Tuscan could have any claim to money deposited into the bank account and dismissed the claim with costs.

Two comments about the *Gainsford* matter would suffice. First, the case emphasises the wisdom of Standard Bank in allowing the court to resolve the third-party claim as regards the deposited money. It is submitted that a bank that finds itself in a similar situation should refrain from taking sides in a dispute pertaining to the ownership of deposited money. This is because the bank may not only have conflicting loyalties as far as the customer is concerned, but taking sides between a customer and a victim of fraud or theft is likely to have a detrimental affect on its ability to conduct business.

An actual example may best illustrate this point. Consider the scenario where Y, a customer of B Bank, claims payment of deposited funds which B Bank suspects he misappropriated from his employer, X. B Bank is in two minds whether to heed Y's instructions and pay the amount to him or whether to refuse and risk being taken to court by Y. B Bank,

¹⁰⁰ As regards 'earmarked' funds, see *Joint Stock* par 35; *Perry* par 18; ch 8.D.2.1.1. For this reason there could not have been a disposition for value as contended by Gainsford.

however, must file a STR to the FIC pursuant to section 29(1)(b)(i) of FICA¹⁰¹ which means that it will be breaching its confidentiality duty to Y.¹⁰² Whilst considering its options, B Bank is informed by X of his intentions to obtain an interdict against the bank because, so he asserts, the money in Y's account was stolen from him by Y. One can only imagine the frustration of B Bank and the time it may have to spend, not to mention the costs involved, to obtain legal advice in order to sort the legal ramifications involved in a situation of kind.

Secondly, it is submitted that even if the money had remained in Tuscan's bank account instead of being paid to G, Tuscan could not have claimed ownership thereof. The reason is that the money as the proceeds of fraud and theft did not belong to anyone except to the companies that were defrauded by Kebble and Poole. Therefore, if the companies failed to claim the funds from the account holder as victims of fraud and theft, the money quite possible would have been declared forfeited to the State.¹⁰³

Returning to the question at hand, namely whether a bank may refuse payment of deposited money which it suspects is the benefits of crime, it is submitted that a bank may only refuse payment of deposited money where it has concrete evidence¹⁰⁴ that the account holder is not entitled to it, or where it is informed by a victim of fraud or theft that the money is the subject of an ownership claim. It is one thing for a bank to refuse payment of deposited money to an account holder where it knows that the money is the subject of an ownership claim, but something quite different where it merely suspects¹⁰⁵ that the deposited funds may have been acquired through criminal means. Ultimately, in the absence of a third-party claim to the deposited money, the bank may have little choice but to pay the money s demanded or risk being sued in civil court by the account holder.

In summary, it is submitted that in most money laundering scenarios the situation is likely to play out as follows: B Bank and C concluded a perfectly legal contract. At some stage whilst exercising control over the funds an employee of B Bank comes to suspect that C may have

¹⁰¹ Which provides that a bank must file a STR if it knows of suspects that a transaction is likely to facilitate the transfer of the benefits of crime (see par B.2.3.3.2 below).

¹⁰² See par B.2.3.3.2 below as regards bank confidentiality.

¹⁰³ See ch 8.D.4 as regards the mechanics of civil forfeiture proceedings.

¹⁰⁴ For example, where a victim of fraud or theft informed the bank that he has filed suit against the account holder for payment of the deposited amount (see ch 8.D.1 for the basis of the claim).

¹⁰⁵ See ch 8.C.3.2, par C.4.2.3.3 as regards the knowledge requirements of section 29 of FICA.

misappropriated some of the deposited money from an account of his one of his clients, N. As a result, B Bank files a STR to the FIC on account of section 29(1)(a) of FICA.¹⁰⁶ If B Bank receives no instructions from C as regards the deposited money, B Bank can simply wait for the FIC's response to the STR that it filed.¹⁰⁷

However, B Bank is likely to face a dilemma if it receives an instruction from C to transfer all of the money in his account to an offshore bank account for investment purposes. In the absence of an ownership claim filed by N¹⁰⁸ against C and, or an interdict¹⁰⁹ to prevent B Bank from transferring the money in C's account, the bank has no reason for adopting the position of a stakeholder as advocated by the *Nissan* court. Moreover, it risks being sued by C for breach of contract if it ignores the transfer instruction. The *ex turpi causa* rule does not apply to the scenario because B Bank and C concluded the contract legally. However, if B Bank continues with the transaction it may be prosecuted for a money laundering offence¹¹⁰ and it may also face a civil claim instigated against it by N for loss suffered because it parted with the stolen money.¹¹¹

Given the circumstances above it is recommended that B Bank approaches the court for directions.¹¹² Depending on the outcome of the matter the bank may further need to reconsider its relationship with C.¹¹³ Irrespective of the foregoing, reality suggests that in most cases a bank will be unaware that the benefits of crime were deposited with it or that a transaction facilitates the benefits of crime. Consequently, the need for effective AML procedures to ferret out criminals and the benefits of their unlawful activities cannot be sufficiently emphasised.¹¹⁴

¹⁰⁶ Which requires B Bank to file a STR if it suspects that the benefits of a crime were deposited with it (see par B.2.3.3.2 below).

¹⁰⁷ See section 33 of FICA which provides that a bank may continue with a transaction after filing a STR; ch 8.C.4.2.3.3 where this provision is criticised.

¹⁰⁸ For the basis of N's civil claim against C, see ch 8.D.1.

¹⁰⁹ See ch 8.D.2.4, par D.4.5 as regards interim orders to prevent dissipation of the benefits of fraud or theft.

¹¹⁰ Note that a bank that has suspicions as regards the legality of a transaction must file a STR to the FIC (see ch 8.E.1) otherwise it may be prosecuted pursuant to section 52 of FICA (see ch 8.C.4.2.3.3).

¹¹¹ See ch 8.D.2–3 as regards the potential success of a victim of fraud or theft who claims loss from a bank as former recipient of the benefits of fraud or theft.

¹¹² As to which, see the English case of *Bank of Scotland v A Ltd* and others [2001] 3 All ER 58 (CA) which is analysed elsewhere in the study (see ch 6.C.3.4.3.3).

¹¹³ See par B.2.1.2.1 above where the *Bredenkamp* matter is discussed.

¹¹⁴ As to which, see ch 8.C.4, par C.5; *Zamzar Trading (Pty) Ltd (in Liquidation) v Standard Bank of SA Ltd* 2001 (2) SA 508 (W) [*Zamzar Trading*] (see par B.2.2 below).

2.2 Bank's Duty of Care

The discussion above illustrates that the relationship between a bank and a customer is usually one of debtor and creditor. The courts have recognised that banks have a common-law duty of care to customers on account of the contract concluded between the parties.¹¹⁵ The extent of the duty of care is determined by a combination of two factors, namely the nature of the contract and where negligence is alleged in terms of a delict, reasonableness and justice based on the relevant facts and circumstances of the matter.¹¹⁶ A bank must therefore exercise care and forethought in the interest of the customer with respect of the customer's affairs.¹¹⁷

In terms of the traditional notion of duty of care a bank must further foresee the possibility of harm occurring to a customer and take steps to prevent such an occurrence.¹¹⁸ The foreseeability of harm depends on the circumstances¹¹⁹ which renders any formulation fixed rules in this regard undesirable. However, mere foreseeability by a bank of likely loss to the customer

¹¹⁵ *Volkscas Bpk v Van Aswegen* 1961 (1) SA 493 (AD) [*Van Aswegen*]; *Harding* 471J–472A; *Liebenberg* 311C–H; *Lillicrap v Wassenaar and Partners v Pilkington Brothers* (SA) (Pty) Ltd 1985 (1) SA 475 (A) [*Lillicrap*] 500G–501G. In *Great Karoo Eco Investments (Edms) Bpk h/a Grobbekaarskraal Boerdery v Absa Bank Bpk* (2003 (1) SA 222 (W) [*Great Karoo*]) the court ruled that a bank teller has a legal duty to inspect a document she received for collection (235G–236E).

¹¹⁶ *Midgley Delict* 50–51; *Joubert Mandate* 11. In *Van Wyk v Lewis* 1924 AD 438 the court observed: '[w]hat is reasonable under the circumstances is for the Court, it will pay high regard to the views of the profession, but it is not bound to adopt them' (488). This reasoning was approved in *Durr v Absa Bank and another* 1997 (3) SA 448 (SCA) [*Durr*] 461A–B.

¹¹⁷ This includes that a party must established a minimum degree of respect for the interest of the other party so that a contract is not used to protect his own interests unreasonably (*Van der Merwe Contract* 295; *Joubert Mandate* 13; *Olivier ABLU-2000* 19–21).

¹¹⁸ *KwaMashu Bakery v Standard Bank of South Africa (Ltd)* 1995 (1) SA 377 (D) [*KwaMashu*] 395; *Malan & Pretorius* (1991) *THRHR* 713; *Malan & Pretorius* (1994) *SA Merc LJ* 219–212; *Pretorius* (2000) *SA Merc LJ* 362. In *Standard Chartered Bank of Canada v Nedperm Bank Ltd* 1994 (4) SA 747 (A) [*Bank of Canada*] the court found Nedperm Bank negligent and in breach of its legal duty to issue correct reports about the financial affairs of customers (769I–J, 770A–B).

¹¹⁹ The standard of the reasonable man or *diligens paterfamilias* is used to determine whether a duty of care exists in a particular matter (*Neethling Delict* 149; *McKerron Delict* 26; *Midgley Delict* 60–62; *Joubert Mandate* 11; *Pretorius* (1986) *De Jure* 244–245; *Lillicrap* 498G–H; *Marais v Richard* 1981 (1) SA 1157 (A) 1168C.

is insufficient for establishing a duty of care.¹²⁰ In *Tabacco Finance (PVT) v Zimnat Insurance Co Ltd*¹²¹ the court referred to the ‘duty issue’ of a duty of care approach meaning that the existence of a legal duty of care should be determined in terms of policy-based considerations.¹²² Many factors are relevant to determine whether a duty of care exists, for example, the relevant history and notions of morals and justice, the convenience of applying such a duty and social ideas about who is liable for loss.¹²³ In *Greenfield Engineering Works (Pty) Ltd v NKR Construction (Pty) Ltd*¹²⁴ the court pointed out that ‘in any given case the problem of determining liability is a pragmatical rather than a jurisprudential one.’ It follows that a bank’s potential liability for breach of a duty to care with respect to money in a customer’s account is determined by the facts of a matter and relevant policy-based considerations existing at the time.

Currently, a bank that opens an account for a new customer has an obligation to ascertain the customer’s identity and obtain information to establish her *bona fides*.¹²⁵ The reason for imposing a duty of care on a bank does not solely concern the KYC standard obligations in terms of FICA and the AML Regulations.¹²⁶ It also pertains to the risks of fraud,¹²⁷ the possibility that accounts may be used to obtain payment of stolen cheques, the fact that banks do not operate under time constraints when reviewing applications for new accounts, the limited amount of costs

¹²⁰ *Lillicrap* 498C; *Administrateur Natal v Trust Bank van Afrika Bpk* 1979 (3) SA 824 (A) [*Administrateur Natal*] 823H.

¹²¹ 1982 (3) SA 55 (Z) 61G–H. In *Knop v Johannesburg City Council* 1995 (2) SA 1 (A) the court asserted as follows (27): ‘[t]he fact-based duty of care forms part of the enquiry whether the defendant’s behaviour was negligent in the circumstances. The whole enquiry is governed by the foreseeability test, and ‘duty of care’ in this sense is a convenient but dispensable concept.’

¹²² Olivier *ABLU-2000* 21; Neethling (1981) *THRHR* 81. A policy-based consideration is an aspect of a ‘duty of care’ by which the ambit of delictual liability is judicially controlled (*Faul Bankgeheim* 397). See also *Great Karoo* where the court listed various policy considerations which recognise the existence of a duty of care (235G–236E).

¹²³ See *Administrateur Natal* 833 where the court remarked on the limited role of the elements of delicts.

¹²⁴ 1978 (4) SA 901 (N) 915G–H.

¹²⁵ See *Bredenkamp* paras 51–52; *Commissioner, South African Revenue Services and another v ABSA Bank Ltd and another* 2003 (2) SA 96 (W) [*Commissioner*]; ch 8.C.4.2.3.2, par D.2.2. In *R v Myers* 1948 (1) SA 375 (A) the court reasoned as follows: ‘[n]egligence in making enquiries ... can never in [itself] amount to an absence of honest believe’ (383). In this matter, Myers honestly believed that goods which were subjected to loans were available even though he did not take precautions to ensure that it was true (381).

¹²⁶ See ch 8.C.5.

¹²⁷ Which was recognised by the court in *Columbus II* par 13.

that proper consideration would incur and the reality that applications for new accounts provide a golden opportunity to prevent subsequent fraudulent conduct.¹²⁸

In *Commissioner* the court recognised that various policy considerations¹²⁹ endorsed the existence of a legal duty of a bank to avoid causing customers economic loss by negligently opening and maintaining an account.¹³⁰ The court further accepted that it is impossible to determine how great a burden this recognition of a duty of care will place on banks,¹³¹ and which procedures banks should followed to monitor customers' accounts. The duty of a bank to act with reasonable care when opening a new account ostensibly does not extend to the bank's existing customers except if circumstances dictate that the bank should conduct further inquiries.¹³² In *KwaMashu* the court asserted as follows:¹³³

[a bank should] not only satisfy himself of the identity of a *new* customer but also to gather sufficient information in regard to such client to enable him to establish whether the person is the person or entity he ... purports to be.

The liability of a bank which breached its duty of care to a customer can be established either within the sphere of breach of contract¹³⁴ or within the law of delict.¹³⁵ Breach of contract is based

¹²⁸ *Malan & Pretorius Malan on Bills* 311; *Energy Measurements (Pty) Ltd v First National Bank of South Africa Ltd* [2000] 2 All SA 396 (W) [*Energy Measurements*] 422C–G; *Columbus II* par 9.

¹²⁹ For example, the fact that the bank knew the account was funded by VAT returns, that it had a statutory duty to report suspicion regarding the account to the FIC, that society demands that banks do not 'turn a blind eye' to the possibility that accounts may be used for criminal purposes (120).

¹³⁰ 124F–G. Nonetheless, it is unhealthy that banks are obliged to evaluate the banking activities of their customers at all times (*Malan & Pretorius ABLU-2003* 17).

¹³¹ *Commissioner* 123F–H.

¹³² *Columbus Joint Venture v Absa Bank Ltd* 2000 (2) SA 491 (W) [*Columbus I*] 510F–H per Malan J; *Columbus II* par 25; *Powell and another v Absa Bank* 1998 (2) SA 807 (SECLD) [*Powell*] 820–821. See in general Hugo (1992) *Stell LR* 128; Pretorius (2002) *SA Merc LJ* 94–102; Van Jaarsveld (2002) *JBL* 123–127.

¹³³ 395I–396B which dictum is also referred to in *Energy Measurements* (427B–C). Likewise in *Columbus II* the court explained that (par 11): '[t]he bank is under a duty to take reasonable measures to ascertain and verify the *new* customer's identity and trustworthiness'. At first instance Malan J pointed out that there was no evidence of what a prudent bank should do under certain circumstances (*Columbus I* 510C).

¹³⁴ Breach of contract is a form of wrongful conduct (Van der Walt *Delict: Principles* 7; Christie *Contract* 575; Stassen (1983) *MBL* 84). A customer who sues a bank for breach of contract does not need to establish fault on the side of the bank (see *Legogote Development Co (Pty) v Delta Trust and Finance Co* (1970 (1) SA 584) where the court reasoned that it should only be proved that a debtor knew or ought to have known when and what it must

on the fact that an obligation was imposed by the contract between the bank and the customer which was meant to be performed.¹³⁶ If the obligation was not performed or performed in the wrong manner the bank as debtor is either in *mora*,¹³⁷ or is guilty of positive malperformance.¹³⁸ In both instances the bank will be liable to its customer for the loss he suffered.¹³⁹

The onus of proof in cases pertaining to a bank's alleged breach of duty of care is not always on the customer. In *Transitional Local Council*¹⁴⁰ where deposited money was stolen the court found that onus of proof is affected by the question whether the claim was delictual or contractual in nature.¹⁴¹ If the claim was based on contract the council had to prove that the deposited money was lost despite due diligence on its part. However, if the action was based on delict, the council had to establish that it suffered a loss due to fault¹⁴² on the bank's part.¹⁴³ On

perform (587E)).

¹³⁵ *Christie Contract 577; Midgley Delict 62*. Although once a bank's duty to act has been established in terms of the contract of mandate, it is unnecessary to extend the duty to one in delict (*Harding 472A–B; Liebenberg 311E*). In *Liebenberg* the court found that a customer could not decide to base his claim on delict if it should be based on breach of contract. If it is established that a bank has a contractual duty in terms of the mandate to, for example, make a payment, there is no need to extent its duty to one in delict (311).

¹³⁶ *Christie Contract 575; Van der Merwe Contract 305, 308–310; Kerr Contract 616*.

¹³⁷ Mulligan (1952) *SALJ 287*.

¹³⁸ Which relates to the manner in which an obligation is performed (*Christie Contract 575; Van der Merwe Contract 321–323; Kerr Contract 688*). A bank commits positive malperformance when it acts contrary to its duty of care, or when its performance is defective. For example, in *Bank of Canada* the bank malperformed because it issued an inaccurate report (762H–I). The court remarked that a skilled banker would not have issued an inaccurate report (*ibid*). Note, a bank can only be guilty of malperformance if it at least performed, otherwise breach of contract will be in the form of *mora debitoris* (*Joubert Contract 207*).

¹³⁹ *Kerr Agency 243–245, 251–252; Kerr Contract 737*.

¹⁴⁰ See par B.2.1 above.

¹⁴¹ *Transitional Local Council 146G–J*.

¹⁴² That is, negligence (for example, in *Harding* the court ruled that Absa Bank was not negligent when it failed to freeze an account as instructed (472B–F)). The court, however, observed in another matter that a bank as an artificial, nonhuman entity is incapable of being negligent itself (*First National Bank of SA v Rosenblum and another 2001 (4) SA 189 (SCA) par 17*). The court further reasoned that when a bank has excluded its liability in a contract, loss or damage due to the gross negligence of its employees is likewise excluded (par 18). It follows that immunity from negligence also extends to gross negligence (par 26). This ruling has been criticised by Itzikowitz ((2001) *Annual Survey 627*) who argues that if one is precluded from contracting out of liability for one's own dishonest conduct, it should likewise be impossible to contract out of liability for employees' dishonest conduct. It is submitted that a finer solution to an issue of kind may be to allow banks to contract out of liability for

the facts before the court the claim was based on delict and therefore the bank had to prove that it as owner¹⁴⁴ of deposited money suffered a loss due to the council's negligence.¹⁴⁵ All the requirements of a delict must further be present before liability can be established. Before a customer can instigate action against a bank for breach of duty of care¹⁴⁶ he needs to establish that the bank's conduct was directly related to the loss he suffered.¹⁴⁷

conduct over which they have no control, for example, *vis mayor* such as where a fire destroys its safety boxes. In all other instances the bank should assume liability for loss suffered by customers where the involvement of its staff is common cause. It could always either insure itself against this type of liability, or file suit against the employees involved.

¹⁴³ *Transitional Local Council* 146H–J.

¹⁴⁴ See par C.2 below.

¹⁴⁵ *Transitional Local Council* 150C–D. The court confirmed that an objective test is to establish negligence on the side of the bank (147G–148G).

¹⁴⁶ Which usually will be in the form of negligence. In *Powell* (822J) the court observed that breach of the bank's internal rules is not necessarily proof of negligence. In *Columbus I* Malan J declared that (513): '[a]n act can only be negligent if it is also wrongful.' In a number of cases it was found that where a bank rendered professional services, it has a duty not to cause loss to others (see, for example, *Indac Electronics (Pty) Ltd v Volkskas Bank Bpk* 1992 (1) SA 783 (A); *Energy Measurements* 429D; *Absa Bank Bpk v ONS Beleggings BK* 2000 (4) SA 27 (SCA) 33; *First National Bank of SA Ltd v Quality Tyres* (1970) (Pty) Ltd 1995 (3) SA 556 (A) 560–561). In *Durr* a customer of Absa Bank suffered loss due to bad investment advice given by the bank. The court confirmed that the standard to establish negligence on the part of the bank's advisor was whether he failed to act with (460G): '[t]he necessary skill and knowledge of a regional manager of the broking division of a bank professing investment skill and offering expert investment advice.' Likewise in *Fedgen Insurance Ltd v Bankorp Ltd* 1994 (2) SA 399 (W) the negligence of the bank was determined with reference to the conduct of the *bonus argentarius* or the reasonable banker, which standard has also been applied by other courts (*Powell* 819–820; *KwaMashu* 395; *Columbus* 99; *Great Karoo* 234).

¹⁴⁷ *Great Karoo* 237.

In *Zamzar Trading*¹⁴⁸ the court made some key observations as regards a bank's liability towards a customer who claimed loss suffered as a result of a fraudulent scheme in which he had participated. The court reasoned¹⁴⁹ that a bank that was unaware of a contractual relationship between a customer and a third-party tainted by turpitude and had no knowledge of such turpitude, could not be held liable to repay money which it had at some stage held legally for the customer. To hold someone liable irrespective of whether he had knowledge of wrongdoing affronted the principle that a party had to act *wrongfully* before it could be held liable for its conduct.¹⁵⁰ The court further found that there was no evidence that the bank breached the contract it concluded with Zamzar Trading or that it had entered into an unenforceable contract with the company.¹⁵¹ The bank merely held money legally for Zamzar Trading and unknowingly assisted in wrongdoing.

Of significance, the court acknowledged that although public policy requires that liability is imposed on a bank in certain circumstances, the liability of the bank should not be destructive to established banking practices.¹⁵² It follows that a bank will not be held liable if the plaintiff

¹⁴⁸ In this case the plaintiff, Zamzar Trading, sought to recover from a bank money used to discharged a supposed indebtedness of it (511–513). The supposed indebtedness stemmed from a fraudulent scheme between Zamzar Trading and one S to claim a refund of VAT in respect of an export agreement of goods. For this purpose Zamzar Trading opened an account at the defendant bank. The bank debited the account with 77,467 000 rand in discharged on a supposed obligation of the company to S which arose from the fraudulent scheme. Zamzar Trading contended, *inter alia*, that it did not know about the indebtedness. It based its claim against the defendant bank on the *condictio ob turpem vel iniustam causam* (see ch 8.D.3.3.4) and sought to claim payment of the 77,467 000 rand. The plaintiff further argued that while the law accepted the *condictio* as an unjust enrichment action, this was incorrect as the real nature of the action had not been properly examined. Therefore, the court should consider public policy to determine whether something given could be recovered despite a lack of enrichment. In response the defendant bank contended that Zamzar Trading's particulars of claim were 'bad in law' because it lacked the elements required for the cause of action (see ch 8.C.3.2).

¹⁴⁹ *Zamzar Trading* 514F–G.

¹⁵⁰ *Zamzar Trading* 514–515.

¹⁵¹ On the evidence before the court the only *turpis causa* alleged was the one between the plaintiff and a third-party to whom the funds were transferred by the bank as instructed by the plaintiff (514–515). See also ch 8.D.3.4.

¹⁵² 514I–J.

failed to establish wrongdoing on the bank's side in the execution of its mandate. The court further observed that:¹⁵³

[s]hould the plaintiff's cause of action be valid it would mean that a ... bank would in respect of each customer and each transaction have to ascertain where the customer's funds came from and the reason therefore and why such funds were being paid to a named payee.

This dictum is particularly significant in light of the KYC standard obligations imposed on banks pursuant to FICA.¹⁵⁴ At the time the ruling was handed down FICA had not come into effect yet. However, since 1 February 2002 banks are legally required to investigate the source of each customer's money before it is allowed to continue with a transaction.¹⁵⁵ In addition, a bank that suspects that a transaction involves the benefits of fraud or theft must file a STR to the FIC.¹⁵⁶

Whether suspicions by a bank as regards the purpose of a transaction amounts to the knowledge required to impose civil liability on it in circumstances where a victim of fraud or theft suffered loss, is one of the issues which is dealt with elsewhere in the study.¹⁵⁷ The perennial problem remains that a bank must find a way to resolve the tension that exists between the reporting duty and heeding a customer's instruction to complete the transaction. Regardless of the bank's choice it must act in good faith and without negligence if it hopes to avoid potential civil and criminal liability. However, it is submitted that it is unlikely that any bank in circumstances similar to those in the *Zamzar Trading* case above would have recognised that the transaction in issue involved the benefits of fraud. This synthesis is based on various problematic issues relating to money laundering, for example, the nature of money acquired through criminal means, the lack of proper guidance in identifying such money and the content of the KYC standard under FICA. These issues and other related ones are considered elsewhere in the study.¹⁵⁸

¹⁵³ *Zamzar Trading* 515B–C. For an instructive perspective of the problems faced by banks due to the provisions of FICA, see Sonnekus (2001) *J for Juridical S* 106–113.

¹⁵⁴ For an evaluation FICA's KYC standard obligations, see ch 8.C.4.2.3.1

¹⁵⁵ See section 21 of FICA; ch 8.C.4.2.2.2.

¹⁵⁶ See section 29(1)(b)(i) of FICA; par B.2.3.3.2 below; ch 8.C.4.2.2.3.

¹⁵⁷ See ch 8.D.2.1.

¹⁵⁸ See ch 8.C.4.2.1.

Although the courts have yet to recognise that a bank's duty of confidentiality duty may undermine its duty of care to customers,¹⁵⁹ it should be evident from the following evaluation that it has become increasingly difficult for banks to observe their duty of care to a customer without becoming embroiled in the technicalities created by FICA's reporting duty.

2.3 Bank's Duty of Confidentiality

2.3.1 Foundation

The concept 'bank secrecy' or 'bank confidentiality' refers to all activities performed within the context of banking business.¹⁶⁰ Faul defines it as the occupational secrets of a banker in terms of which he is prevented from disclosing any information he may possess in terms of the bank-customer relationship, except if he is justified to do so.¹⁶¹ At close examination it may be argued that customers have the right to expect that their dealings with a bank will be treated by the bank as confidential.¹⁶² It follows that the duty not to disclose privilege information lies with the bank whilst the customer has a corresponding privilege.¹⁶³

Many reasons, not all of them illegal, exist why a person may choose to keep his wealth hidden.¹⁶⁴ Organised and syndicated crime organisations as well as the intelligence world depend

¹⁵⁹ See, for example, *Great Karoo* (123D–F) where the court failed to consider the impact of bank confidentiality on the bank's duty of care to the customer.

¹⁶⁰ *Bollmann Switzerland* 669; *Tournier v National Provincial & Union Bank of England* [1924] 1 KB 461 [*Tournier*] 484.

¹⁶¹ *Bankgeheim* 459. See also *Malan & Pretorius Malan on Bills* 310–313.

¹⁶² See in general *Fourie Banking Law* 138–139; *Fourie The Banker* 52–63.

¹⁶³ *Firststrand Bank Ltd v Chaucer Publications Pty (Ltd)* 2008 (2) SA 592 (C) [*Chaucer*] par 20. This case concerned an application by FirstRand Bank ('FirstRand') for an interdict against the publication of an article in *Noseweek*, a magazine published by the respondent, Chaucer Publications. *Noseweek* divulged that FirstRand was party to 'unusual practices' and suggested that two of the directors of the bank's subsidiary were involved in money laundering (par 4). FirstRand sought an interdict against *Noseweek* to prohibit the magazine from publishing in a coming article the customers' identity. Traverso DJP ultimately ruled that FirstRand lacked *locus standi* to apply for an interdict (see below). See ch 8.D.2.3, par D.4.4 where interdicts are discussed.

¹⁶⁴ *Rider Washing Wealth* 4; *Park Anonymous Bank Accounts* 332. The purpose for which the money was required will dictate the kind of transactions used to conceal its nexus to crime (*Rider Taking the Profit Out of Crime* 2–3; *Skousen Guide to Financial Privacy* 78).

on ‘secret money’ to keep certain affairs hidden.¹⁶⁵ A symbiotic relationship exists between bank confidentiality and money laundering;¹⁶⁶ criminals depend on the confidentiality duty of banks to keep their banking affairs secret. They also use bank confidentiality as tool to facilitate money laundering schemes. As a result, the international community had no qualms to sanction the breach of bank confidentiality for money laundering control purposes.¹⁶⁷ Currently, little is left of true bank confidentiality.¹⁶⁸

Three principal legal facts exist in support of bank confidentiality, namely,¹⁶⁹ the right to personal privacy,¹⁷⁰ the contractual relationship between a bank and the customer¹⁷¹ and statutory provisions which govern bank confidentiality.¹⁷² In contrast, section 29 of FICA requires banks to file STRs to the FIC under certain circumstances.¹⁷³ A consequence of permitting banks to violate their confidentiality duty is that customers may be misled to think that banks may have done away with preserving customer confidentiality and that their affairs are readily open for inspection. This view potentially may have a disastrous effect on the bank-customer relationship. Therefore, a more reasoned look at bank confidentiality and its role in allowing crime to prosper is important.

¹⁶⁵ See Rider (*Washing Wealth* 5) who argues that few bankers would admit to contravening bank regulations to assist customers in concealing wealth for whichever reasons.

¹⁶⁶ See ch 4.C–D.

¹⁶⁷ See ch 5.B.3, par C.

¹⁶⁸ As once uttered by Caesar before crossing the Rubicon and thus beginning the Italian Civil war: ‘[I]et the die be cast. What is done is done ... there can be no turning back’ (Fuller *Julius Caesar* 179).

¹⁶⁹ Antione *Confidentiality in Financial Law* 24; McClean *Judicial Assistance* 186.

¹⁷⁰ See section 14 of the Constitution; Faul *Bankgeheim* 1–2; Faul (1986) *TSAR* 180.

¹⁷¹ See par B.2.1 above. The bank’s confidentiality duty derives either *ex contractu* or is implied from the bank-customer relationship (*Chaucer* par 18).

¹⁷² See par B.2.3.3 below.

¹⁷³ See ch 8.C.4.4.3.3 as regards FICA’s suspicious transaction reporting duty.

The archetype of a bank confidentiality developed in 1934 in Switzerland¹⁷⁴ in response to the German Nazi Regime's attempt to seize Jewish assets.¹⁷⁵ However, bank confidentiality may have even older origins than those of the Swiss. It is thought to originate four thousand years ago with the Hammurabi Code in Babylon.¹⁷⁶ During the 1950s and 1960s attempts by US investigators to trace the money of mobster Meyer Lansky in Switzerland failed.¹⁷⁷ At the time the Swiss protected banking confidentiality against foreign enforcement requests. Consequently, organised crime syndicates started buying foreign banks in Switzerland and employed them to hide criminal money.

Currently, all EU and Anglo-American jurisdictions recognise a form of bank confidentiality with the effect that banks are legally required to keep the financial affairs of their customers confidential.¹⁷⁸ Many former English colonies have also adopted strict bank

¹⁷⁴ Breitenstein *Switzerland* 589–591; Horowitz (1985) *Texas Internat LJ* 133; Bollmann *Switzerland* 664–668; Smith (1992) *University of Pennsylvania J of Internat Business L* 124. Swiss confidentiality obligations originates from three sources: laws governing privacy rights, the contractual relationship between a bank and a customer and federal banking statutes. Swiss bank confidentiality statutes codified a custom which hailed from the 17th century when Switzerland's tradition of neutrality acted to support French Huguenots who flee to Switzerland to escape religious prosecution (Kauffman (1985) *Vanderbilt J of Transnational L* 821n50). Some of them became bankers who maintained the secrecy of their compatriots' bank affairs. During the World War II the Swiss parliament included a secrecy provision in their banking regulations following pressure from Adolf Hitler's regime to disclose information about the German customers of Swiss banks. This provision ultimately expounded Swiss bank confidentiality practices (Bollmann *Switzerland* 663–664). It is accepted today that Swiss banking confidentiality is based on duties of fidelity and diligence as included in the banking contract of mandate (Giovanoli *Switzerland* 185–197; Meyer (1978) *New England LR* 22). It follows that any violation of Swiss bank confidentiality will trigger contractual liability.

¹⁷⁵ See in general Blum *Offshore Money* 66; Meier (1973) *International Business L* 17–20; Walter *Secret Money Market* 190–191; Gagnon (1990) *Vanderbilt J of Transnational L* 659; Gilligan *Offshore Sovereignty* 15. Numbered accounts further ensured that the Nazis could not trace money deposited with Swiss banks. Soon, Europeans were also using Switzerland to protect their assets against the impact of World War II (Kauffman (1985) *Vanderbilt J of Transnational L* 821).

¹⁷⁶ Chambost (*Bank Accounts* 3) traces bank confidentiality back to biblical times when temples acted as banks, a suggestion which is accepted by other academic writers as well (see, for example, Gagnon (1990) *Vanderbilt J of Transnational L* 659 and Horowitz (1985) *Texas Internat LJ* 13).

¹⁷⁷ See ch 7.B.2 as regards the origins of US bank confidentiality rules.

¹⁷⁸ See ch 6.B.2.2, par C.2.2; and ch 7.B.2.

confidentiality rules to boost their banking industries.¹⁷⁹ However, there is no gainsaying that the confidentiality duty of banks operates in direct conflict with their reporting duty pursuant to AML legislation.¹⁸⁰

In recent years bank confidentiality's connection to money laundering has rendered it controversial for two reasons.¹⁸¹ First, the AML authorities of countries such as England and the US continue to view bank confidentiality as a tool for money launderers to escape prosecution. Secondly, bank confidentiality due to its connection to money laundering adversely influences both the sovereignty of legal systems and the stability of economic systems.¹⁸² Arguments in favour of banking confidentiality suggest that it is an inherent aspect of human nature, a reasonable reaction to unfair taxation systems, and an individual liberty essential to a democratic society.¹⁸³ Moreover, research suggests that bank confidentiality is rooted in the contractual relationship that exists between a bank and the customer.¹⁸⁴ Which ever way one dissects the practice, one thing that stands out is that banks are caught in the middle between protecting the interest of their customers and observing current AML laws. This realisation underlines the need for a solution that can resolve the tension that exists between the confidentiality duty of banks and their reporting duty.

2.3.2 Common-Law

Traditionally, the common-law imposes a qualified duty of confidentiality on a bank in respect of the affairs of a customer.¹⁸⁵ English law accepts that a bank's confidentiality duty is a

¹⁷⁹ Gagnon (1990) *Vanderbilt J of Transnational L* 660–665; Walter *Secret Money Market* 210–221.

¹⁸⁰ See ch 6.B.3.6, par C.3.4; ch 7.C.2–3, par C.9; ch 8.C.4.2.3.3.

¹⁸¹ Walter *Secret Money Market* 127–129.

¹⁸² See ch 4.E.1–5 as regards the consequences of money laundering.

¹⁸³ Walter *Secret Money Market* 127–129.

¹⁸⁴ *Densam* 110B–C; *George* 736F; Meiring (1991) *SA Merc LJ* 109; Van Zyl (1989) *SA Merc LJ* 344; Faul (1989) *TSAR* 150. Van Zyl (1989) *SA Merc LJ* 344) argues that confidentiality is an implied term in the contract between a bank and its customer.

¹⁸⁵ Itzikowitz *Banking* 173. In *Abrams v Burns* (1914 CPD 452) the court explained that: '[t]he rule is that a banker will be liable for any actual damage sustained by his customer in consequence of an unreasonable disclosure to a third-party of the state of his account. ... the obligation not to disclose is a *moral* rather than a legal one.' (456). Conversely, in *Tournier* *Banks LJ* found the duty 'a matter of law' instead of a moral one (475).

reasonable reflection of the bank-customer relationship.¹⁸⁶ The *locus classicus* on this rule which has been applied by our courts¹⁸⁷ is *Tournier* where the English Appeal Court decided that the duty not to disclose confidential information is an implied term of the contract between a bank and its customer.¹⁸⁸

The facts in *Tournier* are straightforward.¹⁸⁹ Avory J's decision that the bank's disclosure of a customer's affairs was reasonable, was appealed by the customer, *Tournier*.¹⁹⁰ On appeal Bankes LJ found Avory J's decision as regards the nature of bank confidentiality incorrect. He attempted to define the nature of bank confidentiality¹⁹¹ and found it to be a contractual as opposed to a moral duty which could not be defined.¹⁹² At most, a bank's confidentiality duty could be classified and its limitations be indicated. Although *Tournier*'s passbook provided that the bank's employees were obliged to observe bank confidentiality,¹⁹³ the court refused to accept that an absolute contractual undertaking can establish the confidentiality duty of the bank.¹⁹⁴ Instead, it examined the bank's duty of confidentiality anew and confirmed that it was not an absolute but a qualified duty. A bank's duty of confidentiality begins the moment when the relationship

¹⁸⁶ Wadsley & Penn *Domestic Banking* 138. See also ch 6.C.2.1–2.

¹⁸⁷ *George* 735D–E; *Cywilnat (Pty) Ltd v Densam (Pty) Ltd* 1989 (3) SA 59 (W) [*Cywilnat*] 59I–60B; *Densam* 110H–I, 111E.

¹⁸⁸ Scrutton LJ 480; Atkins LJ 484. Bankes LJ reasoned that: '[t]he duty is a legal one arising out of contract ... it is not absolute but qualified. It is not possible to frame any exhaustive definition of the duty. The most that can be done is to classify the qualifications and to indicate its limits' (472).

¹⁸⁹ *Tournier*, a customer of the bank, overdrawn his account and agreed to pay off his indebtedness in weekly instalments. After failing to do so, the bank's manager phoned *Tournier*'s employer to ascertain his address. During the conversation the manager told the employer about *Tournier*'s debt and suggested that he was betting heavily. *Tournier*'s employment contract was not renewed and he consequently sued the bank for slander and for breach of its implied contractual duty of confidentiality (*Tournier* 461–462).

¹⁹⁰ 463–464.

¹⁹¹ Bankes LJ observed that a duty of confidentiality could vary according to the nature of the relationship between the customer and the person on whom the duty rested (474). The information disclosed in *Tournier* was divulged by a person in his character as banker. It was therefore not subject to disclosure.

¹⁹² *Tournier* 475.

¹⁹³ *Tournier* 480.

¹⁹⁴ 471.

between the bank and customer is established,¹⁹⁵ continues after the customer's death¹⁹⁶ and extends to any information derived from the account.¹⁹⁷

The confidentiality duty of banks is further not absolute, but one with four qualifications. A bank may violate the customer's confidentiality when:¹⁹⁸ mandated by law,¹⁹⁹ in the public's interest,²⁰⁰ in the interests of the bank²⁰¹ or when the customer's express or implied consent is given.²⁰² Banks' duty of confidentiality may therefore be negated by statute, agreement or court order. The four qualifications above determine the ambit of a bank's duty of confidentiality. In the recent case of *Chaucer* the court in an application by FirstRand for an interdict to prevent disclosure of customers' names considered the nature of bank confidentiality. It accepted that the relationship between a bank and its customer is confidential in nature.²⁰³ The court observed that various statutes assume that banks have to observe a duty of confidentiality towards customers. Public policy further requires the relationship to be confidential. However, the confidentiality duty of a bank may be overridden by a greater public interest.

Significantly, the court explained that a customer alone can invoke the privilege of bank confidentiality and insist that the bank observes its confidentiality duty so that information about the customer's affairs remained confidential. In *Chaucer* it was not FirstRand that endeavoured

¹⁹⁵ *Tournier* 473.

¹⁹⁶ *Tournier* per Banks LJ 473 and Scrutton LJ 481.

¹⁹⁷ Atkins LJ found that the confidentiality duty goes beyond information about the customer's account and extends after the account is closed (485). In contrast, Scrutton LJ suggested that information a bank acquired before or after the relationship and information which derived from other sources during the relationship would not be covered by this duty (481).

¹⁹⁸ Banks LJ in *Tournier* 472–473. Note, these exceptions are likewise included in the South African Banking Code (see SAB *Banking Code* par 3.6).

¹⁹⁹ For example, in terms of the Income Tax Act 58 of 1962. In *Hindry v Nedcor Bank Ltd and another* (1999 (2) SA 757) the court found that a bank is in no other position than any other debtor when it has to furnish information about the finances of a customer to the tax commissioner (773F–H).

²⁰⁰ *Chaucer* par 20.

²⁰¹ For example, where a bank is suing its customer for payment of an overdraft and is required to disclose the relevant amount (*Tournier* 481; *Cywilnat* 60B; *Densam* 110H–111D), in any legal action between a bank and its customer or where the bank is suing the surety of a customer (Meiring (1991) SA *Merc LJ* 113–114). In *Densam* the court remarked: '[g]enerally speaking, it is reasonable and proper for a bank to further its own interest' (110J).

²⁰² An example of such consent is where a customer gives the bank a reference (*Tournier* 481).

²⁰³ *Chaucer* paras 19–20.

to publish confidential information, but a third-party that obtained documents. Therefore, publication of facts that identified a person as a customer of FirstRand neither impinges on the bank's privacy nor on the privacy of its customers. It follows that the right to privacy in terms of section 14 of the Constitution was not being threatened. The court reasoned that FirstRand failed to establish that it had legal standing at common-law to bring an application for an interdict.²⁰⁴

An evaluation of the facts demonstrated that FirstRand wanted to prevent publication of its customers' names. In essence the bank attempted to prevent its customers from being defamed.²⁰⁵ However, the court found that FirstRand lacked *locus standi* to apply for an interdict on behalf of its customers.²⁰⁶ The court concluded as follows:²⁰⁷

[i]t is clear that only some of the clients made this rather vague request. Yet the application is brought on behalf of all the clients without any indication that they have been given an opportunity to 'opt out.'

From the analysis above it is evident that at common-law banks owe a duty of confidentiality to their customers not to disclose details about them or their affairs. The duty is also statutorily recognised. However, that is not to say that a bank has the right to protect the customer's privacy against disclosure by a third-party. The court reasoned that if some of FirstRand's customers felt that their rights to privacy were in danger of being infringed, they could as individuals brought the application for an interdict to prevent disclosure.

Two comments about the *Chaucer* decision would suffice. First, it is submitted that had FirstRand approached the customers concerned first and discussed its concerns and intention to apply for an interdict the outcome of the matter may have been different. Secondly, the *Chaucer* decision should be hailed by banks for two reasons. First, *Chaucer* represents recent judicial recognition that bank confidentiality is inherent to the bank-customer relationship. Secondly, the court spelt out for banks how to deal with a potential infringement of their confidentiality duty. In short, if a bank is not required to disclose confidential information it should not be the party to apply for an interdict to prevent the disclosure. Whether the bank may approach the court for an

²⁰⁴ *Idem* paras 15–16, 20.

²⁰⁵ *Chaucer* par 24. The court asserted that disclosure that a person is a customer of a specific bank does not infringe either the customer or the bank's right of privacy.

²⁰⁶ This is because the right to privacy is a private right hence each customer may either apply for an interdict against the publication or claim damages for alleged defamation (par 25).

²⁰⁷ *Chaucer* par 28.

interdict to prevent disclosure of confidential customer information as requested in a money laundering investigation is an issue that is dealt with at the end of this section.²⁰⁸ Suffice it to point out that in money laundering related matters a bank is precluded from informing the customer about a request from the authorities for disclosure of his account information.²⁰⁹ Further, research suggests that the bank's confidentiality duty arises by way of an implied obligation that stems from the nature of the bank and customer relationship. In *Cambanis Buildings (Pty) Ltd v Gal*²¹⁰ the court observed that a bank is bound by duty not to disclose any information about its clients. Although the *Densam* court neglected to investigate the nature of the contract between a bank and customer, it agreed that a bank is contractually bound to maintain secrecy about the affairs of its customers.²¹¹

In *George* the court investigated whether a bank can cede its rights against customers to a third-party with the result that it would have to disclose information about the nature of the claims. GS George Consultants, the applicants, argued that the bank cannot cede its claims as such disclosure would breach the bank's duty of confidentiality which is an implied term of the contract between them and the bank.²¹² Ultimately, the court agreed with the latter contention. It reasoned that the bank's confidentiality duty was of such a personal nature that it imports an element of *delectus personae* into the contract.²¹³ Rights under a contract involving *delectus personae* are uncedable.²¹⁴ In absence of an agreement to the contrary, the bank must maintain its customer's confidentiality and since GS George did not consent to the cession of the bank's claims against them, the proposed cession was interdicted from happening.²¹⁵

²⁰⁸ See par B.2.3.4 below.

²⁰⁹ See ch 8.C.4.2.3.3 as regards FICA's provision against tipping-off a customer.

²¹⁰ 1983 (2) SA 128 (N) 137F.

²¹¹ The court explained as follows (*Densam* 110B–C): '[t]here is no need to embark upon a consideration of the juristic nature of the contract between banker and customer ... I must make it plain ... that the bank was contractually obliged to maintain secrecy and confidentiality about its [customer's] affairs, in accordance with the decision in *Tournier's* case.'

²¹² *George* 734A–C. See also Itzikowitz (1989) *Businessman's Law* 255.

²¹³ *George* 736I–736C.

²¹⁴ 737D–F. In contrast, in *Cywilnat* the court ruled that a bank may disclose information in a legal action against its customer (60B). This ruling was overturned on appeal in *Densam*.

²¹⁵ *George* 743C.

The court's decision in *George* was overruled by the Court of Appeal in *Densam*.²¹⁶ In *Densam* the Court of Appeal acknowledged that although a bank owes a duty of confidentiality to its customer, it is 'reasonable and proper' for a bank to further its own interest by ceding a claim to a third-party such as Cywilnat.²¹⁷ It further disagreed with the *George* court that a bank's duty of confidentiality imports an element of *delectus personae* into the contract.²¹⁸ Consequently, the bank is not precluded from ceding claims simply because doing so would result in a breach of customer confidentiality.²¹⁹ It is therefore evident that while the courts recognise a bank's confidentiality duty, the duty remains qualified and subject to potential breach.

2.3.3 Statutory law

2.3.3.1 General Legislation

Legislation has recognised the confidentiality duty of bank in a two-fold manner.²²⁰ First, with the imposition of confidentiality on certain bank officials, and secondly, with the imposition of a reporting duty on banks. Section 33(1)(a) of the South African Reserve Bank Act²²¹ is particularly relevant in this regard because it prohibits disclosure of customer information by an official of the bank. Information, however, may be disclosed with the written permission of the Minister of Finance and the governor of the bank and only after consultation with the customer.²²² Section 236(4) of the Criminal Procedure Act²²³ prohibits the disclosure of written information in court unless pursuant to a court order.

²¹⁶ This matter also concerned the cedability of claims akin to the *George* matter. The bank in question obtained from a customer, Densam, claims against his debtors as security for an overdraft (*Densam* 104–109B–C). It sold these claim to Cywilnat. Densam argued that the bank's claim against it was not cedable as ruled in *George*. Goldstein J in the court *a quo* found in favour of Cywilnat (*Densam* 110E).

²¹⁷ 110J.

²¹⁸ 112A–B.

²¹⁹ 116F.

²²⁰ *Faul Bankgeheim* 449.

²²¹ 90 of 1998, as amended. See also section 68(1) of the National Credit Act 34 of 2005 ('Credit Act').

²²² Disclosure may then be made only to the Minister of Finance or the director-general in the course of an official's duties, before a court or under a law (section 33(1)).

²²³ 51 of 1977, as amended. The Act furthermore provides that no information about a pending charge may be published (section 153(2)(b)).

In contrast, some statutes require that banks disclose customer information under certain circumstances.²²⁴ For example, in terms of section 7(a) of the Banks Act²²⁵ the Registrar of Banks may request a bank to furnish information that is necessary for it to perform its functions. Section 8 of the Inspection of Financial Institutions Act²²⁶ further provides that an inspector carrying out an inspection of a bank is obliged to preserve confidentiality unless the court, the law or the nature of an inspection compels disclosure. The Registrar of Banks, after applying to the court, is empowered to publish information about an inspection.²²⁷ Disclosure to the Registrar of Banks in terms of the Financial Institutions (Protection of Funds) Act²²⁸ requires a court application. It is therefore evident that banks may be required by either the court or in terms of legislation to infringe upon their customers' constitutional right to privacy.

2.3.3.2 Anti-Money Laundering Legislation

Like the legislation above POCA²²⁹ and FICA²³⁰ override the confidentiality duty of banks. More specifically, section 29 of FICA introduces the KYC standard reporting duty which requires a bank to breach customer confidentiality for the sake of money laundering control. No confidentiality duty or other statutory or common-law limitations on the disclosure of information

²²⁴ See, for example, the Promotion of Access to Information Act (2 of 2000, as amended) which was enacted on 3 February 2000 to allow access to information held by the state or by another person such as a bank. A bank that receives a request for disclosure of confidential customer information is obliged to release the information, except where the Act expressly provides that the information may not be released (section 9). Cf Schulze (2001) 13 *SA Merc LJ* 603–607 who lists in full various other statutes which compel disclosure of information under certain circumstances.

²²⁵ Although this request would normally concern information about the business of the bank, information about the affairs of a customer could be included if the required information concerns the foreign activities of the bank (section 53).

²²⁶ 80 of 1998.

²²⁷ *Idem* sections 9–10.

²²⁸ 28 of 2001. Section 6(1)(c) stipulates that the Registrar of Banks may apply to the High Court to compel a bank to furnish information or documents in its control to him (section 6(2)(a)).

²²⁹ See sections 71 and 72 of the Act which concern access to information and civil or criminal investigations.

²³⁰ See sections 27–41 of FICA which cover reporting duties and access to information; ch 8.C.4.2.3.3, par C.5.

affect FICA's disclosure duties.²³¹ Although the reporting obligations of banks pursuant to FICA are analysed elsewhere in this study,²³² it is convenient to accentuate a few relevant issues already at this point.

Section 29(1) of FICA requires that banks file STRs to the FIC.²³³ Four types of transactions must be reported.²³⁴ They include a transaction which facilitates or is likely to facilitate the benefits of crime, has no business or lawful purpose, is conducted with the purpose of avoiding STR or which may be relevant to tax²³⁵ investigations. After the FIC has received a STR, it may request additional information from the bank about the report and the grounds for it.²³⁶ The bank may further be ordered by court to report to the FIC on all transactions with respect to a specific account or facility, or by a specific person.²³⁷ Most notably, a bank is precluded from divulging to the customer that a STR has been filed or that an investigation is under way.²³⁸

In view of the aforementioned it is evident that section 29 of FICA conflicts directly with the confidentiality duty of banks. As a result, a bank that files a STR to the FIC may be sued by a disgruntled customer for breach of contract or delict. FICA in an effort to protect banks that filed STRs against liability, contains a so-called 'safe-habour'²³⁹ provision which is captured by section 38(1) of the Act. Section 38(1) of FICA provides that no civil or criminal liability may be imposed on a bank that files a STR in *good faith*.²⁴⁰ It is submitted that the wisdom of including a good faith-requirement in FICA's safe-harbour provision should be questioned. Since a disgruntled customer may contend that a bank filed a STR *male fide* or negligently, the provision does not seem to protect banks against civil liability based on either breach of contract or delict. As a result, the bank may still face civil litigation because it filed a STR. This possibility renders FICA's safe-

²³¹ See section 37(1) of FICA; Van Jaarsveld (2001) *SA Merc LJ* 580.

²³² See ch 8.C.4.2.3.3. See also ch 6.B.2.2, par C.2.2; ch 7.B.2 as regards bank confidentiality in the EU, England and the US respectively.

²³³ See section 3 of FICA; ch 8.C.4.2.3.3, par E.1 as regards the purpose of the FIC.

²³⁴ Section 29(1)(b)(i)–(iv).

²³⁵ See ch 8.C.4.2.3.3 as regards the connection between tax evasion and money laundering.

²³⁶ Section 32 of FICA.

²³⁷ Section 35(1) of FICA.

²³⁸ Which is known as the 'tripping-off' provision (see section 34 of FICA; FIC *Transaction Reporting* 5.1–5.2; ch 8.C.4.2.3.3).

²³⁹ See ch 5.B.3.3.2, par B.3.4.3; ch 6.B.2.2, paras B.3.2, B.3.4, B.3.6, B.4.1.3, C.2.2, C.3.4.3.1; ch 7.B.2, par C.5; ch 8.C.4.2.3.3.

²⁴⁰ In this regard FICA simulates one of the FATF's forty recommendations (see FATF *Forty Recommendations 1990* Recommendation 16; ch 5.B.3.3.2).

harbour provision ineffective. A bank that considers filing a STR to the FIC is therefore likely to face a dilemma. On the one hand, it has a confidentiality duty towards the customer whilst on the other hand, it is required to disclose confidential customer information to the FIC which may result in the bank being sued by the customer. It is submitted that a bank would only in rare cases assume the risk of being sued, and therefore may think twice before filing STRs to the FIC.

One may argue that section 36(1) of the Constitution limits section 14's right to privacy under certain circumstances and that the disclosure provisions of FICA's section 29 are therefore appropriate.²⁴¹ In addition, since money laundering control is in the public's interest,²⁴² the limitation of the privacy rights of a customer could be deemed as reasonable and justifiable. Although valid, such arguments do little to assist a bank with the practical dilemma it faces when confronted with the two conflicting duties described above. It is therefore submitted that the inclusion of the good faith requirement in FICA's safe-harbour provision should be rethought. The mere notion that a bank would file a report in bad faith or negligently is without merit which renders the good faith requirement of FICA's section 38(1) redundant. If the legislature intended section 38(1) as incentive to banks to comply with FICA's reporting provisions the section should have simply read that banks that file reports to the FIC will be protected against any type of criminal or civil action.²⁴³ A provision with similar wording as the latter would render complete safe-harbour protection to banks that file reports to the FIC.

2.3.4 Limits

While measures are in place which in effect violate the confidentiality duty of banks, the legal privilege afforded to the attorney-customer relationship still remains intact.²⁴⁴ As a result, the common-law right to legal professional privilege is not affected by FICA in as far as communications are made between an attorney and his client for legal advice purposes, or between

²⁴¹ For example, if the limitation is reasonable, justifiable and taking into account all relevant factors. Relevant factors include, for example, the nature of the right and the relation between the limitation and its purpose (see also *Chaucer* (par 20) where the court asserted that: '[t]his duty is subject to being overridden by a greater public interest').

²⁴² See ch 4.E as regards the consequences of money laundering.

²⁴³ See ch 8.C.4.2.3.3 for an example of how the amended section 38(1) may read.

²⁴⁴ Faul (1986) *TSAR* 183–184.

a third-party and the attorney for the purposes of litigation.²⁴⁵ Evidently, communications regarding the financial affairs of a customer will also be afforded confidentiality protection.

In summary as regards resolving the conflict that exists between the confidentiality duty of banks and their section 29-reporting duty, it is submitted that equitable solutions are not readily available. It is therefore recommended that a bank that finds itself in a predicament as regards how much information to disclose or whether to disclose information at all has two options. First, it can require the requesting authorities to apply for a court order to compel it to disclose the information in issue. Secondly, the bank may approach the court on its own for guidance. In verity, regardless of how a bank elects to resolve the situation, it is fair to surmise that neither banking practise nor the bank-customer relationship is likely to escape the fallout unscathed.

3. Legal Nature of Current Accounts

Although banks have various types of accounts on offer, current or running²⁴⁶ accounts are most often used to facilitate financial transactions. This is due to the nature of a current account. A current account is fundamentally an account kept by two parties in which entries concerning their individual debts to each other are made. In *Oeanate I* the court pronounced the relationship between a bank and the customer in relation to a current account as one of debtor and creditor respectively.²⁴⁷

When the customer opens an account with a credit balance at a bank the parties agree that one or more contracts are concluded. First, after the customer has made a deposit with a bank, a contract of loan or money for consumption is concluded in terms of which the bank borrows the deposited money and any future deposits that the customer may make.²⁴⁸ In terms of the second contract, one of mandate, the bank undertakes to both heed the instructions of the customer and to act in his best interest.

When the bank make a payment contrary to the customer's mandate, the customer's claim for the money should not be formulated as a claim for damages.²⁴⁹ In fact, a bank that made a

²⁴⁵ See section 7(5) of POCA; section 37(2)(a)–(b) of FICA.

²⁴⁶ See in general the discussion in *Fox Property Rights* 13–16.

²⁴⁷ 530H. See also Faul (1989) *TSAR* 145; Itzikowitz (1989) *Businessman's Law* 256.

²⁴⁸ See par B.2.1 above.

²⁴⁹ *Liebenberg* 310.

payment contrary to its mandate is precluded from debiting the customer's account with the amount because it became owner of the money as soon as it was paid into the account.²⁵⁰ When a bank grants an overdraft²⁵¹ facility to a customer, it makes a loan to him which is repayable on demand,²⁵² accompanied by an agreement regarding the payment of interest²⁵³ and influenced by the *in duplum* rule.²⁵⁴

C. BANK AS OWNER OF DEPOSITED MONEYS

1. Introduction

The objective in this section is to illustrate that POCA violates the notion that ownership is an absolute right.²⁵⁵ Ownership in Roman law was, however, never absolute - it tolerated restrictions.²⁵⁶ Likewise, it is generally accepted today that legislative measures have resulted in key limitations of the traditional concept of ownership.²⁵⁷ POCA penalises the acquisition of all the benefits of crime with confiscation and civil forfeiture irrespective of whether the benefits are

²⁵⁰ See par C.3.2 below as regards ownership of deposited money.

²⁵¹ See par C.3.3 below.

²⁵² Except where the deposited money is the benefits of crime (see par B.2.1.2 above).

²⁵³ Relevant in this regard are two rules which form part of our law (*Commercial Bank of Zimbabwe v MM Builders & Suppliers (PVT) Ltd* 1997 (2) SA 285 [Zimbabwe] 320F–H, 318B–319F; *Oeanate I* 573F–G; 574A–B). They are the *in duplum* rule in terms of which interest stops running when it equals the capital debt (cf par C.3.3 below) and the English law rule in *Devaynes v Noble, Clayton's Case* (1816) 1 Mer 529 [*Clayton's case*]. In terms of the rule in *Clayton's case* any payments go first towards the reduction of the earliest debt, thus on the principle of 'first-in-first-out' (*Oeanate I* 573B–C). Therefore, although the rule in *Clayton's case* is recognised in our law, it does not apply as long as an account is affected by the *in duplum* rule.

²⁵⁴ See above, par C.3.3 below.

²⁵⁵ The mentioned characteristics have been traced back to Roman and Roman-Dutch law to which the contemporary concept of ownership is compared (Badenhorst *Law of Property* 162). See also ch 2.C.4.2 and the authorities referred there.

²⁵⁶ Visser (1985) *Acta Juridica* 48n7; Birks (1985) *Acta Juridica* 1. Ownership in light of social economic and political changes altered its content and function since Roman times. This is due to both the limitations imposed by the law and the conduct of property owners (Badenhorst *Law of Property* 163).

²⁵⁷ Van der Walt & Kleyn *Divided Ownership* 258; *Van Der Merwe and another v Taylor NO and others* 2007(11) BCLR 1167 (CC) [*Van Der Merwe*] par 26 (see ch 8.D.2.2 for the facts of the case).

money that was fraudulently acquired or stolen from some one, or generated through illegal drug trafficking.²⁵⁸ It follows that POCA violates the notion that ownership is an absolute right. In fact, it is submitted that absolute ownership has become objectionable in light of the needs of society today.

As will be discussed shortly, money acquired through criminal means that is deposited with a bank is subject to confiscation and civil forfeiture no matter that the bank is legally owner thereof and may have been unaware of its nexus to criminal activity.

2. Concept of Ownership

2.1 Definition

The legal meaning of ownership under South African law is foremost determined by accepted common-law rules. These rules are based upon a combination of Roman-Dutch, canon and Germanic customary legal principles.²⁵⁹

At common-law, ownership is defined as a total of all the real rights which a person may have to and over corporeal property²⁶⁰ or as a right that comprises a bundle of rights, powers and liberties.²⁶¹ A real right is the power to do with a thing as one pleases.²⁶² Legal texts define a thing as a corporeal object taking up space and which is an independent legal entity susceptible to private ownership, of use to mankind and of value.²⁶³ Ownership includes the right to possess, use, destroy or alienate an object, and therefore encompasses comprehensive control over it.²⁶⁴ Sonnekus simply delimits ownership as a relationship between a legal subject and a corporeal object whereby a person may for his own benefit do with the object as he pleases provided that it is not forbidden by law.²⁶⁵ Honoré presents a similar albeit more complex description of

²⁵⁸ See ch 8.D.4.2.

²⁵⁹ See in general Van der Merwe *Property in Mixed Legal Systems* 360; Van der Walt (1992) *De Jure* 446–455; Carey Miller *Ownership II* 727, 758.

²⁶⁰ Hall & Maasdorp *Institutes* 27; Van der Merwe *op cit* 365.

²⁶¹ Hahlo & Kahn *Union of South Africa* 578.

²⁶² Voet 5: 2: 1.

²⁶³ Sonnekus *Property Law* 301.

²⁶⁴ Grotius 2: 3: 4; Voet 7: 1: 3.

²⁶⁵ *Property Law* 301.

ownership, identifying eleven elements to provide a complete meaning of the term.²⁶⁶ Legal ownership therefore includes the right to possess, use or manage the income or the capital from a thing.

Ownership gives a person the most comprehensive right in or control over a thing.²⁶⁷ In *Gien v Gien*²⁶⁸ the court denoted ownership as the most comprehensive right that a person can have in relation to property.²⁶⁹ However, the court admitted that ownership may be limited by the law. It follows that ownership like any other right is not absolute. In *First National Bank of SA Ltd t/a Wesbank v Commissioner, South African Revenue Service and another; First National Bank of SA Ltd t/a Wesbank v Minister of Finance* the court reasoned as follows:²⁷⁰

[i]n its context ‘arbitrary’ ... is not limited to non-rational deprivations, in the sense of there being no rational connection between means and ends. It refers to a wider concept that is more demanding than an enquiry into mere rationality.

In reference to section 25 of the Constitution the court further asserted that deprivation would be arbitrary only where the law does not provide sufficient reason for the deprivation or if it is procedurally unfair.²⁷¹

2.2 Requirements

It is impossible to analyse the requirements for the acquisition of ownership at common-law in great detail in this section.²⁷² That is also not the purpose of this section. Instead, basic ownership principles will be highlighted in brief in as far as they relate to money.

²⁶⁶ *Ownership* 113.

²⁶⁷ *Badenhorst Law of Property* 93.

²⁶⁸ 1979 (2) SA 1113 (T).

²⁶⁹ 1120C–D as translated by Neethling *Delict* 114.

²⁷⁰ 2002 (4) SA 768 (CC) [*Commissioner II*] par 65.

²⁷¹ *Commissioner II* par 100. This reasoning was also followed in *Mkontwana v Nelson Mandela Metropolitan Municipality and another, Bisset and others v Buffalo City Municipality and others; Transfer Rights Action Campaign and others v MEC, Local Government and Housing, Gauteng, and others (KwaZulu-Natal Law Society and Msunduzi Municipality as Amici Curiae)* 2005 (1) SA 530 (CC) paras 34–35.

²⁷² For a complete analysis of the prerequisites of ownership, see Carey Miller *Ownership II* 728–735.

At common-law four requirements must be met before ownership of property will pass from one person to some other. In *Dreyer and another NNO v AXZS industries (Pty) Limited*²⁷³ the court asserted that delivery²⁷⁴ of the property coupled with the intention of the parties are required for ownership to pass. It follows that first, pursuant to the *nemo plus iuris* rule the owner must be able to transfer ownership of property to some other.²⁷⁵ Secondly, the person to whom the property is transferred must be able to acquire ownership.²⁷⁶ Thirdly, the owner must have the intention to transfer ownership and the person to whom the property is transferred must have the intention to receive ownership.²⁷⁷ Significantly, in *Unimark Distributors (Pty) Ltd v Erf 94 Silvertondale (Pty) Ltd*²⁷⁸ the court observed that:²⁷⁹

[i]t would still seem as if cases are to be decided on their own facts and that common sense and reasonableness play a prominent role. If someone builds on a piece of land ... there is ownership of the ... material involved, as well as conscious human conduct. ... The owner of the material or thing ... is likely to have something in mind, also with regard to ownership. The *intention* of this person cannot be irrelevant or of little importance ... An intention which is totally insulated from and devoid of reality cannot be recognised and given effect to the law.

Ownership of property therefore will not pass in the absence of a clear *intention* between the parties which is in the form of either an express agreement between them, or an agreement which can be inferred from their conduct.²⁸⁰ The requirement of intention is determined by considering the circumstances of each case.²⁸¹ Fourthly, transfer of ownership of moveables such as money

²⁷³ 2006 (5) SA 548 (SCA) par 17.

²⁷⁴ See in general *Fox Property Rights* 81–85 as regards the delivery requirement.

²⁷⁵ *Mvusi v Mvusi NO and others* 1995 (4) SA 994 (Tk) [*Mvusi*] 999I–J; *Badenhorst Law of Property* 80. Notably, the validity of transfer of ownership is independent on the validity of the underlying transaction (see *Commissioner of Customs and Excise v Randles, Brothers and Hudson Limited* 1941 AD 369 398 – 399, 411; *Trust Bank van Afrika Bpk v Western Bank Bpk en Andere NNO* 1978 (4) SA 281(A) 301H–302A).

²⁷⁶ For example, a child will be unable to acquire ownership in property without the assistance of a legal guardian (*Carey Miller Ownership* 119).

²⁷⁷ Or the *animus* to hold property as owner (*Hahlo & Kahn Union of SA* 574; *Mvusi* 999D–E, 1000J–1001A; *Western Bank* 301H–302A).

²⁷⁸ 1999 (2) SA 986 (T) [*Unimark*]. For the facts of the matter, see ch 8.D.2.1.

²⁷⁹ *Unimark* 1000B–1001H.

²⁸⁰ See *Chong Sun Wood Products Pte Ltd v K and T Trading Ltd and another* 2001 (2) SA 651 (D) 656I–J where the court held that the passing of ownership is ultimately determined by the intention of the parties.

²⁸¹ *Unimark* 998H–999A.

must be completed by *traditio* (delivery) to the acquirer.²⁸² The aforementioned requirements suggest that a fraudster or a thief can never acquire ownership of the money that he fraudulently acquired or stole. This is because the victim of the fraud or theft had no intention to transfer ownership in the money that was fraudulently taken or stolen from him. But what happens when the fraudster or thief deposits the benefits of the fraud or theft with a bank? Can the bank acquire ownership of the deposited funds despite the *nemo plus iuris* rule? These aspects are considered next.

3. Ownership of Money in Account

3.1 Meaning of Receipt

As soon as money is deposited with a bank it ceases to be the property of the account holder. It becomes the property of the bank to deal with the deposited money as it pleases.²⁸³ In the English matter of *Foley*, which was also referred to by the court in *Oneanate I*,²⁸⁴ the court confirmed that banks commonly use money that customers deposited into their bank account.²⁸⁵ The reason for the bank's ownership of deposited money is twofold. First, consider the business of banking. Both the definitions of 'deposit' and the 'business of a bank' in the Banks Act²⁸⁶ suggest that banks operate to receive deposits from the public. Banks require deposits for various reasons, including financial viability, to engage in commerce, for commercial purposes and to facilitate trade and exchange commodities.²⁸⁷

²⁸² *Unimark* 995I-996D; *Chetty v Naidoo* 1974 (3) SA 13 (A) 20C.

²⁸³ This legal principle was established by the court in *Foley v Hill* (1848) 2 HL Cas 28 (HL) [*Foley*] (see ch 6.C.2.1) and followed by the courts in *Perry* par 16 (for the facts of *Perry*, see ch 8.D.2.1); *Janse van Rensburg* 709A—B. See also Cameron *Law of Trusts* 293.

²⁸⁴ 531A.

²⁸⁵ 19D–G.

²⁸⁶ See par B.1 above.

²⁸⁷ See De Jager (2002) *TSAR* 206–207; Hefferman (*Banking* 3-7) explaining that banks depend on long-standing customer relationships to meet loan obligations; Falkena *SA Financial System* 62; Hubbard (*Money* 278–279) who emphasises the profit-seeking side of banks.

From an economic perspective, the primary function of banks is to use deposited money through profited lending agreements.²⁸⁸ None of the functions above would be possible if a bank did not acquire ownership of deposited money.²⁸⁹ This is because, practically regarded, banks must be owners of deposited money in order to engage effectively in financial transactions.²⁹⁰ Ownership of deposited money therefore passes to the bank to enable it to make investments and, hence, profit for itself.

Secondly, a bank acquires ownership of money as soon as it commingles with other funds held in the account. As explained elsewhere in the study,²⁹¹ *commixtio* means that the deposited money mixed in such a fashion with the other money of the bank that it became impossible to distinguish to whom the different coins and notes belong.²⁹² In contrast, deposited notes and coins that are kept in a bag by the bank on the account holder's instructions remain identifiable as the property of the customer who retains ownership thereof. It is submitted that due to electronic banking²⁹³ the latter example is more the exception than the rule so to speak. It follows that in most instances money that is deposited into an account becomes the property of the bank as soon as *commixtio* occurs whilst the account holder gains a personal claim against the bank for repayment of the same amount.²⁹⁴ The bank is further responsible for the amount it received as

²⁸⁸ See in general Samuelson *Economics* 275; Cecchetti *Banking* 263–264.

²⁸⁹ See *Louw NO and others v Coetzee and others* 2003 (3) SA 329 (SCA) [*Louw*] par 13. *Louw* concerned the repayment of trust money which was deposited with Saambou Bank prior to its liquidation. The court *a quo* found that the money did not form part of the bank's assets and order the curator to repay it to the law firm, a decision which the curator appealed. On appeal Lewis AJA agreed with the contention of Saambou Bank's curator that (par 12): '[t]he bank does not hold the money for the customer as agent or trustee: it becomes the owner and has only a personal obligation to repay the amount together with interest if agreed.' It therefore upheld the appeal and confirmed that money, even if held in a trust account, is part of the bank's assets (paras 15–17).

²⁹⁰ A bank as owner of deposited money can do with it as it pleases without having to obtain the permission of the account holder first (see par C.2 above as regards ownership).

²⁹¹ See ch 2.C.4 as regards the criterion of mixing.

²⁹² See in general Van der Merwe *Sakereg* 365; Malan & Pretorius *Malan on Bills* 43; Van Der Merwe *Things* 342; Du Toit *Dematerialisatie van Geld* 10–15; Van Der Merwe par 35 fn41; *Nissan* par 24 (see also par C.3.2.1 below); *Joint Stock* par 42 (see par C.3.2.2 below).

²⁹³ See ch 2.B.2 as regards electronic banking and electronic transfers.

²⁹⁴ See also ch 8.D.2.1–2.2 as regards use of the *rei vindicatio* by a victim of fraud or theft to recover the benefits of fraud or theft from the bank that received the funds.

well as interest and must pay the value of the deposited amount to the customer on demand.²⁹⁵ It is neither an agent nor a factor, but acts in the capacity of the customer's debtor.²⁹⁶ However, sometimes a bank, in addition to its role as a bank, may act in a different capacity and receive money as an agent or trustee. This is for instance where the bank undertakes to sell bills on behalf of the customer.²⁹⁷

Would it be correct to delineate a bank's ownership of deposited money as beneficial ownership instead of legal ownership? Beneficial ownership denotes an entitlement to receive the benefits of ownership where the object's legal title is held by someone else.²⁹⁸ It is perhaps an ownership that exists in little more than an interest in an object. Beneficial ownership does not amount to legal ownership because the rights that a beneficial owner holds over property are restricted. Ancient Roman-Dutch law recognised a division of ownership into full ownership where the title to property and its use were settled in one person, and less than full ownership where title and use were separated.²⁹⁹

In general, South African property law does not recognise the concept of beneficial ownership or divisional ownership. Van der Merwe³⁰⁰ offers a different view and explains that beneficial ownership should be recognised in a construction where the debtor secures nude ownership while the creditor obtains a limited security ownership thereby implying a division of ownership, a view which is also accepted by Cronje.³⁰¹ In contrast, Sonnekus³⁰² criticises the notion that beneficial ownership should be recognised in South African law. At present, beneficial ownership remains unrecognised by our common-law in contrast to English common-law which recognised dual ownership in property.³⁰³ It is submitted that although dual ownership, consisting of legal ownership and beneficial ownership, has not been recognised under South African

²⁹⁵ Except where the bank has concrete evidence that the deposited funds are in fact the benefits of fraud or theft (see par B.2.1.2 above).

²⁹⁶ *Foley* 38–39; *Liebenberg* 309; Stassen (1983) *MBL* 83.

²⁹⁷ Stassen (1983) *MBL* 83.

²⁹⁸ Van der Merwe *Property in Mixed Legal Systems* 365.

²⁹⁹ Van der Walt (1992) *De Jure* 452–453.

³⁰⁰ *Sakereg* 491.

³⁰¹ (1979) *THRHR* 16–25.

³⁰² *Property Law* 311. Sonnekus emphatically states that there is no place in South African law for two ownerships simultaneously on the same thing.

³⁰³ At English common-law dual ownership, which consists of legal ownership and equitable interests or beneficial ownership, of an object is possible (for a detailed analysis of dual ownership under English law, see De Waal (2000) *SALJ* 550–552).

property law, the concept ‘beneficial ownership’ is recognised in other areas of the law albeit with a different meaning attached to it.³⁰⁴

In summary, in the absence of an agreement to the contrary,³⁰⁵ a bank receives money, uses it as it pleases and becomes the debtor of the account holder. It is therefore inaccurate to designate a bank’s ownership of deposited banking as shared ownership. Current AML measures, however, fail to discriminate between the objects of legal ownership and beneficial ownership; any benefit obtained through criminal means is deemed as the ‘proceeds ‘of unlawful activities.’³⁰⁶

3.2 Receipt for Own Use and Benefit

3.2.1 General Principles

Legal research illustrates that a bank’s ownership of deposited money is most often explained with reference to *commixtio* whilst the importance of a bank’s ownership of deposited money on account of the nature of the business of banking is often overlooked.³⁰⁷ It is submitted that the reason for the omission concerns the fact that commingling is a legal concept as opposed to the nature of banking which mostly concerns economical principles.³⁰⁸ Suffice it to emphasise that a bank needs to acquire ownership of deposited money in order to be financially viable.

As explained already,³⁰⁹ when a customer deposits money *in specie* with a bank it usually commingles with other funds of the bank and becomes its property. The bank borrows the deposited amount from the customer and must pay it on demand.³¹⁰ This principle was confirmed

³⁰⁴ For example, beneficial ownership is indirectly recognised by law by vesting ownership in trusts and legal persons.

³⁰⁵ *McEwen* 472D–E; *Dantex Investment Holdings (Pty) Ltd v National Explosives (Pty) Ltd (in liquidation)* 1990 (1) SA 736 (A) [*Dantex*] 749H–750A (see par C.3.2.1 below); *Joint Stock* par 36 (see par C.3.2.2 below).

³⁰⁶ See section 1 of POCA; section 1 of FICA; ch 8.C.4.2.1, par D.4.2.1.1.

³⁰⁷ See, for example, the case law quoted above in par C.3.1 where the courts failed to consider a bank’s ownership of deposited money with reference to the business of banking.

³⁰⁸ See par B.1 above where section 1 of the Banks Act is discussed; ch 2.C.4 as regards the concept ‘*commixtio*’.

³⁰⁹ See above; ch 2.C.4.

³¹⁰ Except where fraudulently acquired or stolen money is deposited into a bank account. In such a case the fraudster or thief will not have a claim against the bank for payment of the amount credited to his account (*Perry* 19; *Nissan* par 21 - see par B.2.1.2 above).

in *McEwen*.³¹¹ The *McEwen* court accepted that when money is paid into a bank account ownership thereof passed to the bank.³¹² Since the debtor in *McEwen* never intended that the money's ownership vested in the account holder, the latter's creditors likewise had no legal right to it. The court therefore ordered payment of the money to the debtor. The fact that a bank becomes owner of deposited money as soon as commingling occurs was further confirmed in *Barnard Jacobs Mellet Securities (Pty) Ltd v Matuson*,³¹³ *Oneanate I*³¹⁴ and *Liebenberg*.³¹⁵ In *Oneanate I* and *Liebenberg* the courts³¹⁶ referred with approval to the following dictum made in *Foley*³¹⁷ as regards the nature of a deposit made by a customer:

[i]t is then the money of the banker ... he makes what profit he can, which profit he retains for himself ... he has contracted, having received that money to repay to the principal when demanded a sum equivalent to that paid into his hands.

In *Oneanate I* the court explained that a customer as creditor of a bank does not owe the money it deposited with the bank.³¹⁸ When the bank pays the deposited money to the customer it pays out

³¹¹ For the facts of the matter, see par B.2.1.2 above.

³¹² 472D–E.

³¹³ 2005 CLR 1 (W) [*Barnard Jacobs*]. The facts in brief form concern an application by B, a cessionary of some monetary claims, for a declarative order that certain funds held in an account as well as money that was refunded to the insolvent estate of a company, ITI, belonged to it. ITI had entered into an agreement to acquire a business. The agreement was subject to certain suspensive conditions which subsequently failed. ITI did not have the necessary funds to pay for the acquisition itself and resorted to 'vendor placing' pursuant to which it proposed to issue shares. The proceeds of the shares issued were to be used to fund the acquisition. Various institutions deposited funds equal to the amount of their commitments into the Vendor Placement Account. The deposits were made provided that the JSE would grant the share listing and were kept in a separate fund. ITI unlawfully misappropriated some of the funds to make payments to Nedcor in reduction of its indebtedness to Nedcor. The acquisition of the business and the listing did not realise and ITI was declared insolvent. Nedcor as part of a settlement repaid some of the funds to ITI's estate. B's case was that the funds held in the Vendor Placement Account were held by ITI as agent on behalf of the institutions pending fulfilment of the condition. The issues before the court therefore concerned the ownership of the refunded funds and the money in the Vendor Placement Account (par 12).

³¹⁴ 531A.

³¹⁵ 308.

³¹⁶ See *Oneanate I* 531A and *Libenberg* 309.

³¹⁷ 19D–G. See also paras B.1 and C.3.1 above.

³¹⁸ 531J–532A

of its own funds and not with the customer's money. The bank then recovers the money paid out by debiting the customer's account. It follows that despite acquiring a 'special property or interest'³¹⁹ in the deposited amount as reflected by his bank statement, the customer's interest in the money constitutes a simple personal right to repayment of an amount similar to the amount deposited.³²⁰

In *Barnard Jacobs* Malan J agreed that although deposited money belongs to the bank, this does not mean that someone else may not be entitled to it.³²¹ In *Bank of Lisbon*³²² the court analysed the situation where fraudulently acquired money was paid into a bank account. It distinguished between two kinds of fraud;³²³ one kind that has no legal consequences, and a second kind that can render a transaction voidable at the insistence of the party that was defrauded. Even though the latter kind of fraud does not affect the passing of ownership to the bank which received the benefits of fraud, there are cases where the fraud is of such a nature that ownership will not pass with delivery of the money.³²⁴ As regards the ownership of the money that was deposited with the Bank of Lisbon, the court succinctly asserted that:³²⁵

[t]he money, being *res fungibiles* and the Bank having received it without reason to believe that it had been stolen ... or obtained by fraud, ownership of the money passed to the Bank when ... paid ... into its account with the bank.

It follows that when the benefits of fraud or theft are deposited into a bank account the funds become the property of the bank.³²⁶ This principle was further confirmed in *Alley Cat Clothing v De Lisle Weare Racing*³²⁷ where the court remarked as follows with regards to ownership of money³²⁸ deposited into a bank account.³²⁹

³¹⁹ *S v Kotze* 1965 (1) SA 118 (A) 125.

³²⁰ *Ex parte Estate Kelly* 1942 OPD [*Kelly*] 272.

³²¹ *Barnard Jacobs* par 26. See also *McEwen* 469H-470A, 472A; *De Hart NO v Kleynhans & Others* 1970 (4) SA 383 (O); *Rousseau NO v Standard Bank of SA Ltd* 1976 (4) SA 104 (C).

³²² See also par B.2.1.1 above.

³²³ 208D–E.

³²⁴ 208F. See also *Nissan* par 23.

³²⁵ 208H–J. See ch 2.C.1.3 as regards money as *res fungibiles*.

³²⁶ See also *Kelly* 272; *Dantex* 748F.

³²⁷ [2002] 1 All SA 123 (D) [*Alley Cat*] (see ch 2.C.5.3.3 for the facts of the case).

³²⁸ Note, R did not deposit cash into his account, but cheques that were stolen from De Lisle (*Alley Cat* 131B).

³²⁹ *Idem* 131A.

[i]t will be of some comfort to those who keep their money under their mattresses to know that they maintain ownership of their coins and notes while those who deposit their money in banks lose their ownership and retain only a personal right against the bank.

The court continued to explain that when cheques are deposited into a bank account, the bank becomes the owner of the moneys which are represented by them.³³⁰ In return, the account holder has a personal right to claim the money back from the bank if he is in credit. If the account is in debit, the bank may set the amount of the cheques off against the account holder's debt. Cheques deposited into a bank account do not refer to actual notes and coins, but merely reflect money which is later credited to the customer's account. When the money is deposited or transferred into an account it become an unidentifiable 'pool of money'³³¹ which is the property of the bank.

In *Amalgamated Society of Woodworkers of South Africa and another v 1963 Ambagsaalvereniging*³³² the court observed in reference to the deposit of an unauthorised donation into a bank account:³³³

I do not think that the fact that the *causa* of the transfer was void renders the transfer of ownership invalid. ... once the money was paid over it became unidentifiable, and rights of ownership if any, were lost. The money can, therefore, not be vindicated.

Likewise in *Standard Bank of SA v Absa Bank Ltd and another*³³⁴ the court made some important remarks as regards the ownership of a stolen cheque that was deposited with a bank despite coming to, it is submitted, an incorrect conclusion as regards the bank's enrichment. The court confirmed that the proceeds of a cheque become the collecting bank's property,³³⁵ but then went on and rejected the collecting bank's contention it could have applied the proceeds of the cheque to set-off the indebtedness of its customer. The court explained as follows:³³⁶

[i]t was in effect stolen money which accounted for the credit in ... [the] bank account. ... The [collecting bank] may be entitled to a set-off to its benefits only and only in

³³⁰ 131B–131I.

³³¹ 132A.

³³² 1967 (1) SA 586 (T) [*Amalgamated Society of Woodworkers*].

³³³ *Amalgamated Society of Woodworkers* 596B–C; *Alley Cat* 132B.

³³⁴ 1995 (2) SA 740 (T) [*Standard Bank*].

³³⁵ 749F–I: '[o]nce the money had reached the [collecting bank] *qua* bank, albeit illegally, ... such money became the property of the [collecting bank]. Against such money, at the best for him, the [customer] had a proprietary right or interest, although it had in fact become the property of the [collecting bank].'

³³⁶ 749E–F. For criticism of the ruling, see Malan & Pretorius (1996) *SA Merc LJ* 399–401; par C.3.3 below.

circumstances where the money is *lawfully* due to its customer At no stage did the money ever become due and lawfully payable to the customer.

Ultimately, the court found that the collecting bank was enriched with the collected amount and therefore had to repay it to the drawee bank.³³⁷ The potential liability of a bank that received fraudulently acquired or stolen money based on one of the unjust enrichment *condictiones* is analysed elsewhere in this study.³³⁸ Suffice it to point out that Standard Bank was not enriched when it applied the proceeds of the stolen cheque to discharge its customer's indebtedness. This is because the bank incurred a corresponding obligation to the customer with the effect that its financial position remained unchanged. Under these circumstances it therefore could not have been enriched.³³⁹

In view of the foregoing it is evident that a bank acquires ownership of money deposited with it. However, the bank's use of deposited money can be tempered by agreement to the contrary by the parties concerned. This was the view of the Court of Appeal in *Dantex*.³⁴⁰ In *Dantex* Milne JA explained that only if Dantex was owner of the money in the bank account as opposed to the bank would it be in position other than a concurrent creditor.³⁴¹ There was no special agreement to that effect between Dantex and Standard Bank. In the words of the court:³⁴²

[i]f there had been an agreement ... that moneys deposited in this account in respect of debts ceded to Dantex could only be withdrawn by Dantex that would, of course, alter the position. That is not the case here. There is no evidence to suggest that the [Standard] Bank agreed to hold the funds in respect of those cheques as agent for Dantex. Had Dantex

³³⁷ See par C.3.3 below.

³³⁸ See ch 8.D.3.2, paras D.3.3.1–3.3.5.

³³⁹ *Nedcor Bank* 730D–E. See also Malan & Pretorius *Malan on Bills* 296; Malan & Pretorius (1994) *TSAR* 390–391.

³⁴⁰ In this case the parties had entered into a factoring agreement in terms of which National Explosives, the respondent, as cedent would offer claims against its debtors for sale to Dantex Investment ('Dantex'), the appellant, as cessionary. The money was to be deposited into a bank account nominated by Dantex. Since Dantex failed to nominate an account, the moneys were paid into the bank account of National Explosives which was then supposed to pay the equivalent over to Dantex. At some point National Explosives ceased payment to Dantex and instead used the money for its own purpose. National Explosives was eventually put in provisional liquidation. Dantex therefore approached the court for an order directing the liquidators to pay over the funds. The court *a quo* refused to grant such an order. It found that in the absence of an agreement to the contrary Dantex had only a personal right as a concurrent creditor to the funds in the account, a ruling which Dantex appealed.

³⁴¹ *Dantex* 748 F-H

³⁴² *Dantex* 749H-750A.

nominated a bank account as provided for in the agreement, and had the cheques in question been paid into that account, the position might have been different.

The funds were not reserved as belonging specifically to Dantex because the account in issue was a general one. As a result, Dantex was not the owner of the money and had to claim payment of the funds as a concurrent creditor. This ruling was accepted by the Supreme Court of Appeal in *Joint Stock*,³⁴³ a case which concerned a disagreement about a bank's use of funds that were deposited with it for a specific purpose.

3.2.2 *Joint Stock Varvarinskoye v Absa Bank Ltd*

3.2.2.1 Facts

The facts in *Joint Stock* are interesting and demonstrate how a common arrangement can have problematic consequences. The parties involved in the matter were Absa Bank, the banking institution where the account in issue was kept, the account holder and a third-party with whom the account holder contracted.³⁴⁴ The appellant was Joint Stock, a company incorporated in Kazakhstan, which was involved with the establishment of a gold and copper mine and processing facilities at a site known as the Varvarinskoye Project in Northern Kazakhstan. Joint Stock appointed MDM Ferroman (Pty) Ltd,³⁴⁵ a South African company, to supply and build a mineral plant for the production of gold ore and copper concentrate. The contract price was in excess of 55 million US dollars. Ferroman was named as lead contractor with the right to appoint sub-contractors. This arrangement involved the use of a special bank account, Account 1313, held at Absa Bank. The money deposited into Account 1313 was to be used to remunerate the sub-contractors. A key fact in this scenario was that Ferroman and various other companies associated with it also held accounts with Absa Bank.

The relationship between Joint Stock and Ferroman became strained with the result that Joint Stock cancelled the contract between them. Ferroman was subsequently placed in provisional liquidation. Absa Bank proposed to apply set-off to the money held in Account 1313 against

³⁴³ See par C.3.2.2.2 below.

³⁴⁴ *Joint Stock* paras 1–21.

³⁴⁵ Or 'Ferroman'.

Ferroman's overdrawn accounts. To this end, it appropriated the money in Account 1313. Joint Stock approached the court for relief. It contested that the money in Account 1313 account belonged to Ferroman and could therefore be subject to a set-off arrangement between Ferroman and Absa Bank. Joint Stock further argued that at the time of Absa Bank's appropriation of the money in Account 1313, no money was owed to Ferroman and that only the sub-contractors had any claim to the money in the account. It therefore sought a declaratory order that the money in Account 1313 belonged to it and requested the court to order Absa Bank to repay it.

The High Court refused to grant the order and found that there was no concrete evidence that the funds in the account belonged to Joint Stock and that Absa Bank was aware of this. It consequently dismissed Joint Stock's application, a decision which Joint Stock successfully appealed.

3.2.2.2 Decision

In his opening statement Navsa JA for the majority made two observations as regards money deposited with a bank. First, it is incorrect to assume it an universal and inflexible rule that only an account holder may assert a claim to money held in its account with a bank.³⁴⁶ Secondly, the proposition that money deposited in an account becomes the property of the bank militates against a legitimate claim by some other party to the money in the bank account. Money in an account may therefore 'belong' to someone other than the account holder or for that matter, the bank holding it.

The court then evaluated the *McEwen* and *Dantex* decisions³⁴⁷ and accepted the courts' findings that money deposited into a bank account belongs to the bank unless when there is an agreement to the contrary among the parties concerned.³⁴⁸ It pointed out that Absa Bank knew of the purpose and the source of the funds in Account 1313.³⁴⁹ Absa Bank agreed that funds could only be withdrawn after a particular procedure were followed and that the account holder had no interest in or control over the funds. Under these circumstances Absa Bank could not rely on set-off

³⁴⁶ *Joint Stock* par 31.

³⁴⁷ See par C.3.2.1 above.

³⁴⁸ *Joint Stock* paras 33–35.

³⁴⁹ *Idem* par 36. However, see *Joint Stock* (par 44) for a contrasting viewpoint.

to justify its appropriation of the funds in issue because it merely acted as Joint Stock's agent to 'warehouse' the money in Account 1313.

In reference to the *Nissan* decision³⁵⁰ where the court found that due to modern banking payment systems ownership in specific coins no longer existed,³⁵¹ the court observed that since the parties agreed that no one other than Joint Stock had a claim to the money in Account 1313, Joint Stock was entitled to relief.³⁵² It therefore upheld Joint Stock's appeal with cost and ordered Absa Bank to pay the amount claimed as well as interest to it. In a separate concurring minority judgment Cachalia JA took the view that the agreement between Joint Stock and Ferroman required that the money paid into Account 1313 was to be held in trust and dealt with only in accordance with *ex contractu* instructions.³⁵³ The court reasoned that if Absa Bank did not have any right to the money, the account holder also had no right to it. Of note, the court said that while Absa Bank may be the owner of the money in Account 1313, it had no right to use it.³⁵⁴ Absa Bank's knowledge of the arrangement between Joint Stock and Ferroman was consequently irrelevant.

3.2.2.3 Discussion: Money for Own Use

Overall, the outcome of the Supreme Court of Appeal in *Joint Stock* cannot be faulted; Joint Stock was clearly entitled to the relief it sought. Absa Bank's conduct in using the money in Account 1313 to set-off the debts of Ferroman was inappropriate. However, it is submitted that the court failed to emphasise the importance of contractual relationship that exists between the bank and the customer.

As discussed elsewhere in the chapter,³⁵⁵ the contract between a bank and customer is *sui generis* whose terms are dependant upon the terms of the agreement between the parties. In the absence of an agreement to the contrary, a bank becomes owner of funds deposited into a current

³⁵⁰ For a detailed analysis of the matter, see ch 8.D.1, par D.2.1.2.

³⁵¹ See *Nissan* (par 24) where the court referred to an observation made in *Graham* (idem 576E–H). See also ch 2.C.4.2 where modern payment systems and the commingling of money deposited into a bank account are discussed.

³⁵² *Joint Stock* paras 29, 42.

³⁵³ *Joint Stock* paras 49–53. See par B.2.1 above as regards the nature of the bank-customer relationship.

³⁵⁴ *Joint Stock* par 51.

³⁵⁵ See par B.2.1 above.

account and may use the money according to whim. The customer obtains a personal claim against the bank for repayment of the deposited amount. The bank is therefore the customer's debtor. These principles are well-established.³⁵⁶

In contrast, where money is held for a specific purpose in an account a special agreement to the effect must exist between the bank and the customer. Although the bank becomes owner of the deposited funds,³⁵⁷ it may only use the funds in the account as instructed by the customer. It is submitted that this was exactly what occurred in *Joint Stock*. The court agreed that Absa Bank was aware of the purpose of Account 1313 as well as the purpose of the funds.³⁵⁸ It further found that Absa Bank acted as Joint Stock's agent to warehouse the money in Account 1313 for that specific purpose. Absa Bank's appropriation of the money in Account 1313 was therefore inappropriate on two accounts. First, it used the funds to set-off the debt of another customer, Ferroman. Secondly, Absa Bank did so without any instruction by the customer, Joint Stock. If not for the special agreement between Joint Stock and Absa Bank in terms of which the money in Account 1313 was to be used to remunerate sub-contractors, Absa Bank may have used the funds according to whim. It is therefore evident that due to the agreement that existed between Joint Stock and Absa Bank, the latter should not have used the money in Account 1313 to set-off Ferroman's overdraft.

However, one remark by Navsa JA for the majority and one remark by Cachalia JA for the minority should be criticised. Navsa JA reasoned that deposits made into a current account may belong to some other than the bank.³⁵⁹ In this regard it is submitted that if this dictum is accepted without reservation it will have some serious consequences for the business of banking. To say that a bank is owner of deposited money yet does not have a right to it does not make sense. As illustrated above,³⁶⁰ ownership confers to a person extended rights to do with the property as he pleases. A bank therefore either acquires ownership of deposited money and may use it as it pleases, or deposited money remains the property of the account holder in which case the bank would need the former's permission to deal with it. In addition, as pointed out already,³⁶¹ the business of banking requires that a bank acquires ownership of deposited money and deals with it

³⁵⁶ See par B.2.1.1 above.

³⁵⁷ See par C.3.1 above.

³⁵⁸ *Joint Stock* paras 36, 44.

³⁵⁹ See *Joint Stock* par 33.

³⁶⁰ See par C.3.2.

³⁶¹ See par C.3.1 above; ch 2.C.4.2.

as it pleases. This is because banks can only engage in financial transactions as owners of money deposited with them. For this reason it is submitted that a bank becomes owner of money deposited into a current account and, therefore, may deal with it as it pleases except where there is an agreement to the contrary between it and the account holder. And it is at this point where Absa Bank's knowledge of the arrangement between Joint Stock and Ferroman becomes relevant which brings me to the second point of criticism.

Cachalia JA for the minority regarded Absa Bank's knowledge of the arrangement between Joint Stock and Ferroman as irrelevant for the purpose of deciding the matter.³⁶² It is submitted that this finding cannot be accepted without reservation. Since Absa Bank clearly knew that the money in Account 1313 was deposited for a specific purpose, it had no right to use it to set-off Ferroman's debt. Moreover, Absa Bank had no instruction to the effect from Joint Stock. It follows that Absa Bank's knowledge of the arrangement is critical in light of the nature of the bank-customer relationship.³⁶³ Even if Absa Bank had no knowledge of the agreement, it still could not have used the money in Account 1313 to set-off Ferroman's debt because Joint Stock as customer did not instruct it accordingly. It is therefore submitted that Absa Bank's knowledge of the purpose of Account 1313 was just as important as the special agreement that it concluded with Joint Stock.

In summary then, from the foregoing evaluation two points must be emphasised. First, money that is deposited with a bank becomes the property of the bank for two reasons. First, due to the nature of the business of banking and secondly, as a result of commingling which occurred in the bank account.

Secondly, a bank may use money deposited into a current account according to whim except if there is an agreement between the parties to the contrary. In that case the bank may use the deposited money only as instructed by the customer. The *Joint Stock* case clearly demonstrates that due to the agreement between Absa Bank and Joint Stock, the bank had no right to use the money in issue to set-off some other person's debt. The latter point connects with the issue that is discussed in the next section, namely, the bank's right to use deposited money to reduce the customer's debts.

3.3 Receipt as Reduction of Overdraft

³⁶² *Joint Stock* paras 49, 50, 53.

³⁶³ See par B.2.1 above.

In *Kearney Hill* the court reasoned as follows:³⁶⁴

[a]ny amount deposited to the credit of the customer immediately upon receipt becomes a loan to the bank and is not held in trust for the customer. The relationship is different when the customer's account is overdrawn. In that case the customer is the debtor and any deposit to his account is in effect pro tanto payment of the customer's indebtedness to the bank.

An overdraft is a loan by the bank which is repayable on demand.³⁶⁵ Each overdraft constitutes a separate debt made to a customer whilst each payment in an overdraft account by the customer are repayments of the amount borrowed from the bank coupled with interest.³⁶⁶ However, the nature of the contract between the parties is not altered or determined by the granting of an overdraft by a bank because the loan merely assist in the execution of the mandate that already exists between the bank and the customer.³⁶⁷

The position of both the bank and the customer as regards an overdraft facility has been aptly summarised by the court as follows:³⁶⁸

[a] bank is not obliged to permit a customer to overdraw. An overdraft, being a borrowing and lending, is a matter of contract which can be expressly or impliedly concluded. Where the parties expressly agree that the bank will permit the customer to overdraw and thereby borrow moneys from the bank, there is usually a limit agreed upon which the bank will not advance further moneys. Often the bank and its customer will only expressly agree upon the limit to which the bank will advance moneys.

Temporary overdraft facilities may be terminated at any time although it generally terminates as soon as the account shows a credit balance.³⁶⁹ Lack of authority to transfer funds from one overdrawn account to another may further result in the bank cancelling the entries and the

³⁶⁴ 650.

³⁶⁵ See in general Willis *Banking in SA Law* 141–143; Malan & Pretorius (1996) *SA Merc LJ* 402–403.

³⁶⁶ *Oeanate I* 546E–H; *Senekal v Trust Bank of Africa Ltd* 1978 (3) SA 375 (A) 384F–H; *Ex parte Minister of Justice* 1978 (2) SA 572 (A) 597F–G. According to the common-law *in duplum* rule a creditor may not claim an amount of interest that exceeds the capital sum that was borrowed (*De Wet Kontraktereg* 230; *LTA Construction Bpk v Administrateur Transvaal* 1992 (1) SA 473 (A) 482; *Standard Bank of South Africa Limited v Oeanate Investments (Pty) Ltd (In Liquidation)* 1998 (1) SA 811 (A) [*Oeanate II*] 828D–E, D).

³⁶⁷ See Malan & Pretorius *Malan on Bills* 318–319; par B.2.1 above. See also Malan & Pretorius (1996) *SA Merc LJ* 403–405.

³⁶⁸ *Oeanate I* 545G–I.

³⁶⁹ *Sarwan* 55; Fourie *The Banker* 111–113.

repayment of the overdraft that would have been effected by them.³⁷⁰ In *Sarwan* the court asserted that the right of a bank to reverse an overdraft facility is an implied term of the contract and as such independent of the intention or knowledge of the parties.³⁷¹ An overdraft is further immediately repayable unless otherwise agreed to by the parties.³⁷² However, the bank must give the customer reasonable notice before withdrawing the overdraft facilities.³⁷³

The common-law *in duplum* rule entails that interest stop running as soon as the unpaid interest equals the unpaid capital.³⁷⁴ A bank may therefore not recover more than the unpaid capital together with interest which equals the capital of the debtor. Interest debited by a bank to the customer's overdrawn account and added to the outstanding capital amount does not lose its character as interest and thus does not constitute capital.³⁷⁵ Where a customer owes a bank capital and interest as part of the same debt, any payments that are made are credited first to the repayment of the interest amount and only after that to pay the outstanding capital amount.³⁷⁶ Therefore, *Clayton's case* rule, which was mentioned earlier,³⁷⁷ is also applied by our courts. Malan and

³⁷⁰ *Oeanate II* 823B–I. A bank that credits the wrong overdraft account by mistake, may, however, not merely cancel the incorrect entry (*First National Bank of Southern Africa Ltd v Acufin Industries (Pty) Ltd* 1995 CLD 157 (W)).

³⁷¹ *Sarwan* 55. In *ABSA Bank Ltd v IW Blumberg and Wilkenson* (1997 (3) SA 669 (A) [*Blumberg*]) the bank did not expressly grant an overdraft to the customer. Yet, it honoured the latter's cheques when no funds were available. When it demanded repayment from the customer, the latter countered that since an overdraft was never agreed upon, the bank should meet the loss (675–676). The court disagreed. It ruled that the customer requested a loan and thus borrowed the money from the bank when it honoured the customer's cheques in absence of an overdraft facility (676C–D).

³⁷² *Oeanate I* 550I–J; *ABSA Bank Bpk v Saunders* 1997 (2) SA 192 (NKA) 196J.

³⁷³ Cf sections 229–230 of the Credit Act which set out the procedures to be followed should a customer fail to repay a loan. In *Penderis and Gutman NNO v Liquidators, Short-term Insurance Business, AA Mutual Insurance Association Ltd* (1992 (4) SA 836 (A)) the court held that it was not established that an overdraft was valid only for as long as the notarial bond remained undamaged. In contrast, in *Van Aswegen* the court ruled that an overdraft is terminated as soon as a surety withdraws (496C–H).

³⁷⁴ *Oeanate I* 559I–J; *LTA Construction Bpk v Administrateur, Transvaal* 1992 (1) SA 473 (A) [*LTA Construction*] 481H–482C; *F & I Advisors (Edms) Bpk v Eerste Nationale Bank van Suidelike Afrika Bpk* 1999 (1) SA 515 (SCA) [*F & I Advisors*]; Malan & Pretorius (1996) SA *Merc LJ* 403–405; Schulze (1999) SA *Merc LJ* 112–117.

³⁷⁵ *Oeanate I* 561I–561A–B, 572A–B; *LTA Construction* 482F–G. See also Malan (1993) SA *Merc LJ* 300 where the legalities of overdrafts and interest rate changes are considered.

³⁷⁶ *Oeanate I* 572J–573A.

³⁷⁷ See par B.3.1 above.

Pretorius³⁷⁸ disagree and argue that the rule in *Clayton's case* is inequitable. As a result, the common-law should be applied so that payments by a customer are first applied towards interest and thereafter to outstanding capital.

Further, whether a debtor can waive the benefits of the *in duplum rule* has been considered by the courts.³⁷⁹ It would seem that the *in duplum* rule as part of our common-law cannot be waived merely to accommodate banking practice.³⁸⁰ Schulze³⁸¹ proposes that where a debtor waived the benefits of the *in duplum* rule, it should not be construed as an exception to the rule. Instead, the waiver should be regarded as a novation of the original debt if it is possible to find such an intention in the common intention to cancel the original contract and replace it with a new agreement.

A curious situation prevails where the bank used deposited benefits of fraud or theft to discharge the customer's overdraft. In *Standard Bank*³⁸² the court had to decide whether a drawee bank which paid the proceeds of a cheque with forged signatures could recover the amount from the collecting bank which used part of the funds to discharge the customer's indebtedness. The court reasoned that since the cheque in issue was corrupted by the forgery, no credit existed which the bank could have collected on behalf of its customer.³⁸³ Consequently, neither the customer nor the collecting bank could 'properly and lawfully'³⁸⁴ have received the proceeds of the cheque in issue. The court further disagreed with collecting bank's contention that after payment for the cheque has been received, set-off of the customer's indebtedness occurred by operation of the law. More specifically, the court reasoned as follows:³⁸⁵

[t]his argument based on set-off has several flaws. The first of these is that the cash which ... was credited to the account ... arose on account of theft and forgery and was thus a nullity. It was stolen money which accounted for the credit in [the] ... account. ... The [bank] may be entitled to set-off to its benefit only ... where the money is *lawfully* due to its customer.

³⁷⁸ *ABLU-1996* par 7.

³⁷⁹ *Zimbabwe* 322E–326B; *Oeanate II* 828D–E; *F & I Advisors* 525G.

³⁸⁰ See *Oeanate II* 828D–E. In the *Zimbabwe* case the court agreed that since the *in duplum* rule was conceived as protection, waiving it would be against public policy. The court did, however, agree that it is possible for the parties to *ex post facto* agree to a novation of the principal debt (321F–G).

³⁸¹ Schulze (1999) *SA Merc LJ* 117.

³⁸² See in general par C.3.2.1 above; Malan & Pretorius (1996) *SA Merc LJ* 403–405.

³⁸³ *Standard Bank* 749A–B.

³⁸⁴ *Idem* 749B.

³⁸⁵ 749C–F.

Since set-off is not possible *ex turpi causa*, the money in this matter could have never become lawfully payable to the collecting bank's customer. The court therefore found that the drawee bank was impoverished and the collecting bank enriched with the stolen money and, therefore, it could recover the amount of the cheque from the collecting bank with the *condictio sine causa*.³⁸⁶ The court's ruling was appealed to the Supreme Court of Appeal which agreed with the decision of the court *a quo*.³⁸⁷

Four remarks as regard the court's decision in *Standard Bank* are necessary. First, a bank that received the benefits of fraud or theft into a bank account and subsequently realises that the deposited money was acquired through criminal means is precluded from paying it to the fraudster or thief on demand.³⁸⁸ However, as submitted elsewhere in the chapter,³⁸⁹ the bank may not refuse to pay deposited money to the account holder if there is no concrete evidence to support its suspicion that the money was acquired through criminal means. The bank must therefore have proof, for example, knowledge of an ownership claim against the account holder before it can refuse to pay the benefits of fraud or theft to the account holder on demand. Secondly, bank that refuses to pay the deposited benefits of fraud or theft to the account holder must hold the money for the claimant (victim of the fraud or theft) until the court can decide the matter.³⁹⁰ Since the fraudster or thief as account holder no longer has a claim against the bank for payment of the deposited amount,³⁹¹ the bank quite possibly may be enriched with the amount. However, whether it will be necessary or possible for the victim of fraud or theft to claim the deposited benefits of fraud or theft from the bank with one of the unjust enrichment *condictiones* is considered in detail elsewhere in the study.³⁹²

Thirdly, the assets of a bank that used stolen money to pay the overdraft of the fraudster or thief, do not increase with the amount received because the payment involves a book entry. For this reason it is submitted that in *Standard Bank* the collecting bank's financial situation remained

³⁸⁶ *Standard Bank* 745C–D. See ch 8.D.3.3.2 as regards the *condictio sine causa*.

³⁸⁷ *Absa Bank Ltd v Standard Bank of SA Ltd* 1998 (1) SA 242 (SCA).

³⁸⁸ See par B.2.1.2.2 above.

³⁸⁹ *Ibid.*

³⁹⁰ Note that the court may also order civil forfeiture of the money in the fraudster or thief's account (see ch 8.D.4).

³⁹¹ See paras B.2.1, paras C.3.1–3.2 above.

³⁹² See ch 8.D.3.2, par D.3.3.1–3.3.5.

unchanged when it used the stolen money as payment of the customer's overdraft. It therefore could not have been enriched with the proceeds of the cheque.³⁹³ Since Standard Bank was not enriched, the *condictio sine causa* could not have laid to avail the drawee bank in a claim against it.³⁹⁴ It is fourthly significant that the court recognised the difference between receiving payment for a cheque with a forged signature on it and receiving payment for a cheque which was validly drawn. It is submitted that knowledge on the side of the bank as regards the fact that it may be dealing with a forged cheque is pivotal before civil liability will be imputed to the bank. A bank that is suspicious about the purpose of a transaction³⁹⁵ is required in terms of section 29(1)(b)(ii) of FICA to file a STR to the FIC.³⁹⁶ If the bank fails to report its suspicions, it will be prosecuted for a money laundering offence.

From the foregoing, it should be evident that as soon as a bank does business with a person whom it suspects may be a criminal a number of contentious issues are imported as regards the bank's position *vis-à-vis* the deposited money and the account holder's right thereto. Some of the issues include, for example, the bank's potential civil liability whilst exercising control over the money or where it parted with deposited money which turns out to be the benefits of fraud or theft. These and other related issues are explored in detail elsewhere in the study.³⁹⁷

D. CHAPTER COMMENTARY AND SUMMARY

This chapter examined aspects of the bank-customer relationship under South African law. Its focus was cast on the banking jurisprudence of South Africa with analogies drawn from the common-law. Some of FICA's provisions were analysed in an effort to ascertain whether it could resolve the tension that exists between the confidentiality duty of banks and their reporting duty. The chapter essentially illustrates that a bank that filed a STR pursuant to FICA is likely to find

³⁹³ See *B & H Engineering* 294I; ch 8.D.3.2.

³⁹⁴ Note that the facts of the case dictates this submission. For similar criticism against the court's decision, see Malan and Pretorius ((1996) *SA Merc LJ* 400) who explain that the '[t]he bank has received what was due to it, *suum recipit*.' See also ch 8.D.3.3.2.

³⁹⁵ For example, the bank may suspect that the account holder is using the benefits of fraud or theft to discharge a debt to the bank as part of a money laundering scheme (see ch 4.B.4, par D.1).

³⁹⁶ See ch 8.C.4.2.3.3.

³⁹⁷ See ch 8.D.2–3.

itself proverbially between the devil and the deep blue sea, the devil being the customer and the deep blue sea, the FIC.

It was shown that over the years different opinions were expressed as regards the nature of the bank-customer relationship, varying from one of debtor and creditor to some kind of a contractual agreement. A finer reconciliation of the various positions establishes the bank-customer relationship as one of debtor and creditor deriving from a contract of mandate. It was further illustrated that a contract between a bank and customer will be *ab initio* void only if both parties were aware at the time of concluding the contract that the bank account will be used for an illegal purpose. It follows that a mere subsequent suspicion by the bank that a transaction may be conducted for money laundering purposes does not affect the legality of its agreement with the customer. However, there can be no gainsaying that the bank-customer relationship is influenced by current money laundering control measures.

Recent case law illustrated that a bank that suspects that deposited funds may be the benefits of crime may terminate its relationship with the customer. Although a bank generally has to pay money that was deposited with it to the account holder on demand, this duty has recently been influenced by the reality that bank accounts are used by criminals as conduits for money laundering. The courts consequently found that a bank that suspects that deposited money may be the benefits of crimes such as fraud or theft must refuse payment thereof to the account holder. The reason is that the account holder may not be not entitled to the deposited money. The bank may therefore be holding the money for a victim of crime such as fraud or theft. However, it was submitted that in the absence of an interdict or concrete evidence that deposited money is indeed the benefits of fraud or theft the bank may have little choice but to continue with a transaction as instructed by the account holder or risk being sued by the latter for breach of contract.

The bank's duty of good faith then fell under the spotlight. It was seen that a bank's confidentiality duty is an extension of its duty of good faith. FICA imposes mandatory customer identification and suspicious transaction reporting obligations on banks. Various difficulties for banks were left in its wake as regards reconciling common-law principles of confidentiality with statutory imposed reporting duties. In particular, the chapter showed that the reporting duty of FICA directly conflicts with the confidentiality duty of banks. It was soon evident that it is impossible for banks to observe absolute customer confidentiality in light of FICA's reporting duties. It was further submitted that the *ex turpi causa* rule which applies to illegal contracts could have resolved the dilemma of banks because if applicable, it could have voided the contractual relationship

between the bank and the (criminal) account holder. For a bank an outcome of this kind would mean that it would be under no obligation to observe its confidentiality duty to the account holder. Unfortunately, this is not the case. As the chapter illustrated, despite the account holder's suspected *male fides*, the contract between a bank that acted in good faith and the account holder remains valid because it was validly concluded. It follows that the bank is left with little choice but to heed the provisions of FICA and to file a STR when required.

The investigation further revealed that despite FICA's safe-harbour provision, a door has been left open for the filing of a civil suit against a bank by a disgruntled customer. In the end it was established that FICA fails to resolve the tension that exists between bank confidentiality and the reporting duty of banks. It was therefore recommended that a bank when faced with the decision whether or not to disclose customer information should turn to the courts for guidance despite it being a potential costly avenue to follow.

Further in this regard, two additional solutions were proposed which may resolve the tension between the confidentiality duty of banks and their reporting duty pursuant to FICA. First, it was proposed that Parliament should amend section 38(1) of FICA so that a bank that filed a STR pursuant to section 29 of FICA is protected against all subsequent criminal and civil litigation and not simply where a report was filed in good faith as the situation currently stands. In this regard, the safe-harbour provisions of international AML legislation³⁹⁸ can provide valuable assistance in determining which type of amendment to FICA would be most appropriate.

Secondly, additional guidelines as regards the extent of a bank's confidentiality duty to customers may be of assistance to banks. It is submitted that in the absence of suitable bank industry guidelines banks may decide individually as opposed to collectively how to deal with a situation. However, as in most legal matters a uniform approach does not only enhance the bank-customer relationship, but is also likely to counteract uncertainty in this regard on the side of both banks and customers. It follows that guidelines on bank confidentiality would not only promote consistent enforcement of the law, but may also save banks the costs of approaching the courts for guidance, costs that are usually relayed back to customers. In the meantime, given the absence of guidance in this regard, it is proposed that banks in cooperation with the Reserve Bank should assume a leadership role and consider issuing guidelines which advise banks how to protect

³⁹⁸ See ch 5.C.1; ch 6.B.3.6, par C.2.2; ch 7.B.2.

themselves against civil litigation as well as how to deal with requests for disclosure of customer information.

The chapter then continued to examine a bank's ownership of deposited money, be it legitimately earned or through criminal means. It was shown that money paid into a bank account becomes the property of the bank whilst the customer acquires a personal claim against it for payment of the amount instead of a right *in rem* to the deposited money. The analysis revealed that due to the business of banking a bank indeed becomes owner of deposited benefits of crime. It was submitted that a bank as owner may do with deposited money as it pleases except if there was an agreement to the contrary between it and the account holder. Further in this regard, it was seen that POCA penalises the acquisition of the benefits of fraud or theft with confiscation and forfeiture. POCA therefore violates the notion that ownership is an absolute right. It was submitted that although title to the deposited benefits of fraud or theft passes to the bank when a deposit is made, the account holder is the owner of the debt that the bank owes as a consequence of the deposit. It follows that it is that debt and not the original deposited the benefits of fraud or theft that is the subject of a civil forfeiture application.

The chapter further illustrated that a curious situation prevails where a bank sought to apply the benefits of fraud or theft towards reducing the account holder's overdraft. This scenario is likely to create a number of legal difficulties for the bank where it is interdicted from applying the deposit to reduce the customer's overdraft or where the money is the subject of civil forfeiture proceedings. Ultimately, it is the bank that is left to face the proverbial music. This chapter demonstrated that there are no easy solutions to the conundrum presented by FICA and POCA's AML provisions. From the analyses it is further evident that money laundering control enjoys preference to all other issues that are detrimentally affected by AML measures.

To draw from the chess analogy, the sacred role of banks in the money laundering control effort cannot be overemphasised. It is evident that FICA and POCA were not enacted for the protection of banks. Yet it is ironic that money laundering control would be unattainable if not for the active participation of banks in the AML effort. There is no gainsaying that if banks are beaten by criminals in the game of money laundering control, any effort to reduce crime would be in vain.

In Chapter 4 the reasons for money laundering control are examined. It will be shown that money laundering is an insidious crime that carries considerable adverse consequences for a country that has inefficient measures in place to combat it. Chapter 4 of the study is therefore an

attempt to promote the necessity for money laundering controls in banks. To this end, it will be argued that it is impossible to sufficiently accentuate the role of banks in money laundering control in general and in particular, in identifying criminals and the monetary benefits of their criminal activities. Against this background, the mechanics of money laundering and related issues are examined in the next chapter.

[Chapter 4 to follow]

PTO

CHAPTER 4**THE JURISPRUDENCE OF MONEY LAUNDERING**

Reason in Chess ... is not of the mathematical order. Chess is no certainty. And when it becomes one, Chess will have ceased to be useful.

LASKER *Chess* 15

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A. INTRODUCTION

Already in biblical times instances were recorded where persons attempted to conceal and disguise the origin and ownership of money acquired through criminal means.¹ This is in essence what

¹ See *The Bible* Acts 5, verses 1–10 where the conversation between Ananias and Peter is recounted.

money laundering entails - concealing the nexus that money has to criminal conduct so that it can be used by criminals without fear of incrimination.² Criminals who through unlawful activities dispose of money need to give it a legitimate appearance which is where money laundering comes in.³ The end result of a successful money laundering scheme is twofold; the criminal nexus of the benefits of crime has been concealed and, therefore, the benefits of crime can be moved freely through the banking system to be used to finance future illegal activities. Money laundering therefore allows crime to thrive.

Chapter 2 of the study established that money is by itself a neutral medium, but the criminal conduct and intention of its owner or possessor designates it as the benefits of crime.⁴ In turn, Chapter 3 illustrated that money laundering and money laundering control carry unforeseen consequences for the bank-customer relationship. In particular, it was established that section 29 of FICA has eroded the confidentiality duty of banks. This chapter sets out to investigate whether the characteristics and consequences of money laundering warrant the imposition of stringent AML measures. Accordingly, the jurisprudence of money laundering is examined within the context of the following critical aspects: (I) the characteristics of money laundering; (II) the money laundering process; (III) the manner in which criminals use banks to facilitate money laundering; and (IV) the consequences that money laundering carries. The chapter concludes with a summary and some commentary as regards the nature of money laundering.

B. WHAT IS MONEY LAUNDERING?

1. Definition

² Madinger & Zalopany (*Money Laundering* 13) compare money laundering to stage magic; the benefits of crime do not disappear but are merely concealed which renders the funds harder to find.

³ See in general Rider *War on Terror and Crime* 63 ev; Lilley *Dirty Dealing* 64 ev; Clutterbuck *Drugs, Crime & Corruption* 5; Bosworth-Davies & Saltmarsh *Economic Crime* 42; Reuvid *Focus on Laundering* 178–179; Rider *Taking the Profit Out of Crime* 1; Hinterseer *Criminal Finance* 12 ev; Stessen *Money Laundering - Enforcement Model* 83; Palmer *Trade Finance Risk* 5; Rider (1999) *J of Money Laundering Control* 212; Intriago *International Money Laundering* 3; Hinterseer *Laundering and Tracing* 3 ev.

⁴ See ch 2.C.5.

The literature, in an effort to define money laundering, distinguishes between functional definitions that describe money laundering from a phenomenological point of view and legal definitions used in legal text, such as statutes, directives, and case reports that deal with the criminal liability of money launderers.⁵ In this chapter only the functional definitions of money laundering that are essential for establishing what the process of money laundering involve are examined.⁶

Despite a suggestion to the contrary,⁷ academics produced for the most part similar definitions of what money laundering amounts to.⁸ Money laundering is widely understood as the process of concealing⁹ the origin or ownership of the benefits of crime, or the illegal nature of a financial transaction.¹⁰ The definition comprises four elements, namely:¹¹

- a process;
- a particular outcome: concealing the origin and or ownership of money;
- the object of the process: the benefits of crime; and
- a goal: foiling the AML authorities.

Although the definition above describes the money laundering process correctly, it has been proposed¹² that definitions that describe the money laundering process fail to suffice as far as delimiting what money laundering amounts to. The difficulty is that in most legal instruments

⁵ Schudelaro *Electronic Payments* 53.

⁶ In contrast, legal definitions of money laundering may vary between legal instruments and jurisdictions (see ch 6.B.3.4, par B.3.6; par C.3.4; ch 7.C.2–3; ch 8.C.3.2, par C.4.2.1).

⁷ See Shams (*Money Laundering* 365) who proposes that fundamental differences exist among the elements of money laundering definitions. This is due to the various priorities and perspectives between prosecutors, attorneys, bankers and regulators coupled with the disparities that exist between government AML policies. It is submitted that despite the latter differences the core elements of the money laundering definitions are identical (see below).

⁸ Rider *Taking the Profit Out of Crime* 1; Alldridge *Money Laundering Law* 2; Bosworth-Davies & Saltmarsh *Money Laundering* 5; Schudelaro *Electronic Payments* 54; Hinterseer *Criminal Finance* 16; Schaap *Fighting Money Laundering* 12; Stessen *Money Laundering* 5; Reuter & Truman *Chasing Dirty Money* 25.

⁹ The reasons for concealing the criminal origin of money is three-fold (Saxena (1998) *St Thomas L R* 685; OECD *Corporate Veil* 34), namely to avoid prosecution, prevent forfeiture by the state and to enable use of the benefits of crime.

¹⁰ Savona & De Feo *International Money Laundering Trends* 10. Note, money laundering is called ‘riciclaggio’ in Italia, ‘blanqueo’ in Spanish, ‘blanchiment’ in French, ‘witwassen’ in Belgium and ‘Geldwäsche’ in German.

¹¹ Shams *Money Laundering* 365.

¹² Savla *Money Laundering* 7.

studied in this study the concept 'benefits of crime' has been defined in such a manner that it excludes activity that is not criminal from the ambit of money laundering.¹³ Therefore, it may be more sensible to refer to a non-legal source such as a dictionary to find a practical definition of money laundering. Therefore, money laundering¹⁴ concerns the movement of illegality acquired money through foreign banks to make it appear to originate from legitimate sources. Part of this definition is, however, inaccurate because it suggests that money laundering may be conducted through foreign banks only. The dictionary definition of money laundering also fails to describe the actual money laundering process. It follows that a clear distinction should be drawn between legal and functional definitions of money laundering because legal definitions usually provide a finer rendition of what money laundering amounts to.¹⁵

Money laundering has further been defined in a narrow sense or in a broad sense.¹⁶ Broadly regarded, money laundering is an element of two concepts, namely financial abuse and financial crime. Financial abuse describes a system that, due to a lack of proper regulation for example, poor financial supervision, allows criminal activity to grow which results in an exploitation of national and international economic systems. A financial crime is any type of illegal activity that results in a financial loss.¹⁷ It follows that in a broad sense money laundering is a type of financial abuse and, or a financial crime. But even broad definitions of money laundering fail to encompass all the dimensions of the crime such as the desire of criminals to protect their money from forfeiture by the state.¹⁸ It is submitted that if not for the threat of civil forfeiture there would be no need to protect the benefits of crime from the authorities by making it appear legitimately derived.

The narrow functional definition of money laundering describes the money laundering process.¹⁹ One may say that money laundering is the final stage of committing a crime; if the

¹³ See ch 2.C.5.3 where three categories of the benefits of crime are considered.

¹⁴ See Simpson & Weiner *Oxford Dictionary* sv 'launder'; Collins *Dictionary* (sv 'launder') where laundering is defined as: 'to make (money illegally obtained) appear to be legally gained by passing it through foreign banks or legitimate enterprises.' Note the restriction of money laundering to foreign banks only. This is obviously incorrect to suggest that money laundering takes place through foreign banks only (see par B.2 below).

¹⁵ As to which, see ch 6.B.3.6, par C.3.4; ch 7.C.2–3; ch 8.C.4.

¹⁶ IMF *Financial System Abuse* par 5; Williams (1997) *SA J of Internat Affairs* 73.

¹⁷ IMF *Financial System Abuse* paras 9–11; IMF *Financial System Abuse* Annex III: *What is a Financial Crime - A Survey of Concepts* 20–21.

¹⁸ See Williams (1997) *SA J of Internat Affairs* 73 designating this desire the 'most fundamental component of money laundering.'

¹⁹ See par B.4 below.

process is successful, it will allow the criminal to enjoy the benefits of his criminal conduct without fear of prosecution.²⁰ Definitions of this kind are more acceptable from a legal viewpoint because they describe the essence of money laundering which is to conceal the benefits of crime's connection to unlawful activities. For this reason Van Duyne²¹ favours a narrow definition of money laundering. He prefers a meaning of the concept that hinges on the component 'laundering' and argues that any definition of money laundering must be restricted to its purpose, namely to legitimise the benefits of crime. Therefore, so the argument runs, as long as the benefits of crime have not become legitimate, money laundering has not been committed. This narrow definition of money laundering gives way to simple and unambiguous definitions such as 'money laundering is falsely claiming a legitimate source for an illegally gained advantage.'²²

Some other functional definitions of money laundering uses the phrase 'asset and income laundering' to delimit the crime.²³ Asset and income laundering is the process through which illegally obtained assets and income have been disguised and subsequently are considered legitimately acquired. This shift from illegality to legality requires concealment of the assets and income that reduces the risk of identifying the criminal origin of the benefits following the money laundering process. Rider²⁴ protests that the concept 'money laundering' invokes only the shady world of 'men in wide-striped suits claiming to be bankers that act for ill-defined customers and vague offshore enterprises.' It fails to depict the sophistication and complexity of contemporary money laundering techniques. Although Rider may be over-dramatic in his criticism of the concept, at this point it should be evident that there is nothing elementary about contemporary money laundering techniques. A final popular definition of money laundering that is related to shady financial dealings is the description of money laundering as a type of financial manipulation.²⁵ Financial manipulation transpires due to the use of offshore bank accounts to facilitate complex financial transactions in jurisdictions that are protected from foreign investigations.

The above definitions share the common truth that money laundering is about making illegally acquired benefits appear like legally obtained money. This endeavour is often regarded as

²⁰ OECD *Corporate Veil* 34.

²¹ *Money Laundering* 68–70.

²² Van Duyne *op cit* 70.

²³ Thoumi *Transnational Crime* 122; IMF *Money Laundering and the Financial System* 3.

²⁴ *Taking the Profit Out of Crime* 3; (1996) *J of Fin Crime* 235.

²⁵ Levy *Global Corruption Report* 204; UN *Financial Havens* 41.

a simplistic process.²⁶ Few recognise that the process of laundering money involves a chain of events as well as different legal enforcement considerations that must be reckoned with.²⁷ The past three decades saw money laundering changed from being an unstructured series of events to the present sophisticated and organised system of so-called ‘alternative financial management.’²⁸ To facilitate money laundering the involvement of a financial institution, preferably a bank, is required.²⁹ After considering various functional definitions of money laundering, it is proposed that any definition of money laundering should comprise the following three core elements: one, illegally acquired money, known as the benefits of crime, two, a nexus between money and criminal activity, and three, conduct aimed at concealing the latter nexus. Therefore, a purely functional definition money laundering should describe money laundering as any type of conduct aimed at concealing the nexus that exists between money and a criminal activity.

Since the functional definition of money laundering has been established, the next issue to consider concerns the purpose of money laundering. Contemporary money laundering operations are diversified across financial sectors and pertain to core and non-core financial activities of all types of businesses.³⁰ The benefits of crime may be transferred through legitimate businesses to conceal their criminal source.³¹ In banks the funds may be subjected to a series of transactions to appear like income derived from legitimate financial investments.³² Any money laundering process is aimed at concealing the trail³³ that connects the benefits of crime to the illegal activities through which they were acquired or from which they originated. For this purpose the process may be straightforward or it may involve variable criminal activities.³⁴

²⁶ Rider *Washing Wealth* 10.

²⁷ For example, the KYC standard which is central to all effective AML measures (cf ch 5.B.3.2–3.4; ch 6.B.3.4, par B.3.6, par C.3.4; ch 7.C.2–3; ch 8.C.4.2.3).

²⁸ Bosworth-Davies & Saltmarsh *Money Laundering* 5–6; Van Duyne (1994) *J of Asset Protection* 60; Comstock (1994) *Northwestern J of Internat L & B* 141.

²⁹ See par C below.

³⁰ IFAC *Anti-money Laundering* 5; Savona *Money Trails* 3.

³¹ Munro (2001) *J of Fin Crime* 134; Comment (1985) *Tex Internat LJ* 136–137.

³² OCC *Money Laundering* 3

³³ Cohen & Carroll *United States* 705; Welling (1998) *Florida Law R* 327.

³⁴ Robinson *Laundrymen* 269; Hill *Money Laundering - Work of Art* 28. The irony is that conduct that is criminal in one jurisdiction may be legal in some other jurisdiction (Strange *Mad Money* 124). See also ch 2.C.5.3 where the concept ‘benefits of crime’ is analysed.

In general, money launderers have a key objective, namely to disguise the ownership and the source of the benefits of crime whilst maintaining control over the money.³⁵ By virtue of the money laundering process a number of offenses are committed. Stessen³⁶ denotes the principal purpose of money laundering as concealing the link between the benefits of crime and the crimes that produced the funds so that the money can be used again without risk of detection. For this reason money laundering has been described as the ‘life blood’ of criminal enterprises.³⁷ In summary, the benefits of crime that have been successfully laundered serve two purposes. First, the money can be used to advance further criminal activity and secondly, it renders linking a specific criminal activity to an individual impossible.

2 Historical Development of Money Laundering

2.1 Historical Context

The fact that so much crime exists today is proof that crime pays.³⁸ It follows that crime is war-proof, terrorist-proof and independent of the price of commodities.³⁹ Since the end of the Cold War a global increase in corruption, organised crime and drug trafficking has been observed.⁴⁰ This is due to globalisation⁴¹ that has affected not only world economies, but unsurprisingly also has presented new opportunities for organised crime.⁴² In particular, globalisation of financial markets has assisted organised crime syndicates in their money laundering activities.⁴³ Therefore, it is

³⁵ Antoine *Confidentiality in Financial Law* 147; Abadinsky *Organised Crime* 343.

³⁶ *Money Laundering - Enforcement Model* 5.

³⁷ Gilmore *Dirty Money* 23.

³⁸ Graham *Money Laundering* 1.

³⁹ See IMF *Money Laundering and the Financial System* 1–14 where the impact of crime on society and the economy is analysed in detail.

⁴⁰ Jordan *Drug Politics* 98.

⁴¹ Globalisation is a contested concept that essentially entails subverting sovereignty with capital networks and trade (Ruggiero *Global Markets and Crime* 173). It is characterised by increased deregulation and privatisation (Alldridge *Money Laundering Law* 7).

⁴² Fisse & Fraser (1993) *Alabama LR* 738; IMF *Money Laundering and the Financial System* 1; Hannerz *Transnational Connections* 18.

⁴³ This is because globalisation of world capital markets allows for the movement of money across borders (Lilley *Dirty Dealing* 2–3; Tanzi *Money Laundering and the Financial System* 1–2; Arlacchi *Need for Global Attack* 5).

suggested that money laundering presents ‘a continuation of the liberal rule of profit maximisation at a time of globalisation of trade.’⁴⁴ Organising crime allows it to prosper.⁴⁵ Money laundering provides a pivotal ‘juncture’⁴⁶ between the criminal world and the legitimate society.

As mentioned elsewhere,⁴⁷ concealing the source of money is nothing new. It is a practice as old as ‘the need to hide one’s wealth from prying eyes and jealous hands.’⁴⁸ In medieval times credit agreements were branded by the Roman Catholic Church as criminal acts.⁴⁹ People consequently resorted to other ways of concealing and moving money. The objective was to make interest charges either disappear or to change them into something different.⁵⁰ However, separating income from the business that produced it is a contemporary practice and something more sinister.⁵¹

⁴⁴ Fabre *Criminal Prosperity* 67.

⁴⁵ Fisse & Fraser (1993) *Alabama LR* 738; Ruggiero *Global Markets and Crime* 174. Criminals from strife-torn countries tend to migrate to developed or developing countries where they continue their activities. See also ch 8.B.1 as regards the situation in South Africa.

⁴⁶ Williams (1997) *SA J of Internat Affairs* 72.

⁴⁷ See ch 3.B.2.3.

⁴⁸ Bosworth-Davies & Saltmarsh *Economic Crime* 43-44; Rider *Washing Wealth* 1.

⁴⁹ Blum et al *Financial Havens* 2--4. See, for example, in Shakespeare’s *Merchant of Venice* where Shylock despised by Antonio simply because Shylock charged interest on the money he lent (Rosenshield (2002) *Shofar* 34–35). In contrast, see Noodt (*Interest-Bearing Loans* 85–91) who presents various examples to rebut suggestions that the church prohibited the practice of charging interest on loans

⁵⁰ Rider (*Washing Wealth* 1) correctly points out that although methods employed by modern money launderers are more sophisticated than those used by Indian jewel smugglers or the Knights Templar, their objectives and *modus operandi* have remained similar. The reference to the Knights Templar should be explained. According to Cardinale (*Orders of Knighthood* 178–181) the Knights Templar, also known as the Order of the Poor Knights of Christ and of the Temple of Solomon, was a religious, military, and banking order founded by the Crusaders in Jerusalem to defend the holy Sepulchre and Christian pilgrims. It was established in 1119 by Hugues de Payens. The Knights Templar invented cheque accounts and multinationals, and, due to their immense wealth, were a key political influence in Europe. They owed banks, including the Paris Temple, that was the centre of the world’s economy, and had the power to dispose of large amounts of money. Due to political resentment, the possessions of the Knights were confiscated in 1311 after a decision by the Council of Vienna. They were disbanded in the 14th century after their leader, one Jacques de Moley, was burned to death by King Philip of France (Naylor *Hot Money* 81).

⁵¹ Rider *War on Terror and Crime* 76, 82.

In the 1920s and 1930s mobsters such as Al Capone used launderettes⁵² to mix the benefits of crime with the legally acquired money of other small businesses, a process that is known as commingling.⁵³ Contemporary money laundering practices are the legacy of Meyer Lansky⁵⁴ who arguably was the most influential money launderer ever.⁵⁵ His complex infrastructures for ‘cleaning’ the benefits of crime in the early 1930s still remain relevant today. Lansky’s money laundering methods included employing multi-state offshore bank accounts in the Bahamas and Switzerland and layering⁵⁶ account records. Lansky was furthermore first to recognise that legal gambling offered a chance to skim money and move it away for tax evasion purposes. But, to properly set forth what necessitated 21st century money laundering, the financial atmosphere following the First World War should be explained.

Old European regimes fractured after the First World War that left the US as the leading international financial power.⁵⁷ Its economic control, however, was thwarted by unregulated gambling in public securities which resulted in the Wall Street crash of 1929 and the start of the Great US Depression. In addition, the First World War created huge international debts that reduced cash flow into the US. This coupled with a loss of confidence in banks⁵⁸ and credit restrictions resulted in the US government setting its confidence in so-called ‘sound money’.⁵⁹ Among criminals the need to disguise illegal earnings had arisen. This was the result of the prohibition which provided criminals with huge amounts of cash from the illegal sale of alcohol.⁶⁰

⁵² Abadinsky *Organised Crime* 342; Lilley *Dirty Dealing* 5–6. This may be where the concept ‘money laundering’ originated.

⁵³ Madinger & Zalopany *Money Laundering* 56. Commingling is the process where legally derived cash is mixed with the benefits of crime (see ch 2.C.4.2, par C.5.3; ch 6.C.4.3.3; ch 7.D.3.3 where the difficulties of commingling in the context of money laundering are explored).

⁵⁴ McIntosh *Organisation of Crime* 51.

⁵⁵ Bosworth-Davies & Saltmarsh *Money Laundering* 2–4; Jordan *Drug Politics* 104; Ehrenfeld *Evil Money* 5–8. Lacy (*Little Man Meyer* 6) and Williams ((1997) *SA J of Internat Affairs* 74), however, argue that Lansky’s role in money laundering is exaggerated. Nevertheless, the fact that Lansky’s money laundering methods were original cannot be contested.

⁵⁶ See par B.2.5 below.

⁵⁷ Bosworth-Davies & Saltmarsh *Money Laundering* 2.

⁵⁸ The practice of hoarding cash was regarded as economically prudent at the time, a situation that later switched around (Williams & Whitney *Federal Money Laundering* 6).

⁵⁹ Naylor *Hot Money* 20; Naylor *Analysis of Profit-driven Crime* 37.

⁶⁰ The Prohibition of 1920 laid the foundation for modern organised crime in the US (Abadinsky *Organised Crime* 75). The ratification of the Eighteenth Amendment to the US

The availability of the benefits of crime enabled ‘loansharking’ that posed another dilemma for criminals to disguise the benefits of crime.

In the 1960s the technology of credit cards and cheque accounts allowed customers to keep their money in a bank while having access to it.⁶¹ However, high inflation in the 1970s and the early 1980s meant that money that was not deposited lost its value. The increase in crime made hoarding cash unwise but also increased the profits that criminals made from crime. Since transactions with credit cards or anything that left paper trails were dangerous, organised crime syndicates were inundated with cash. By the mid 1980s the use of large amounts of cash became the trademark of organised crime. In the 1990s as crime became more sophisticated and international in nature, so did the scope and the complexity of money laundering.

2.2 Development of Anti-Money Laundering Legislation - Moral Panic

Money laundering control only became an issue of federate concern in the late 1930s. In 1937 US President Roosevelt received a report from then Treasury Secretary Henry Morgenthau on tax evasion that warned against the pervasiveness of organised crime.⁶² The public first took notice of the concept ‘money laundering’ with the development of the drug markets of the 1960s.⁶³ Alldridge⁶⁴ thought that the moral panic theory⁶⁵ could justify the public demonisation of money

Constitution that prohibited the manufacture, sale and transportation of alcohol within and from the US, contributed to its growth. The Prohibition led to a new level of criminal organisation where protection from rivals became more imperative than protection from law enforcement (Goode & Ben-Yehuda *Moral Panics* 14–15). With the end of the Prohibition in 1933, many alcohol smugglers either went into legal businesses with money earned from criminal activities, or continued with criminal activities (Block *Bad Business* 234).

⁶¹ Williams & Whitney *Federal Money Laundering* 6–7.

⁶² Morgenthau *Joint Committee on Tax Evasion and Avoidance, Hearings: Part I* 2–5.

⁶³ Savona & De Feo *International Money Laundering Trends* 10. Prior to 1986, money laundering was not criminalised in the US. Financial transactions that formed a money laundering scheme were investigated or prosecuted under other statutes, but money laundering itself was neither defined nor criminalised pursuant to statute (see ch 7.C.3.1).

⁶⁴ *Money Laundering Law* 13–14.

⁶⁵ Moral panic is a theory used to account for the public’s reaction to the ‘mods and rockers’ of the 1960’s. ‘Mods and rockers’ were viewed as a form of adolescent deviance among the British working class youth that was evident between 1964 and 1966. These youths were observed as ‘folk devils’ causing a collective havoc at English seaside resorts (Cohen *Folk Devils* 19–20, 29). Communities began to censure their behaviour with the rhetoric that they would not allow the country be taken over by such ‘hooligans or hippies’

laundering in the 1960s. Moral panic, however, did not explain the public's adverse reaction towards crime.⁶⁶ This is because at the time money laundering lacked the two factors required for a moral panic, namely public recognition and international interest.⁶⁷ Instead, it was a broad concern about financial and drug-related crimes that resulted in the enactment of the first AML legislation, namely the US Bank Secrecy Act of 1970.⁶⁸

3. Scale of Money Laundering

The volume of laundered money increased in recent years due to the speed and flexibility of electronic banking.⁶⁹ In general, estimates of the amount of money that has been laundered provide an indication of the issues involved, even if they do not describe the socioeconomic problems that are created by the crime.⁷⁰ Most notably is the fact that an inherent difficulty exists in tabulating money laundering.⁷¹ In addition, the range of activities and financial instruments involved in the money laundering process, many of which are inconspicuous, makes meaningful estimates difficult to collect.⁷²

(197). Moral panic therefore depicts the moral indignation of the public towards norm violators. During a moral panic the behaviour of some members of society is considered problematic enough to others that serious steps are taken to control the behaviour and repair the damage (Goode & Ben-Yehuda *Moral Panics* 31–39).

⁶⁶ As mentioned elsewhere in the study (see par B.2.1 above), money laundering is not a twentieth century crime. Yet interest in enacting AML legislation was evident only in the late 1960s and only in answer to the prevalent use of illegal drugs (see ch 7.C.3.1).

⁶⁷ Alldridge *Money Laundering Law* 14. At the time no united international community existed whose interest it was to combat money laundering.

⁶⁸ Which is codified in Title 31 of the U.S.C. (as to which, see ch 7.C.2).

⁶⁹ Ehrenfeld *Evil Money* 246.

⁷⁰ See Munro (2001) *J of Fin Crime* 135–136 who accentuates that money laundering increases other criminal activity as well, a point that was made already (see par B.1 above).

⁷¹ Quirk *Implications of Money Laundering* 1; Stessen *Money Laundering* 88; Rider *War on Terror and Crime* 85; Alldridge *Money Laundering Law* 4; Reuter & Truman *Chasing Dirty Money* 9; Saxena (1998) *St Thomas LR* 5; Straub (2002) *Suffolk Transnational LR* 515.

⁷² Walker (1999) *J of Money Laundering Control* 26; Noble & Golombic (1997-1998) *NYU J of Internat Law & Politics* 86; Hallett *Measuring Illegal Activity* 89; IMF *Money Laundering and the Financial System* 3. The inconspicuous nature of both the activities and financial instruments that are involved in money laundering attributes to the difficulty. It renders comprehensive estimates difficult to compile.

The available estimates are impressive. In 1990, it was calculated⁷³ that annual drug sales in the US and in the EU earned 122 billion US dollars for drug traffickers with between 50 to 70 percent of it being available for money laundering. In the mid-1990s, the annual amount of illegally earned capital was considered to be between 300 and 500 billion US dollars globally.⁷⁴ If one accepts that the annual amount of money laundered ranges between two and five percent of the global gross domestic product.⁷⁵ As a result, money laundering earns criminals between 590 billion to 1.5 trillion US dollars annually.⁷⁶ In an independent study⁷⁷ the global scale of money laundering was determined by a crime-economic model that uses crime statistics to estimate the amount of money generate in each country in the world. It was found that:⁷⁸

[i]nitial output from the model suggests a global money-laundering total of \$2.85 tn [\$2.850,470,000,000] per year, heavily concentrated in Europe and North America.

The amount of money laundered annually depends on two factors. First, how broadly money laundering is defined and secondly, whether the count is made by transaction or by the benefits of crime.⁷⁹ It follows that attempts to quantify laundering should clarify the method of accounting.⁸⁰ Other estimates are based on determining the potential demand for money

⁷³ FATF *Report 1989-1990* 4–5. The report, however, does not contain estimates of money laundering associated with organised crime (see below for comments re the typologies of the FATF).

⁷⁴ Gilmore *Dirty Money* 22; Baldwin (1996) *Dickenson J of Internat L* 415–416. It was estimated in 1999 that Columbian drug cartels may have generated more than 10 billion US dollars which were available to them through money laundering (Bruton (1999) *J of Money Laundering Control* 11).

⁷⁵ Alldridge *Money Laundering Law* 5.

⁷⁶ Comstock (1994) *Northwestern J of Internat L & B* 139; UNDCP *Money Laundering* 1.

⁷⁷ Walker (1999) *J of Money Laundering Control* 25–26.

⁷⁸ Walker *op cit* 26. However, Walker acknowledges the weaknesses in his model which are due to the secretive nature of money laundering, a problem that has been acknowledged by academic writers as well (see, for example, Noble & Golumbic (1997-1998) *NYU J of Internat Law & Politics* 86; Hallett *Measuring Illegal Activity* 89; Quirk *Macroeconomic Implications* 1).

⁷⁹ Alldridge *Money Laundering Law* 5. Sheptycki (*Policing the Virtual Launderette* 136) agrees that the problem of quantifying laundered money revolves around the commingling of legitimately earned money with the benefits of crime (see also ch 2.C.5).

⁸⁰ Tanzi *Money Laundering and the Financial System* 3.

laundering⁸¹ or estimating the income generated by major crimes.⁸² At best these figures suggest that a large demand exists for money laundering services but as yet it has not been established that money laundering accounts for hundreds of billions of US dollars. There are various sources of economic information that may assist in tabulating the overall amount of money laundering.⁸³ It follows that information exists on money laundering itself, on the underground macro-economy,⁸⁴ and statistics on the cross-border flows of cash. The economic effect of the illegal industry will depend on how arduous it is to launder the benefits of crime.⁸⁵

Van Duyne⁸⁶ has an interesting approach to address the tabulation quandary. He criticises all estimates on money laundering and argues that attempts to estimate the scale of money laundering are equivalent to the work of archeologists that at best is based on estimates only. Consequently, a danger exists to over or under estimate the prevalence of the crime. Therefore, so the arguments runs, one should inquire into the criminal aspects that necessitates money laundering.⁸⁷ Van Duyne⁸⁸ comes to the conclusion that attempt to determine the scale of money laundering have resulted in more questions than answers about the correctness of money

⁸¹ Which is known as the macroeconomic approach to measure the demand for money laundering (Reuter & Truman *Chasing Dirty Money* 11; IMF *Money Laundering and the Financial System* 7). The macroeconomic approach accepts that any income on which no tax is paid must be laundered in an effort to conceal its nexus to crime. Determining the amount of money that circulates within the underground economy (which is also known as the 'parallel economy' - see par D.4.3.2 below) is key to an approach of this kind (Quirk *Macroeconomic Implications* 6).

⁸² Which is known as the microeconomic approach to estimate the demand for money laundering (Reuter & Truman *Chasing Dirty Money* 19–23). The approach focuses on different forms of crime and estimates the income from each.

⁸³ Quirk *Macroeconomic Implications* 6–7. Quirk, however, concedes that surveys of various macroeconomic and microeconomic factors aimed at calculating the size of money laundering differ widely.

⁸⁴ The underground macroeconomy consists of typical criminal activities such drug trafficking (Schneider *Macroeconomics: Financial Flows* 98; Stieranka *Protecting Against Laundering* 123–124).

⁸⁵ Thoumi *Impact of the Illegal Drug Industry* 120.

⁸⁶ *Money Laundering* 74, 98–100; (1994) *J of Asset Protection* 58–76. Van Duyne denounces the work of the FATF because 'methodologically it [is] a disgraceful undertaking, based on untenable assumptions' (see also ch 5.B.3.3 where the FATF's AML efforts is weighed).

⁸⁷ Van Duyne *Money Laundering* 74–75, 98–100.

⁸⁸ (1994) *J of Asset Protection* 66–67, 75. This because estimates tend to take the highest numbers as a point of departure and therefore, are inaccurate.

laundering estimates. Instead, to determine the nature of the money laundering threat one should differentiate between the manner in which the benefits of crime endanger society.⁸⁹ Some forms of the threat may be of a higher level than others.

In summary, it is evident that tabulations of the amount of money laundered annually are unreliable and should not be regarded as scientifically correct. But money laundering numbers should not be dismissed because they are essential to devise methods to combat crime in general and in particular, money laundering. This is because the volume of laundered money presents the only evidence of the effectiveness of efforts aimed at controlling money laundering. It is, however, clear that care should be taken not to invest too much time on determining the volume of laundered money. Instead, the point of departure should be that amounts are guesstimates only that can assist with pinpointing areas where the money laundering threat seems to be the greatest. Subsequent AML efforts should be concentrated in that area and assistance by the international community should be forthcoming if necessary. Ultimately, police authorities should strive to identify money laundering schemes⁹⁰ with a view of apprehending the beneficiaries, which brings the discussion to the money laundering process.

4. Stages in the Money Laundering Process

Money laundering relies on a complex infrastructure within the international banking system itself that includes bank accounts, shell corporations⁹¹ and other intermediaries used to facilitate the money laundering process. In contrast to other crimes, money laundering is known for the diversity of its forms, participants and settings.⁹² The money laundering process poses a particular problem for criminals because new techniques are a necessity to stay one step ahead of the authorities.

⁸⁹ Van Duyne *Money Laundering* 76–77.

⁹⁰ See par D below.

⁹¹ See par C.2 below. A ‘shell corporation’ exists on paper only and undertakes little or no business in the country where registered (Reuter & Truman *Chasing Dirty Money* 25; FATF *Report 1999-2000* par 41).

⁹² Tan (2002) *J of Fin Crime* 277; Lilley *Dirty Dealing* 47–53; Bell (1999) *J of Money Laundering Control* 105; Rider (1996) *J of Fin Crime* 234.

Elsewhere in the study the historical development of money was examined, and it was illustrated how barter was superceded by the invention of paper money.⁹³ At present, paper money or cash to a large extent has been replaced by a system of electronically conducted financial transactions that generates records.⁹⁴ Electronic methods of payment render it difficult for a money launderer to conceal transactions.⁹⁵ Even though cash may provide some anonymity, the movement of money from a cash transaction system to an electronic transaction system is where the money launderer appears to be most vulnerable.⁹⁶ Money launderers employ sophisticated schemes, techniques and transactions to accomplish their purpose.⁹⁷ At present, criminals employ different kinds of monetary instruments,⁹⁸ electronic fund transfers⁹⁹ and available technology. It is necessary to simulate legal transactions as far as possible to render a money laundering operation difficult to detect.¹⁰⁰ However, moving money in bulk continues to present difficulties for criminals.¹⁰¹

⁹³ See ch 2.B.1.

⁹⁴ See ch 5.B.3.4.4; ch 6.B.3.6, par C.3.4; ch 7.C.2–3; ch 8.C.4.2.3.4 as regards the record-keeping obligation of banks.

⁹⁵ This is due to the fact that the source and destination of transactions can be traced to the perpetrator (Zagaris & Castilla (1993) *Brooklyn J of Internat Law* 872–874).

⁹⁶ Schaap *Fighting Money Laundering* 14; Schuldclaro *Electronic Payments* 56.

⁹⁷ UN *Financial Havens* 41; IMF *Money Laundering and the Financial System* 4. As a result, it is impossible to analyse all the forms of money laundering in existence. For a list of money laundering methods, see President's Commission *Cash Connection* 8.

⁹⁸ For example, cheques, money orders, and travellers' cheques (Sultzer (1995) *Tennessee Law R* 149). Negotiable instruments are easier to falsify than cash and allow a criminal to deposit financial instruments at banks.

⁹⁹ See ch 2.B.2.3.

¹⁰⁰ Arlacchi *Need for Global Attack* 6.

¹⁰¹ Ehrenfeld *Evil Money* 217; Sultzer (1995) *Tennessee Law R* 149.

Since the methods of money laundering money vary with technological advances, three¹⁰² standard stages can generally be identified:

1. placement;¹⁰³
2. layering,¹⁰⁴ and
3. integration.

¹⁰² Schudelaro *Electronic Payments* 55–58; Madinger & Zalopany *Money Laundering* 15; OECD *Corporate Veil* 34; Williams (1997) *SA J of Internat Affairs* 77–78; Banach *European Norms* 47. Sheptacki (*Policing the Virtual Launderette* 138) refers to the process as ‘wash, spin and dry.’ Depending on the nature of the money laundering process not all stages occur in each case or in the same order (Schaap *Fighting Money Laundering* 14). Due to the risk of discovery, the beginning of each phase is known as ‘choke points.’ The three stages of money laundering are not cast in stone. Arlacchi (*Need for Global Attack* 6) identifies the following three steps in the process that differ from the steps that are generally accepted: first, money is moved away from any association with crime, secondly, the trail is disguised to foil pursuit, and thirdly, the money is made available again to criminals whilst its source is kept secret. Udink (*Criminele Geldstromen* 18–19) discerns four money laundering stages, namely placement, layering, justification, and social integration. The third and fourth stages are designed to provide criminal money with a lawful source and to invest it in the legal economy. Van Duyne identifies five money laundering stages (*Money Laundering* 79). The first three stages coincide with the standard stages of placing, layering, and integration. However, the two additional stages, namely justification and embedding, depict what occurs with the benefits of crime after the integration stage. Schaap (*Fighting Money Laundering* 14) likewise identifies five stages, adding an exchange and a legitimisation stage to the three basic stages. Both additional phases are implemented by money launderers to bypass AML legislation, especially legislation dealing with the identification of the benefits of crime in a bank account (see ch 6.B.4.4). The exchange stage is aimed at concealing money as the benefits of crime. Legitimation, which correlates in purpose with the justification and social integration stages identified by Udink (*Criminele Geldstromen* 18–19), occurs by means of fake trade transactions and endeavours to make deposited the benefits of crime available for use.

¹⁰³ Placement refers to the introduction of the benefits of crime into the legal payment system as opposed to injecting the money into the underground economy (see par B.3 above; Schaap *Fighting Money Laundering* 12; Straub (2002) *Suffolk Transnational L R* 517–518; Sultzer (1995) *Tennessee Law R* 149). At placement stage, the benefits of crime are most commonly in the form of cash (FATF *Report 2000-2001* 16).

¹⁰⁴ Which, according to Schaap (*Fighting Money Laundering* 12), is a key activity within the laundering process as it is aimed at obscuring the paper trail and concealing the money’s nexus to crime.

The financial systems of wealthy countries such as the US are commonly employed as initial hosts for money laundering operations.¹⁰⁵ But developing economies have of late also become useful to money launderers as vehicles for concealing laundered money.¹⁰⁶

Placement is that part of the money laundering process where the benefits of crime are moved into the financial system in such a way that detection is avoided.¹⁰⁷ A common placement technique involves structuring¹⁰⁸ cash deposits. Prior to placing, the benefits of crime are converted into other currencies. The conversion aims to separate the money from its illegal source to minimise the risk of detection.¹⁰⁹

The layering stage consists of generating a series of transactions to distance the benefits from the criminal source and to obscure the money laundering trail.¹¹⁰ Layering can be achieved through making giro transfers¹¹¹ to a 'bank secrecy haven'¹¹² or to countries with little record-

¹⁰⁵ It is less risky to conceal suspicious transactions in the financial system of a country that has to facilitate an enormous amount of transactions on a daily basis. But, countries with large economies such as the US (see ch 7.C.2–8), have stringent AML legislation in place with the result that money launders have been turning to other, less risky jurisdictions to facilitate the money laundering process.

¹⁰⁶ This is due to the fact that developed countries have a huge demand for illegal drugs which remains a main money laundering activity (IFAC *Anti-money Laundering* 4–5). See ch 2.C.5.2 where the nexus among the benefits of crime, illegal drug trafficking and money laundering is discussed.

¹⁰⁷ UN *Financial Havens* 41.

¹⁰⁸ Structuring in a money laundering context means splitting large amounts of cash into smaller amounts for the purpose of avoiding detection by banks (see also par D.1 below).

¹⁰⁹ Schudelaro *Electronic Payments* 56.

¹¹⁰ Straub (2002) *Suffolk Transnational L R* 518; Beare *Criminal Conspiracies* 100.

¹¹¹ Giro transfers involve moving a credit balance from one account to another account that is accomplished by adjusting the balances of both the payer and the payee's accounts (see Ellinger et al *Modern Banking Law* 461; Hooley & Taylor *Payment by Fund Transfer* 49; ch 2.B.2.3.1 as regards giro transfers).

¹¹² A country is regarded as a 'secrecy haven' when its own, or another government is unable to obtain information about financial transactions (Schaap *Fighting Money Laundering* 18; UN *Financial Havens* 41–42; Karzon (1983) *Vanderbilt J of Transnational L* 817–818; Blum *Offshore Banks* 1–28). Secrecy havens render finding and confiscating the benefits of crime nearly impossible. Offshore money laundering havens include the Caymen Islands, Panama and the Bahamas (Karzon (1983) *Vanderbilt J of Transnational L* 818). The reason for the unavailability of the information is twofold (Walter *Secret Money: Tax Evasion* 187): one, the existence of strict bank secrecy rules (see ch 3.B.2.3) and two, juristic entities with bearer shares that are held by a trustee, preferably one with a duty of professional confidentiality (see par C.4 below).

keeping and reporting requirements. The use of EFTs as an essential method of accomplishing layering has been described as follows:¹¹³

[EFTs] offer criminals many advantages as they seek to cover their trail. Speed, distance, minimal audit trail, and increased anonymity amid the enormous daily volume of electronic fund transfers are all major benefits.

During the layering stage the benefits of crime must be brought back from ‘the underworld into legal society’¹¹⁴ and each transaction is a step further in this process. Consecutive electronic and cross-border transactions are employed in a process known as stacking. The benefits of crime may be divided into smaller amounts that after having been transferred several times are brought back together.¹¹⁵ In the meantime, the benefits can be withdrawn in cash and deposited elsewhere into the system.¹¹⁶ Transfers take place through bank accounts and postal orders or cheques may also be used.

The final money laundering stage is known as integration which is defined as the unnoticed introduction of the now laundered money into the economy.¹¹⁷ A variety of spending, investing, and lending activities as well as cross-border transactions accomplish the integration process.¹¹⁸ The now laundered money usually returns to the legal monetary system as investments.¹¹⁹ Where

¹¹³ Savona & De Feo *International Money Laundering Trends* 27. See also par D.4 below.

¹¹⁴ Schaap *Fighting Money Laundering* 13; Sheptacki *Virtual Launderette* 139.

¹¹⁵ Ordinary money transfers from one account to other accounts constitute a favourite laundering method (Tan (2002) *J of Fin Crime* 277; Forbes *Fleeing Money* 150–151). The technique of disguising the ownership of the benefits of crime and providing anonymity is known as a ‘starburst’ (Nakajima *Offshore Centres* 238). This is because an amount of the benefits of crime is divided into smaller sums that are dispersed to a number of banks before the money is returned to a single location.

¹¹⁶ Schudelaro *Electronic Payments* 57–58. Large amounts of money are moving around in the global banking system at any given time (see ch 2.C.5.3.1). Part of it is earmarked for legitimate trade or investment whilst the remainder is either the benefits of crime or money that will be used from criminal purposes.

¹¹⁷ Straub (2002) *Suffolk Transnational L R* 519; Comstock (1994) *Northwestern J of Internat L & B* 142; Zagaris *Money Laundering* 20.

¹¹⁸ It is only at the integration stage of the money laundering process that criminals are able to withdraw the money for use (Tan (2002) *J of Fin Crime* 277).

¹¹⁹ In a country with a developing economy such as South Africa six factors exist to create a strong demand for anonymous investments (IMF *Money Laundering and the Financial System* 4), namely: 1. privatisation of public enterprises; 2. growth of the stock-market; 3. diversification of financial instruments; 4. the presence of international capital

the integration process has been ineffective the benefits of crime will be traced back to a criminal, confiscated, and may be forfeited to the state.¹²⁰

It is submitted that a fourth stage, namely legitimisation, occurs after integration.¹²¹ Although not generally recognised as a stage in the money laundering process, legitimisation is required to make the laundered money available for use. It is accomplished by, for example, using the laundered money in a fictitious trade transactions where no questions are asked about the origin of the money. Therefore, legitimisation provides proof that the money laundering process was successfully completed.

Techniques used to launder money are infinite. However, it may be of interest to mention a few of the more common techniques here. For example, property is purchased below its market value while the remainder of the purchase price is paid under the counter. The property is subsequently sold for its true market value.¹²² Other money laundering schemes include the purchase of winning lots in a lottery for more than their value or justifying the benefits of crime as income generated by consultancy firms where the value is subjective and only capable of being established by persons with a high degree of expertise. Large amounts of internationally acquired the benefits of crime are further laundered on asset markets where price changes enable money laundering. The benefits of crime may also be laundered using actual transactions such as purchasing art and shares.¹²³ In fact, opportunities are infinite as far as money laundering schemes are concerned. Nevertheless, it is submitted that irrespective of the technique used to launder money ultimately, the benefits of crime in the form of money will find their way back to the financial system through deposits made into bank accounts. As will be illustrated below, this is

belonging to entities registered in tax havens (see above); 5. little economic regulation; and 6. a demand for foreign capital.

¹²⁰ Straub (2002) *Suffolk Transnational L R* 519; Sulzer (1995) *Tennessee Law R* 151.

¹²¹ Schaap *Fighting Money Laundering* 15. The layered funds are usually invested in real estate and business projects (Lilley *Dirty Dealing* 73–87; IMF *Money Laundering and the Financial System* 7).

¹²² Schaap *Fighting Money Laundering* 10.

¹²³ Tan (2002) *J of Fin Crime* 279. This method of laundering money exploits the high prices set on items that are in demand. A money launderer would buy a rare item, push its price up and sell it to an accomplice at a large profit. The price difference is subsequently deposited into a bank account as legitimate earnings. See par C.2 above as regards the purchasing of shares.

because the different stages of money laundering can easily be accomplished with the use of bank accounts.¹²⁴

C. HOW DOES MONEY LAUNDERING WORK?

1. Misuse of the Financial System

With the introduction of measures to prevent banks from being used for money laundering purposes some criminals have turned to other financial institutions that are not so familiar with compulsory identification procedures.¹²⁵ Criminals employ non-bank financial institutions¹²⁶ as part of either the placement or the integration stages of the money laundering process. Ultimately, the benefits of crime most often end-up in a bank account. This is due to the availability of corrupt bank employees who grant the money launderer access to banking products and bank accounts.¹²⁷

Non-bank financial institutions that are vulnerable to money laundering include securities and commodities brokerages,¹²⁸ insurance providers,¹²⁹ currency exchange houses,¹³⁰ casinos and card clubs¹³¹ and money transmitters.¹³² Criminals use any medium either alone or in combination

¹²⁴ Which necessitate the use of AML measures that can render the banking system inaccessible to criminal seeking to launder the benefits of their crimes (see par D.4.3.4 below; ch 5.B–D; ch 6.B.3.6, par B.5, par C.3.4, par C.5; ch 7.C.2–9, par E; ch 8.C.4, paras C.5, E).

¹²⁵ For example, the KYC standard and other due diligence measures (see ch 5.B.3.4).

¹²⁶ Non-bank financial institutions provide bank-like services, but are less supervised than banks (Savona & De Feo *International Money Laundering Trends* 24)

¹²⁷ Reuter & Truman *Chasing Dirty Money* 34; UN *Financial Havens* 43.

¹²⁸ The securities sector is characterised by large volumes of transactions. Criminals therefore uses it to make the benefits of crime appear as earnings from the financial markets (Dini *The Problem and Its Dimensions* 31). The securities sector is commonly used during the layering and integration stages because cash is rarely accepted by brokers (FATF *Annual Report 1996-1997* par 29; Bosworth-Davies *Global Ungovernability* 5). A criminal will layer a transaction by buying securities with benefits of crime that have been transferred from one or more accounts. He then presents the benefits as legitimate income.

¹²⁹ The insurance industry is also most often used during the layering and integrating stages of the money laundering process (cf Gilmore *Dirty Money* 44).

¹³⁰ FATF *Report 1996-1997* par 27; Reuvid *Focus on Laundering* 183.

¹³¹ For example of techniques, see General Accounting Office *Growth of Casinos* paras 6–8, 19–27; FATF *Typologies 1997-1998* par 55; FATF *Report 2000-2001* par 16.

¹³² The list of businesses that may be used in a money laundering scheme is endless (see, for example, FATF *Report 1996-1997* par 29).

for the purpose of laundering money. All forms of corporate and trust structures are further employed to launder illegal profits.¹³³ Moreover, legal and underground financial systems¹³⁴ in all their variety are susceptible.

Derivatives are financial instruments that are primarily used to manage and reduce financial risk.¹³⁵ At present, moves towards greater deregulation of financial markets coupled with developments in technology have signified a change in the derivative markets in both the products they trade and in the fashion in which they are traded. Derivative markets have been described as ‘invisible’ because:¹³⁶

[m]oney, in the form of any negotiable instrument or currency, whether black or white, clean or ‘funny’, can pour in at one end of the audit trail, and can exit at the other in the form of tradeable facilities; currencies; futures contracts; options; swaps; or just plain, old-fashioned negotiable instruments, payable anywhere in the world; having passed through half a dozen trader’s hands or company’s books ... and cause no ripple on the undisturbed surface of a theoretically orderly market.

Money launderers tend to use derivative markets because they are assisted by brokers who know and understand the securities business.¹³⁷

Offshore financial institutions provide money laundering opportunities for international corporations, security brokers, and insurance companies.¹³⁸ In addition, they serve the money laundering needs of organised crime.¹³⁹ Assets held in offshore centres are mixtures of legal money, concealed tax, and the benefits of crime. In short, offshore financial institutions undercut economic regulation and present ample opportunities to money launderers.¹⁴⁰

¹³³ *Sherman Efforts to Combat Money Laundering* 14.

¹³⁴ See par D.4.3.2 below.

¹³⁵ *Kelly Derivatives* 213–231; Malan (1990) *TSAR* 577–604.

¹³⁶ *Bosworth-Davies Global Ungovernability* 11–12; *Kelly Derivatives* 219–222.

¹³⁷ For an account of how financial brokers Dennis Levine, Ivan Boesky, and Michael Milken used the accounts of derivative-trading companies for money laundering purposes, see *Bosworth-Davies Global Ungovernability* 35–38.

¹³⁸ *Blum Offshore Money* 57; *UN Financial Havens* 41–42; Rider (1996) *J of Fin Crime* 239; *IMF Money Laundering and the Financial System* 5; *Nakajima Offshore Centres* 220–222.

¹³⁹ *Kelly, Schatzberg & Chin Black Money* 311; *Abadinsky Organised Crime* 347.

¹⁴⁰ *Blum Offshore Money* 60; *Lilley Dirty Dealing* 93–107; *Gilligan Offshore Sovereignty* 16–18. This is due to the fact that these institutions have been established in jurisdictions that provide for the concealment of the beneficial ownership of a corporation (see ch 3.C.3).

2. Misuse of Legal Entities¹⁴¹

2.1 Shell Companies

It has been a known fact that legal entities are also employed by criminals as tools to launder the benefits of crime.¹⁴² These legal entities include companies, trusts,¹⁴³ partnerships and close corporations. It is plausible that a company may be controlled by people who are neither its directors nor its owners. In addition, individuals controlling the assets of a company which was established for criminal purposes may attempt to obtain beneficial ownership of its shares.¹⁴⁴

Various difficulties exist in establishing the identities of a company's beneficial owners.¹⁴⁵ Some of the problems concern the type of information that company registers contain. Attempts at establishing ownership by reference to the register of members frequently prove futile.¹⁴⁶ In addition, stacking¹⁴⁷ may occur.

Shell companies, also called 'international business corporations' or 'private investment companies', are often used to carry out criminal activities and to conceal the benefits of crime from

¹⁴¹ The misuse of juristic persons for money laundering purposes is discussed in this setting because they provide indirect access to the banking system.

¹⁴² UN *Financial Havens* 42; Rider (1996) *J of Fin Crime* 239–240. There are various reasons why it is possible to employ multinationals for money laundering purposes (Santino (1988) *Contemporary Issues* 212–213). Some of the reasons include a lack of control over international banking activities and the availability of financial instruments which are most suitable for international activity (cf Ehrenfeld *Evil Money* 62–110).

¹⁴³ Trusts used for laundering money are known as 'asset protection trusts' or 'state-of-the-art trusts' (FATF *Report 1996–1997* Annex B par 63). Cf Cameron *Law of Trusts* 146.

¹⁴⁴ HM Treasury *Beneficial Ownership* 11. Front companies or legitimate businesses through which the benefits of crime are channelled, are employed by almost all money laundering groups (Bell (1999) *J of Money Laundering Control* 104–105).

¹⁴⁵ UN *Financial Havens* 42–43; Bell (1999) *J of Money Laundering Control* 105.

¹⁴⁶ HM Treasury *Beneficial Ownership* 16; UN *Financial Havens* 42. The reason concerns the difficulty that exists in defining ownership. Company registers do not identify all those who have an interest in a company. Existing minimum-disclosure provisions are inadequate in expediting identification.

¹⁴⁷ In the context of money laundering 'stacking' refers to a scheme which sees an offshore company with bearer shares holding bearer shares of another company. The aim is to conceal the identities of the company's beneficial owners (Schaap *Fighting Money Laundering* 12).

the authorities.¹⁴⁸ Shell companies usually display two traits.¹⁴⁹ First, they are purchased from banks or attorneys and accountants so that they have a history. Secondly, shell companies operate outside the countries where they are incorporated. Little is known about the assets of a shell company because it is not required to file financial reports. The benefits of crime are loaned to businesses owned by criminals by shell companies which render the latter a low risk vehicle for money laundering.¹⁵⁰ Double invoices are subsequently sent to these businesses to confuse the audit trail.¹⁵¹

The use of all types of legal entities for money laundering purposes may be prevented if effective mechanisms can be established to obtain and to share information internationally on beneficial ownership and control.¹⁵² The following three objectives provide a means for measuring the effectiveness of mechanisms of this kind:¹⁵³ first, information about beneficial ownership must be maintained, secondly, proper oversight of the system that obtains and maintains the information must exist and thirdly, non-public information on beneficial ownership must be shared internationally. It is trite that information obtained to prevent the use of legal entities will vary depending on the type of entity.¹⁵⁴

In South Africa a bank may pursuant to section 51 of the Promotion of Access to Information Act¹⁵⁵ approach the information officer of a registered company with a request to disclose records pertaining to the ownership of the company. This information could serve as point of departure to establish who owns the controlling interest in a company, especially as regards establishing the identification of a company for money laundering control purposes.¹⁵⁶

3. Misuse of Certain Professional Groups: Attorneys

¹⁴⁸ OECD *Corporate Veil* 7; FATF *Report 1996-1997* paras 18, 73.

¹⁴⁹ HM Treasury *Beneficial Ownership* par 1.1.

¹⁵⁰ Sheptacki *Virtual Launderette* 140. Since the rule in money laundering is to approximate legal transactions, devices used to conceal the benefits of crime in a corporate setting mirror methods employed by legitimate businesses.

¹⁵¹ Which are made easier by technology to falsify documents and the complexity of financial instruments such as derivatives (Jones *Auditing Practice* 195–197).

¹⁵² OECD *Options for Obtaining Information* 5.

¹⁵³ OECD *op cit* 5–7.

¹⁵⁴ See ch 5.B.3; ch 6.B.3.6, par C.3.4; ch 7.C.2–3; ch 8.C.4.2.3.2.

¹⁵⁵ 2 of 2000 (see ch 3.B.2.3.3.1).

¹⁵⁶ See ch 8.C.4.2.3.2 as regards the identification obligation pursuant to FICA.

Like other criminals, money launderers are sometimes in need of legal advice whilst planning their activities. Merely providing legal advice to known criminals is legal. But three factors relating to the professional services that attorneys¹⁵⁷ provide make them susceptible to become involved in money laundering schemes. First, an attorney may inadvertently give a criminal access to the banking system through the use of his trust account. The benefits of crime that are commingled in a trust account become indistinguishable from other funds in the account.¹⁵⁸ In this sense, a criminal is able to launder the benefits of crime with little risk attached.¹⁵⁹

Secondly and more alarming, an attorney may intentionally assist in the money laundering process.¹⁶⁰ His name can be used to acquire bank loans and credit cards on behalf of a client, or an attorney may establish a shell corporation, trust, or partnership under the protection of privilege rules. For this reason most AML legislation requires that attorneys comply with set identification requirements¹⁶¹ when cash payments over a certain threshold are received. Thirdly, since attorneys are bound by privilege rules, it is difficult to probe their or their clients' involvement in illegal activities. However, regardless of the privilege of non-disclosure attorneys are expected to establish the identity of a client, especially when dealing with an intermediary or legal entity, and to ascertain that the services they render do not veil illegal activities. Ultimately, it is in the attorney's best interest to ensure that he does not accept the benefits of crime either as trust money or as remuneration.

Professional persons are also most likely to offer money laundering services in return for payment which render professional services more expensive. This results in a reduction of both the volume of money laundering conducted by professionals for crime syndicates as well as the volume of crimes associated with the process.¹⁶² Due to the fact that some professional persons provide

¹⁵⁷ Note that other professionals such as accountants who have access to the banking system by virtue of the services they render are likewise required to identify their clients (FATF *Annual Report 1996–1997* 7; Bosworth-Davies & Saltmarsh *Economic Crime* 42; Reuvid *Focus on Laundering* 179–180).

¹⁵⁸ See ch 2.C.2.

¹⁵⁹ See ch 2.C.5.3.2 where the US taint theory is discussed.

¹⁶⁰ Reuter & Truman *Chasing Dirty Money* 34; UN *Financial Havens* 43; Tan (2002) *J of Fin Crime* 279; Van Duyne (1997) *Crime, Law & Social Change* 228–229.

¹⁶¹ See ch 5.B.3, ch 6.B.3.4, par B.3.6, par C.3.4, ch 7.C.2–3, ch 8.C.4.2.3.2.

¹⁶² Reuter & Truman *Chasing Dirty Money* 35–36.

only partial money laundering services¹⁶³ whilst others are involved with the whole process, the price paid by a criminal to a professional for laundering money is impossible to determine. It has been suggested that the price depends on the risks involved.¹⁶⁴

4. Integration of Benefits of Crime

As mentioned before, various methods exist for laundering the benefits of crime. Since the criminal acquired the benefits of crime through criminal means, its nexus to crime must be concealed which is part of the purpose of money laundering.¹⁶⁵ Part of the money laundering process may include mixing the benefits of crime with legitimately earned money in order to confuse and to conceal the funds' nexus to crime. For this reason criminals employ bank accounts to launder money. For example, a thief can simply deposit the stolen money into his bank account where after he either transfers it to some other account or leave it to commingle with the money he legitimately earned as a salary.

Either way, bank accounts can facilitate three of the four stages of the money laundering process which is why the KYC standard and other AML measures have been imposed on banks as part of the global and national money laundering control efforts.

D. EMPLOYING THE BANKING SYSTEM

1. General Banking Services

Banks are primarily targeted by criminals and used to launder the money they acquired through criminal means.¹⁶⁶ This is because the benefits of crime can enter the banking system through cash

¹⁶³ As reasoned by the FATF (*FATF Report 2000-2001* 12): '[n]ot all of these functions have the same utility to a potential laundering operation.'

¹⁶⁴ The price of money laundering further depends on the quantity of the money involved; the bigger the amount, the higher the risks which increase the price demanded by the money launderer (Van Duyne (1997) *Crime, Law & Social Change* 229).

¹⁶⁵ See par B.1 above.

¹⁶⁶ IFAC *Anti-money Laundering* 9; Lilley *Dirty Dealing* 10–16. Banks are regarded as 'crime-enabling ... institutions' (Passas (1993) *Crime, Law & Social Change* 293; Santino (1988) *Contemporary Issues* 206–237).

deposits over the counter,¹⁶⁷ EFTs¹⁶⁸ from one bank to some other bank and letters of credit from businesses. The money laundering process is effective only when the benefits of crime are presented to legitimate businesses in such a fashion that its criminal nexus remains concealed. It follows that the responsibility to control money laundering mainly reside with banks.

Elementary money laundering techniques have remained similar over the years although technology may have made the process easier, or more difficult depending on the facility used.¹⁶⁹ For example, a member of a criminal syndicate will open a bank account at a bank situated in an offshore haven or, if possible, establishes an exempt company and open an account in its name.¹⁷⁰ After the account has been opened, members of the syndicate will smuggle the benefits of crime to the offshore bank.¹⁷¹ As mentioned already, structuring or ‘smurfing’ is the process of breaking down large amounts of cash in smaller amounts.¹⁷² One or more persons are usually hired to deposit small amounts of cash into different bank accounts, or to buy cashier cheques for small amounts for the purpose of evading the bank’s reporting duties.¹⁷³

In recent years, banks apparently have improved their AML controls, a situation which have forced criminals to diversify their operations and to expand into other financial institutions. The difference between ‘money movement facilities’ and ‘money laundering’ is a fine one from the perspective of a bank employee who needs to close a deal. Rendering services for customers constitute the basis of banking profitability.¹⁷⁴ Irrespective of the fact that bank secrecy has been

¹⁶⁷ Ehrenfeld *Evil Money* xviii; Reuvid *Focus on Laundering* 181.

¹⁶⁸ As mentioned already (see ch 2.B.2.3), EFTs present a method through which a bank controls transfers of money by sending an electronic notification to another institution (FATF *New Payment Methods* 3–14). The benefits of crime can be transferred through several banks in different countries to obfuscate the source of the funds.

¹⁶⁹ See par D.4 below.

¹⁷⁰ Grilli (1987) *Syracuse J of International LC* 69; Gilligan *Offshore Sovereignty* 19–20; Blum *Banking Secrecy* 10.

¹⁷¹ Which is accomplished by presenting money to a bank which electronically transfers it to an offshore destination (Comment (1985) *Tex Internat LJ* 139–140).

¹⁷² The concept ‘smurfing’ was introduced during an AML operation called ‘Greenback’ which was set up in Miami, Florida between 1980 and 1984 (Reuvid *Focus on Laundering* 182). It resulted in the seizure of the benefits of crime to the value of 38.8 million US dollars (Walter *Secret Money: Tax Evasion* 244–245). The practice of smurfing refers to front men making numerous deposits of the benefits of crime. Their frantic behaviour mimic that of cartoon figures with the same name (Sheptycki *Policing the Virtual Launderette* 138; Banach *European Norms* 47).

¹⁷³ See ch 5.B.3.4.3; ch 6.B.3.6, par C.3.4; ch 7.C.2–3; ch 8.C.4.2.3.3.

¹⁷⁴ Levi *Money Laundering and Policies* 263–264; Ehrenfeld *Evil Money* 244.

curtailed during the last decade,¹⁷⁵ banks remain the key target of criminals to use as tools for money laundering.¹⁷⁶ This is due to the availability of specialised money laundering techniques with which to exploit banking products on offer.¹⁷⁷ Establishing the ownership of the benefits of crime with a degree of success depends on the type of banking product that was used during the money laundering process. The famous collapse of the BCCI¹⁷⁸ is particularly significant in this context, because it demonstrates how a bank's association with fraud and money laundering may lead to its eventual demise. Suffice it to mention that the BCCI's money laundering activities catalysed the onset of management problems and a subsequent run on its deposits. The collapse of the BCCI therefore underlines the consequences of having lax internal controls within banks. The BCCI's collapse further compelled the international community to introspection, especially with regard to the overall effectiveness of AML policies within the banking industry.

At present, due to the imposition upon banks of more stringent and focussed AML measures,¹⁷⁹ it has become hazardous for criminals to employ general banking facilities to launder money. Consequently, money launderers have been turning to similar facilities in an effort to introduce the benefits of crime into the banking system, namely private and correspondent banks.¹⁸⁰

2. Correspondent Banking

Correspondent banking involves one bank, the correspondent bank, that provides financial services to some other bank, the respondent bank. An institution acting as a correspondent bank usually controls a number of financial transactions for customers of the respondent bank. The result is that the correspondent bank has little choice but to rely on the respondent bank to verify the legitimacy of its customers' earnings and therefore, may be exposed to certain risks.¹⁸¹ Some of these risks

¹⁷⁵ See ch 3.B.2.3.

¹⁷⁶ IMF *Pilot Program* par 29; Council *Council Recommendation* 172.

¹⁷⁷ Consider, for example Absa Bank's CashSent facility which allows customers to send money to a non-customer of the bank. After the money has been withdrawn by the recipient, there is no way to identify either it or the purpose for which the funds will be used.

¹⁷⁸ See ch 1.A; Hemraj (2005) *J of Money LC* 346–353 as regards the connection between the BCCI's collapse and money laundering.

¹⁷⁹ See ch 5.B.3; ch 6.B.3.6, par C.3.4; ch 7.C.2–3; ch 8.C.4.2.3.

¹⁸⁰ FATF *Report 2001-2002* par 3.

¹⁸¹ See FATF *Report 2001-2002* paras 24–32; ch 6.D.4. Bosworth-Davies ((2001) *Money Laundering Bulletin* 4) suggests that many international banks provide services to

include, for example, that the correspondent bank will seldom know the quality of the AML measures which are in place at the respondent bank, and that the respondent bank may act as an intermediary for an unknown bank. Consequently, a correspondence bank may be conducting business with a sub-respondent bank without knowing anything about its customers or reputation.

It has been suggested¹⁸² that the responsibility to combat money laundering between the two banks involved in a correspondent relationship remains with the correspondent bank itself. Therefore, correspondent banks are expected to ensure that their customer-identification policies are updated on a regular basis to incorporate customers of respondent banks. However, it is submitted that identifying the customers of some other bank is likely to present various difficulties for the correspondent bank.

3. Private Banking

The nature of private banking renders it susceptible to money laundering.¹⁸³ Private banks offer preferential financial services to customers with a high net worth.¹⁸⁴ Private bank accounts are opened in the name of an individual, a company, a trust or an intermediary, and are managed by an appointed banker. In the context of money laundering a banker may fail to exercise due diligence as regards the movement of funds in the account of a customer. Unfortunately, as was discovered by the AML authorities, identifying novel ways which criminals use to launder money is of little use if the measures created to eradicate them have not been implemented.

The main problem with private banking is that an appointed banker is responsible for both providing a personalised service to a customer and for developing a long-term banking relationship with the customer.¹⁸⁵ In return for service the banker can earn fees in excess of one million US dollars per customer annually. Private banking services also demand a high degree of confidentiality as regards customer account information. As a result, some private bankers are known to have assisted customers in financial planning through offshore banks. Shell companies may also be formed to hold a customer's assets. Consequently, it is the shell company instead of

'high risk foreign banks' that operate in countries with weak regulatory controls.

¹⁸² FATF *Report 2001-2002* par 31; Yim *Brave New World 2*; Lilley *Dirty Dealing* 65.

¹⁸³ IMF *Pilot Programme* paras 33–44.

¹⁸⁴ FATF *Report 2001-2002* par 34.

¹⁸⁵ US Senate *Correspondent Banking* 2–4.

the beneficial owner of the assets that becomes the account holder at the private bank. Moreover, there are four factors inherent to private banking that increase its vulnerability to money laundering. They are, namely¹⁸⁶ the role of private bankers as customer advocates, powerful customers discouraging questions, a corporate culture of secrecy and relaxed controls, and the competitive nature of the industry. In short, the fact that private bankers are required to assume contradictory roles poses a serious problem to the effective detection of money laundering within the private bank relationship. On the one side, private bankers are expected to develop a personal relationship with a customer and to increase deposits with the bank. On the other side, they must heed relevant AML legislation by monitoring customers' accounts for suspicious activity. These contradictory roles are likely to cause a banker to neglect his AML duties.¹⁸⁷ Money launderers are aware of the dilemma that private bankers face and exploit it to the private bank's detriment.

It is submitted the abuse of private banking by money launderers may be prevented if sound private-banking practices are implemented.¹⁸⁸ Therefore, due diligence policies, procedures to compel private banks to verify customer information and the source of his money, and guidelines on the manner in which suspicious account activities can be identified are advocated as measure to prevent money laundering in private banks. In addition, private bankers should analyse the intended use of a customer's account and review account activity to ensure that the customer act within the boundaries of the relationship. However, it is evident that the effectiveness of the AML measures above depends on the willingness of private banks to cooperate with the AML effort.

4. Electronic Banking Services

4.1 Background

Professional money launderers rely on electronic payment systems that offer the best attributes of traditional currency, ease of use and relative anonymity.¹⁸⁹ Cyberbanking¹⁹⁰ allows a criminal to

¹⁸⁶ US Senate *Private Banking* 13, available at <http://gov-aff.senate.gov/110999_report.htm> (2011.03.10).

¹⁸⁷ US Senate *Private Banking* 21.

¹⁸⁸ FATF *Report 2001-2002* par 39. See also ch 5.D.4.

¹⁸⁹ See in general Zagaris (1999) 32 *Vanderbilt J of Transnational Law* 1112; Bonorris & Coates *Digital Money v*; Zagaris & McDonald (1992) *George Washington J of Internat*

move money to anywhere in the world as fast as transfer and computer systems allow.¹⁹¹ This sphere of banking is ideal for money laundering because most banks cannot afford the cost of implementing programmes to detect suspicious transactions.¹⁹² In addition, the nature of the bank-customer relationship has changed so much so that physical contact between the parties has become redundant. Cyberbanking enables the opening of a bank account and the transfer of money without ever visiting a bank in person.¹⁹³

The following four key areas pose threats to internet-based financial transacting, namely¹⁹⁴ fraud by imposters posing as authorised personnel, damage inflicted by computer hackers, sabotage in the format of computer viruses and interception of confidential information through criminal access. The difficulty in monitoring criminal activity over the Internet is illustrated by the fact that financial crimes that are committed in cyberspace such as cyberlaundering¹⁹⁵ are almost invisible. Even more taxing is the reality that domestic regulators are unable to prevent banks from setting up business in inadequately regulated jurisdictions where it is possible for them to serve customers from anywhere in the world via the Internet.¹⁹⁶

Law & Economy 63; Wyrsh (1992) *Denver J of Internat L & P* 515; FATF *New Payment Methods* 10–11. Lilley (*Dirty Dealing* 118) describes electronic payment systems as the ‘greatest boon’ for money launderers.

¹⁹⁰ Obviously it is not physical money that is electronically transferred, but electronic data (see ch 2.B.2.3).

¹⁹¹ Arlacchi (*Need for Global Attack* 5) defines electronic money as: ‘[m]egabyte money existing on terminals from New York to Tokyo and everywhere in between’ whilst Kurtzman (*Death of Money* 11) argues that the development of EFTs has enabled the movement of money anywhere in the world with speed and ease.

¹⁹² Tan (2002) *J of Fin Crime* 279–281; Lilley *Dirty Dealing* 116–126. Many of the benefits of electronic banking render it suitable for money laundering, for example, the possibility of remote access which makes customer identification difficult and the number of transactions that cyberbanking allows. See also Munro (2001) *J of Fin Crime* 144–148; Wyrsh (1992) *Denver J of Internat L & P* 515–516 as regards the risks of cyberbanking.

¹⁹³ For a description of the actual process of transferring money electronically, see ch 2.B.2.1–2.2.

¹⁹⁴ Johnstone (1999) *J of Money Laundering Control* 257–259; Saxena (1998) *St Thomas LR* 705–706.

¹⁹⁵ Which is the concept used for money laundering that is perpetrated in cyberspace (see par D.4.3 below).

¹⁹⁶ Breuer *Banking in the Electronic Age. A Banker’s View* 36; Munro (2001) *J of Fin Crime* 146; Zagaris & McDonald (1992) *George Washington J of Internat Law & Economy* 63. Macintosh ((1998) *Harvard J L T* 738) describes the Internet’s impact as ‘anywhere, any time’ (see also ch 2.B.2.3.1, par B.2.3.4).

4.2 Anonymity

Anonymity is the ability to conceal a user or value within a larger group of users or values. This is exactly what a money launderer desires.¹⁹⁷ Cryptology makes anonymity possible even in the face of tracking software such as the PROMIS program that is available in the US.¹⁹⁸ It does not, however, distinguish between permissible anonymity and criminal anonymity. Ironically, cryptology is indispensable in solving potential security problems relating to the unlawful access of financial information.¹⁹⁹

Since encryption transforms a message into a form that is meaningless without special knowledge of some secret key,²⁰⁰ the decryption key, it can be used as a tool to protect the confidentiality of information in files. In addition, a criminal can, due to contemporary encryption methods, employ cellular telephones and other hand-held devices to shift money around and still rely on absolute anonymity.²⁰¹

4.3 The Internet as Platform for Money Laundering Activities

4.3.1 Background

¹⁹⁷ See in general Lilley *Dirty Dealing* 88–107; Malkhi & Pavlov *Anonymity without Cryptography* 116. Hoffman ((1998) *Fordham Internat LJ* 857) declares as follows: '[c]ryptology presents an insurmountable barrier to tracing suspect electronic transmissions.'

¹⁹⁸ Grabbe *End of Ordinary Money* 6–8, available at <<http://www.aci.nt/kalliste/money2.htm>> (2011.03.10); Straub (2002) *Suffolk Transnational LR* 520. PROMIS software was initially created for federal prosecutors to track the status of their cases. It was subsequently sold to financial institutions that use it to track customer account activities.

¹⁹⁹ See Horn *Banking in the Electronic Age. Legal Issues* 11–12; Solomon *Virtual Money* 227–229; Welling (1998) *Florida Law R* 321 detailing the benefits of using electronic money that is created through the use of encryption.

²⁰⁰ Straub (2002) *Suffolk Transnational L R* 521; Douglas & Lohr (2005) *Wisconsin LR* 1042; Fazy *Debate and Discussion* 37. Cryptology conceals the identity of an account holder by encoding the transaction (see Welling (1998) *Florida Law R* 321–322 for a discussion of the mathematical cryptographic process).

²⁰¹ See Munro (2001) *J of Fin Crime* 146; Field (1997) *American University LR* 982 as regards the anonymity and untraceability of electronic money.

Cyberspace is a ‘virtual geography’²⁰² created by computers and networks that includes²⁰³ ‘invisible and intangible paths constructed though the space continuum.’ It has been fittingly characterised as:²⁰⁴

[a] consensual hallucination experienced daily by billions of legitimate operators, in every nation ... a graphic representation of data abstracted from the banks of every computer in the human system. Unthinkable complexity.

Fraud by imposters posing as authorised personnel, damage inflicted by computer hacker, sabotage in the format of computer viruses and the interception of confidential information through criminal access are some of the areas that pose significant threats to internet-based financial transacting.²⁰⁵ In addition, the difficulty in monitoring criminal activity is demonstrated by the fact that financial crimes such as cyberlaundering are nearly invisible. This may be the reason why cyberlaundering is estimated to have earned criminals approximately 50 billion US dollars in 2001 alone.²⁰⁶ It is evident that criminals have found finer, lower risk ways to replace traditional money laundering methods²⁰⁷ to integrate the benefits of crime²⁰⁸ into the global financial system. The dangers imposed by the Internet have been appropriately summarised as follows:²⁰⁹

[i]t seems possible that electronic mechanisms that can hold large balances and make large untraceable transfers over communications networks could become attractive vehicles for money laundering ... especially if they are widely used.

Very little success has been had at combating cyberlaundering. The reason is two-fold.²¹⁰ First, the following four features of the Internet render it perfect for money laundering: the speed of transacting, easy access, anonymity of parties and the capacity to traverse countries within

²⁰² Gringras *Laws of the Internet* 456. The concept ‘virtual geography’ refers to an electronically created world comprising infinite resources which are identified by their uniform resource locators or URLs.

²⁰³ Solomon *Virtual Money* 36-37, 47.

²⁰⁴ Gibson *Necromancer* 51. See ch 2.B.2–4 for the mechanics of electronic banking.

²⁰⁵ Johnstone (1999) *J of Money Laundering Control* 257–259; Munro (2001) *J of Fin Crime* 142.

²⁰⁶ Philipsohn (2001) *J of Money Laundering Control* 87.

²⁰⁷ See paras C-D above.

²⁰⁸ See ch 2.C.5.

²⁰⁹ Blinder *Report on the Future of Money* 70–71.

²¹⁰ Philipsohn (2001) *J of Money Laundering Control* 87. For detail analyses of Internet features that facilitate cyberlaundering, see Solomon *Virtual Money* 35–37; Gringras *Laws of the Internet* 2–6; Konvisser (1997) *Harvard JLT* 349.

milliseconds. Secondly, money launderers flourish in low-risk environments which is a characteristic of cyberspace that attracts criminals to the Internet.²¹¹

4.3.2 Money Laundering Methods over the Internet²¹²

As asserted elsewhere in the study,²¹³ money has evolved over the centuries. At this point it is important to reemphasise that electronic money²¹⁴ exists outside ordinary bank deposits and has no physical presence. Cybermoney is a form of e-money that exists in the memory bank of a computer drive or server system.²¹⁵ Since e-money does not have a physical manifestation, it lends itself to being manipulated (via transfers) through any computer at any time and from any place in the world. In addition, electronic cash transactions are borderless and the principle of anonymity renders identification nearly impossible.²¹⁶ Accordingly, the availability of e-money has created a money laundering paradise for criminals.²¹⁷

Money laundering via the Internet may occur in a number of ways. Customers using on-line banking²¹⁸ facilities access their accounts from a personal computer using Internet browser software through an Internet service provider. After a customer has provided his personal identification number to the bank's web server, he may access his account from anywhere in the world. Since access is indirect as opposed to face-to-face where a transaction takes place inside the bank, the bank would have no means of verifying the identity of its customer. It is for this reason that banks are advised to use alternative methods of verifying the identity of non-face-to-face customers.²¹⁹

²¹¹ Munro (2001) *J of Fin Crime* 138–139; Fisse *Electronic Money Systems* 8.

²¹² See ch 2.B.2.3.4, par B.2.4 where the mechanics of EFTs is explained.

²¹³ See ch 2.B.1. Physical goods and paper that initially served as payment gave way to EFTs and so-called 'plastic money' which include credit and debit cards.

²¹⁴ Or 'e-money' (see ch 2.B.2.4).

²¹⁵ Effros *Electronic Payment Systems* 190–191; Solomon *Virtual Money* 63–78.

²¹⁶ FATF *Report 1999–2000* 2–3; Kurtzman *Death of Money* 11.

²¹⁷ See Munro ((2001) *J of Fin Crime* 142–148); Lilley (*Dirty Dealing* 118–126); the FATF (*New Payment Methods* 4–16) and Struber (*Electronic Purse* 22) describing the risks of money laundering through the use of e-money purses.

²¹⁸ FATF *Report 1999–2000* 2–3; Hoffman (1998) *Fordham Internat LJ* 806.

²¹⁹ See par D.4.3.4 below.

Criminals further target online money value transfer²²⁰ for money laundering purposes.²²¹ Since money value transfers facilitate anonymous fund transfers, few or no records are kept which makes it gruelling to trace funds after the a transaction has been completed. Payment takes place through any type of communication or transfer or through the clearing network to which the MVT provider belongs. MVTs are provided formally through the formal regulated financial system or informally outside the regulated system.²²² Some on-line money remittance systems facilitate payments for the online purchase of goods, for example, Ebay. A buyer can make a payment by credit card to an online service provider and simply specify the e-mail address of the intended beneficiary. No other particulars are required and no limitation to the amount of money that can be remitted exists. Whilst such online money remittance service providers assist with the development of e-commerce, they can also be employed by money launderers to move the benefits of crime around the world anonymously.

Informal financial systems are commonly referred to as an ‘underground remittance systems’²²³ and include practices such as Hawala,²²⁴ Hundi²²⁵ and *Fei Ch’ien*.²²⁶ Key to the

²²⁰ Or ‘MVTs’ which are financial service providers that accept a monetary instrument in one location and pay a corresponding sum in cash or other monetary forms to a beneficiary in some other location (FATF *Alternative Remittance Systems* paras 4–5). See also ch 6.B.4.3.3.

²²¹ FATF *Alternative Remittance Systems* par 6–8; Tan (2002) *J of Fin Crime* 280. Some of the crimes that have been associated with money laundered through money value transfers include drugs, arms trafficking and terrorism.

²²² For example, MVT providers are listed as ‘accountable institutions’ in FICA (see Schedule 1 of the FICA; ch 8.C.4.1).

²²³ Sheptycki *Policing the Virtual Launderette* 139; FATF *Report 1999–2000* paras 15–32; Williams (1997) *SA J of Internat Affairs* 78–79; Gilligan *Offshore Sovereignty* 24. Parallel banking systems are based on family connections and enhanced with understanding agreements enforced through violence. A person utilising a parallel banking system deposits money with some other who acts as a banker. The banker is frequently a business owner situated in one country who receives the equivalent of the money back in another country upon presentation of a receipt called a ‘chit’ or ‘chop’ (Rider (1996) *J of Fin Crime* 240).

²²⁴ Hawala, an Arabic word meaning ‘transfer’, is a traditional method of moving funds between South Asia and Europe (FATF *Report 1999–2000* paras 23–27; Lambert (1996) *SAPRA India Bulletin* 1–10; El Qorchi; Maimbo & Wilson *Informal Fund Transfer* 6–7; Abadinsky *Organised Crime* 347). Hawala thrives in countries where a formal banking system is absent, for example, Afghanistan (El Qorchi; Maimbo & Wilson *Informal Fund Transfer* 22–24). In Hawala recipient countries the practice is either prohibited (India), or restricted to licenced banks only (Pakistan). Hawala’s link to crime and the fact that payment settlements occur outside the formal banking system, however, resulted in attempts to

effectiveness of underground banking systems is that monetary value is moved from one location to another location without the physical movement of currency. Significantly, it is not the benefits of crime only that are transferred through underground banking systems. Legitimate money is also made available though underground banking systems.

Sometimes, legitimate money is funnelled through various banks to finance criminal causes such as terrorism. This process is known as ‘reversed’ money laundering,²²⁷ although it is submitted that it does not at all amounts to money laundering.²²⁸ Other ways to launder money in cyberspace include the use of fraudulent credit cards, security and commodities markets, and e-money to purchase fictitious goods or services.²²⁹ But the possibilities are endless. The Internet is simply a medium that revolves around messages. Where cash is stationary such as with Hawala or

regulate the practice more stringently. In Hawala money is moved between money launderers who collect it and others who distribute it. The system operates like an ordinary EFTs where a person who is, for example, situated in London, contacts some other who resides in Bombay. The former will request that an equivalent sum of money (minus a small commission) be paid in Indian rupees to an individual who is designated by the customer in London.

²²⁵ The Hundi was used in India before modern-day banking (El Qorchi; Maimbo & Wilson *Informal Fund Transfer* 11; Gilligan *Offshore Sovereignty* 24). It developed with numerous rules and customs that compelled the Indian legislature to recognise it.

²²⁶ *Fei Ch’ien* is a Chinese word meaning ‘flying money’ and dates back to the Tang Dynasty (618–907 BC) when the need for a fund transfer system in the place of carrying cash was first acknowledged (El Qorchi, Maimbo & Wilson *Informal Fund Transfer* 10).

²²⁷ The concept ‘reversed’ money laundering was first coined in the US as a result of the country’s post-September 2001 war on terrorism (see Lauber (2004) *Terrorism Monitor* 1; Lilley *Dirty Dealing* 129–131; ch 7.C.8.1). Reversed money laundering involves the utilisation of legitimate funds to finance terrorist activities. Money donated by sympathetic supporters of a specific cause is transferred through various bank accounts, or alternative banking systems such as *Hawala*, in an effort to conceal its ultimate criminal purpose. At present, reversed money laundering refers only to one type of criminal activity, namely terrorism. However, there is no reason why the reversed money laundering should not be used in relation to other potential criminal activities as well.

²²⁸ Note that reversed money laundering does not conform to either the functional (see par. B.1 above) or the legal definitions of money laundering (see ch 6.B.3.4, par C.3.4; ch 7.C.2–3; and ch 8.C.3.2, par C.4.2.1). It merely describes the potential purpose of legitimate money instead of a process aimed at concealing money’s connection to crime. Therefore, reversed money laundering is not money laundering. However, although reversed money laundering is not recognised as money laundering *per se*, it is nevertheless mentioned in this study because it influences the identity and reporting obligations of banks in terms of the KYC standard (see ch 5.B.3; ch 6.B.3.4; par C.3.4; ch 7.C.2–3; ch 8.C.4.2.3.3).

²²⁹ Morris-Cotterill (1999) *Inter R of Law Comp & Tech* 218–221;

where e-money is issued through non-regulated entities there is no suspicious transaction to report to the authorities.²³⁰

4.3.3 The Virtual Money Laundering Process

Electronic transactions take place in a second.²³¹ They can be conducted from anywhere in the world and routed through various jurisdictions to conceal their place of origin, obscure the trail and obstruct possible investigations. Similar to the ordinary money laundering process described earlier,²³² laundering money in cyberspace also requires three stages.²³³ After placing criminally acquired e-money in cyberspace,²³⁴ criminals aim to disguise the criminal nexus of the money by completing numerous transactions with it. The e-money is subsequently transferred to an account or various accounts which renders it impossible for the authorities to follow its trail. The anonymity created by cyberlaundering facilitates the process.²³⁵

4.3.4 International Aspects

4.3.4.1 The European Convention on Cybercrime

The public perception of cyberlaundering is that it is innocuous, especially since victims are perceived to be multinationals rather than persons.²³⁶ Initial responses to the money laundering problem which included monitoring known criminals have been recognised as ineffective in combating the cyber aspect of the crime. At present, governments ally the funding that was once

²³⁰ But see par D.4.3.4 below.

²³¹ See ch 2.B.2.3.

²³² See par B.4 above.

²³³ Namely placement, layering and integration (see par B.4 above).

²³⁴ The placement stage involves depositing e-money in cyberspace by, for example, exchanging a smart card (see ch 2.B.2.4) from one person to some other (Philipsohn (2001) *Comp & Security* 485--486). Some smart cards have microprocessors that function as a computer. Other smart cards have magnetic strips only, are chipless and hold little information.

²³⁵ See par D.4.2 above.

²³⁶ Johnstone (1999) *J of Money Laundering Control* 259.

spent on following known criminals towards cybercrime prevention.²³⁷ Strategies focus on the prevention rather than the detection of cyberlaundering *post facto* when the trail may already be too cold to follow.

Although sophisticated encryption generally presents a possible, though costly, solution to cybercrimes it is unable to assist in the prevention of cyberlaundering.²³⁸ The way forward in terms of combating cyberlaundering is to focus on commercial and legal awareness.²³⁹ It is with this in mind that the European Convention on Cybercrime of 2001²⁴⁰ and related recommendations of the FATF are of particular importance.²⁴¹

The European Council adopted the 2001 Convention in November 2001 and it has been open for signature ever since. It is the first international convention aimed at combating cybercrime and therefore, it pursues three aims.²⁴² First, the formulating common definitions of criminal offences to harmonise domestic law, secondly, creating cyber-appropriate investigation methods and thirdly, restoring ways of international cooperation against cybercrime. The 2001 Convention does not refer to money laundering specifically, but indirectly empowers the authorities to combat the crime in three ways. First, cyber-offences that are grouped in four different categories are created by the 2001 Convention.²⁴³ Secondly, it was recognised²⁴⁴ that applying ordinary investigation methods to cybercrimes were futile. Therefore, the 2001 Convention provides for specific rules on the formulation of procedural methods.²⁴⁵ One such a provision concerns requests by the authorities to compel a person or service provider to render specified stored computer data. Thirdly, due to the borderlessness of cybercrime, it is vital that a cybercrime agreement provides for international collaboration if so required. For this reason the

²³⁷ Haines & Johnson (1999) *J of Money Laundering Control* 322–323.

²³⁸ This is because encryption aims to prevent the fraudulent use of customer accounts and unauthorised access to funds (see par D.4.2 above).

²³⁹ Haines & Johnson (1999) *J of Money Laundering Control* 322.

²⁴⁰ Or ‘2001 Convention.’ For detailed background on the 2001 Convention, see EC *Convention Explanatory Report* par 9.

²⁴¹ See also ch 6.B.4.3.

²⁴² EC *Convention Explanatory Report* par 16.

²⁴³ Articles 2–13 of the 2001 Convention. Some of the offences include illegal computer access and computer-related forgery which are usually committed when money is laundered in cyberspace.

²⁴⁴ De Vel *Cybercrime Convention* par 3.

²⁴⁵ Articles 14–21 of the 2001 Convention.

2001 Convention provides for the application to cybercrime of traditional forms of international cooperation.²⁴⁶

The 2001 Convention provides indispensable assistance in combating cyberlaundering. It is submitted that the importance of the 2001 Convention in combating cyberlaundering is twofold. First, the 2001 Convention constitutes the first international treaty to criminalise computer-related crime. Secondly, it requires international cooperation as regards the investigation of cybercrimes whilst removing obstacles in securing electronic evidence of potential cybercrimes. Cyberlaundering per definition is a borderless crime which renders the 2001 Convention key in effectively warring it.

4.3.4.2 Recommendations of the Financial Action Task Force

The leadership of the FATF in the area of money laundering prevention is undeniable.²⁴⁷ The FATF has included various measures aimed at combating cybercrime in its forty recommendations and revised recommendations,²⁴⁸ Special Recommendation VI (Alternative Remittance)²⁴⁹ and the Interpretative Note²⁵⁰ to Special Recommendation VII (Wire Transfers). In the main the forty recommendations of the FATF²⁵¹ advise banks and non-bank financial institutions against keeping anonymous accounts and to use reasonable measures to obtain information regarding the true identity of customers on whose behalf accounts are opened.²⁵²

More to the point in the context of cyberlaundering is the FATF's Special Recommendation VI which encourages member countries to:²⁵³

²⁴⁶ For example, mutual judicial assistance (articles 25, 27) and extradition (article 24). See also ch 5.C.2 in this regard.

²⁴⁷ See also ch 5.B.3.3.

²⁴⁸ See FATF *Forty Recommendations 1990*; FATF *Revised Recommendations 2003*; ch 5.B.3.3.2–3.3.4.

²⁴⁹ In October 2001 the FATF dealt with the issue of terrorist financing and issued eight special recommendations on terrorist financing (see FATF *Eight Special Recommendations 2001*). Cf ch 5.B.3.3.3).

²⁵⁰ Since 1990, the FATF has issued various interpretative notes to augment its recommendations. They are designed to clarify the latter's application.

²⁵¹ See also FATF *Revised Recommendations 2003*.

²⁵² FATF *Forty Recommendations 1990* recommendations 10-29, as amended.

²⁵³ FATF *Eight Special Recommendations 2001* Special Recommendation VI par 2.

[t]ake measures to ensure that persons or legal entities ... that provide a service for the transmission of money or value ... should be licensed ... and subject to all the FATF Recommendations that apply to banks.

Special Recommendation VI therefore addresses the problem of alternative money, or value, transfer service providers which are employed as money laundering tools.²⁵⁴ It consists of two parts: part one that concerns MVT providers in general, and a second part that deals with AML measures. Part one of Special Recommendation VI advises member countries to assist banks to: improve the identification of activities that are suggestive of MVT providers, to use this information to identify money laundering activities and to create educational and compliance programmes that remind MVTs providers of their reporting and record-keeping obligations.²⁵⁵

Part two of Special Recommendation VI pertains for the most part, similar to the Forty Recommendations of the FATF, to KYC standard-related issues such as suspicious transaction reporting and setting-up internal training programmes.²⁵⁶ MVT providers are encouraged to continue contracting with a non-face-to-face customer only after the latter's identity has been established and to keep records of all transactions for a period of up to five years. MVT providers who fail to comply with these suggestions will be subjected to criminal or administrative sanctions depending on the severity of the offence. The FATF's Special Recommendation VII was developed with two objectives in mind:²⁵⁷ first, preventing criminals from having free access to electronic means²⁵⁸ for moving funds, and secondly, detecting misuse when it occurs. More specifically, it aims to ensure that information on the originator of electronic fund transfers is immediately available to the AML authorities for prosecutorial purposes, financial intelligence units²⁵⁹ for analysing suspicious activities, and beneficiary financial institutions to assist in the identification and reporting of suspicious transactions. In short, Special Recommendation VII is

²⁵⁴ See also par D.4.3.2 above.

²⁵⁵ See FATF *Eight Special Recommendations 2001* Special Recommendation VI par 14 (Identification strategies) and par 15 (Awareness raising campaign).

²⁵⁶ FATF *Eight Special Recommendations 2001* Special Recommendation VI paras 16–21, 23.

²⁵⁷ FATF *Eight Special Recommendations 2001* Special Recommendation VII par 1.

²⁵⁸ Note that in the special recommendations of the FATF the concept 'wire-transfer' is employed in the place of 'electronic fund transfer' or EFT.

²⁵⁹ Or 'FIU', which is an internationally recognised acronym used in reference to bodies established with the specific purpose of identifying the benefits of crime and combating money laundering (see ch 5.D.5; ch 6.C.5.1; ch 7.E.1; ch 8.E.1).

directed at all the parties involved in an EFT and applies to cross-border and domestic transfers among banks.²⁶⁰ The FATF advises ordering, beneficiary and intermediary financial institutions to ensure that electronic fund transfers are accompanied by accurate originator information.²⁶¹

In summary, the difficulty in monitoring criminal activity is emphasised by the fact that cyberlaundering is nearly invisible because of the sphere in which it occurs.²⁶² Although sophisticated encryption presents a plausible, though costly, solution to cybercrimes in general, it remains uncertain whether it can assist in preventing cyberlaundering. Instead, the way forward as regards combating cyberlaundering should be to focus on commercial and legal awareness.²⁶³ In addition, the reality of globalisation means that regulators are unable to prevent banks from setting-up business in inadequately regulated centres where it is possible for them to serve customers from any where in the world via the Internet.²⁶⁴ Perhaps by addressing this issue, which at heart questions the credibility of financial regulation, some of the barriers²⁶⁵ to so-called ‘police-bank’²⁶⁶ harmony can also be dealt with. A two-fold solution has been suggested.²⁶⁷ First, by establishing industry self-regulation as a source of guidance for banks regulators will not have to compel the former to comply with requests for information. Since clearer guidelines on how to track or identify cyberlaundering transactions would have to come from the industry, no ambivalence would be plausible.

²⁶⁰ Special Recommendation VII in FATF *Eight Special Recommendations 2001* par 10.

²⁶¹ FATF *Eight Special Recommendations 2001* Special Recommendation VII paras 4–9, 11–14.

²⁶² But see Straub ((2002) *Suffolk Transnational L R* 533–534) and Hoffman ((1998) *Fordham Internat LJ* 802–803) proposing a two-fold solution to counteract the use of e-money for money laundering purposes: one, utilising decrypted audit trails to minimise anonymity, and two, establishing a universal key escrow system that would enable the identification of the beneficiaries of suspicious transactions.

²⁶³ Haines & Johnson (1999) *J of Money Laundering Control* 322. Tan ((2002) *J of Fin Crime* 282) supports legal awareness as a plausible answer to cyberlaundering.

²⁶⁴ Breuer *Banking in the Electronic Age* 36.

²⁶⁵ Various barriers exist which stymie cooperation between AML authorities and banks (Levi *Customer Confidentiality* 3; Gold & Levi *Money Laundering in the UK* 5). Most of the barriers pertain to divergent moral beliefs and commercial interests. This means that in the context of the contemporary AML control a period of ‘perpetual readjustment’ (Osofsky (1993) *J of Internat Banking L* 360) is prevailing where countries are looking to level the areas of money laundering control.

²⁶⁶ Levi *Customer Confidentiality* 3; Gold & Levi *Money Laundering in the UK* 5.

²⁶⁷ Garten *Why Bank Regulation Failed* 165–168.

Secondly, regulators should experiment with these self-regulatory rules through their power to create conditions to the approval of bank applications for products expansion. Moreover, since the existence of banks depends on the services that they are able to provide to customers,²⁶⁸ it should be remembered that the traditional face-to-face identity verification of customers is a thing of the past.

E. LEGAL CONSEQUENCES OF MONEY LAUNDERING

1. Why Combat Money Laundering?

In two controversial articles it was argued that AML efforts should be terminated because it presents a ‘classic no-win situation’ for the police authorities.²⁶⁹ The two articles provide various contentions to substantiate the futility of fighting money laundering. A key contention holds that smaller countries with financial sectors built on financial confidentiality²⁷⁰ are coerced into abolishing such secrecy, which decreases their economic and social well-being.²⁷¹ The danger of money laundering was summarised as follows:²⁷²

[m]oney laundering, organised crime, and economic crime are often integrally linked, and criminal organisations will use their profits to infiltrate or acquire control of legitimate businesses They can also use those profits to bribe individuals and even governments. Over time, this can seriously weaken the moral and ethical standards of society and even damage the principles underlying democracy.

A question which lies at the heart of this section is whether there is any truth to the statement above, or whether it is an over-dramatic estimation by a person trying to validate the existence of an organisation set-up for the sole purpose of combating money laundering? Even if one agrees that international AML authorities are overly aggressive in their pursuit of those individuals and

²⁶⁸ See Hutchins ((2000) *J of Money Laundering Control* 234) declaring that ‘people require banking more than banks.’

²⁶⁹ Rahn *War on Money Laundering* 149; Sheptycki *Policing the Virtual Launderette* 167 (see also ch 5.A, par E).

²⁷⁰ See par E.5 below; ch 3.B.2.3.1.

²⁷¹ Rahn *War on Money Laundering* 153–155.

²⁷² Tan (2002) *J of Fin Crime* 277. See also in this regard UNDCP *Ten Laws*.

countries which harbour money launderers, or questions the amount of resources spent in the effort, the rationales forwarded for fighting money laundering are nonetheless compelling. The literature review suggests that there are five vital reasons for combating money laundering.²⁷³ First, money laundering is a by-product of crime and should be combated if crime is to be reduced.²⁷⁴ Secondly, it undermines financial markets, thirdly, it corrupts professionals, fourthly, money laundering harms the banking industry whilst fifthly, it brings about additional costs to banks that are spent on implementing money laundering control measures. Four of the aforementioned reasons are evaluated next in an effort to establish whether the imposition of stringent AML measures is warranted.

2. Undermining of Financial System

Broadly regarded, money laundering provides criminals with the financial means to expand their enterprises. Consequently, criminals can manipulate nationally and internationally financial systems alike which, in turn, may have a negative impact on the global and national financial system.²⁷⁵

As illustrated already,²⁷⁶ money laundering revolves around crime and those benefits that were acquired through criminal means. The main goal of the money laundering process is to conceal the criminal nexus of the benefits of crime.²⁷⁷ To this end, the benefits of crime are deposited into bank accounts where the funds mix with legitimately earned funds which renders the former indistinguishable from the latter. The mixed fund negatively impact on both economic and financial systems because it distorts competition between global markets.²⁷⁸ In addition,

²⁷³ Fundanga *Role of Banking Sector* 2–3; McDowell (2001) *Economic Perspectives* 7–8, available at <<http://usinfo.state.gov/journals/ites/0501/ijee/state1.htm>> (2011.03.10).

²⁷⁴ See below; ch 1.A.1.

²⁷⁵ See in general UNDCP *Ten Laws*; IMF *Money Laundering and the Financial System* 6–10, 14; US *International Narcotics Control Strategy Report* 4; Hinterseer *Criminal Finance* 1; McDowell (2001) *Economic Perspectives* 7; Keh (1996) *Transnational Organised Crime* 68–82; Fabre *Criminal Prosperity* 156–160; Kay *Truth About Markets* 4; Sultzer (1995) *Tennessee Law R* 148–149.

²⁷⁶ See par B.2 above. See also ch 2.C.5.1–5.3 as regards the nexus between the benefits of crime and the activities of organised crime syndicates.

²⁷⁷ See par B.1 above.

²⁷⁸ Reuid *Financial System* 191–192; Van Duyne *Money Laundering* 106–108.

money laundering has an adverse impact on national and global interest rates because criminals reinvest funds in countries where their money laundering schemes will not be detected instead of where return rates are higher due to sound economic principles. Fabre²⁷⁹ agrees that crime, and per association money laundering, have a negative impact on the economies of certain countries. Money laundering modifies financial markets through its impact on real estate and stock speculation and creates false competition with resulted international losses. Its impact on developing economies is even more significant. Singh²⁸⁰ identifies four dimensions in which money laundering intrudes on financial deregulation, the latter being a normal process for developing markets to adopt.²⁸¹ In the first dimension emerging markets move away from exchange control to a process of deregulation that embraces capital account convertibility.²⁸² Deregulation provides an easy opportunity for money laundering to occur since exchange controls are relaxed. The question that subsequently arises is what kind of action must be taken to prevent market abuse by money launderers. Any suggestion will need to balance the positive outcomes of deregulation against measures ensuring market protection against money laundering

In the second dimension emerging markets favour the privatisation of public and state enterprises.²⁸³ Where such privatisation does occur the scope for money laundering increases. Therefore, attention must be given to the legal framework that allows privatisation to prevent money laundering from occurring. In the third dimension, developing countries may subscribe to a fiscal policy that supports money laundering schemes. At present, countries that find themselves in this situation are faced with a real dilemma. On the one hand, they may need to win international favour by promoting a policy of no-tolerance as regards money laundering. On the other hand, most developing countries are in particular need of foreign investment and, therefore, stringent export controls which act in support of AML policies, have correctly being identified as discouraging foreign investments. The fourth dimension in which money laundering intrudes on

²⁷⁹ *Criminal Prosperity* 163–164.

²⁸⁰ *Emerging Economies* 18–19.

²⁸¹ Which is also the situation in South Africa. The financial deregulation of a developing country's monetary system is suggestive of national and international confidence in its economy, but it is not a process that should be lightly considered. The fact is that a deregulated financial system is vulnerable to the benefits of crime seeking placement (see par C.1 above) and consequently, to money laundering.

²⁸² *IMF Money Laundering and the Financial System* 8.

²⁸³ Which has already transpired in South Africa with the privatisation of Transnet.

financial deregulation concerns financial reform. The deregulation of a financial sector goes hand in hand with financial sector reform. Problems associated with the reforms of the financial system and the integration of capital markets are therefore rife.²⁸⁴

At the heart of the matter is a realisation that combating money laundering with any measure of success within the four dimensions is unlikely to occur in isolation. The prevalence of the crime should be addressed jointly with issues pertaining to the judicial process and international cooperation on investigations so that developing countries act in tandem with the rest of the world.

Other matters relating to the financial policies of a country may also be adversely influenced by money laundering.²⁸⁵ As it is pointless to discuss the latter in detail, five remarks should suffice. First, the import of the benefits of crime has been found to cause national market-orientated exchange rates to depreciate resulting in a rise in the price of imports and a decrease in the price of exports.²⁸⁶ It follows that a country that allows an influx of the benefits of crime is likely to be left poorer in the sense that the amount of export tax is reduced. Secondly, money laundering may have a negative impact on international trade relations of a country on account of its connection with international terrorism.²⁸⁷ The issue of global participation to combat what some countries may perceive as terrorist activities, is likely to strain foreign trade relationships among countries which do not consider such activities as terrorism.²⁸⁸

Thirdly, money laundering allows organised crime syndicates access to illegal profits and interest-free money created outside the legitimate banking world.²⁸⁹ The political and ethical implications are enormous. Not only does money laundering halt the growth of the legitimate

²⁸⁴ IMF *Money Laundering and the Financial System* 10–11; Bosworth-Davies *Global Ungovernability* 20–21.

²⁸⁵ Fabre *Criminal Prosperity* 162; Keh (1996) *Transnational Organised Crime* 70–75; IMF *Money Laundering and the Financial System* 2, 10.

²⁸⁶ Walter *Secret Money: Tax Evasion* 301–307; Bosworth-Davies *Global Ungovernability* 20.

²⁸⁷ FATF *Terrorist Financing 2001* 799–804; Comstock (1994) *Northwestern J of Internat L & B* 145.

²⁸⁸ In this context one visualises not only trade embargoes among countries such as the US and Iraq due to the war in Iraq, but also the political ramifications of the ensuing tension that exists between Western countries such as Canada and the US, and the US and France.

²⁸⁹ Lynch ((1987) *Columbia LR* 689; Council *Commission Report on Money Laundering Directive* 18–19.

financial community, but it also imposes heavy burdens on the world's economy by harming economic activities. It further promotes suspicion in the financial system which, in turn, reduces economic growth.²⁹⁰ Consequently, by allowing money laundering national and international financial systems likewise are endangered. Fourthly, money laundering has an adverse influence on foreign investments.²⁹¹ Returns on capital in countries permeated by money laundering push investment diversification by emphasising the monetary destabilisation of developing countries. As a result, money laundering forces the attraction between so-called 'criminal economies'²⁹² and international investment which are based on false data. Fifthly, as pointed out already money laundering carries particular adverse consequences for developing economies.²⁹³ Money launderers can manipulate a developing country's financial systems to accommodate their criminal activities. Businesses that are financed by the benefits of crime also damage the stability and development of those that are operated with legally earned money.

Ultimately, the presence of the benefits of crime erodes the global financial system. However, prudent enforcement of supervisory practices as advocated by the Basel Committee and the FATF²⁹⁴ may prevent some of the aforementioned negative effects that the benefits of crime and money laundering have on the financial system.

3. Corruption of Professionals

Surprisingly little evidence exists that money laundering involves professionals who provide services to multiple customers.²⁹⁵ Money is mostly laundered by criminals themselves, or by a professional who carries out a few transactions for a specific person. Money laundering is,

²⁹⁰ Tanzi *Macroeconomic Implications* 96.

²⁹¹ Fabre *Criminal Prosperity* 165; McDowell (2001) *Economic Perspectives* 8; Keh (1996) *Transnational Organised Crime* 68.

²⁹² The concept 'criminal economies' refers to the economies of poor countries which comprise mostly of the benefits of crime (Bosworth-Davies *Global Ungovernability* 21).

²⁹³ IFAC *Anti-money Laundering* 5. See also par E.5 below.

²⁹⁴ See ch 5.B.3.2–3.3 respectively.

²⁹⁵ Reuter & Truman *Chasing Dirty Money* 4; Scheptycki *Policing the Virtual Launderette* 165.

however, unlikely to take place without the complicity of corrupt bank employees, accountants and legal professionals,²⁹⁶ especially attorneys.²⁹⁷

Criminals employ businesses more often as conduits than as means of obtaining assets.²⁹⁸ The use of a business to launder the benefits of crime negatively affects its financial statements less than other types of fraud, for example, misappropriations. While other forms of fraud may result in the loss of an asset or revenue, money launderers manipulates the benefits of crime so that they can be separated from the criminal source as swiftly as possible. As signified by the failure of the BCCI,²⁹⁹ the mere association or mere alleged association with money laundering has the potential to cause significant damage to a business, in particular, to a bank's reputation.

4. Harm to the Banking System

The benefits of crime are globally present and have the ability to destroy the reputations of businesses, banks, law enforcement, accountants, politicians, legislators and governments alike. Massive amounts of money are available to criminals, their supporters and protectors.³⁰⁰ Criminals must conceal the origin of the benefits of crime so that the funds can be used without risk of incrimination. The natural importance of combating money laundering is evident in the fact that it allows criminals to generate and employ the benefits of crime outside the legitimate banking system.³⁰¹

The large volume of benefits of crime creates the illusion of wealth in the banks but this last only a while.³⁰² Unlike other transactions the benefits of crime do not stay long enough in banks to encourage economic health because they are employed as conduits only. Once the benefits of crime have been laundered, they remain in the banking system only until they can be

²⁹⁶ Ehrenfeld *Evil Money* 246; Van Duyne (1997) *Crime, Law & Social Change* 228–229. For an economic analysis of the consequences of corruption, see Jager *The Case of Corruption* 153–169.

²⁹⁷ See par C.3 above.

²⁹⁸ IFAC *Anti-money Laundering* 6; Hubbard *Money Laundering* xxviii.

²⁹⁹ See ch 1.A as regards the failure of the BCCI.

³⁰⁰ Ehrenfeld *Evil Money* 247; Keh (1996) *Transnational Organised Crime* 68–82; Van Duyne *Money Laundering* 107.

³⁰¹ Chaiken *Investigating Criminals* 261–262; Comstock (1994) *Northwestern J of Internat L & B* 144.

³⁰² Ehrenfeld *Evil Money* xix; Keh (1996) *Transnational Organised Crime* 69.

used to finance crime. Measures to prevent the introduction of the benefits of crime into the banking system are not taken only to safeguard the reputations of banks, but also serve to protect banks against crime and use by criminals for money laundering purposes.

5. Costs of Regulation

At present, several ways exist in which the international community is setting about to combat money laundering.³⁰³ In fact, domestic AML measures have been superceded by efforts of the international community to create an international global regime against money laundering. The activities of the FATF have been of particular significance due to its typology exercises³⁰⁴ which are accompanied by sector specific recommendations. The result is tailor-made domestic AML frameworks.³⁰⁵

However, conducting investigations and evaluations and setting AML guidelines is an expensive endeavour.³⁰⁶ The international policing community expects banks to bear the brunt of the costs involved in setting up measures to combat money laundering.³⁰⁷ Member countries of the UN³⁰⁸ and the FATF have been required to implement international AML guidelines, mostly at their own expense. It is for this reason that AML efforts recently have come under fire recently with opinions being expressed that the money spent in combating money laundering could be employed for better, more worthwhile purposes.³⁰⁹ Further, technology is an indispensable tool in the identification and tracking of the benefits of crime.³¹⁰ The development of sophisticated computer software monitoring and detection systems have enhanced the ability of the authorities

³⁰³ See in general Lilley *Dirty Dealing* 58–63; ch 5.B–D.

³⁰⁴ See ch 5.B.3.3.1–3.3.4.

³⁰⁵ See ch 6.B.3.4, par C.3.6, par C.3.4; ch 7.C.2–3; ch 8.C.4.2.3.

³⁰⁶ It is not simply a matter of promulgating AML legislation that affords legitimisation to money laundering control efforts (Reuvid *Financial System* 193). Several requirements must be met before a country is regarded by the international community as being sufficiently involved in combating money laundering (see ch 6.B.3.4–3.6, par C.3.4; ch 7.C.2–8; ch 8.C.4.2.3).

³⁰⁷ Van Duyne (1997) *Crime, Law & Social Change* 226; Reuvid *Financial System* 193; Cuéllar (2003) *J of Crim L C* 391.

³⁰⁸ See ch 5.C.1–4 as regards the role of the UN in combating money laundering.

³⁰⁹ Rider (1999) *European J of L Reform* 501, 509–516;

³¹⁰ Williams (1997) *SA J of Internat Affairs* 87.

to identify unusual activities in trade and financial flows.³¹¹ Yet, AML efforts have been hampered by the costs of implementing the latest technology and training software specialists.³¹² In fact, the costs involved in establishing a comprehensive AML framework seems to be the overall reason why the gap between the money launderers and the authorities are widening.³¹³

To conclude, this discussion of the consequences of money laundering commenced with a proposal³¹⁴ that money laundering prevention is futile, *inter alia*, because the economies of poorer countries benefit as a result of the influx of money acquired through criminal means, which in turn, enlarge the personal wealth of both individuals and governments. But it should be remembered that this is true for any type of crime, not solely for money laundering. Accepting the futility of combating money laundering is analogous to argue that financial crime should be allowed because it is bound to happen. There is little doubt that combating money laundering is an expensive endeavour, but likewise is crime prevention in general. In any event, conclusive proof that money laundering indeed does hold adverse consequences for any country which allows it without incrimination may never be found due to the clandestine nature of the crime. It follows that the issue of whether money laundering should be combated ought to be turned around so that it is not the value of combating the crime that is questioned. Instead, ways to streamline the AML effort with a view of minimising costs should be investigated.

F. CHAPTER COMMENTARY AND SUMMARY

This chapter set out to investigate whether the nature and consequences of money laundering control warrants the imposition of current stringent AML measures. It follows that various critical aspects were examined for the purpose of determining the mechanics and consequences of money laundering.

Early on it was revealed that one could draw a distinction between the functional and legal definitions of money laundering. The functional definition of money laundering explains the crime

³¹¹ See par D.4 above.

³¹² For a detailed discussion on the financial burden that AML measures present to banks, see Alford (1994) *North Carolina J of Internat L & Comm R* 437–444.

³¹³ See Williams ((1997) *SA J of Internat Affairs* 88–92) who proposes that AML frameworks are doomed to failure as a result of insufficient funding.

³¹⁴ Rahn *War on Money Laundering* 149.

in terms of its main objective, namely, removing the criminal nexus from the benefits of crime so that the money's origin remains concealed. Although various, sometimes divergent, functional definitions exist to delineate money laundering, it was suggested that these definitions have as common denominator three specific elements, namely, money that is acquired through illegal means, a clear nexus between the money and crime and conduct aimed at removing this nexus. In combination these elements denote money laundering.

The discussion then proceeded to consider the historical development of money laundering. In this regard it was evident that the notion of concealing the origin of money acquired through criminal means is as old as time itself. But, contemporary money laundering techniques differ from ancient techniques in two salient ways. First, criminals have access to the most advanced technology which they successfully employ to foil attempts by the authorities to pinpoint them and the benefits of their crimes. Secondly, contemporary money laundering techniques are characterised by the enormous volume of the benefits of crime that move around in the global banking system at any given time. However, it was evident due to various factors which was spelt out in the chapter that it is impossible to measure the amount of the laundered benefits of crime with accuracy.

It was further illustrated that although various sectors are vulnerable to money laundering, banks remain most susceptible to this threat. The reason concerns the nature of banking and the specialised services on offer. It was evident that the option of conducting banking over the Internet exposes banks to a greater extent to money laundering threats. The subsequent analyses revealed the ironic truth that tools such as encryption devices used to protect banks from unauthorised access, also serve to assist money launderers in preserving anonymity. Whether the erosion of bank confidentiality³¹⁵ coupled with the disclosure requirements of AML legislation may alleviate some of these concerns are explored in depth elsewhere in the study.³¹⁶ The issue of whether money laundering is worth combating was considered against the background of internationally recognised consequences of the crime. The chapter demonstrated that money laundering by and large allows crime to increase. For this reason it must be combated with the fervour it deserves.

In conclusion, this chapter commenced with a chess quotation that suggests that certainty in a chess match renders the match of little value. To draw on the chess analogy, it is submitted

³¹⁵ See ch 3.B.2.3; ch 6.B.2.2, par C.2.2; ch 7.B.2.

³¹⁶ See ch 6.B.3.6, par C.3.4; ch 7.C.2–8; ch 8.C.4.2.3.3.

that before the AML authorities can hope to achieve victory over money launderers and consequently, crime, they need to understand the characteristics and the consequences of money laundering. When the AML authorities are able to identify money laundering schemes with a measure of success, money laundering will no longer hold any value to criminals which in turn, should lead to a reduction in crime. If money laundering schemes can be identified with a measure of certainty, global money laundering control is likely to become an attainable objective. Until that time arrives the AML authorities face the challenge of staying one step ahead of the perpetrators of crime. Ultimately, the chapter imparted three realities that exist in relation to money laundering:

- money laundering allows criminal activity to flourish because it provides criminals with the means to enjoy their criminally acquired gains;
- banks are used most commonly by criminals to facilitate the money laundering process; and
- money laundering carries various adverse consequences for banks and the financial system alike.

It is submitted that in combination the realities mentioned above warrant the imposition of stringent AML measures, including those devised by the international community. It is to this issue that the attention will turn to next.

Chapter 5 analyses the money laundering control efforts of the international community. The emphasis is placed on the KYC standard because it features as a primary measure in most of the AML guidelines of the international community. The efforts of the Basel Committee on Banking Regulation and Supervisory Practices, FATF, UN and various other internationally active organisations to control money laundering within banks are considered next in great detail.

(Chapter 5 to follow)

PTO

CHAPTER 5

INTERNATIONAL CODES, CONVENTIONS AND PROPOSALS

What distinguishes the Chess-players, all of whom follows the same rules, is called strategy: the plan, meaning, intent, force, briefly the reason of their moves ... On the same tree where a little branch hangs, called the logic of Aristotle, there hangs another branch named strategy in Chess.

LASKER Chess 13

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A. INTRODUCTION

Following the analyses of the nature of money, the consequences that money laundering control carries for the bank-customer relationship and the characteristics of money laundering in the previous chapters, in this chapter the focus is cast on the determination of the international community to combat money laundering. Transnational organised crime prevention became the focus of efforts at international level only during the late 1980s. The international community¹

¹ Note, the concept ‘international community’ denotes countries, transnational bodies and forums that are involved in the fight against money laundering on a collective basis.

supported three levels of governance to deal collectively² with organised crime, drug trafficking and money laundering. The first level of governance concerned international norms that were included in various treaties on drug trafficking.³ With the second level improved information sharing policies were envisioned to enhance transnational law enforcement efforts⁴ whilst the third level of governance was directed at establishing educational programmes to counteract money laundering.

The international community's response towards money laundering led to efforts to outlaw the crime globally. Yet, the international AML regime⁵ does not primarily target money laundering. Instead, it is aimed at reducing criminal activities that necessitate money laundering, protecting the integrity of the financial system and controlling corruption.⁶ Recently, the task of combating money laundering has been compared⁷ to the task foisted on the Greek mythological character, Sisyphus.⁸ The comparison imparts feelings of dread and optimism alike;⁹ dread

² The need for collective action is due to the fact that organised crime, drug trafficking and money laundering form the three corners of an internationally recognised criminal triangle (see ch 2.C.5.2). Banach (*European Norms* 49) calls international cooperation the 'conditio sine qua non' for tackling the money laundering problem.

³ See paras C.1–4 below.

⁴ See par D.2 below.

⁵ In this context the concept 'international regime' denotes: '[a] system of norms, standards, procedures, institutions and rules of conduct that constrain and shape state behaviour in a particular issue area' (Alexander (2001) *J of Money Laundering Control* 231). It follows that the international AML regime encompasses procedures and rules aimed at controlling money laundering. Nadelmann ((1990) *International Organisation* 479–481) suggests that only crimes with an international dimension should be subjected to global prevention measures. Money laundering fits the criteria (cf ch 4.B–D as regard the global nature of money laundering).

⁶ Reuter & Truman *Chasing Dirty Money* 6.

⁷ Sheptycki *Policing the Virtual Launderette* 167.

⁸ According to an essay by Albert Camus, questioning the value of life and death, Sisyphus was an evil yet wise mortal (Bronner *Portrait* 41–42). He betrayed the secrets of the gods and chained the god of death so that the deceased were unable to reach the underworld (Mairowitz *Camus* 74). In death Sisyphus was condemned and tasked to roll a boulder up a steep hill where after it would simply roll down again. This was an everlasting process that compelled him to reevaluate the purpose of his life.

⁹ In his contribution Sheptycki (*Policing the Virtual Launderette* 167) employed the mythology of Sisyphus to demonstrate the hopelessness in combating money laundering. His assessment matches the opinion of Tanzi (*Macroeconomic Implications* 13) that fighting money laundering is much like fighting a war: one always prepares according to what was taught in past battles, but there are always new manoeuvres which leave one ill-prepared and vulnerable.

because the ingenuity of money launderers has been emphasised already in this study¹⁰ and optimism because there is no time like the present to assess the content of the KYC standard akin to Sisyphus who was compelled to reassess the purpose of his life. In fact, AML policies should be reevaluated at regular intervals to ascertain their applicability to contemporary trends, and if necessary, to modify their content.

It follows that the chapter sets out to investigate first, whether the international community has made any effort to resolve the tension between the confidentiality duty of banks and their reporting duty. Secondly, the KYC standard falls under the spotlight in an effort to determine whether it has kept up with the changing face of money laundering. Accordingly, the AML effort of the international community is examined within the context of the following critical aspects: (I) the content of the KYC standard; (II) AML efforts of the Basel Committee on Banking Regulations and Supervisory Practices and the FATF as self-appointed leader in the fight against money laundering; (III) AML provisions of certain treaties; and (IV) auxiliary AML measures of international organisations. The chapter concludes with a summary and some comments on bank confidentiality in light of internationally set AML standards as well as the current content of the KYC standard.

B. MONEY LAUNDERING CONTROL

1. Objective Model of Money Laundering Control

It is a primary principle of international law that a country can only act against offences within its own territory.¹¹ This principle has not been affected by multinational strategies against money laundering. International money laundering control strategies comprise four components, namely¹² incrimination of money laundering, implementation of tools to prevent the use of the bank system for money laundering purposes, methods to strengthen the ability of the authorities to trace, freeze and confiscate the benefits of crime and the improvement of international cooperation. In combination these components have gone a long way to establish an international standard for

¹⁰ See ch 4.C–D.

¹¹ Gregory *Private Criminality* 129.

¹² Shams *Money Laundering* 368.

combating money laundering despite the disparities that exist among countries as regards the content en enforcement of AML policies.

The disparities are due to the fact that most countries adopted either one of the following two models¹³ for money laundering control or a combination of both, namely the:

1. Objective Model of Money Laundering Control; or
2. Subjective Model of Money Laundering Control.

The Objective Model of Money Laundering Control and the Subjective Model of Money Laundering Control derive from the belief¹⁴ that banks are used as the main means to integrate the benefits of crime into the financial system for the purpose of money laundering.¹⁵ A money laundering operation is particularly vulnerable during the placement and layering stages¹⁶ because not only will the criminal be required to open a bank account and deposit (place) money in the bank, but subsequent transfers (the layering stage) among accounts, banks and different jurisdictions will be essential to obscure the money's criminal origin. The little, or no physical contact required between a bank and a customer to facilitate EFTs¹⁷ coupled with the large number of transactions that are executed daily, means that banks experience difficulty in monitoring the accounts of customers effectively.¹⁸ Therefore, international efforts to combat money laundering are aimed at identifying suspicious customers and their transactions already during the placement stage of a money laundering operation.

The Objective Model of Money Laundering Control imposes mandatory reporting and record-keeping duties on banks.¹⁹ Banks are required to report all cash transactions above a set amount regardless of whether or not they appear suspicious. The FIU²⁰ to which a STR is made is tasked to determine whether a transaction is indeed suspicious. Therefore, the Objective Model does not require that banks determine which type of transaction should be deemed suspicious.

¹³ Noble & Golumbic (1997-1998) *NYU J of International Law & Politics* 80–84.

¹⁴ See par B.3.1 below where the origins of the KYC standard are discussed.

¹⁵ Mortman (1992) *Fordham LR* 459–463; Zagaris & McDonald (1992) *George Washington J of Internat Law & Economy* 65.

¹⁶ See ch 4.B.5.

¹⁷ See ch 2.B.2, ch 4.D.4.2.

¹⁸ KPMG *AML Survey 2004* 4–5, 33)

¹⁹ Noble & Golumbic (1997-1998) *NYU J of International Law & Politics* 83.

²⁰ See par B.3.3.4 below; ch 6.B.3.6; par C.5.1 ch 7.E.1.5; and ch 8.E.1.

Banks are merely required to report all transactions above a set amount.²¹ It is evident there are advantages and disadvantages to the Objective Model of Money Laundering Control.²² Since banks are compelled to report all transactions above a set amount, they do not need to determine when a transaction will be suspicious or worth reporting. Therefore, no specialised employee training is required and transactions can be automatically elected by a computer and electronically submitted to the designated FIU.

There are, however, also disadvantages to the Objective Model of Money Laundering Control. Since all transactions above a set limit are automatically reported, the receiving FIU is usually flooded with unnecessary reports overloading both its computer systems and employees. A wide margin for human error is further created because all the received reports must be individually processed and evaluated. Moreover, this method of detecting suspicious transactions does not provide for structuring²³ or some of the other techniques of laundering money.²⁴

2. Subjective Model of Money Laundering Control

The Subjective Model of Money Laundering Control also relies on banks to report suspicious activities to a designated FIU.²⁵ The difference is, however, that when the Subjective Model is employed to control money laundering it is left to the bank to determine the type of transaction that it will regard as suspicious and therefore, decide to report.²⁶ It follows that banks must be familiar with the identities of customers and the type of transaction activities that are likely from them to assist with the determination of whether a transaction is suspicious.

There are four obvious benefits to employing the Subjective Model of Money Laundering Control in the place of the Objective Model. First, the Subjective Model usually benefits the FIU to which the report is made because the number of reports filed is reduced. Filing fewer reports is likely to reduce administration costs. Secondly, a FIU is not required to spend time or expertise

²¹ Which is also known as ‘blanket reporting’ (Maroldy (1990) *Notre Dame LR* 865).

²² Noble & Golumbic (1997-1998) *NYU J of International Law & Politics* 83–84; FATF *Other Initiatives* 10–11, available at <http://www.oecd.org/fatf/Initiatives_en.htm> (2011.03.10).

²³ See ch 4.B.2, par D.1.

²⁴ See ch 4.C–D.

²⁵ See par B.3.3.4, par D.5 below.

²⁶ Noble & Golumbic (1997-1998) *NYU J of International Law & Politics* 83.

in attempting to ascertain whether money laundering is in fact occurring within a bank. Thirdly, seeing that banks are left to determine whether money laundering occurs within their businesses, they also decide how much resources to allocate to comply with the reporting duty. Moreover, banks are in a better position to determine the suspicious nature of a particular transaction since they have access to detailed customer data.

However, the Subjective Model of Money Laundering Control holds disadvantages for both banks and FIUs. It has little deterrence value for criminals because they are aware that as long as transactions appear normal, banks can be used to launder money. Under-reporting of suspicious activities by banks leaves the authorities with no data to investigate. Even if a suspicious transaction is identified and reported, the paper trail may be impossible to follow. Reporting may also be reduced by banks due to cost restraints. Banks may further have to arrange extensive training for its personnel with an expected rise in expenditures. Ultimately, the greatest disadvantage of the Subjective Model is the reality that money laundering activities are likely to go unnoticed and hence unreported. Accordingly, the success of the Subjective Model hinges on internal bank policies²⁷ that are geared towards eradicating money laundering from the banking industry.

Nevertheless, the Subjective Model of Money Laundering Control has most often been employed by international organisations issuing AML guidelines.²⁸ However, member states of international organisations may elect to integrate either the guidelines into their national AML legislation, or to use them as templates for individualised AML policies.

3. The Know Your Customer (KYC) Standard

3.1 Background

The KYC standard forms the cornerstone of global AML efforts because it mandates that banks obtain sufficient information about customers and use it effectively.²⁹ The KYC standard is all

²⁷ See paras B.3.1, B.3.2.4, B.3.3.2, B.3.4.3, B.3.4.5, B.3.5, D.5 below.

²⁸ See, for example, the Basel Committee on Banking Regulations and Supervisory Practices and the FATF (see paras B.3.2–3.3 below) and the EU legislature (see ch 6.B.3.4).

²⁹ See in general Lilley *Dirty Dealing* 182–188; IFAC *Anti-Money Laundering* 8; KPMG *AML Survey 2004* 22.

about transparency, a goal that is in conflict with bank confidentiality rules. The assumption is that unless a bank knows who its customer is and anticipates his behaviour, it can never reasonably distinguish possible suspicious activity from usual behaviour.

The KYC standard derives from a US statutory requirement that compels designated institutions such as banks to file currency-transaction reports of transactions above a set threshold.³⁰ It was introduced in 1980 in Europe for the first time in the form of customer identification and suspicious transaction reporting.³¹ Contemporary KYC policies represent intricate models that aim to cater for all money laundering eventualities as opposed to initial KYC programmes that comprised vague guidelines only. Many KYC policies also sprouted ancillary strategies resulting in highly specialised protocols.³²

A standard KYC standard model consists of the four requirements, namely the:

1. know you customer requirement that forms the basis for establishing the identity of a potential or existing customer;
2. recognition and reporting requirement that creates an obligation to recognise suspicious activities and to report either knowledge, or suspicion of money laundering;
3. retention of records requirement that describes which records must be kept and for how long a period; and
4. awareness raising and training requirements that describe internal procedures to assist a bank in complying with the aforementioned requirements.

The fundamental objective of any KYC programme is to determine the true identity of customers seeking to employ the bank's services. All international AML initiatives cover some or all of these components. The initial KYC guidelines of the Basel Committee on Banking Regulations and

³⁰ Williams & Whitney *Federal Money Laundering* 227; Zagaris (1999) 32 *Vanderbilt J of Transnational Law* 1069.

³¹ The Council of the EU took the first official step to address money laundering by imposing specific duties on banks operating in its region (Rizkalla (1998) *Tulane European & Civil L Forum* 112 - cf ch 6.B.3.1). In its recommendation (see Council Recommendation R(80) of 27 June 1980 on Measures Against the Transfer and Safekeeping of Funds of Criminal Origin - Explanatory Memorandum (27 June 1980) Recommendation (a)(I) reproduced in Gilmore *International Efforts* 172), the Council stated ambiguously that banks must *know* the persons with whom they have dealings as they can assist authorities in fighting money laundering.

³² See, for example, the IMF's Pilot Programme (see par D.2 below).

Supervisory Practices³³ and the FATF³⁴ were key in establishing a primary international standard for money laundering prevention. The latter two organisations have consistently issued guidelines on how to identify potential laundering schemes within the banking industry. At present the KYC standard encompasses comprehensive due diligence programmes that are regarded as the best defence for a bank against being used for money laundering purposes.³⁵ In addition, due diligence programmes ensure compliance with the reporting requirement of the KYC standard.³⁶

The international community further recommends use of the Baden Scale³⁷ to determine when further enquiries about a customer are necessary. The Baden Scale emphasises that a duty exists to undertake further enquiries about a customer when certain facts and circumstances raise the suspicion of a reasonable person. It recognises the following five mental states of knowledge that concern the ‘duty to enquire’, namely,³⁸ actual knowledge, willful ignorance, wilfully and negligently failing to enquire as a reasonable person would do, knowledge of facts that may indicate certain information to a reasonable person and knowledge of circumstances that would lead a reasonable person to enquire. The due diligence process starts early in a transaction and, therefore, junior bank employees often carry the burden of deciding whether further enquiries are required.³⁹ For this reason, most banks employ a ‘two pairs of eyes’ system in which two bank employees are tasked with reviewing documents. It is submitted that in countries where banking supervision is not strictly enforced, due diligence rules are also not followed. A suspicious transaction that raises a red flag is likely to be heeded only because banks need to avoid being accused of assisting terrorists or of dealing with the benefits of crime.

³³ Or ‘Basel Committee’ (see par B.3.2 below).

³⁴ See par B.3.3 below.

³⁵ OCC *Money Laundering* 9. See also ch 6.B.3.6 in this regard. The concept ‘due diligence’ stems from the legal concept of duty of care (Palmer *Trade Finance Risk* 93; Zagaris (1999) 32 *Vanderbilt J of Transnational Law* 1069). In short, the concept ‘duty of care’ is an obligation put on individuals in specific professions such as banking to exercise due diligence or a duty to enquire further throughout transactions where enquiries should be made (cf ch 3.B.2.2).

³⁶ See par B.3 below.

³⁷ Which was established by Gibson J in the English case of *Baden Delvaux & Lecuit v Societe Generale pour Favoriser le Developpement du Commerce et de l’industrie en France S.A.* [1993] 1 WLR 509 [*Baden Delvaux*]. For an analyses of the facts of the case and the decision of the court, see ch 6.C.2.1, par C.4.2.2.

³⁸ *Baden Delvaux* 575–576.

³⁹ Palmer *Trade Finance Risk* 96.

For nearly two decades the Basel Committee and the FATF alike have broadened the content of the KYC standard so that it remains relevant to challenges experienced by the banking industry. The following table summarises documents of note⁴⁰ issued by the two organisations, all emphasising the necessity of having adequate internal KYC standard programmes in place within banks:

Figure 5.1

	BASEL COMMITTEE	FATF
1988	Statement of Principles * Customer identification * Record keeping * Training	
1990		Forty Recommendations * General Framework * Improve national systems * Enhance financial system * Suggest international cooperation
1996		Revised Recommendations * Extend definition of money laundering * Accentuate role of banks
1997	Basel Core Principles * Require adequate KYC policies * Adoption of FATF's Forty Recommendations	

⁴⁰ Note that since 2005 the FATF has issued no recommendations of importance to money laundering control. In 2006, the Basel Committee revised its core principles (see par B.3.2.3 below) and core methodology (see par B.3.2.4 below). However, none of these are relevant as regards money laundering control in banks.

1999	Basel Core Methodology * Elaborates on Core Principles * Lists 25 essential and additional criteria * Recognises 4 requirements of KYC: customer acceptance policy, customer identification, monitoring of accounts and risk management.	
2001	Client Due Diligence * Elaborates on key KYC requirements * Gives detailed customer identification requirements * Beneficial ownership	Eight Special Recommendations * Pertain to terrorist financing * Warn against alternative money transfer services and EFTs
2003	General Guide to Opening an Account * Lists various elements to consider when opening account * Distinguishes types of customers and list procedures * Demands detailed verification	Revised Recommendations * Consider legal systems * Accentuate role of banks to prevent laundering and terrorism * Other measures * International cooperation * Risk calculation and profiles * FIUs
2005		Ninth Special Recommendation * Concerns detection and prevention of cash couriers for terrorist and criminal purposes
2006	Revised Core Principles Revised Core Methodology	

The content of the Basel Committee and the FATF's documents listed above are henceforth discussed.

3.2 Basel Committee on Banking Regulations and Supervisory Practices

3.2.1 Introduction

Initial AML efforts at international level were put forward by the Basel Committee,⁴¹ a supranational committee devoted to creating non-binding supervisory principles and standards. In 1988, after acknowledging that banks are employed money laundering vehicles, the Basel Committee issued a statement of principles⁴² that encourages banks to put measures in place to prevent money laundering. It was the first transnational AML initiative of the kind, and the first time the Basel Committee set ethical standards of professional conduct for banks to follow.

Overall, the Basel Committee has issued four key documents pertaining to the KYC standard and customer due diligence. They are namely the:⁴³

1. Basel Statement of Principles;
2. Basel Core Methodology for Effective Banking Supervision;
3. Client Due Diligence for Banks; and
4. General Guide to Account Opening and Client Identification.

Despite the fact that none of the Basel Committee's guidelines are legal documents or legally binding on its members,⁴⁴ their content promote the presumption that banks are key in the prevention and detection of money laundering operations.⁴⁵ Significantly, the Basel Statement of Principles represents the first international recognition that was afforded to the KYC standard.⁴⁶

3.2.2 Statement of Principles (1988)

⁴¹ The Basel Committee is a committee of banking supervisory advisors established in 1975. Its members are central bank governors of the G10 countries (for a complete list of membership, see at <<http://www.imf.org/external/np/exr/facts/groups.html#G10>> (2011.03.10)). The Basel Committee operates under the administrative auspices of the Bank for International Settlements in Basel, Switzerland. See also Lee (1998) *J of International L* 1–40; Hernandez (1993) *North Carolina J of Internat L & Comm R* 286.

⁴² *BIS Statement 1988* reproduced in *Commonwealth Best Model* 67-101.

⁴³ The documents are available at <<http://www.bis/org>> (2011.03.10).

⁴⁴ *BIS Statement 1988* Preamble par 6; Alford (1994) *North Carolina J of Internat L & Comm. R* 444. In contrast, see Sherman (*Efforts to Combat Money Laundering* xvi) who suggests that the adoption of informal guidelines are becoming less voluntary than ever before.

⁴⁵ Noble & Golumbic (1997-1998) *NYU J of International Law & Politics* 117; Gilmore *Dirty Money II* 53.

⁴⁶ Although at the time, the EU and the US had measures in place that vaguely resembled the KYC standard (see par B.3.1 above; ch 6.B.3; ch 7.C.2–3).

In 1988, the Basel Committee issued a Statement of Principles on Money Laundering⁴⁷ in which it warns that:⁴⁸

[b]anks and other financial institutions may be unwittingly used as intermediaries for the transfer or deposit of funds derived from criminal activity.

The Basel Committee therefore endeavoured to outlaw anonymous accounts and took as point of departure the interest that a bank has in maintaining a positive image.⁴⁹ The Statement stipulates the procedures that banks should implement to protect the financial system against money laundering. It furthermore focuses on the common sense of banks to inspect their minimum capital requirements in order protect themselves from the dire consequences that the benefits of crime may carry for capital reserves.⁵⁰ Significantly, the Statement emphasises the integrity of bank managers and their:⁵¹

[v]igilant determination to prevent their institutions [from] becoming associated with criminals or being used as a channel for money laundering.

Pursuant to this aim, the Basel Committee delineated four ground rules or ethical principles for how banks can protect themselves against money laundering.⁵² Banks are advised to determine the ‘true’ identity of customers and to confirm the true ownership of accounts.⁵³ In addition, banks should not conduct transactions which they have ‘good reason to suppose’⁵⁴ are conduits for money laundering.

Most significantly, the Statement includes three⁵⁵ of the four key requirements⁵⁶ of what would eventually become known as the KYC standard. However, it is worth pointing out that, at

⁴⁷ Or ‘Statement’.

⁴⁸ *BIS Statement 1988* par 1.

⁴⁹ Sheptycki *Policing the Virtual Launderette* 150; Hernandez (1993) *North Carolina J of Internat L & Comm R* 445. See Bosworth-Davies & Saltmarsh (*Money Laundering* 171–176) who analyse the philosophy of compliance.

⁵⁰ See ch 4.E.2, par E.4.

⁵¹ *BIS Statement 1988* Preamble par 6.

⁵² *BIS Statement 1988* Principles I–IV. The four principles concern the purpose of the Statement, customer identification, compliance with legislation and cooperation among authorities respectively.

⁵³ *Idem* Principle II.

⁵⁴ *BIS Statement 1988* Principle III.

⁵⁵ Namely, customer identification, record-keeping and training of employees as regards money laundering control measures (*idem* Principles I and V).

⁵⁶ The fourth requirement of the KYC standard is suspicious transaction reporting (see par B.3.4 below).

the time, the Basel Committee failed to resolve the tension between the confidentiality duty of banks and their reporting duty. While the Statement does not advise banks to file STRs to the authorities, the Basel Committee expected of banks to comply with requests for information. In this sense, the Basel Committee should have been alive to the fact that banks, in complying with the Statement, would be acting in violation of their duty to observe the confidentiality of customers.

The failure of the Basel Committee to acknowledge the plight of banks is peculiar for two reasons. First, the Statement was issued two years after the US Congress enacted the Money Laundering Control Act of 1986.⁵⁷ The latter Act was controversial at the time because it imposes mandatory disclosure duties on banks. Its provisions were therefore challenged in court several times. One would have expected that the Basel Committee as an internationally active organisation would have been aware of the controversy that disclosure by banks of customer information to the authorities would cause.

Secondly, it should be kept in mind that the Basel Committee works under the auspices of the Bank for International Settlements which is a major international financial institution. It is therefore reasonable to expect the Basel Committee to foresee and address the potential pitfalls that the implementation of AML measures may hold for banks. Indeed, one may surmise that if the difficulties that banks are experiencing with the provisions of money laundering control legislation were acknowledged and debated in 1988, the fragmented approach of the banking industry towards money laundering prevention would have never existed. It is submitted that although its efforts to combat money laundering is a laudable enterprise, in the years to follow the failure of the Basel Committee to take an active interest in assisting banks with the practical challenges presented by money laundering control tarnished its reputation as an organisation that is in touch with practical challenges faced by ordinary banks.

3.2.3 Basel Core Principles (1997)

⁵⁷ See ch 7.C.3.

The Basel Committee compiled the Basel Core Principles for Effective Banking Supervision⁵⁸ in 1997⁵⁹ in cooperation with banking supervisors from different countries.⁶⁰ The Core Principles were drafted mainly to strengthen prudential banking supervision⁶¹ and to assist countries with assessing the quality of their supervisory and regulatory systems.⁶²

The Core Principles comprise 25 supervisory criteria that are further supported by the Basel Core Methodology⁶³ which was issued in 1999. Even though the original Core Principles were revised in October 2006,⁶⁴ none of the revisions differ substantially from the original principles as regards money laundering. Instead, the revisions are more geared towards enhancing the consistency between the Core Principles and the corresponding standards for money laundering control.⁶⁵ The Core Principles further serve as a basic reference to bank supervisors and outline effective supervisory arrangements.⁶⁶ In introducing the Core Principles, the Basel Committee recognised that weaknesses in the banking system in developed or developing countries, threaten financial stability. It further indicated that it would monitor the implementation of the Core Principles in conjunction with, *inter alia*, the IMF and the World Bank.

The Basel Committee included five conditions for effective banking supervision in the Core Principles.⁶⁷ Core Principle 1 lists the most substantial conditions for effective banking supervision, and comprises five additional oversight conditions of which a suitable legal framework⁶⁸ is most pertinent in the context of money laundering control. Other measures pertain,

⁵⁸ Or 'Core Principles'.

⁵⁹ See *BIS Core Principles 1997*, available at <<http://www.bis.org/publ/bcbs30a.pdf>> (2011.03.10).

⁶⁰ For a complete list of the countries involved with the core principles, see *BIS Core Principles 1997* 1–3.

⁶¹ *BIS Core Principles 2006* par 5. Walker (*Financial Crisis* 214) describes the purpose of the Core Principles as follows: '[t]his attempts for the first time to integrate all the ... aspects of supervisory and regulatory practice within a single paper and ... provide a comprehensive model for national financial market control.'

⁶² *BIS Core Methodology 2006* par 1.

⁶³ See par 4.2.4 below.

⁶⁴ See *BIS Core Principles 2006*, available at <<http://www.bis.org/publ/bcbs129.pdf>?noframes=1> (2011.03.10).

⁶⁵ *Idem* paras 2–3.

⁶⁶ *BIS Core Principles 2006* paras 4--6.

⁶⁷ The conditions include a sound macroeconomic policy, well-developed infrastructure, effective market discipline, procedures for the problem resolution and mechanisms that provide for systemic protection (*BIS Core Principles 2006* par 11).

⁶⁸ *BIS Core Principles 2006* Principle 1.

inter alia, to the licencing and structure of banks and prudential regulation requirements.⁶⁹ Core Principle 18 pertains to the KYC standard albeit in a round-about way. It advises bank supervisors to ensure that banks have strict KYC policies in place to protect them from use by criminals. Supervisors are further encouraged to implement the forty recommendations of the FATF⁷⁰ to ensure adequate customer identification, record-keeping and detection of suspicious transaction activities.

The Core Principles have been criticised⁷¹ as being vague and devoid of fixed rules which render them inappropriate to some countries. However, it should be remembered that the Core Principles were not destined as a detailed set of rules that are applicable only to countries with a well-developed banking system.⁷² Instead, with the Core Principles the Basel Committee attempted to establish a general framework suitable for use by most countries, an objective that it attained.

3.2.4 Basel Core Methodology (1999)

Although the Core Principles were designed for the purpose of providing general supervisory guidance to banks, it soon became evident that varied interpretations resulted in inconsistent regulatory advice.⁷³ A ‘harmonised’⁷⁴ assessment system was required that resulted in the drafting of the Basel Core Methodology.⁷⁵

In general, the Core Methodology restated the objectives of the Core Principles and advised when bank assessments should be conducted. It is an assessment system that includes different criteria to ascertain compliance with the Core Principles.⁷⁶ The criteria constitute detailed guidelines on how to comply with the Core Principles. The Core Methodology comprises a set of

⁶⁹ See BIS *Core Principles 2006* Core Principles 2–17.

⁷⁰ See par B.3.3.2 below.

⁷¹ Walker *Financial Crisis* 215.

⁷² See BIS *Core Principles* par 7 which promotes the Core Principles as: ‘neutral with regard to different approaches to supervision, so long as the overriding goals are achieved.’

⁷³ Pickering *Ongoing Challenges* 41.

⁷⁴ BIS *Core Methodology 1999* paras 23–24, available at <<http://www.bis.org/publ/bcbs61.pdf>> (2011.03.10). In line with the revision of the Core Principles, a revised version of the Core Methodology was likewise released in 2006 (see BIS *Core Methodology 2006*).

⁷⁵ Or ‘Core Methodology’.

⁷⁶ BIS *Core Methodology 2006* par 8.

essential criteria and additional criteria for each of the 25 Core Principles.⁷⁷ Particularly relevant to the KYC standard is Core Principle 18, entitled ‘Abuse of financial services’ as well as the 12 essential criteria and one additional criterion listed in support of it. Core Principle 18 requires that banks should have policies in place to prevent them from being used for criminal purposes. To this end, most of the essential criteria listed in supports of Core Principle 18 describe the contents of a sound KYC programme.⁷⁸ Significantly, bank supervisors are required to ensure that banks have internal⁷⁹ policies in place that provide for:⁸⁰ a customer acceptance policy, customer identification and due diligence programmes,⁸¹ processes to monitor suspicious transactions, referrals to senior management of decisions to contract with high-risk customers and unambiguous rules concerning the keeping of customer records.

Essential criterion 5 advises banks to obtain sufficient information about other banks with which they engage in business. The one additional criterion listed with Principle 18 advises the presence of an internal money laundering control expert to assist a bank supervisor.⁸²

In summary, the Basel Core Methodology read together with the Core Principles establishes a minimum international standard for banks to promote high ethical standards. The Core Methodology is considered⁸³ an invaluable document adding substance to the Core Principles. The description would have been apposite if not for the fact that the Basel Committee overlooked the bank confidentiality controversy and neglected to advise banks on the issue. The omission is peculiar, especially since the Basel Committee advises supervisors to distribute information on money laundering schemes among themselves whilst keeping data confidentiality in mind.⁸⁴ The Core Methodology provided ample opportunity for the Basel Committee to resolve

⁷⁷ *BIS Core Methodology 2006* 6–40. The essential criteria are elements that indicate compliance with a core principle whilst additional criteria are recommended elements designed to strengthen bank supervision.

⁷⁸ *BIS Core Methodology 2006* Core Principle 18 essential criteria 4–12.

⁷⁹ External policies as regards KYC standard obligations are determined by the money laundering control legislation of a country (see ch 6.B.3.6, par C.3.4; ch 7.C.2–3; ch 8.C.4).

⁸⁰ *BIS Core Methodology 2006* Core Principle 18 essential criterion 4.

⁸¹ There are two types of due diligence programmes; due diligence programmes that concern the customers of a bank (see par B.3.2.5 below) and programmes that pertain to correspondent banks (see ch 4.D.2).

⁸² *BIS Core Methodology 2006* 31.

⁸³ Walker *Financial Crisis* 215; Hubbard *Money Laundering* 20.

⁸⁴ *BIS Core Methodology 2006* 6, 8, 9, 19, 31, 33, 35, 37 and 39.

the tension between bank confidentiality rules and the duty of banks to file STRs. Most likely that the Basel Committee decided to leave the controversial issue to the legislature of its member countries.

Significantly, the Core Methodology constitutes the first document where the Basel Committee advises banks to file STRs to local FIUs for the purpose of money laundering control. However, the Basel Committee bypassed a second opportunity to resolve or simply acknowledge the tension between the confidentiality duty of banks and their reporting duty. In all other aspects, particularly as regards the KYC standard, the Core Methodology is a well thought- through and innovative document.

3.2.5 Client Due Diligence (2001)

In contrast to the Core Principles and Core Methodology that pertain to aspects other than the KYC standard,⁸⁵ the Basel Committee issued two other documents that relate solely to customer identification. They are namely the:

1. Client Due Diligence for Banks;⁸⁶ and
2. General Guide to Account Opening.

The CDD outlines standards and guidelines for banks to follow when conducting business with existing and new customers.⁸⁷ More specifically, it comprises fundamental elements that must be covered by KYC programmes. These elements pertain to customer acceptance policies,⁸⁸ customer identification⁸⁹ and risk management in general.⁹⁰ In this respect the Basel committee advises banks to:⁹¹ insist that customers identify themselves with documents that are difficult to counterfeit, close relevant accounts if verification of a customer's identification is impossible,

⁸⁵ In the main, both documents concern the setting of minimum requirements to address the variety of risks in the financial systems of individual countries.

⁸⁶ Or 'CDD'.

⁸⁷ BIS *Client Due Diligence for Banks 2001* paras 2 –30. The *CDD* defines the concept 'customer' as a person or entity that either holds an account with a bank, or is connected to it with a transaction (par 21).

⁸⁸ Banks should consider, for example, the background of a customer and the type of transactions that he is likely to conduct (*Client Due Diligence for Banks 2001* par 20).

⁸⁹ *Idem* paras 21–52.

⁹⁰ *Idem* par 19.

⁹¹ BIS *Client Due Diligence for Banks 2001* paras 23,25, 28, 32–33, 38 and 45.

establish the true nature of a relationship where an intermediary acts on behalf of a customer,⁹² ensure sufficient understanding of corporate structures when funds are pooled together and use special measures⁹³ to mitigate the risk of conducting business with non-face-to-face customers.⁹⁴

Significantly, the Basel Committee warned of the consequences of the failure to heed mandatory KYC standards. It explained that:⁹⁵

[b]anks may become subject to lawsuits resulting from the *failure to observe mandatory KYC standards* or from *the failure to practice due diligence* ... Banks will be unable to protect themselves effectively from such legal risks if they do not engage in due diligence in identifying their customers and understanding their business.

There are three reasons why the Basel Committee encourages banks to have KYC policies in place. First, to satisfy due diligence rules, secondly, to implement money laundering control policies, and thirdly, to protect themselves against litigation. Although the Basel Committee failed to specify whether it had criminal prosecution or civil litigation, or both, in mind with the aforementioned warning, it is understood that it referred to both. The reason for this supposition is two-fold. First, due to the criminalisation of money laundering it is certain that failure by banks to heed AML legislation will result in criminal prosecution, hence the Basel Committee's use of the phrase 'failure to observe *mandatory KYC standards*.'⁹⁶

Secondly, from a criminal law perspective it is impossible to judge the sincerity of a bank to practice due diligence. However, from a civil law perspective the availability of the reasonable bank test and the Baden Scale to determine the extent of a bank's due diligence⁹⁷ renders it most likely that the Basel Committee had civil litigation in mind when it used the phrase 'failure to practice due diligence.' Thus, although no direct mention to civil litigation was forthcoming from

⁹² The Basel Committee recommends that banks must assess whether introducers of customers are 'fit and proper' persons themselves (*idem* par 36).

⁹³ For example, effective identification procedures and adequate measures to mitigate the higher risk (cf *BIS Client Due Diligence for Banks 2001* par 48).

⁹⁴ Non-face-to-face customers are person who, for example, make use of electronic banking services as provided by the Internet (*idem* par 46). See also ch 4.D.4.

⁹⁵ *BIS Client Due Diligence for Banks 2001* par 13.

⁹⁶ As pointed out earlier (see par B.3.2.1 above), the Basel Committee's guidelines are not legally binding because they constitute 'soft law' as opposed to AML legislation whose implementation is mandatory (see ch 6.B.3.6, par C.3.4; ch 7.C.2–9; ch 8.C.4).

⁹⁷ See par B.3.1.

the Basel Committee, it at least had the foresight to warn banks of the potential consequences for failure to observe the KYC standard.

The aforementioned warning of the Basel Committee is of fundamental importance for banks in the face of potential civil litigation. It stands to reason that the potential civil liability of a bank is likely to depend on its degree of knowledge or suspicion as regards the origin of deposited money and its nexus to crime.⁹⁸ In short, banks that failed to establish that the account holder to whom it made a payment on demand was in fact entitled to it, are likely to face civil action if a victim of fraud or theft can establish that the money was in fact the benefits of fraud or theft and that payment was made to an account holder who was not entitled to it.⁹⁹

3.2.6 General Guide to Account Opening (2003)

In 2003 the Basel Committee issued a guide entitled ‘The General Guide to Account Opening’¹⁰⁰ to assist banks with the prudential identification of customers.¹⁰¹ Much of the information in the Guide is similar to the contents of documents published by the FATF.¹⁰² In essence, the Guide recommends¹⁰³ that banks weigh transactions and customer alike with care for the purpose of determining the extent of detail verification that is required. The Basel Committee also warns again¹⁰⁴ against the legal consequences for banks that failed to enforce KYC standards.¹⁰⁵

As suggested above,¹⁰⁶ due to the KYC standard’s suspicious transaction reporting requirement banks are more likely¹⁰⁷ to face civil litigation instead of criminal prosecution.¹⁰⁸

⁹⁸ See ch 6.C.4; ch 7.D.2–3; ch 8.D.2.2, par D.3.3.4.

⁹⁹ See in this regard ch 6.C.4.2–4.3; ch 7.D.2–3; ch 8.D.2–3.

¹⁰⁰ Or ‘Guide’, which is available at <<http://www.bis.org/publ/bcbs85annex.htm>> (2011.03.10).

¹⁰¹ BIS *General Guide to Account Opening 2003*.

¹⁰² See paras B.3.3.2–3.3.4 below.

¹⁰³ BIS *General Guide to Account Opening 2003* paras 4–6.

¹⁰⁴ See par B.3.2.5 above.

¹⁰⁵ BIS *General Guide to Account Opening 2003* par 1.

¹⁰⁶ See par B.3.2.5 above.

¹⁰⁷ It is submitted that there are two main reasons why a bank may fail to implement the KYC standard. First, no AML legislation exists in the jurisdiction where it operates and secondly, it operates as a front for organised crime syndicates (see ch 2.C.5.2.1). At present, due to international pressure and the reality of terrorist financing (see ch 4.D.4) there are few countries that have no AML legislation in place (see par B.3.3.1 below). Following the BCCI

Why the Basel Committee then saw it fit to emphasise in general terms only the potential legal consequences to a bank that fails to file STRs is open to speculation. It probably felt that a civil lawsuit based on breach of customer confidentiality is a civil matter best left to be dealt with according to the civil law of the jurisdiction in which the bank is operating. Nevertheless, it was a significant oversight of the Basel Committee to imagine that members would deal individually with the legal risks such as civil litigation being posed by AML obligations.

In conclusion, it is fair to observe that in instances where uncertainty prevails in the banking industry as regards an issue bearing upon the bank-customer relationship, it is in the best interest of all relevant parties to confer with one another and to reach a consensus on how to deal with the issue at hand. Merely ignoring potential problems neither contributes to good relations between banks and customers nor among banks and international bodies such as the Basel Committee. This point is especially significant in light of the fact that the Basel Committee prides itself on being a body committed to key regulatory and supervisory issues pertaining to the banking industry. Whether the FATF has raised to the occasion so to speak to advise banks on pressing matters as regards money laundering control is considered next.

3.3 Financial Action Task Force

3.3.1 Introduction

incident (see ch 1.A.1; ch 4.D.1), the international community accepts that criminal activity within the banking industry does irreparable damage to the reputation of banks and the industry alike. It is therefore difficult to imagine a bank that is willing to risk losing its reputation, licence to operate and customers simply because it willfully ignores the KYC standard's requirements. Consequently, banks are more likely to face civil litigation instead of criminal prosecution as a result of the KYC standard (see also ch 6.B.4, paras C.4.2–4.3; ch 7.D.2–3; ch 8.D.2–3).

¹⁰⁸ It is submitted that banks as giant commercial enterprises have unlimited funds to their disposal in contrast to an individual criminal who may be a pauper. Therefore, it makes more sense for a person who suffered a loss to litigate against a bank instead of against a fraudster or thief (see also ch 1.B).

The Financial Action Task Force¹⁰⁹ was established in 1989 by the Organisation for Economic Development and Cooperation¹¹⁰ at the G7¹¹¹ Economic Summit in Paris. The G7 found it necessary to create:¹¹²

[a] true multinational bank regulatory body that would function like ... the Federal Reserve or the Department of Justice to compel examination of the sources of deposit in every nation.

The FATF is the only international body that specialises in strategies to control money laundering.¹¹³ To this end, its purpose is primarily two-fold:¹¹⁴ to prevent banks and other financial institutions from being used by criminals for money laundering purposes¹¹⁵ and to establish measures¹¹⁶ that countries can employ to combat money laundering. In pursuance of its mandate, the FATF released a set of forty recommendations in April 1990¹¹⁷ that aimed to serve as a prevention strategy to counteract money laundering in the banking system. Subsequent documents followed whose content emphasised the FATF's commitment to be actively involved in combating money laundering within the banking industry.¹¹⁸

¹⁰⁹ At present, the FATF comprised 34 member countries (for a complete list of membership, see FATF *Annual Report 2007* I). South Africa joined the organisation in June 2003.

¹¹⁰ Or 'OECD', which is situated in Paris where the FATF maintains a small secretariat (Alexander (2001) *J of Money Laundering Control* 233; Ashe & Reid *Money Laundering* 22).

¹¹¹ For a delineation of the G7's activities, see Comstock (1994) *Northwestern J of Internat L & B* 149–150, 172–173.

¹¹² Andelman (1994) *Foreign Affairs* 106; Nakajima *Offshore Centres* 237. Note that the FATF does not meet this criterion as it functions similar to a transnational organisation.

¹¹³ For a summary of the reasons for establishing the FATF, see Zagaris & Kingma (1991) *Emory Internat LR* 460–462; Alexander (2001) *J of Money Laundering Control* 233–240.

¹¹⁴ See FATF *Report 1989–1990* par 2. Pursuant to its recently revised mandate, the FATF prioritises to enhance global surveillance of criminal activities, react to new threats to the financial system and raise AML standards (FATF *Ministerial Meeting 2008* 1).

¹¹⁵ OCC *Money Laundering* 7; FATF *Annual Report 2004-2005* par 2.

¹¹⁶ FATF *Annual Report 2004-2005* paras 1, 7–8.

¹¹⁷ See Gilmore (1992) *Commonwealth L Bulletin* 1138--1139; par B.3.3.2 below.

¹¹⁸ See par B.3.2.1 above, paras B.3.3–3.3.4 below.

The FATF further conducts annual mutual evaluations¹¹⁹ of members' progress in implementing the recommendations, and measures the compliance¹²⁰ of other countries in combating money laundering. Moreover, regional FATFs¹²¹ were established to promote the goals and objectives of the main organisation. Elsewhere in the study it was suggested¹²² that precise knowledge of money laundering trends is a prerequisite for designing effective AML countermeasures. For this reason the FATF conducts annual topology¹²³ exercises to expose new money laundering techniques and to develop strategies to counteract them.¹²⁴

It is submitted that over the years, the contribution of the FATF in combating money laundering has been immeasurable. It constantly widened the scope of AML geographically,¹²⁵ sectorially and functionally.¹²⁶ The authority of the FATF is also observable in the international authorities that act as observers.¹²⁷ Finally, before evaluating the content of the FATF's recommendations, it should be pointed out that the AML recommendations of the task force are aimed at countries and banks alike. Ultimately, the FATF's recommendations which are most pertinent to banks revolve around the KYC standard.

3.3.2 Forty Recommendations (1990)

¹¹⁹ Which are aimed at measuring the extent of the international cooperation that exists with regards to existing AML measures and its connection with 'serious crime' (Sherman (1993) *Hume Papers* 22).

¹²⁰ Compliance stands central to the FATF's recommendations (cf par B.3.1 above).

¹²¹ FATF-style regional bodies include, for example, the Caribbean Financial Action Task Force, the Eastern and Southern Africa Anti-Money Laundering Group (see ch 8.E.3) and the Intergovernmental Task Force against Money Laundering in Africa.

¹²² See ch 4.B.5.

¹²³ Topology meetings generate the main source of expertise in this field because experts in law enforcement exchange their experiences.

¹²⁴ Note, the FATF was never intended to be a permanent fixture. Its mandate was therefore extended in 1991, 1994, 1998 and again in 2004 for an eight year period (FATF *Annual Report 2004-2005* par 1) until it is deemed to be no longer required.

¹²⁵ FATF *Report on Non-cooperative Countries 2000* par 4.

¹²⁶ For example, the FATF was instrumental in establishing contact among various FIUs (cf par D.5 below).

¹²⁷ Some of the FATF's observers include, for example, the African Development Bank and the Commonwealth Secretariat (for a complete list of observers, see at <http://www1.oecd.org/fatf/Members_en.htm#OBSERVERS> (2011.03.10)).

In 1990, the FATF issued a report comprising an assessment of the money laundering problem and forty recommendations that established a strategy for countries to combat it.¹²⁸ The Forty Recommendations is an attempt to establish an AML regime with two components, namely:¹²⁹

1. a national regulatory regime encompassing monitoring and reporting of cash transactions above a certain amount and suspicious activity reporting; and
2. a network for international cooperation against money laundering that include mutual assistance treaties and extradition as well as information dissemination.

Therefore, the FATF set a minimum criteria for an effective AML programme which is known as the Forty Recommendations. The original Forty Recommendations provide a broad set of measures to build an AML system with universal application. It follows that they are flexible and may be adopted by countries with dissimilar legal systems. The FATF placed much emphasis on countries establishing first a standard AML framework before attempting to implement more advance measures.¹³⁰

The Forty Recommendations are divided into four¹³¹ main groups whose recommendations fell into three categories,¹³² namely, first, legal recommendations explaining what law-making bodies must do to create a legal framework to combat money laundering,¹³³ secondly, financial regulatory recommendations that outline how countries should regulate their

¹²⁸ See FATF *Forty Recommendations 1990* ('Forty Recommendations').

¹²⁹ Williams *Crime & Money Laundering* 123; Ashe & Reid *Money Laundering* 21–22.

¹³⁰ See Recommendations 1 and 4 of the Forty Recommendations that urge countries to implement the Vienna Convention of 1988 to enable the criminalisation of drug money laundering.

¹³¹ FATF *Forty Recommendations 1990* paras 1–40. The four main groupings include: 1. general framework (Recommendations 1–3); 2. improvement of national legal systems to combat money laundering (Recommendations 4–8); 3. enhancement of the role of the financial system (Recommendations 9–29); and 4. strengthening of international cooperation (Recommendations 30–40).

¹³² IFAC *Anti-money Laundering* 5. In contrast, Gilmore (*Dirty Money* 101) proposes that the three core measures constituting the purpose of the Forty Recommendations are the ratification of the Vienna Convention (see par C.1 below), the limitation of bank confidentiality and the increase of international cooperation (see par C.2 below).

¹³³ For example, the first recommendation stipulates that countries should criminalise money laundering as opposed to criminalising its connection to drug trafficking (FATF *Forty Recommendations 1990* Recommendation 5).

financial systems¹³⁴ and thirdly, international cooperation recommendations that clarify how governments should facilitate cooperation among one another.¹³⁵ The financial provisions of the Forty Recommendations mirror general KYC standard provisions.¹³⁶ The FATF recommends that banks eliminate anonymous accounts and make use of record keeping and suspicious transactions reporting to counteract money laundering schemes.¹³⁷ Legislative measures of the Forty Recommendations offer guidance to countries on how to identify, trace, evaluate and confiscate the benefits of crime.¹³⁸ It is therefore fair to describe the Forty Recommendations as a cornerstone for the three-fold role that the FATF holds, namely monitoring the progress of countries to implement AML measures,¹³⁹ reviewing money laundering trends and extending the adoption of the Forty Recommendations for the purpose of constructing a global money laundering control network.

In keeping with elementary KYC standard measures the FATF ensured that increased due diligence guidelines¹⁴⁰ were included in the Forty Recommendations. Banks are advised to pay special attention to unusual transactions¹⁴¹ and to report suspicions about money laundering to their local FIUs. Significantly, Recommendations 16 and 17 establish two measures to protect banks against criminal or civil liability when filing a report. First, reporters are afforded legislative protection when a report is filed in good faith regardless of whether the suspicion was warranted.¹⁴² Secondly, no information about the filing of a report may be disclosed to a

¹³⁴ FATF *Forty Recommendations 1990* Recommendation 16.

¹³⁵ *Idem* Recommendations 30–40.

¹³⁶ See par B.3.4 below.

¹³⁷ See FATF *Forty Recommendations 1990* Recommendations 5–16 and Recommendations 21–25 respectively.

¹³⁸ FATF *Forty Recommendations 1990* Recommendation 8.

¹³⁹ See, for example, FATF *Report on Non-cooperative countries 2000*; par B.3.3.1 above. The blacklisting of countries, referred to as the FATF's 'name and shame' strategy (Hinterseer *Criminal Finance* 235), is aimed at exerting pressure on non-cooperative countries to improve internal AML strategies (Lacy & George (2003) *Northwestern J of Internat L & Business* 348).

¹⁴⁰ FATF *Forty Recommendations 1990* Recommendations 15–22.

¹⁴¹ See *idem* Recommendation 15 that advises that banks: '[s]hould pay special attention to all complex, unusual large transactions, and all unusual patterns of transactions, which have no apparent economic or visible purpose.'

¹⁴² The so-called 'safe-harbour' AML provision (see also par B.3.4.3 below; ch 3.B.2.3.3; ch 6.B.2.2, par C.2.2; ch 7.B.2).

customer, a provision known as the non-tipping off or non-disclosure provision.¹⁴³ Banks must also develop detailed internal programmes to counteract money laundering schemes.¹⁴⁴ In line with the Basel Committee's Statement of Principles¹⁴⁵ the Forty Recommendations place extensive responsibilities on banks to maintain effective customer identification procedures. More so, the FATF extended the provisions of the Statement of Principles by specifying precisely what banks is expected of banks do to prevent money laundering.

Significantly, the FATF with the Forty Recommendations establishes suspicious transaction reporting for the first time as an appropriate AML measure.¹⁴⁶ Although the Basel Committee readily accepted the role of banks in the money laundering process, the FATF emphasised it even further by including detailed KYC obligations in the Forty Recommendations. In the first report on how the AML effort was proceeding, the FATF recognised¹⁴⁷ that the Forty Recommendations may need periodic revision. Accordingly, in 1996 the Forty Recommendations were amended with a two-fold purpose in mind. First, to update information as regards money laundering techniques, and secondly, to improve the understanding of the crime.¹⁴⁸ The revised Forty Recommendations also extended the scope of predicate offences from drug offences to include all serious criminal activities.¹⁴⁹ In the periods between revisions the FATF issued so-called 'Interpretive Notes'¹⁵⁰ in an effort to clarify the application of the newly released recommendations.

3.3.3 Eight Special Recommendations on Terrorist Financing (2001)

Following the September 2001 terrorist attacks on the US,¹⁵¹ the FATF was duty-bound to address the concerns of the international community about the use of the banking industry by

¹⁴³ See ch 6.B.3.2, par C.3.4.3.3; ch 7.C.8.2; ch 8.C.4.2.3.3.

¹⁴⁴ FATF *Report 1989–1990* Recommendation 20(a)–(c).

¹⁴⁵ See par B.3.2.2 above.

¹⁴⁶ Note the difference in emphasis here in contrast to the Basel Committee's guidelines which in the main focus on prudential customer identification (see paras B.3.2.2–3.2.6 above).

¹⁴⁷ FATF *Report 1989–1990* par 15.

¹⁴⁸ A process referred to as 'stocktaking' (FATF *Annual Report 1993-1994* 7).

¹⁴⁹ FATF *Annual Report 1995-1996 Revised Recommendations* Recommendation 4.

¹⁵⁰ See par B.3.3.1 above.

¹⁵¹ See ch 7.C.1.

terrorists.¹⁵² It therefore released an additional eight special recommendations¹⁵³ aimed at combating terrorist financing.¹⁵⁴

The Special Recommendations advise ratification of the UN' money laundering and terrorist related instruments, criminalisation of terrorist acts, organisations and financing, freezing and confiscation of terrorist assets,¹⁵⁵ reporting of suspicious transactions relating to terrorism,¹⁵⁶ international cooperation, alternative remittance services, electronic fund transfers and the prevention of non-profit organisations for terrorist purposes.¹⁵⁷ Only three of the eight Special Recommendations contain provisions that are not covered by the FATF's Forty Recommendations and the 1996 revised Forty Recommendations.

As mentioned elsewhere in this study,¹⁵⁸ Special Recommendations VI and VII, which pertain to money transfer services offered by non-banking organisations and electronic fund transfers respectively, are of particular importance in the sphere of money laundering prevention. An interpretative note¹⁵⁹ was subsequently issued with Special Recommendation VII to assist members in implementing measures to prevent the negative consequences of electronic payment systems.¹⁶⁰ Special Recommendation VII aims to ensure that information on the originator of a fund transfer is made available to a FIU so that suspicious transactions can be identified and reported.¹⁶¹

¹⁵² See FATF *Eight Special Recommendations 2001* Annex A Preamble; Lilley *Dirty Dealing* 150–152.

¹⁵³ Or 'Special Recommendations' (see also ch 4.D.4.3.2, par D.4.3.4.2).

¹⁵⁴ FATF *Eight Special Recommendations 2001*. While the FATF advises its members to ratify existing UN instruments on terrorism (Special Recommendation I), the provisions of the first five Special Recommendations are similar to the provisions of the UN International Convention on Terrorism that was adopted by the General Assembly on 9 December 1999.

¹⁵⁵ FATF *Eight Special Recommendations 2001* Special Recommendation III.

¹⁵⁶ Any *reasonable* suspicions as regards money designated for terrorism should be promptly reported to the local FIU (FATF *Eight Special Recommendations 2001* Special Recommendation IV).

¹⁵⁷ FATF *Eight Special Recommendations 2001* Special Recommendations I–VIII respectively. Cf Gilmore *Dirty Money II* 119--129.

¹⁵⁸ See ch 4.D.4.3.2, par D.4.3.4.2.

¹⁵⁹ FATF *Wire Transfers 2003*. The interpretive note was issued in June 2003 to assist members with addressing the dangers of alternative money transfers (see FATF *Alternative Remittance Systems 2003*).

¹⁶⁰ FATF *Annual Report 2002-2003* 8.

¹⁶¹ FATF *Wire Transfers 2003* par 1.

In 2005, the FATF issued another special recommendation pertaining to the detection and prevention of cross-border transportation of cash by, *inter alia*, terrorists.¹⁶² The purpose of the Ninth Special Recommendation is two-fold: first, to give guidance to members regarding the detection of cash carriers, and secondly, to instruct banks on how to implement measures to prevent their use by terrorists.¹⁶³ Ultimately, not much additional detail is given in the Ninth Special Recommendation although it informs the banking industry of ways in which both terrorist activities and money laundering can be combated.

3.3.4 Revised Recommendations (2003)

In 1999, as a result of concerns raised by the G7-member countries, consensus was reached that the FATF should concentrate more on the issue of suspicious transaction reporting, a decision that led to a formal review of the revised Recommendations in 2001.¹⁶⁴ Therefore, a modified version of the revised Recommendations¹⁶⁵ was adopted in 2003 to inform banks about new money laundering matters.¹⁶⁶ Interpretative notes¹⁶⁷ were also issued in conjunction with some of the Revised Recommendations.¹⁶⁸ The forty Revised Recommendations are structured as followed: legal systems (Revised Recommendations 1 to 3), measures to be taken by banks to prevent money laundering and terrorist financing (Revised Recommendations 4 to 25), other measures necessary in systems for combating money laundering and terrorist financing (Revised Recommendations 26 to 34) and international cooperation (Revised Recommendations 35 to 40). Pursuant to the purpose of the Special Recommendations to counteract the financing of

¹⁶² FATF *Detecting Transportation of Cash 2005* ('Ninth Special Recommendation'). See Nakajima *Offshore Centres* 241–244 as regards the FATF's efforts to combat terrorist financing.

¹⁶³ FATF *Detecting Transportation of Cash 2005* par 2.

¹⁶⁴ FATF *Report 2000-2001* 17–18.

¹⁶⁵ Or 'Revised Recommendations'.

¹⁶⁶ FATF *Revised Forty Recommendations 2003*.

¹⁶⁷ FATF *Revised Forty Recommendations 2003 Interpretative Notes to the Forty Recommendations*.

¹⁶⁸ See, for example, FATF *Revised Forty Recommendations 2003* Recommendations 5-6, 9-10.

terrorism,¹⁶⁹ the Revised Recommendations extent to terrorist financing without including the former.¹⁷⁰

The revised customer due diligence and record-keeping measures are of particular importance.¹⁷¹ Revised Recommendation 5, like Recommendation 12 of the FATF,¹⁷² advises banks against allowing anonymous accounts.¹⁷³ Customer due diligence measures should further be undertaken in four particular instances, namely when new business is accepted, occasional transactions are conducted,¹⁷⁴ a suspicion of money laundering or terrorist financing exists and when the bank doubts the accuracy of information obtained from a customer.

Finally, it is useful to emphasise the importance of FIUs. Neither the original Forty Recommendations nor the 1996 revised version thereof advocated setting-up a FIU for the collection and dissemination of information relating to potential money laundering schemes. In 2003 the FATF addressed this lacuna in the Revised Recommendations¹⁷⁵ where it proposes the establishment of FIUs to receive, analyse and disseminate suspicious transaction reports.

In summary, the Revised Recommendations modernised key aspects of the Forty Recommendations. It is further evident that the KYC measures of the FATF akin to the guidelines of the Basel Committee, are neither stagnant nor calls for the implementation of measures that are left unexplained. Having said that, there are two dangers in leaving the implementation of general AML measures in the hands of member countries that do not have national AML legislation in place.¹⁷⁶ First, if FATF members leave the implementation of the

¹⁶⁹ See par B.3.3.3 above.

¹⁷⁰ See FATF *Revised Forty Recommendations 2003* par 3 explaining that the Revised Recommendations: '[n]ow apply not only to money laundering but also to terrorist financing ... [and] provide an enhanced, comprehensive and consistent framework of measures for combating money laundering and terrorist financing.'

¹⁷¹ See FATF *Revised Forty Recommendations 2003* Revised Recommendations 5–12 that are regarded as setting firmer, more detailed standards coupled with a flexibility that corresponds to contemporary KYC practices (FATF *Annual Report 2002-2003* 5).

¹⁷² See par B.3.3 2 above.

¹⁷³ FATF *Revised Forty Recommendations 2003* Revised Recommendation 5.

¹⁷⁴ Two types of transactions are specified: transactions above a set threshold and electronic transfers (FATF *Revised Forty Recommendations 2003* Revised Recommendation 5).

¹⁷⁵ See *Revised Forty Recommendations 2003* Revised Recommendation 26 that suggests that FIUs be granted appropriate access to all information it may require to assist with its functions.

¹⁷⁶ KPMG *AML Survey 2004* 13; KPMG *Global Report-2007* 50.

broadly designed FATF policies solely to the discretion of banks, it may render them vulnerable to risk.¹⁷⁷ Secondly, the implementation of global AML policies is likely to be more onerous than those applicable to local banks that possibly may result in haphazard implementation. Regardless of the unrepresentative membership¹⁷⁸ and the unenforceable nature of its recommendations, the FATF remains the global leader with respect to the conception and revision of AML strategies.¹⁷⁹ For this reason, most of the FATF's recommendations have been integrated into the laws of both member and non-member countries.¹⁸⁰

One point of criticism against the FATF relates to its failure to directly acknowledge the conflict between the confidentiality duty of banks and their reporting duty. The failure may be attributed to the fact that its recommendations constitute soft law¹⁸¹ which renders their implementation discretionary. Most likely the FATF hoped that members will address problematic issues in national AML legislation. It is, however, evident that the FATF foresaw some potential liability problems with suspicious transaction reporting hence the inclusion of a safe-harbour provision in the Forty Recommendations.¹⁸² Although the FATF failed to elaborate on the issue of protecting reporters of suspicious activities, the mere recognition of the need for such a provision could result in member countries including similar provisions in their own AML legislation. More so, the protection given by its safe-harbour provision may resolve some of the tension that exist between the two conflicting obligations.

¹⁷⁷ The reason is that some banks may find the implementation of detailed KYC policies too burdensome and instead put superficial measures in place.

¹⁷⁸ See par B.3.3.1 above.

¹⁷⁹ For example, the FATF publically committed itself to a more practical partnership with banks for the purpose of fighting money laundering (FATF *Ministerial Meeting 2008* 1).

¹⁸⁰ Shams *Money Laundering* 368.

¹⁸¹ See Aust (1986) *International Commercial LQ* 787–812 for a detailed discussion of the nature of different international agreements. Note that in contrast to the treaties of the UN, guidelines issued by non-governmental forums such as the Basel Committee (see par B.3.2 above), the FATF and other agencies (see par D below) that function transnationally have no binding power. This is because a treaty is binding on those countries that assented to be bound by it. It is therefore in character similar to a contract (Aust *Treaty Law* 131). A treaty enters into force in the manner and date decided upon by the negotiating countries. Yet, it is submitted that these voluntary guidelines influenced the international AML regime substantially and moulded it into the comprehensive regime that it is today.

¹⁸² *FATF Forty Recommendations 1990* Recommendation 16 (see par B.3.3.2 above).

However, at some point the FATF will have to formally acknowledge the potential quagmire banks face in light of their confidentiality duty and their reporting duty. A related issue centers around the actual effectivity of the KYC standard in assisting banks to identify the benefits of crime *before* the funds are deposited into a bank account. Plenty have been said about the duty of banks to implement the KYC standard¹⁸³ yet no data exists to substantiate its effectiveness. In fact, it appears as if money laundering is more pervasive today than ever before.¹⁸⁴ Guidance to these problems and related ones need to come from an organisation such as the FATF that operates at the forefront of the global AML effort. In verity, regardless of its laudable involvement in combating money laundering, more in-depth analysis of the challenges banks are facing in light of AML policies is required from the FATF if it hopes to count on the continuous good esteem of the banking industry.

3.4 Essential Requirements of the KYC Standard¹⁸⁵

3.4.1 Customer Acceptance Policy

At present, guidelines for the opening of a personal bank account include obtaining satisfactory identification, considering the vicinity of the customer's residence or his business, call-verifying a customer's residence, place of business and place of employment, considering the source of funds used to open the account and investigating prior banking references for larger accounts.¹⁸⁶ Additional steps include third-party references, verification-agencies and Internet search methods.¹⁸⁷

¹⁸³ See par B.3.4, paras C–D below; ch 4.D.1; ch 6.B.3.4, par C.3.4; ch 7.C.2–3; ch 8.C.4.2.1

¹⁸⁴ See ch 4.B.3.

¹⁸⁵ Due to the scope of the study, the following section will highlight only a few pertinent issues as regards the KYC standard. See ch 6.B.3.4–3.6, par C.3.4; ch 7.C.2–3; ch 8.C.4.2.1 as regards country-specific KYC standard requirements.

¹⁸⁶ OCC *Money Laundering* 10. For a list of suspicious behaviour at account opening stage, see SIA *Deterring Money Laundering* 12.

¹⁸⁷ OCC *Money Laundering* 10. Banks should likewise request the details of the beneficial owners of accounts (see ch 3.C.2.3 and ch 4.C.2).

The process of knowing a customer is not concluded once the initial account opening information has been obtained. Even after an account is established, banks must continue to build upon the data it obtained and ensure that it is updated regularly.¹⁸⁸

3.4.2 Know Your Customer Principle 1 - Identification

The first and most fundamental step in effective customer due diligence is verifying the identity of a customer.¹⁸⁹ Not only are banks required to verify the identity of customer to whom services are rendered on a face-to-face basis, but the identities of beneficial account owners must also be established.¹⁹⁰

Various factors should be considered to determine the type of measure required to establish the identity of a particular customer.¹⁹¹ Banks must distinguish among, *inter alia*, individual accounts, foreign accounts, accounts of legal entities and accounts opened via the internet. The duty to know a customer requires identifying customers and being alert to unusual transactions.¹⁹² In general, the KYC standard advocates sufficient knowledge as regards the: identity of the beneficial owners¹⁹³ of legal entities and parties to transactions, source of funds, intended use of funds, appropriateness of business activities and the pattern of transactions in the context of the business. Procedures for establishing the identity of an individual account holder must differ from those employed for commercial or business account holders.¹⁹⁴

3.4.3 Know Your Customer Principle 2 - Reporting

¹⁸⁸ *SIA Deterring Money Laundering* 5.

¹⁸⁹ *OCC Money Laundering* 10.

¹⁹⁰ Zagaris (1999) 32 *Vanderbilt J of Transnational Law* 1080.

¹⁹¹ *SIA Deterring Money Laundering* 8.

¹⁹² See further par B.3.4 below.

¹⁹³ See ch 3.C.2.3; ch 4.C.2.

¹⁹⁴ For example, information required to establish the identity of an individual should pertain to his personal particulars, nett worth and occupation (*SIA Deterring Money Laundering* 7). Carr and Morton ((1989) *Internat Financial LR* 13), however, criticise rigorous questioning and point out that it is likely to cause even honest customers to seek out different banks with which to conduct business.

The objective of a suspicious transaction reporting system is to create a repository for the reporting of suspected criminal violations and suspicious financial transactions.¹⁹⁵ It requires that banks report transactions that have no legal purpose or are of a kind in which the particular customer would normally not engage.¹⁹⁶ Monitoring can be performed through a range of internal or external resources.¹⁹⁷ It is crucial to ensure that the monitoring process is independent of the areas of business responsible for operating the procedures.

In general, banks should be on the alert for transactions that serve no perceptible economic purpose.¹⁹⁸ Suspicious activity is likely to occur either at the outset of the bank-customer relationship or long after the relationship has been initiated. Thus, transactions should be regarded in the context of other account activity to determine whether it is in actual fact suspicious. Unusual transactions may include transactions that lack a reasonable economic basis or recognisable strategy based on what is known about the particular customer.¹⁹⁹

Suspicious transaction reporting is likely to be more effective when two legal conditions are fulfilled.²⁰⁰ They are namely, a safe-harbour provision and a non-tipping off or non-disclosure provision. As mentioned above,²⁰¹ safe-harbour provisions should indemnify banks against civil lawsuits filed by a customer after the bank filed a STR. Non-tipping off provisions call for a moratorium on informing the customer about the filing of a STR. Inclusion of the two conditions in AML legislation and policies is likely to result in banks filing STRs more freely and prevent criminals being warned before conclusion of an investigation. It is therefore fair to state that if the two conditions are carefully worded they should render AML prevention policies more effectively, because they may then resolve some of the tension that exists between bank confidentiality and suspicious transaction reporting. Nevertheless, it is not always evident what type of activity should be regarded as suspicious because the legal reportable conditions of

¹⁹⁵ Carrington *Rule of Law* 13. The information is subsequently made available to local FIUs to analyse and to disseminate if necessary to law enforcement authorities.

¹⁹⁶ OCC *Money Laundering* 10; IFAC *Anti-money Laundering* 8.

¹⁹⁷ KPMG *AML Survey 2004* 15.

¹⁹⁸ Schaap *Fighting Money Laundering* 15–16; IFAC *Anti-money Laundering* Appendix II 20.

¹⁹⁹ SIA *Deterring Money Laundering* 11.

²⁰⁰ IFAC *Anti-money Laundering* 8.

²⁰¹ See paras B.3.3.2, B.3.3.4 above.

suspicious activity vary greatly.²⁰² Therefore, it is possible that an activity that is illegal in one country can be perfectly legal in another.²⁰³

An effective compliance programme includes measures to identify and file STRs immediately.²⁰⁴ Banks must employ appropriate customer due diligence rules to enable them to evaluate transactions and conclude whether to file a STR.²⁰⁵ STRs must further be filed within the prescribed period and following the discovery of a transaction that is either above a set reporting limit, or if the bank suspects that the transaction: involves money that derived from illegal activities, is conducted to either conceal criminal money, or violate STR requirements, is designed to evade AML legislation, has no apparent lawful business in which one would expect a customer to engage and the bank knows of no reasonable explanation after examining the facts of the transaction. The filing of a STR must be confidential and should be conveyed to the board of the bank.

3.4.4 Know Your Customer Principle 3 - Record Keeping

Principle 3 of the KYC standard which concerns the storing by a bank customer and account activity information, requires that banks have proper storage and availability of documentation on account activities.²⁰⁶ Where information about the identity of foreign beneficial account holders is stored outside a particular country, banks could be required to disclose it within a

²⁰² See ch 6.B.3.6, par C.3.4; ch 7.C.2–3; and ch 8.C.4.2.3.3

²⁰³ IFAC *Anti-Money Laundering* 9. See also ch 2.C.5.3.1.

²⁰⁴ Tattersall (1994) *J of Asset Protection and FC* 108. Control reference systems, such as the CROCODILE grid system (Palmer *Trade Finance Risk* 83–92), can be used by a bank to determine, on a scientific basis, the chance of money laundering being present in a transaction. The concept ‘CROCODILE’ is an acronym for different factors a bank should consider to determine areas where fraud is prevalent. It follows that in terms of the CROCODILE method a bank, in searching a transaction for possible money laundering, needs to consider the following factors: Country of origin, Reputation, Organisational structure, Currency, Operational structure, Due diligence, International network of branches or subsidiaries, Location of branch and Earning potential of a deal.

²⁰⁵ Zagaris (1999) 32 *Vanderbilt J of Transnational Law* 1074; KPMG *AML Survey* 2004 24.

²⁰⁶ Zagaris (1999) 32 *Vanderbilt J of Transnational Law* 1079–1080.

specified period of time to the FIU of the country in which the bank operates. The logistical difficulty that requests of this kind is likely to engender are explored elsewhere in the study.²⁰⁷

3.4.5 Know Your Customer Principle 4 - Training

Banks must educate their employees to use their internal AML procedures. The latter usually include the detection of unusual transactions and compliance with its internal AML policies, regulations and reporting requirements.²⁰⁸ It is further prudent for banks to incorporate a section that explain its AML policies in all its relevant manuals and materials. AML manuals must be readily available to employees. Employees who deal with customers and transactions on a daily basis must be familiar with all aspects as regards the bank's AML policies.²⁰⁹

3.5 Value of KYC the Standard for Banks

It has been suggested²¹⁰ that the KYC standard is insufficient to deal with money laundering. The reason for this view is that banks are pressured to file STRs in conflict with bank confidentiality duties. There is, however, no gainsaying that the KYC standard plays an important role in money laundering prevention because it provides a template of a standard AML policy. In addition, not only does the KYC standard comprise straightforward AML guidelines, but it also ensures a measure of uniformity in the banking industry with respect to internal AML policies. Be that as it may, it is submitted that the detailed provisions of the KYC standard do little to assist banks with the practical dilemmas they are facing as regards money laundering control.

Although the notion of due diligence operates to assist banks in deciding when to file a STR or when to abstain from doing so, it fails to address the everyday dilemmas that confront banks. In fact, the KYC standard and accompanying due diligence provisions focus mainly on issues that relate to suspicious transaction reporting, for example, whether the duty exists, at which point the duty commences, and the manner in which a report should be filed. These factors

²⁰⁷ See ch 3.B.2.3; ch 6.B.2.2, par C.2.2; ch 7.B.2.

²⁰⁸ *SIA Deterring Money Laundering* 15.

²⁰⁹ Tattersall (1994) *J of Asset Protection and F C* 10; KPMG *AML Survey 2004* 27–29. See also ch 8.C.4.2.3.5.

²¹⁰ Palmer *Trade Finance Risk* 120.

are pivotal in the context of having sound KYC standards in place, but they do not provide practical guidance that can protect banks from civil litigation.

It is further evident that in light of the KYC standard the purpose and use of bank confidentiality rules have become redundant in certain instances. Therefore, it is proposed that the banking industry should attempt to reach some type of consensus that due to the prevalence of money laundering²¹¹ and the adverse consequences it carries for the banking industry, confidentiality rules should apply only in situations where there are no suspicions of money laundering. It stands to reason that customers must be informed that banks may violate their confidentiality in light of contemporary AML policies. Conversely, under normal circumstances banks remain obligated to follow bank confidentiality rules.

Senior management determines the focus of a bank's AML compliance arrangements in three crucial areas that provide the control framework:²¹² one, designing the bank's AML policies, two, in delegating responsibilities through a logical structure, and three, in monitoring the money laundering control process. It follows that the senior management of a bank is in an ideal position to rely problems with the execution of AML duties to the bank's board of directors. In turn, the latter can approach the industry watchdogs, professional associations, for example, the Association of Banking Lawyers of South Africa and other industry role players to formulate an industry policy on the future of bank confidentiality in the context of the AML legislation in general, and in particular, the KYC standard.²¹³

The next section will illustrate that while legislation constitutes the foundation of global AML policies, many international organisations operate at the frontline of money laundering control.

C. UNITED NATIONS²¹⁴

²¹¹ See ch 4.B.3 where the scale of money laundering is considered.

²¹² KPMG *AML Survey 2004* 8.

²¹³ See also ch 8.C.4.2.3.2, par F for recommendations forwarded in respect of FICA.

²¹⁴ In addition to providing a forum for international AML legislative measures, the UN has been otherwise engaged in combating money laundering. Its Global Programme Against Money Laundering ('GPML') was established in 1997. It constitutes a mechanism through which the UN is able to ensure that member countries achieve the objective of putting AML legislation in place.

1. UN Convention Against the Illicit Traffic in Narcotic Drugs (1988)

1.1 Background

The growth in money laundering can be ascribed to its complexity and international character.²¹⁵ In combination the integration of economies, free movement of money and the speed of financial transactions create new money laundering opportunities. At present, money laundering is as much a global crime as a national one with criminals moving money to and from countries with less stringent controls.²¹⁶ Moreover, countries that have developed AML regimes have done so in various degrees.²¹⁷

Against this background the UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances²¹⁸ is regarded as²¹⁹ ‘the foundation of the international legal regime.’ The Vienna Convention is the first binding multilateral agreement comprising measures against money laundering designed to promote cooperation among signatories so that drug trafficking could be more effectively combated.²²⁰

In 1984, at the request of the Venezuelan government, the UN commenced working on a convention to combat the escalating drug problem.²²¹ The end product was a 34 article convention that was presented to 106 countries at the Vienna Conference in 1988. For the first time it was internationally acknowledged that the authorities require tools to undermine the

²¹⁵ See ch 4.B.2.1.

²¹⁶ Intriago *International Money Laundering* 3; Zagaris & Castilla (1993) *Brooklyn J of Internat Law* 874.

²¹⁷ Gilmore *Dirty Money II* 22; Kent (1992) *Criminal LQ* 21.

²¹⁸ Or ‘Vienna Convention’ as the UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances of 1988 is known. It came into force in November 1990.

²¹⁹ Savona & De Feo *International Money Laundering Trends* 123. The Vienna Convention has also been designated as: ‘[t]he watershed international money laundering agreement’ (Comstock (1994) *Northwestern J of Internat L & B* 148).

²²⁰ The Vienna Convention was not the first initiative aimed at combating drug trafficking. International initiatives of this kind date back to the International Opium Convention of 1912 (cf Bassiouni *Narcotics Control* 507–24; Boister (1997) *CILSA* 1–18).

²²¹ UN *Comprehensive Outline* in UN International Conference on Drug Abuse and Illicit Drug Trafficking of 1987 recital III.

financial capabilities of drug trafficking organisations, and that international cooperation must be an integral part of this aim.²²²

1.2 Anti-Money Laundering Provisions

Salient provisions of the Vienna Convention as regards money laundering control are included in article 3 (Offences and sanctions), article 7 (Mutual legal assistance) and article 9 (Other forms of cooperation and tracing) of the convention. Article 3(1) of the Vienna Convention is regarded as a ‘cornerstone’²²³ article because parties are mandated ‘to adopt measures as may be necessary’ to criminalise, *inter alia*, drug trafficking.

The Vienna Convention refrains from using the concept ‘money laundering.’ Instead, it refers only indirectly to money laundering because conduct that amounts to money laundering crime is criminalised. Parties must therefore criminalise the conversion or transfer of property whilst knowing²²⁴ that it derives from criminal activity, or concealment of the property’s true nature and/or source.²²⁵

Article 7 of the Vienna Convention has been described as a ‘miniature legal assistance treaty’²²⁶ because it focuses not so much on procedural detail, but instead accentuates key elements for effective mutual legal assistance.²²⁷ Requests for assistance are subject to the national law of the requested party, yet the latter may not refuse a request on the ground of its bank confidentiality laws, a provision that is pivotal to the success of money laundering

²²² Steward (1990) *Denver J of Internat LP* 392; Ashe & Reid *Money Laundering* 19.

²²³ See US Delegation Report *Adoption of a Convention Against Illicit Traffic in Narcotic Drugs* in Gilmore *International Efforts* 100.

²²⁴ Potential liability for knowledge must be determined ‘from objective, factual circumstances’ (article 3(3)). The exact wording of the article was eventually reproduced in the Strasbourg Convention, a testimony of its significance (see article 6(2)(c) of the latter convention; ch 6.B.3.2).

²²⁵ Article 3(b)(i)–(ii) of the Vienna Convention.

²²⁶ US Delegation Report *Adoption of a Convention Against Illicit Traffic in Narcotic Drugs* in Gilmore *International Efforts* 127–128.

²²⁷ Mutual legal assistance treaties are most effective in combating money laundering because they used to provide a means to circumvent bank confidentiality and facilitate cross-border investigations (see par C.2 below).

control.²²⁸ A request for mutual legal assistance, however, may be refused²²⁹ or postponed on grounds that it interferes with an on-going investigation.²³⁰ In contrast to article 7 which formally provides for mutual legal assistance, article 9 creates an informal mechanism for mutual assistance and training. This process entails, *inter alia*, that parties establish ways to ensure cooperation as regards requests for information and coordination towards establishing training programmes.²³¹

Article 5(1) of the Vienna Convention provides for the enactment of legislation that allows for the confiscation of the benefits of crime. Bank records must furthermore be available to the authorities regardless of bank confidentiality laws.²³² A requested party cannot decline to assist in the tracing, identification, seizure, freezing or forfeiture of the benefits of crime.²³³ It therefore guarantees that parties treat drug-related money laundering as an urgent criminal offence. Much of the remaining provisions of the Vienna Convention were designed to ensure that money laundering is afforded the attention that it deserves by the judicial authorities of participating parties.²³⁴ Pursuant to international law, measures contained in the convention may be defined and implemented according to the national law of parties.²³⁵

Despite referring to money laundering only indirectly, the Vienna Convention contributed to future AML policies in three ways. First, it compelled parties to criminalise certain types of conduct that amounts to money laundering and secondly, it fashioned international cooperation among signatories. Thirdly, the Vienna Convention allowed for information dissemination across borders through mutual legal assistance requests.²³⁶

²²⁸ Articles 7(3), 7(5) of the Vienna Convention.

²²⁹ Four grounds for such refusal are listed (see article 7(15)(a)-(d)), one of which is that the request is contrary to the laws of the requested party.

²³⁰ Article 7(17).

²³¹ Article 9(1)--(3).

²³² Article 5(3) of the Vienna Convention. Cf Kent (1992) *Criminal LQ* 48; Steward (1990) *Denver J of Internat LP* 395).

²³³ Article 5(2) of the Vienna Convention.

²³⁴ Cf Gilmore *Dirty Money II* 64; Noble & Golumbic (1997-1998) *NYU J of International Law & Politics* 113.

²³⁵ See article 3(5)(h) and article 5(9) of the Vienna Convention.

²³⁶ *Idem* articles 7(2)(g), 7(5).

The Vienna Convention remains one of the most detailed and far reaching instruments ever adopted in international criminal law.²³⁷ If effectively implemented, it should provide a foundation for the synchronised enforcement of standard AML measures. Although effectively banishing bank confidentiality through its disclosure provisions, the Vienna Convention constitutes a detailed yet elementary legal instrument - characteristics that ensure ratification by signatories.

2. Mutual Legal Assistance Treaties in Criminal Matters

2.1 Background

International cooperation is vital to combat money laundering.²³⁸ This is because criminals are known to exploit the benefits of globalising the money laundering process. Mutual legal assistance aims to address this problem by alleviating the process of securing documentary evidence and other legal assistance to assist the authorities in investigating and prosecuting money laundering.²³⁹ Unilateral action by US law enforcement agencies to collect information abroad was the principal incentive for other countries to negotiate mutual legal assistance treaties designed to combat money laundering.²⁴⁰

2.2 Role in Preventing Money Laundering

²³⁷ Steward (1990) *Denver J of Internat LP* 388; Bosworth-Davies & Saltmarsh *Money Laundering* 198; Savona *Money Trails* 22.

²³⁸ See ch 4.B.1, par D.

²³⁹ See Gurule ((1998) *Fordham International LJ* 91) and Knapp ((1988) *Case Wes J Internat L* 406–407) who argue that multilateral treaties exist to enhance the effectiveness of international cooperation in relation to crime.

²⁴⁰ Nadelman *Cops Across Borders* 315; Gagnon (1990) *Vanderbilt J of Transnational L* 868.

Mutual legal assistance treaties²⁴¹ allow various types of across-border assistance.²⁴² This include, for example, execution of requests related to criminal matters,²⁴³ obtaining records of judgements, securing the appearances of witnesses before the court of the requesting state and locating individuals. MLATs furthermore enable across-border asset forfeitures, a sanction of particular importance in combating money laundering²⁴⁴ and one that is particularly challenging to apply transnationally.

Significantly, depending on the MLAT, ratification thereof could afford parties the right to bypass an agreeing government's bank confidentiality laws.²⁴⁵ The Treaty on Mutual Assistance in Criminal Matters,²⁴⁶ adopted by the UN in 1992, is a perfect example of a MLAT that contain an optional protocol relating to the 'proceeds of crime'.²⁴⁷ Although only indirectly concerned with money laundering, various forms of assistance that can be provided by a requested country are listed in the treaty.

Types of assistance that are included are:²⁴⁸ pinpointing the location of the benefits of crime, following the benefits of crime and investigating STRs. In addition, with the inclusion of provisions relating to the confiscation and forfeiture of the benefits of crime, parties to the treaty contract to afford each other assistance with matters that are usually, by virtue of distance, difficult to manage. This is probably the most significant contribution of the 1992 Treaty in combating international money laundering.

To conclude MLATs, it is submitted that the main difficulty with a MLAT is the fact that it is unlikely to prevent a criminal from transferring the benefits of crime from one country to

²⁴¹ Or 'MLATs'.

²⁴² See Zagaris (2000) *Nova LR* 728–730; Ellis & Pisani *Mutual Assistance* 158--159; UN *Money Laundering Report* 72 as regards the value of the international cooperation in judicial assistance.

²⁴³ Bassiouni & Gualtieri *Money Laundering* 113.

²⁴⁴ See ch 6.B.4.2, par C.4.4; ch 7.D.4; ch 8.D.4.

²⁴⁵ Jordan *Drug Politics* 208; Knapp (1988) *Case Wes J Internat L* 412.

²⁴⁶ UN Model Treaty on Mutual Assistance in Criminal Matters of 1992 ('1992 Treaty').

²⁴⁷ The concept 'proceeds of crime' is defined as any property which directly or indirectly *derived* as a result of crime, or representing the value of property *derived* from crime (1992 Treaty Optional Protocol 1).

²⁴⁸ 1992 Treaty Optional Protocols 2–3. When suspected benefits of crime are found, the requested country must take measures to prevent their disposal pending a judicial decision (Optional Protocol 4).

another if the former is not party to the treaty. This loophole may be addressed by bilateral treaties that can create a network aimed at money laundering prevention.²⁴⁹

3. UN Convention Against Transnational Organised Crime (2000)

3.1 Background

The UN Convention Against Transnational Organised Crime of 2000²⁵⁰ is the most essential anti-organised crime initiative since 1988.²⁵¹ This is because it concerns the prevention and prosecution of various offences as regards organised crime including money laundering.²⁵² The inception of the Palermo Convention came about as a result of the fact that the list of criminal activity that constitutes an issue of international concern increased dramatically. Organised crime in particular was recognised as a cause for concern by the international community.²⁵³ Therefore, in 1994 the World Ministerial Conference on Organised Crime²⁵⁴ formulated an action plan against transnational organised crime, stressing both the need for knowledge about organised crime and for assistance to countries in drafting legislation for improved international assistance. The Palermo Convention was finally adopted by the UN' General Assembly on 15 November 2000.²⁵⁵

3.2 Anti-Money Laundering Provisions

²⁴⁹ Grilli (1987) *Syracuse J of International LC* 87–88; Gagnon (1990) *Vanderbilt J of Transnational L* 867–868.

²⁵⁰ As UN Convention Against Transnational Organised Crime: Protocol to Prevent, Suppress and Punish Trafficking Persons, Especially Women and Children and the Protocol Against the Smuggling of Migrants by Land, Sea and Air of 2000 ('Palermo Convention') is known.

²⁵¹ Graham *Money Laundering* 34; Banarji (2002) *Indian J of International L* 562.

²⁵² See article 3(a)(i)–(v), article 3(b)–(c) respectively of the Palermo Convention. See ch 2.C.5.2 where the nexus between money laundering and organised crime is considered.

²⁵³ Which has led to the development of modes of cooperation such as extradition and mutual legal assistance (see par C.2 above).

²⁵⁴ Williams *Crime & Money Laundering* 118–119.

²⁵⁵ See UN *Summary of the Convention Against Organised Crime* par 3, available at <<http://www.unodc.org/adhoc/palermo/convensumm.htm>> (2011.03.10).

The purpose of the Palermo Convention is to promote international cooperation in an effort to prevent and combat international organised crime, including the availability of the benefits of crime, more effectively.²⁵⁶ It applies to the prevention, investigation and prosecution of transnational²⁵⁷ offences by organised crime groups, which, as mentioned already, include money laundering.²⁵⁸

The Palermo Convention compels parties to cooperate²⁵⁹ closely in tracking suspects involved in money laundering, or tracing the benefits of crime.²⁶⁰ The international community recognised that without national legislation the provisions of the Palermo Convention would be difficult to implement. Therefore, parties are obliged to establish a national regime and to use as guidelines existing regional and multilateral organisational rules.²⁶¹

Article 7 contains the Palermo Convention's money laundering control measures. It accentuates the importance of the KYC standard to deal with money laundering in banks more effectively. Significantly, parties are required to:²⁶²

[i]nstitute a comprehensive domestic regulatory and supervisory regime for banks ... susceptible to money laundering within its competence, in order to deter and detect all forms of money laundering, which regime shall emphasise requirements for customer identification, record keeping and the reporting of suspicious transactions.

In addition to suspicious transaction reporting, parties must establish a FIU to collect, analyse and disseminate information²⁶³ on potential money laundering schemes.

The importance of the Palermo Convention lies in the fact that it formally renders the KYC standard and all its elements a matter of international law with all the benefits that this holds. Prior to the adoption of the convention, the guidelines of the Basel Committee and the

²⁵⁶ UN *Summary of the Convention Against Organised Crime* par 2

²⁵⁷ An offence is transnational if it is committed in more than one country, or in one country, but has 'substantial effects' in another country (article 3(d) of the Palermo Convention).

²⁵⁸ *Idem* article 3(c)(i)–(iv).

²⁵⁹ Article 9(1) of the Palermo Convention.

²⁶⁰ *Idem* article 9(1)(b)(i)–(ii).

²⁶¹ Article 7(3) of the Palermo Convention..

²⁶² *Idem* article 7(1)(a). Parties must ensure that local FIUs are able to facilitate international information exchanges (article 7(1)(b)).

²⁶³ Article 7(2) of the Palermo Convention.

FATF had no binding power. It follows that member countries of the two organisations were able to decide unilaterally whether to integrate certain rules into their own AML legislation whilst non-member countries were sanctioned with ‘naming and shaming’ listings²⁶⁴ only. With the adoption of the Palermo Convention a basic international criterion for KYC standard-related provisions was set. Moreover, the criterion is supplemented with other supportive measures, for example international cooperation, to assist in finding the benefits of crime and prosecuting internationally active criminals.

In verity, without the required ratification of the Palermo Convention and its subsequent inclusion in national legislation it will be very difficult for a country’s authorities to use the AML measures of this international instrument effectively.

D. AUXILIARY INTERNATIONAL ANTI-MONEY LAUNDERING MEASURES

1. Introduction

From what was discussed thus far in the chapter, it is evident that it is impossible to emphasised sufficiently the international component of money laundering control. Indeed, to paraphrase Banach,²⁶⁵ international cooperation is the ‘*condictio sine qua non*’ for effective money laundering control. The AML initiatives of the Basel Committee and the FATF have demonstrated that money laundering control initiatives do not, and should not, come from the international community alone, but should emanate from the private sector as well.

For this reason there are other international groups that are also actively involved in the AML effort and that share the desire to partake in the international fight against money laundering. It is therefore important to evaluate the role of four of these groups and organisations in assisting banks with money laundering control.

2. International Monetary Fund and the World Bank

²⁶⁴ See par B.3.3 above.

²⁶⁵ *European Norms* 49 (see par A above).

In 2001, the International Monetary Fund²⁶⁶ conceded that money laundering posed a threat to both the international financial system and the good governance of banks.²⁶⁷ Since then the IMF has contributed to the fight against money laundering in three ways. First, it applies its experience in conducting financial sector assessments and assists the FATF in its reviews. Secondly, the IMF in collaboration with the World Bank conducts studies²⁶⁸ as regards the nature of money laundering in an effort to assist with accumulating information²⁶⁹ about the crime. Thirdly, it provides technical assistance to its members to strengthen national regulatory and supervisory frameworks.

However, realistically regarded, the IMF deals by and large with matters pertaining to the global monetary system. Therefore, the practical difficulties that banks are encountering as regards the KYC standard have yet to attract its attention. Most likely, the IMF views the plight of banks as ‘growing pains’, and counts on its members to address the matter within the framework of national law.

Similarly, little assistance in addressing the practical difficulties of money laundering control is likely to come from the World Bank. The nature of international law and the dynamics of international relations are to blame for this. But to be fair, neither the IMF nor the World Bank is concerned with the banking industry in more than a peripheral way. Consequently, in matters that pertain to the actual inclusion and application of the KYC standard in a national statutory context, assistance is more likely to come from the banking industry itself.

Therefore, organisations that are actively involved in the banking industry, for example, the Wolfsberg and Egmont Groups,²⁷⁰ are ideally placed to find solutions to the practical and legal difficulties that banks face as a result of the KYC standard.

²⁶⁶ The IMF was established in the 1940s to act with the World Bank as a ‘neo-colonial’ overseer of national monetary policies (*Strange Mad Money* 163).

²⁶⁷ IMF *Money Laundering* 1.

²⁶⁸ For example, in March 2003 the IMF in collaboration with World Bank issued a twelve month pilot programme to assess the implementation of an AML action plan (see IMF *Pilot Programme*). It concluded that some countries were placing a high priority on meeting international AML standards (*idem* 3).

²⁶⁹ For example, following the 2001 September terrorist attacks, the IMF superimposed the FATF’s Forty Recommendations (see paras B.3.3.2–3.3.4 above) in its own codes.

²⁷⁰ See paras D.4–5 below.

3. Interpol

International cooperation among national authorities is a primary mechanism to effectively combat money launderers who are active transnationally. Interpol²⁷¹ adopted the task of assisting countries to communicate with each other in the investigation of money laundering.

Interpol was established in 1923 and is based in Lyon, France.²⁷² Its main purpose is to facilitate mutual assistance among countries.²⁷³ Its position has been described as ‘unique’²⁷⁴ due to the fact that it has no legal basis, yet is publically funded with legally recognised roles in transnational police cooperation. Interpol’s workgroup, the *Fonds Provenant d’Activites Criminelles* was established to review asset forfeiture and other economic crime issues.²⁷⁵ It adopted a series of resolutions on combating transnational money laundering and forfeiting the benefits of crime. The resolutions of Interpol are aimed at demonstrating its efforts to establish agreement among its members and with international organisations to cooperate against money laundering.²⁷⁶

Of note, Interpol’s national centre bureaux that are situated in member countries form a vital part of the organisation’s system of notices. The system includes requests for arrests with a view of extradition, information requests as well as the circulation of information about suspects or crimes.²⁷⁷ Interpol has no operational role and does not initiate judicial enquiries. Its primary function is to exchange messages between police forces and judicial authorities of its membership.

²⁷¹ Which is the initial telegraphic name of the headquarters of the International Police Commission (‘ICPC’) chosen in 1946 (Schudelaro *Electronic Payments* 106). In 1956, the ICPC was renamed as the International Criminal Police Organisation-Interpol, or ICPO-Interpol (‘Interpol’) for short.

²⁷² For the complete history of Interpol, see Swallow (1996) *Transnational Organised Crime* 106–110.

²⁷³ Dini *The Problem and Its Dimensions* 38.

²⁷⁴ Swallow (1996) *Transnational Organised Crime* 106.

²⁷⁵ At present, Interpol facilitates international police cooperation among 176 countries, including South Africa (Swallow *op cit* 108).

²⁷⁶ Which Reiner (*Policing* 1007) describes as: ‘the new international of technocratic police experts.’ See also Sheptycki *Global Law Enforcement* 51.

²⁷⁷ Springer (2001) *J of Fin Crime* 161.

The efforts of Interpol to assist in combating international crime have, however, been limited because of its uncertain legal status.²⁷⁸ Nevertheless, its efforts in creating transnational networks amongst law enforcement agencies from different countries should be recognised.

4. Wolfsberg Anti-Money Laundering Principles

The Wolfsberg Group²⁷⁹ operates with the aim of setting guidelines for private banks to combat money laundering within the private banking industry. It was established in 2000 at a meeting at the Wolfsberg Castle in Switzerland that was attended by representatives from international banks and Transparency International²⁸⁰ to compile AML guidelines for private banks.

The Wolfsberg Group's principles for private banking²⁸¹ are an essential component of global efforts to combat money laundering.²⁸² This is because the Wolfsberg Group secured the commitment of private banks,²⁸³ which are at present, one of the newest target of criminals for laundering the benefits of crime. The Code²⁸⁴ of the Wolfsberg Group comprises 11 principles²⁸⁵ that are 'appropriate for private banking relationships.'²⁸⁶ Included are guidelines on customer acceptance and a list of additional scenarios where enhanced due diligence²⁸⁷ is advised when, for example, conducting business with a customer connected with high risk countries, or who is

²⁷⁸ Williams *Crime & Money Laundering* 126; Swallow (1996) *Transnational Organised Crime* 125.

²⁷⁹ Which is an association of 12 international banks that aims to develop financial service industry standards (see Wolfsberg *Global Banks* 1, available at <<http://www.wolfsberg-principles.com>> (2011.03.10)).

²⁸⁰ Transparency International is a Berlin-based non-governmental organisation, dedicated to increase government accountability and curbing international corruption.

²⁸¹ See Wolfsberg Group *Principles for Private Banking 2000* as revised ('the Code').

²⁸² Lacy & George (2003) *Northwestern J of Internat L & Business*; Carrington *Rule of Law* 16.

²⁸³ See ch 4.D.3 as regards the vulnerabilities of private banking to money laundering.

²⁸⁴ Wolfsberg Group *Principles for Private Banking 2000*; FATF *Annual Report 2002-2003* Annex VI 36.

²⁸⁵ The principles advise on various aspects concerning due diligence and suspicious transaction reporting (Wolfsberg Group *Principles for Private Banking 2000* Principles 1–11).

²⁸⁶ *Idem* Preamble.

²⁸⁷ For example, customers with funds originating from countries with inadequate money laundering controls (Wolfsberg Group *Principles for Private Banking 2000* Principle 2.2).

a 'politically exposed person.'²⁸⁸ Under the Code private banks have three options when faced with suspicious transactions²⁸⁹ for which no plausible explanation is forthcoming:²⁹⁰ they could cancel the business relationship, continue with it with increased monitoring or report the relationship to the local FIU.

In 2002 the Wolfsberg Group released principles for correspondent banking.²⁹¹ The Second Code advocates a risk-based approach²⁹² to due diligence. Since correspondent bank customers are perceived to present a greater risk than private bank customers,²⁹³ certain account-related factors²⁹⁴ are listed for consideration by the bank rendering corresponding services.

One may ask why the challenges posed by suspicious transaction reporting have not yet been officially recognised or addressed by the Wolfsberg Group. This remains a question that is open to speculation. If one has to guess the omission probably stems from a lack of complaints by member banks of the group. This in itself is peculiar in light of the civil litigation that has been documented as a result of money laundering control. Again, the nature of international law and the perceived unwillingness of transnationally active organisations such as the Wolfsberg Group to become involved in the national arrangements of its members could shoulder the blame. Nevertheless, the Wolfsberg Group provides an excellent forum from which to explore the issue.

5. Egmont Group

²⁸⁸ Politically exposed persons are persons who have prominent positions in a foreign country such as a head of state (FATF *Revised Recommendations 2003* Glossary par 14).

²⁸⁹ Which may include cash transactions over a certain amount (Wolfsberg Group *Principles for Private Banking 2000* Principle 4.1).

²⁹⁰ *Idem* Principle 4.3.

²⁹¹ Wolfsberg Group *Principles for Correspondent Banking 2002* ('Second Code'). See ch 4.D.2 as regards the use of correspondent banking for money laundering purposes.

²⁹² *Wolfsberg Group Risk Based Approach for Money Laundering 2007*.

²⁹³ Correspondent banking is defined as: '[t]he provision of a current or other liability account and related services to another institution' (Wolfsberg Group *Principles for Correspondent Banking 2002* Principle 2). See also ch 4.D.2 as regards correspondent banks.

²⁹⁴ For example, Principle 4 emphasises proof of the customer's business and domicile.

The Egmont Group of Financial Intelligence Units of the World²⁹⁵ is an FATF-affiliated organisation that holds a membership of 106²⁹⁶ FIUs, each representing a different country. It was established in 1995 on the initiative of Belgium and the US and operates under the auspices of the FATF.²⁹⁷ The Egmont Group issued a statement of purpose in June 1997 that included a number of guidelines that were revised in June 2001.²⁹⁸

The main purpose of the Egmont Group is to stimulate transnational training and information exchanges among agencies that are responsible for receiving STRs.²⁹⁹ To this end, members are required to established FIUs³⁰⁰ to receive, analyse and disseminate information with the view of combating money laundering. The creation of FIUs has not been without obstacles. The main obstacle was found to be the different types of FIUs.³⁰¹ Similar to the rating that the AML regime of a country receives from the international community,³⁰² the choice of a appropriate FIU model is a crucial one as this determines the efficiency of a country's AML efforts. Although the Egmont Group encourages cooperation among FIUs, facilitating the necessary cooperation is more complicated than it may seem.

It has been suggested³⁰³ that a key condition for an effective disclosure system is the relation of trust that must exist among banks, customers and FIUs. No amount of legislative action or sanction is likely to be effective if the involved parties are unconvinced that submitted

²⁹⁵ Or 'Egmont Group'. The Egmont Group was named after the Egmont Arenbert Palace in Brussels, Belgium, where the first meeting was held on 9 June 1995 (FATF *Egmont Group* par 1. See also De Ruyver et al *Combating Organised Crime* 415).

²⁹⁶ [Egmont Group Statement of Purpose](http://www.egmontgroup.org/statement_of_purpose.pdf), available at <http://www.egmontgroup.org/statement_of_purpose.pdf> (2011.03.10). For a complete list of the Egmont Groups' members, see FATF *Annual Report 2002-2003* Annex VI 30.

²⁹⁷ FATF *Other Initiatives* 1–2.

²⁹⁸ Egmont Group *Principles* par 2; Commonwealth *Best Model* 132.

²⁹⁹ Egmont Group *Principles* Preamble paras 1–4; EC Commission *Report on Money Laundering Directive* par 6.1; Verhelst *Financial Intelligence Units* 415.

³⁰⁰ The Egmont Group defines a FIU as a (Egmont Group *Statement of Purpose* 2): '[c]entral, national agency(s) responsible for receiving ... analysing and disseminating to the competent authorities, disclosures of financial information (i) concerning suspected proceeds of crime, or (ii) required by national legislation ... in order to counter money laundering.'

³⁰¹ EC Commission *Report on Money Laundering Directive* par 6.1; Verhelst *Financial Intelligence Units* 406.

³⁰² The rating is determined by whether the country opted for a Subjective or Objective Model of Money Laundering Control (see paras B.1–2 above).

³⁰³ Verhelst *Financial Intelligence Units* 408.

information is used towards combating money laundering. Memorandums of understanding among countries, however, may address some of these difficulties.³⁰⁴

Money laundering is an international problem that renders the work of the Egmont Group crucial because a FIU can operate as a ‘filter’ between banks and law enforcement.³⁰⁵ Since a FIU provides a gathering point for analysing information,³⁰⁶ it assists in detecting patterns among large numbers of complex and suspicious transactions. Therefore, it constitutes a crucial element in initiatives aimed at combating money laundering. Moreover, the Egmont Group is the only transnational organisation that has so far succeeded in establishing basic rules for managing the confidentiality of received information and the exchanged thereof.

Finally, it is important to briefly mention the activities of other smaller international bodies³⁰⁷ that are involved in AML initiatives. Although these multilateral organisations are not affiliated with the FATF, they have recommended various ways of how to avoid money laundering. Some of the recommendations include, for example,³⁰⁸ the creation of specialised FIUs to collect data on suspicious transactions and streamlining KYC policies.

A final thought in this regard: a FIU is only as good and as motivated to be involved in the AML effort as the particular country’s AML legislation allows.³⁰⁹ It is one thing to enact elementary AML legislation but quite another to foster an atmosphere where effectivity is allowed to flourish. Therefore, the reputation of a country’s AML regime and the potency of its FIU are solely dependant on its government’s commitment to the global AML effort.

E. CHAPTER COMMENTARY AND SUMMARY

The objective of this chapter was two-fold: first, to establish whether the AML measures of the international community have resolved some of the tension between the confidentiality duty of

³⁰⁴ See par B.3 above.

³⁰⁵ Carrington *Rule of Law* 13; Verhelst *Financial Intelligence Units* 415.

³⁰⁶ See EC *Commission Report on Money Laundering Directive* par 6.1; FATF *Annual Report 2002-2003* Annex VII 40 as regards the purpose of FIUs.

³⁰⁷ For example, the Commonwealth Secretariat and the Financial Stability Forum.

³⁰⁸ Palmer *Trade Finance Risk* 123–124; Verhelst *Financial Intelligence Units* 427–428.

³⁰⁹ See ch 8.E.1, par F as regards the criticism levelled against South Africa’s FIU, the FIC.

banks and their reporting duty and secondly, to determine whether the KYC standard has kept up with the changing face of money laundering. This chapter gave an overview of the concerted effort of the international community to combat money laundering. It then distinguished between the Subjective Model of Money Laundering Control and the Objective Model of Money Laundering Control. The advantages and disadvantages of both models were highlighted.

It was illustrated that different countries have been summoned to cooperate within AML frameworks established by both international treaties and action programmes. The basic principle of international law that a country can act only against offences within its own territory has not been affected by the international action against money laundering. It was further seen that the AML measures of the international community have been mostly aimed at streamlining the fight against money laundering. Indeed, it soon became evident that a huge effort is worldwide underway to counteract the laundering of the benefits of crime through banks. In this regard, the chapter pointed out that the Basel Committee, the FATF and certain other international organisations as well are at the forefront of designing measures aimed at money laundering control.

The strategy of the FATF to established a panoptic AML network with the cooperation of FATF-styled regional bodies coupled with the supervisory efforts of the Basel Committee and the codes of the Wolfsberg and Egmont Groups render this objective achievable. The chapter emphasised the importance of ensuring that all efforts to improve existing AML regimes are aimed at achieving a high degree of cooperation.

However, the investigation revealed that the international community failed to acknowledge the conflict between the confidentiality duty of banks and their reporting duty. The disparities between the potential civil liability and criminal liability of banks unfortunately may obstruct a concerted approach. This obstacle is strengthened by countries' adherence to the notion of sovereignty. It was evident that the prevailing attitude that national law is the last pillar of sovereignty renders international organisations reluctant to become involved with problems experienced by banks on national level. The irony is that AML measures have been imposed on banks as a result of the internationally endorsed KYC standard.

It was further seen that the Basel Committee thus far has made no attempt to acknowledge or resolve the tension between the confidentiality duty of banks and their reporting duty. To date the FATF has only addressed the issue peripherally through the inclusion of a safe-harbour provision in the Forty Recommendations. It is submitted that a formal acknowledgment by the

FATF would have gone a long way in airing existing problems in this regard. Much attention is afforded in KYC standard-related documents to the reporting obligation of banks. But no practical guidelines have yet been issued as regards the recognition of a suspicious transaction. In addition, it was evident that in spite of the immense effort that has gone into streamlining the content of the KYC standard so that it can cater for all money laundering eventualities, the actual effectiveness of the standard has never been tested. More alarming is the fact that no other AML tool exists to supplement the KYC standard or to replace it.

Conflicting goals further present a difficulty for international organisations to overcome. Whilst the Basel Committee strives for money laundering prevention from a regulatory and supervisory viewpoint, the FATF is more geared towards protecting the global financial system as a whole against money laundering. To this end, the FATF engages all countries, an endeavour that leaves it little time to focus on the practical difficulties that the banking industry has to confront in light of AML measures.

I agree with Tanzi³¹⁰ who suggests that fighting money laundering is much like fighting a war: one always prepares according to what was learned in past battles, but there are always new manoeuvres coming along. With the rapid growth of technology and the adoption of new financial instruments, more opportunities will arise for money laundering. I cannot shake the feeling that the international community in its efforts aimed at money laundering control is continuously harping on the same string akin to Sisyphus³¹¹ whose unfortunate position is legendary, namely, the obligation of banks to identify suspicious transactions and to file STRs. Yet, problems with the identification of suspicious transactions exist in relative simple, conspicuous cases of money laundering, for example, when the benefits of crime are deposited into the bank account of a known criminal. The KYC standard with all its guidelines that apparently provide for most eventualities should prevail in a situation like this - but it does not because criminals are ingenious and the KYC standard fails to recognise this fact. The problem may be found in the mechanics of money laundering. The creative genius of money launderers has yet to be acknowledged by the international community in its KYC standard obligations. It is submitted that FIUs are doomed to failure in as far as the successful prosecution of money launderers is concerned until the identification of suspicious transactions in terms of the KYC standard policy is rethought.

³¹⁰ *Macroeconomic Implications* 13 (see par A above).

³¹¹ See par A above.

It was also seen that the AML efforts of internationally active organisations such as the Wolfsberg Group and the Egmont Group to engage in the global AML effort are commendable. But, the failure of the Wolfsberg Group in particular to acknowledge the practical and legal difficulties of money laundering control is curious to say the least. It is in this context that the group most likely may make a vital contribution to the AML effort. Otherwise, it will have to be content to function as yet another grouping of bankers who in actual fact is out of touch with the plight of the banks in light of money laundering control measures.

Further in this regard, the Egmont Group whose goal is geared towards effective data collection, is indispensable in the context of international money laundering prevention. One requirement, though, must be satisfied if its primary goal is to be realised. For information to be of value to the global AML effort its dissemination and origin should be without reproach. The Egmont Group should consider broadening its mandate from mere information dissemination to the verification thereof. In this regard, it would be serving the AML community in a novel way.

This chapter showed that irrespective of the measures of international organisations, the three goals of reducing crime, protecting the integrity of the financial system and controlling corruption have not been completely achieved.³¹² Overall the international AML regime, however, may be deemed reasonably effective in protecting the core financial system. But, due to the complexity of global money laundering it is impossible for an AML regime to single handedly make a significant contribution to combat it.

In conclusion, this chapter commenced with a chess quotation that suggests that strategy is a key factor in determining the outcome of a chess match. To draw from the chess analogy, this chapter illustrated that the international community in its quest to combat money laundering in banks has streamlined the KYC standard into intricate AML protocols. However, with the exception of the FATF, the international community thus far has failed to resolve the conflict between bank confidentiality and suspicious transaction reporting. This is likely to undermine the effectiveness of its AML measures. Moreover, all jurisdictions that are serious about money laundering control needs an AML regime that can provide for all money laundering eventualities and money laundering control pitfalls.

It is to this issue, *inter alia*, that attention is afforded to next. In Chapter 6 and Chapter 7, the two comparative chapters of this study, the spotlight is cast on the AML regimes of the EU,

³¹² See par A above.

England and the US respectively. The AML regimes of the jurisdictions will be compared to, and distinguish from the AML regime of South Africa whose content is considered in Chapter 8. The aim of each of the following chapters is mainly three-fold: first, to establish the strength and, or the weaknesses of the AML regime of each jurisdiction, secondly, to evaluate the adequacies of its civil remedies in availing a victim of fraud or theft against a bank that parted with the benefits of fraud or theft and thirdly, to determine if South Africa's AML regime needs to be improved.

(Chapter 6 to follow)

PTO

CHAPTER 6

COMPARATIVE POSITION RE MONEY LAUNDERING I - THE EUROPEAN PERSPECTIVE

Many [chess] combinations have been composed from time immemorial ... You may take up a combination that arose in actual play to get rid of non-essentials and thus refine it. This method is superior.

LASKER *Chess* 164

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A. INTRODUCTION

Chapter 5 concluded with the submission that despite the best efforts of the international community to establish a panoptic AML framework ultimately, countries determine the substance of their AML regimes individually. This chapter sets forth the AML regimes of the EU¹ and England as EU member state. It, therefore, comprises two parts. The first part considers the AML regime of the EU. In the second part the AML regime of England falls under the spotlight. At the conclusion of this chapter I will demonstrate that England by incorporating the core of the EU's

¹ Note that in this study the acronym 'EU' is employed to denote the 29 countries on the European continent that are members of the European Union (see par B.1 below).

AML law in its national AML legislation elected to employ the Subjective Model of Money Laundering Control.²

The chapter commences with a brief introduction about the mechanics of EU law. Thereafter the AML regimes of the EU and England are evaluated within the context of the following critical aspects: (I) the consequences that money laundering and money laundering control carry for the bank-customer relationship; (II) AML legislation in so far as it concerns the KYC standard; (III) the extent to which EU law and English law allow for civil claims against a bank as recipient of the benefits of fraud or theft; (IV) the mechanics of civil forfeiture as codified remedy; and (V) the individualised AML measures of the two jurisdictions. The chapter concludes with a summary and some comments about the above mentioned aspects.

B. EUROPEAN UNION

1. Introduction

The first international AML legislative initiative that is pertinent to Europe was not initiated until the early 1980s when it became evident that drug abuse was posing a twofold threat to the stability of the continent.³ First, an increase in drug related offences was detected and secondly, the international community realised that huge profits were being acquired through crime. In 1988 the Vienna Convention⁴ was concluded under the auspices of the UN to address these concerns.

The Council of the EU's Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime of 1990⁵ followed in the wake of the Vienna Convention and represents the first EU AML legislative measure that was taken specifically to address the pervasiveness of organised crime in the region. Circumstances at the time necessitated legislative action of this kind; the creation in 1990 of a single market⁶ in the EU assisted not only legitimate business but

² See ch 5.B.2.

³ Gilmore *International Efforts* ix–x; Magliveras (1998) *ILSA J of Internat & Comp Law* 93–94; Vlogaert (2001) *J of Fin Crime* 22.

⁴ As the UN's Convention Against the Illicit Traffic in Narcotic Drugs and Psychotropic Substances of 1988 is known (see ch 5.C.1).

⁵ Or 'Strasbourg Convention' (see also paras B.3.2, B.4.2.2 below).

⁶ See Council Treaty Establishing the European Union, and Protocol on the Transition to the Third Stage of Economic and Monetary Union, and Protocol on the Statute of the

simultaneously created opportunities for money laundering and other financial crime in the region.⁷ In Europe the growth of the illegal drug trade raised the fear that:⁸

[c]onjunction of 1992's single market, drug trafficking, and money laundering could undermine the integrity of the financial system and disrupt financial markets.

In response, in 1991 the Council of the European Union issued a directive⁹ aimed solely at protecting the EU financial system from being misused for money laundering purposes. Two other directives targeted at combating money laundering followed.¹⁰

At the outset it is important to explain what is meant by the concept 'Europe' in the context of money laundering control. Although it is possible to distinguish three 'Europes' from a criminal law point of view,¹¹ only two are relevant to this study, namely, the Europe that is part of the Council of Europe and the Europe that is represented by the Council of the EU. The Council of Europe forms an essential part of Europe.¹² It was established, *inter alia*, to foster European unity by promoting legal reform and cooperation among its members.¹³

European System of Central Banks and the European Central Bank of 1992 ('Maastricht Treaty'). It affirms the freedom of EU member states to provide financial services across borders in the union.

⁷ Quirk (1997) *Finance & Development* 6; Smith (1992) *University of Pennsylvania J of Internat Business L* 103–104; (Oliver & Bache (1989) *Common Market LR* 66.

⁸ Zagaris & Bornheim (1990) *Banking Report* 119. For the role of effective bank supervision in combating money laundering, see Magliveras *EC Lowering the Barriers* 81–82.

⁹ Council Money Laundering Directive on the Prevention of the Use of the Financial System For the Purpose of Money Laundering 91/308/EC of 10 June 1991 ('1991 Directive').

¹⁰ Namely, Council Money Laundering Directive 2001/97/EC of 4 December 2001 Amending EC-Directive No 91/308/EEC on the Prevention of the Use of the Financial System For the Purpose of Money Laundering ('2001 Directive'), Council Money Laundering Directive 2005/60/EC of 26 October 2005 on the Prevention of the Use of the Financial System For the Purpose of Money Laundering and Terrorist Financing ('2005 Directive').

¹¹ Keyser-Ringnalda (1992) *European LR* 500–501. The third 'Europe' is represented by the 25 countries that signed the Council Acquis Convention Implementing the Schengen Agreement of 14 June 1985 between the Governments of the States of the Benelux Economic Union, the Federal Republic of Germany and the French Republic on the Gradual Abolition of Checks at Their Common Borders of 1990 ('Schengen Agreement'), available at <<http://europa.eu.int/scadplus/leg/en/lvb/l33020.htm>> (2011.03.10) - see par B.4.2.3 below.

¹² Council *About Us* 1, available at <<http://www.coe.int>> (2011.03.10).

¹³ Article 1(a)–(b) of the Statute of the Council of Europe of 1949 (*EC Manual* 299).

The Council of Europe, however, must be distinguished from the Council of the EU¹⁴ which is governed by the Maastricht Treaty. The Council and the European Parliament constitute the two legislative organs of the EU. The Council was the first transnational body to focus on the problem of money laundering.¹⁵ It further may adopt laws that have the force of law without them being approved in advance by the parliaments of its members.¹⁶ Moreover, EU member states accept that EU law prevails over national law. Money laundering is primarily being fought in the EU through conventions and directives.

2. Bank-Customer Relationship

2.1 Debtor and Creditor Relationship

The contract forms the core of all bank¹⁷ and customer relationships in the EU.¹⁸ It usually comprises a number of documents that govern aspects of the relationship between a bank and a customer. Traditionally, banks operating in the EU have three main duties.¹⁹ They must properly execute the orders of customers,²⁰ pursue the best interests of each customer and always maintain solvency.

¹⁴ Or 'Council'.

¹⁵ See ch 5.B.3.1.

¹⁶ See Hanlon *EC Law* 40; Davies *EU Law* 34–35; Brealey & Hoskins *Remedies* 3–20; Beatson & Schrage *Enrichment* 10 as regards the functions of the two legislative bodies and EU law.

¹⁷ Pursuant to EU law the concept 'credit institution' is employed to denote a deposit-taking institution (see art 1 of the First Banking Directive of 1977 ('1977 Banking Directive') as reproduced in art 1 of the Second Banking Directive of 1989 ('1989 Banking Directive')). Therefore, a credit institution is: '[a]n undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account.' Note that in this setting the concept 'bank' is employed for the sake of uniformity.

¹⁸ Cranston *England* 12.

¹⁹ Hirsch (1986) *J of Comparative B & CM Law* 373.

²⁰ Note that banks may engage only in activities that are listed in the Annex to the 1989 Banking Directive. It follows that banks may engage in 13 activities that are regarded as 'integral to banking' (article 16 of the 1989 Banking Directive). Some of these activities include, for example, deposit-taking, money transmission services and money broking (for a complete list of activities, see 1989 Banking Directive Annex points 2–12,14).

Banks operating in the EU must observe EU law when contracting with customers. Where a deposit is made into a bank account, the relationship between bank and customer is one of debtor and creditor respectively. However, depending on the national laws of the country where the bank operates, EU law is usually relegated to apply only to situations that are left uncovered by national law except if the latter leaves a party worse off than in terms of EU law. In that event case national courts must apply EU law. Recently, additional duties were imposed on banks in the interest of combating money laundering in the EU. In particular, banks are forbidden from receiving money which they know or suspects is the benefits of crime or partaking in criminal activity.²¹

2.2 Bank Confidentiality

The principle of confidentiality in financial matters developed before Roman times when temples acted as banks.²² On the European continent bank confidentiality found its way into civil codes, customary laws and common-law remedies. A decline during the past two decades in the confidence of Swiss bank secrecy prompted EU investors to transfer funds to banks in other secrecy jurisdictions.²³ This undertaking has been expedited since the unification of Europe in 1992. The reason for this are attempts by the Commission to establish a unified banking system throughout the EU.²⁴ However, EU member states continue to favour their own confidentiality laws which leave little room for a unified confidentiality system in the EU.

EU law bank confidentiality is an element of the fiduciary duty imposed *ex contractu* on the bank.²⁵ A bank may by interpreting the contract between itself and the customer determine which facts and information the customer wishes to keep confidential. Confidentiality may be further expressly agreed upon. Within the framework of the bank-customer relationship a factual relationship exists that encompasses the duty of the bank to maintain the confidentiality of its customer on the basis of the protection of good faith. Before 1977 the general rule in the EU as regards bank confidentiality was that information must be treated as confidential as provided for

²¹ See par B.3 below.

²² See ch 3.B.2.3.1.

²³ Note (1988) *Vanderbilt J of Transnational L* 105–106.

²⁴ Usher *Financial Services in the EC* 137.

²⁵ Taisch (1998) *Internat Fin LR* 10. This is also the position at South African common-law (see ch 3.B.2.3.1).

by the laws of the country from which the bank originated.²⁶ In the mid-1970s the Council sought to address the divergent confidentiality rules of the EU. To this end, it adopted the 1977 Banking Directive which constituted the first legislative instrument in the EU to address bank confidentiality. The 1977 Banking Directive dealt solely with the confidentiality duties of bank supervisors from different EU member countries. It mandated that information received by the supervisors must be treated as confidential except if disclosure was legally sanctioned.²⁷

In 1985, the EU Court of Justice for the first time had an opportunity to pronounce on bank confidentiality issues. In *Municipality of Hillegom v Hillenius*²⁸ the court had to decide whether Hillenius, a bank supervisor at the Dutch Central Bank, could refuse to disclose information as regards its supervision of a foreign owned bank that failed.²⁹ On behalf of the municipality it was argued that article 12 of the 1977 Banking Directive and the Dutch Civil Code alike authorised disclosure in criminal matters. The Court of Justice reasoned that courts were duty bound to find a balance between the interest in establishing the truth in a matter and the interest in maintaining confidentiality.³⁰ Where national legislation contains confidentiality provisions the national court must weigh the interests at stake and decide the importance of the information.³¹ As article 12 of the 1977 Banking Directive did not forbid disclosure, Hillenius was compelled to disclose the information in issue.

In contrast, in *Santa Fe*³² the court accepted that circumstances may exist in which it would be against public interest to order disclosure of confidential information. The *Santa Fe* matter concerned an application by the US Securities and Exchange Commission³³ for the disclosure of documents by a Luxembourg bank that had a branch in England.³⁴ An English court required the examination of the Luxembourg bank's employees. Consequently, the employees approached the

²⁶ Clarotti (1982) *Common Market LR* 265; (1984) *J of Common Market S* 218.

²⁷ Article 12 of the 1977 Banking Directive.

²⁸ 110/84 [1985] ECR 39 [*Hillenius*].

²⁹ The municipality of Hillegom lost money due to the failure of the bank and thus tried to establish that the Dutch Central Bank failed in its supervision of the bank (*Hillenius* paras 5–9).

³⁰ *Hillenius* paras 32–33.

³¹ See article 12 of the 1977 Banking Directive *Hillenius* par 34.

³² 1985 ECC 187 [*Santa Fe*].

³³ Or 'SEC'.

³⁴ The SEC brought a civil case in New York alleging that insider trading had occurred before an announcement of a takeover of Sant Fe by the Kuwait Petroleum Corporation (*Santa Fe* 188–189).

court for an order to set aside the examination on the ground that they were forbidden by Luxembourg confidentiality laws from disclosing the identity of customers of the bank. The court held that there was no ‘substantial risk’³⁵ of the employees being charged with a criminal offence in Luxembourg if they disclose confidential information. However, the court agreed that there could be circumstances in which it would be against the public interest to order such disclosure.

The court further found that public interest dictated that the confidential bank-customer relationship should not be used to conceal fraudulent activities.³⁶ The court, therefore, dismissed the application of the employees and ordered them to disclose the information to the SEC. Although the judgment was handed down more than twenty years ago, it remains significant for two reasons. First, the court indirectly implied that the outcome of the matter may have been different if the employees were to face criminal charges based on breach of customer confidentiality as a result of the disclosure. It is submitted that the confidentiality rules of the country where the bank conducts business at the time of the request should be decisive in determining whether it may be ordered to disclose information. This means that with the exception of instances where national law violates EU law, bank confidentiality matters should be adjudicated in terms of the national law of the country where the bank is situated. This solution will demonstrate deference to the national laws of EU member states. Secondly, the court recognised that while public interest favours bank confidentiality, public interest also demands a sound banking system untainted by benefits of crime.

The importance of the *Sante Fe* ruling cannot be sufficiently emphasised. More than 20 years ago when the ruling was handed down by the court, AML measures hardly existed and little was known about the potential consequences that the crime carries for banks.³⁷ Nevertheless, the court was alert to the potential abuse of the confidential nature of the bank-customer relationship by criminals. Clearly the court was ahead of its time and pre-empted the difficulties that were to follow as regards resolving the tension between bank confidentiality and the reporting obligation of banks.³⁸ Moreover, in essence the court gave credence to future AML policies that stemmed from a desire to keep the benefits of crime out of the banking system. It is therefore curious that the *Sante Fe* ruling and in particular, the remarks of the court failed to attract international

³⁵ *Santa Fe* 192.

³⁶ *Ibid.*

³⁷ See ch 4.E.1–5.

³⁸ See paras B.3.4–3.6 below.

attention.³⁹ Although pure speculation, it is likely that had the potential abuse of the banking system by criminals received proper attention at that time, many of the problems that banks face as a result of money laundering control would have been aired and dealt with.⁴⁰

The 1989 Banking Directive also touches on the issue of bank confidentiality albeit in an indirect manner. Article 12(1) of the 1989 Banking Directive provides that:

[n]o confidential information may be divulged to any person or authority ... except in summary or collective form ... without prejudice to cases covered by criminal law.

Information, therefore, may be divulged for supervisory purposes⁴¹ and to facilitate judicial assistance in criminal matters.⁴² The 1977 and the 1989 Banking Directives further collectively failed to consider the consequences of the unification of Europe.⁴³ The removal of restrictions on capital movements among EU member states resulted in EU residents transferring funds to EU jurisdictions that maintain liberal confidentiality laws in spite of AML legislation.

Although the statutory control of money laundering is analysed in the next section,⁴⁴ it is important to consider briefly at this point the impact of the 2005 Directive on bank confidentiality. The 2005 Directive encourages banks to file STRs⁴⁵ to FIUs.⁴⁶ Banks may further be required to provide assistance in subsequent investigations.⁴⁷ Suspicious transaction reporting conflicts with the confidentiality duty of banks.⁴⁸ A bank that discloses information about a customer may expose itself to civil liability due to a breach of bank confidentiality. Therefore, article 23 of the 2005 Directive provides the following safe-harbour protection to reporters:

[t]he disclosure *in accordance with the requirements* of this Directive to the financial intelligence unit ... shall not constitute a breach of any restriction on disclosure of

³⁹ See ch 5.B–C.

⁴⁰ See ch 1.A.3.

⁴¹ See articles 12(5) and 12(7) of the 1977 Banking Directive, as amended by article 16 of the 1989 Banking Directive.

⁴² See article 23 of Council Convention on Mutual Assistance in Criminal Matters of 1959 as amended by the Second Additional Protocol to the Convention on Mutual Assistance in Criminal Matters of 2001 (cf par B.3.3 below).

⁴³ Gagnon (1990) *Vanderbilt J of Transnational L* 691–692; Mitsilegas *EU Counter-Measures* 130–131.

⁴⁴ See par B.3 below.

⁴⁵ Article 8(2) of the 2005 Directive.

⁴⁶ See article 18 of the 2005 Directive. See also ch 5.B.3.3.4, par D.5 as regards the concept ‘financial intelligence unit’.

⁴⁷ Articles 20–27 of the 2005 Directive.

⁴⁸ See paras B.3.2–3.6 below.

information imposed by *contract or by any legislative, regulatory or administrative provision*, and shall not involve the institution or person or its directors or employees in liability of *any kind*.

Under the now repealed 1991 Directive, banks were likely to face civil liability when it could be established that the disclosure was made contrary to good faith.⁴⁹ Therefore, the 2005 Directive replaced the requirement of good faith with the provision that a disclosure must be made ‘in accordance with [its] requirements’ in order for a bank to avoid liability. But even more significant, article 23 of the 2005 Directive further extended the protection provision; a bank that filed a STR is protected against liability of ‘any kind.’ The only avenue left for a customer to pursue as regards civil litigation is to claim that the bank disclosed information contrary to the requirements of the 2005 Directive. It is evident that despite the extended safe-harbour provision of the 2005 Directive, a bank that filed a STR may still face civil litigation as well as negative publicity. In fact, as the following section illustrates, money laundering control legislation creates as byproduct various grounds for calling a bank to answer in court.

3. Anti-Money Laundering Legislation

3.1 Council of the European Union

In essence, jurisdictions usually take one of three steps to combat money laundering:⁵⁰ they criminalise it, they impose measures to identify the benefits of crime for the purpose of confiscating the funds or they enact laws to prevent the benefits of crime from being laundered by banks in the first place. The Council introduced all three steps above to combat money laundering in the EU and thereby demonstrated its commitment to combat money laundering in banks.

The Council further introduced the KYC standard to EU banks in the form of customer identification and suspicious transaction reporting obligations.⁵¹ Banks were warned of the

⁴⁹ Article 9 of the 1991 Directive (see par B.3.4 below). See also ch 3.B.2.3.3.2 as regards FICA’s safe-harbour provision which corresponds with article 9 of the 1991 Directive.

⁵⁰ Home Office *Confiscation and Money Laundering* 67.

⁵¹ See ch 5.B.3.1.

dangers of money laundering through a set of recommendations that imposes certain obligations on the banks operating in the EU.⁵² Moreover, EU member states were advised to support national and international cooperation between banks.⁵³ The initial recommendations of the Council were followed by legislation that established customer identification as focal point of its AML initiatives.

3.2 Strasbourg Convention

The Strasbourg Convention was drafted⁵⁴ mainly for two reasons. First, to devise ways to overcome the difficulties of conducting transnational criminal investigations⁵⁵ and secondly, to set uniform rules as regards the confiscation of the benefits of crime within the EU.⁵⁶ In 1990 the Council followed the lead of the UN⁵⁷ in combating money laundering by adopting the Strasbourg Convention.

The Strasbourg Convention requires parties to implement a system of international cooperation to ‘deprive’⁵⁸ criminals of the ‘proceeds of crime’.⁵⁹ In many ways, its content emulates the content of the Vienna Convention.⁶⁰ But in some key aspects the Strasbourg Convention also differs from the Vienna Convention. First, obligations under the Strasbourg Convention are more detailed and specific. Secondly, in contrast to the Vienna Convention which criminalises various drug-related offences, article 6(1) of the Strasbourg Convention lists four

⁵² See Council Recommendation R(80) of 27 June 1980 on Measures Against the Transfer and Safekeeping of Funds of Criminal Origin, Explanatory Memorandum (‘Council Recommendation’) reproduced in Gilmore *International Efforts* 172–173.

⁵³ Council Recommendation point b. For detailed discussion of the recommendations, see Kochinke (1990) *Internat Enforcement L Reporter* 50–51.

⁵⁴ Due to the fact that some of the signatories were not members of the EU, the Strasbourg Convention does not carry the word ‘European’ in its title like the other conventions of the Council (Council *Explanatory Report* par 4).

⁵⁵ Council *Explanatory Report* paras 9–10.

⁵⁶ See par B.4.2.2 below.

⁵⁷ See ch 5.C.1.

⁵⁸ Strasbourg Convention Preamble Recital 5.

⁵⁹ The Strasbourg Convention defines the concept ‘proceeds’ broadly to include (article 1(a)): ‘[a]ny economic advantage from criminal offences.’ An ‘economic advantage’ is likely to comprise any property as defined by the convention.

⁶⁰ See ch 5.C.1.

specific acts⁶¹ that constitute money laundering. The definition of money laundering was, therefore, broadened to go beyond the Vienna Convention's 'traditional association'⁶² with drug trafficking.

Article 6(2)(c) of the Strasbourg Convention corresponds with some of the provisions of the Vienna Convention. It determines that knowledge of an accused of whether property was criminally acquired property must be determined in terms of the factual circumstances that prevailed.⁶³ However, conduct must be criminalised where the accused 'ought to have assumed that the property was proceeds.'⁶⁴ It follows that the Strasbourg Convention advocates the use of both an objective and a subjective test to determine liability for money laundering. Article 18(7) of the Strasbourg Convention stipulates that refusal to cooperate with requests for information based on national bank confidentiality rules is not permitted unless sanctioned by court.

Although the Strasbourg Convention provides for problems stemming from its confiscation provisions,⁶⁵ it fails to provide similarly for problems stemming from bank confidentiality. The omission probably originated from a concern that should bank confidentiality be afforded any protection, banks may refuse to disclose information in which event the effectiveness of the AML effort could be seriously compromised. However, due to legal nature of conventions the aforementioned concern still has to be realised. Despite ratifying the Strasbourg Convention, a party may nevertheless provide safe-harbour protection to banks by including provisions to the effect in its national AML legislation.⁶⁶ A court may also regardless of the state's national AML legislation, decline to order a bank to disclose requested information. Finally, the Strasbourg Convention permits parties to adopt bilateral or multilateral agreements

⁶¹ Offences listed in article 6(1) of the Strasbourg Convention include (article 1(3)): '[a]ny criminal offence as a result of which proceeds ... may become the subject of an offence as defined in Article 6 of this Convention.'

⁶² Gilmore (1992) *Commonwealth L Bulletin* 1135–1136.

⁶³ For example, article 1 of the Vienna Convention (see ch 5.C.1). Liability in terms of article 6(2)(c) of the Strasbourg Convention is determined on grounds of individual knowledge and the circumstances of the matter.

⁶⁴ Article 6(3)(a) of the Strasbourg Convention.

⁶⁵ See article 5 of the Strasbourg Convention; par 4.4.2 below.

⁶⁶ See par B.2.2 above; ch 3.B.2.3.3.2; ch 5.B.3.3.2; ch 7.C.5; and ch 8.C.4.2.2.3 as regards safe-harbour protection. Note that the scope and application of a safe-harbour provision are left in the hands of individual states.

to strengthen its provisions.⁶⁷ It, therefore, acknowledges the need to follow a ‘common criminal policy’⁶⁸ in combating money laundering. As Zagaris⁶⁹ observes:

[the Convention] has the potential to revolutionize international co-operation and the overall development of the regime of regulation of international money movement.

Despite this glowing testimonial, a number of flaws have been identified in the Strasbourg Convention.⁷⁰ First, parties are afforded wide discretion to elect which criminal activity to include in national AML legislation. Secondly, although money laundering conduct must be criminalised, criminalisation of this kind is discretionary if it would go against a state’s constitution.⁷¹ Thirdly, the risk of civil litigation and liability on account of money laundering has not been recognised or addressed in the Strasbourg Convention. Therefore, if a state fails to address the issue in its national AML legislation, national banks may be vulnerable to civil claims on account of money laundering control. It is submitted that this consequence undermines the money laundering control value of the Strasbourg Convention.

More positively regarded, due to its scope the Strasbourg Convention has greater potential than the Vienna Convention as an international treaty to combat money laundering.⁷² Moreover, its provisions complement other EU conventions used in the EU to combat money laundering.⁷³

3.3 Convention on Mutual Assistance in Criminal Matters

Money laundering has become a financial crime with an international character.⁷⁴ It follows that cooperation among countries to identify the benefits of crime and prosecute money launderers are pivotal to the success of global and national AML effort. Judicial cooperation among EU member states in civil and criminal matters are for the most part arranged in terms of conventions,

⁶⁷ Article 39(2) of the Strasbourg Convention.

⁶⁸ Quillen (1991) *Duke J of Comparative and Internat L* 220.

⁶⁹ (1990) *Internat Enforcement L Reporter II* 352–353.

⁷⁰ Rizkalla (1998) *Tulane European & Civil L Forum* 115–116.

⁷¹ Article 6(1) of the Strasbourg Convention.

⁷² Alford (1994) *North Carolina J of Internat L & Comm. R* 449.

⁷³ Nilsson (1991) *Crim LF* 424. For example, EC Convention on the International Validity of Criminal Judgements of 1979 that provides for the enforcement of confiscation orders in EU member states.

⁷⁴ See ch 4.D.4, ch 5.A.

The Council issued two conventions on mutual cooperation in criminal matters in 1957 and 1959.⁷⁵ In 1996, the Council commenced work on a second protocol to supplement the Convention of 1959 and its protocol⁷⁶ and to modernise existing methods aimed at obtaining mutual assistance. The Council adopted the Second Additional Protocol to the EC Convention on Mutual Assistance in Criminal Matters⁷⁷ in 2001. The 2001 Protocol streamlines mutual cooperation among EU member states by providing for direct transmission of requests between judicial authorities without the involvement of central authorities.⁷⁸ This is of paramount value to matters relating to money laundering where time is often of the essence.⁷⁹ Outgoing requests may be submitted for injunctions pertaining to benefits of crime or when a confiscation order has been made already, for the realisation of criminally obtained property.⁸⁰

Article 2(b) of the 1959 Convention was left unamended by the 2001 Protocol presenting one of the greatest handicaps to foster cooperation among EU member states. It, namely, provides that a requested state may refuse a request for assistance if it is regarded as detrimental to the state's sovereignty, security or national interests. Therefore, while a state may ratify the 2001 Protocol, it may nevertheless refuse assistance to the requesting state.

It is difficult to imagine a scenario where a state would refuse requests for documentation or ordinary information by some other EU state. However, requests pertaining to the repatriation of the benefits of crime could be hampered or simply refused because the requested country considers it contrary to national interest to repatriate money that could be applied in its own territory. Similarly, a requested country may argue that disclosing information about its banking system or the account activities of specific customers may prejudice its reputation. Sadly, there is little a requesting country can do if its request for assistance is refused. It is left with three

⁷⁵ Namely, Council Convention on Simplified Extradition Procedures Between the Member States of the European Nation of 1957 and Council Convention on Mutual Assistance in Criminal Matters of 1959 ('1959 Convention').

⁷⁶ See Council Additional Protocol to the Convention on Mutual Assistance in Criminal Matters of 1978.

⁷⁷ Or '2001 Protocol'.

⁷⁸ Article 4(1)–(10) of the 2001 Protocol.

⁷⁹ As a direct consequence of e-banking, it is possible for a criminal to transfer funds to various destinations with the click of a button (see ch 4.D.4.3).

⁸⁰ Article 12(1)–(4) of the 2001 Protocol.

options. It can request reasons for the refusal,⁸¹ resubmit an amended request or approach Interpol⁸² for assistance.

It is evident that although the 1959 Convention and its protocols provide for mutual assistance among EU member states, there is still some considerable way to go. Nevertheless, the 1959 Convention and the protocols contribute to the money laundering control effort by harmonising procedures aimed, *inter alia*, at facilitating transnational assistance. The geographical proximity of EU member states is further likely to encourage requests for assistance among them. In this sense, the 1959 Convention may be more effective in facilitating requests for mutual assistance than, for example, the conventions of the UN.⁸³

Of significance, as already pointed out in the study⁸⁴ due to the nature of international law and the latitude it affords states to include or exclude the provisions of conventions in national legislation, the measure of assistance that is likely to be provided will depend solely on the requested country. As will be illustrated next, despite detailed provisions and the distinct protection it affords to banks against potential civil liability based on breach of bank confidentiality, the 2005 AML directive fails to foster mutual cooperation among EU member states. Instead, banks are encumbered with deciding whether to grant or refuse a request for transnational assistance.

3.4 First Anti-Money Laundering Directive (1991)

After the AML efforts of the FATF⁸⁵ attracted the attention of the international community, the Council adopted a money laundering directive on the prevention of the use of the financial system for the purpose of money laundering. The 1991 Directive was designed to legitimise the Forty Recommendations of the FATF in the EU.⁸⁶ Therefore, it is small wonder that much of the

⁸¹ Article 19 of the 1959 Convention.

⁸² See ch 5.D.3.

⁸³ See ch 5.C.1–3.

⁸⁴ See ch 5.E.

⁸⁵ For an evaluation of the AML measures of the FATF, see ch 5.B.3.3.

⁸⁶ See in general Council *Proposal for A Council Directive 1990* par 6; Ewing (1991) *J of Internat Banking L* 140–141; Zagaris *Money Laundering* 37.

directive's content emulated the 1990 Forty Recommendations.⁸⁷ Although the 1991 Directive was introduced for the protection of the financial system,⁸⁸ public demand for action against drugs and the 'protection of the Single Market'⁸⁹ against money launderers⁹⁰ were driving its adoption.

The 1991 Directive followed a 'minimum standard approach'⁹¹ for the prevention of money laundering and provided for suitable sanctions so that EU member states were able to adopt stricter measures to prevent money laundering. Credit institutions,⁹² financial institutions and businesses that carried out life insurance activities all fell within the scope of the 1991 Directive.⁹³ The 1991 Directive comprised four key features, namely, ⁹⁴ incriminalisation of conduct that constituted money laundering, proper customer identification, adequate retention of account records and international cooperation aimed at combating money laundering. EU member states were compelled to prohibit money laundering as defined⁹⁵ in the 1991 Directive. The 1991 Directive used the verb 'derived from' in its definition of money laundering.

⁸⁷ See articles 3 to 5 of the 1991 Directive whose content matched recommendations 10 to 12 of the FATF's Forty Recommendations (Customer identification and record keeping rules).

⁸⁸ Council *Proposal for A Council Directive 1990* par 2.

⁸⁹ See 1991 Directive Preamble recital 2 where the words 'integrated financial area' are employed.

⁹⁰ 1991 Directive Preamble recitals 2–3.

⁹¹ Mitsselegas *Chameleon Threat of Dirty Money* 200.

⁹² The 1991 Directive defined the concept 'credit institution' in terms of articles 1(1) and 3 of the 1977 Banking Directive (see par B.2.1 above).

⁹³ See article 1 of the 1991 Directive which is denoted as the '*ratione personae*' (Banach *European Norms* 53; Ewing (1991) *J of Internat Banking* L 141) of the instrument.

⁹⁴ See article 2–4, 8 respectively of the 1991 Directive.

⁹⁵ Article 1 of the 1991 Directive defined money laundering as: '[t]he following acts [when committed intentionally]: - the *conversion or transfer* of property, knowing that such property is *derived* from criminal activity or from an act of participation in such activity, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such activity to evade the legal consequences of his action; - the *concealment or disguise* of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is *derived* from criminal activity or from an act of participation in such activity; - the *acquisition, possession or use* of property, knowing, at the time of receipt, that such property was *derived* from criminal activity or from an act of participation in such activity; - *participation in, association to* commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the actions mentioned in the foregoing paragraphs.' - *Knowledge*, intent or purpose required as an element of the abovementioned activities, may be inferred from objective factual circumstances. Money Laundering shall be regarded as such even where the activities which generated the property to be laundered were perpetrated in the territory of another Member State or in that of a Third country.'

Although imitating the definition used in the Vienna Convention⁹⁶ and to a certain extent the definition used in the Strasbourg Convention,⁹⁷ the 1991 Directive extended the definition of money laundering by broadening the list of predicate crimes beyond drug trafficking to include any other ‘criminal activity.’⁹⁸ Like the Strasbourg Convention, the 1991 Directive determined that knowledge, intent or purpose, required as an element of activities designated as money laundering, might be inferred from objective factual circumstances.⁹⁹ No subjective determination of knowledge was required.¹⁰⁰

The 1991 Directive further used the KYC standard promoted by the Basel Committee.¹⁰¹ Significantly, interbank transactions were not subject to the identification requirement. The omission most likely afforded money launderers the opportunity to launder money through interbank transfers. Like the voluntary report system suggested by the Basel Committee and the FATF,¹⁰² the 1991 Directive established a regime of voluntary reporting. In terms of article 6(2) of the 1991 Directive an authority had to be established to receive STRs. The 1991 Directive included both safe-harbour and anti-tipping off provisions. Article 9(2) granted special protection to banks that filed a STR, namely, that disclosures made in *good faith* to the designate authority:¹⁰³

[s]hall not constitute a breach of any restriction on disclosure of information imposed by contract or by legislative, regulatory or administrative provision.

It is difficult to imagine what the Commission had in mind with the above requirement of good faith. Probably, it seemed prudent to leave it to the judiciary of EU members to decide whether a specific disclosure was made in bad faith, and, therefore, open to litigation. Like the safe-harbour provisions, anti-tipping off provisions are aimed at protecting investigations against sabotage by suspects.¹⁰⁴ Therefore, article 8 of the 1991 Directive prohibited any disclosure to a

⁹⁶ See ch 5.C.1.

⁹⁷ See par B.3.2 above.

⁹⁸ See article 1 of the 1991 Directive that defined the concept ‘criminal activity’ to mean: ‘[a] crime specified in Article 3(1)(a) of the Vienna Convention and *any* other criminal activity designated as such for the purposes of this Directive by each Member State.’

⁹⁹ Which standard was copied from the Strasbourg Convention (see par B.3.2 above).

¹⁰⁰ In contrast to the Strasbourg Convention (see par B.3.2 above).

¹⁰¹ See ch 5.B.3.2.2.

¹⁰² See ch 5.B.3.2–3.3 respectively.

¹⁰³ See article 9(2) of the 1991 Directive.

¹⁰⁴ See also paras C.3.4.3.3–3.4.3.4 below.

customer as regards the fact that an investigation was under way. Levi¹⁰⁵ argues that the general ambience of the 1991 Directive differs from the ambience of the Vienna Convention and the Strasbourg Convention. In contrast to the aforementioned conventions the primary objective of the 1991 Directive was to prevent money laundering. It is, therefore, submitted that the 1991 Directive is more compatible with the guidelines of the Basel Committee and the recommendations of the FATF than with the conventions of the Council.

3.5 Second Anti-Money Laundering Directive (2001)

Nearly a decade after the 1991 Directive was released, the Commission realised that it should update the instrument's AML provisions.¹⁰⁶ Accordingly, two key amendments to the 1991 Directive were made by the 2001 Directive. First, definitions of money laundering and criminal activity were extended to encompass all types of serious crime¹⁰⁷ and secondly, KYC standard obligations were superimposed on non-financial service providers.¹⁰⁸

The first amendment does not come as a surprise because internationally the trend was to cover all types of predicate offences in AML legislation.¹⁰⁹ The amended definitions were intended to be wide in order to conform it with existing international instruments.¹¹⁰ Most notably, the second key amendment to the 1991 Directive that was inserted as article 2A, subjected attorneys to KYC standard obligations. However, legal advice remains subject to professional privilege except when the attorney:¹¹¹ partakes in money laundering activities, provides legal advice for money laundering purposes or knows that advice was sought to circumvent money laundering legislation. Even then, attorneys are allowed to disclose information as regards potential money laundering schemes to their professional association instead of to a FIU. Significantly, the

¹⁰⁵ Levi (1991) *British J of Criminology* 1138.

¹⁰⁶ Wiessala (2001) *J of Common Market Studies* 181.

¹⁰⁷ Article 1(c) of the 2001 Directive.

¹⁰⁸ 2001 Directive Preamble Recitals 14–17, article 2(A). For example, attorneys were included under 'non-financial services providers' (see also ch 4.C.3).

¹⁰⁹ See, for example, the FATF's Revised Recommendations (see ch 5.B.3.3.2)

¹¹⁰ See article 1(e) of the 2001 Directive; EPFS *Combating Money Laundering* par 2.

¹¹¹ Article 6(3) of the 2001 Directive (in contrast, see paras C.3.4.2.2, C.3.4.3.1–3.4.3.4 below).

Commission appears to respect attorney-client privilege and, therefore, aimed to resolve the tension that existed between the professional privilege of attorneys and their reporting duty.

The relevance of article 2A of the 2001 Directive to the position of a banks lies in the fact that both attorneys and banks can be employed by criminals for money laundering purposes. The question is why attorneys were afforded special consideration as regards filing a STR as opposed to banks that find themselves in a similar position. If money laundering control is to be effected through STRs attorneys who often handle money on behalf of clients should be subjected to the same stringent rules as banks. It is impossible to deny the parallel between the position of banks and the position of attorneys as regards money laundering control. Yet, the Commission did exactly that with article 2A.

A final issue concerns the KYC standard. The 2001 Directive improved the rules on customer identification, especially the rules dealing with risks created by new technologies such as banking over the Internet. Newly inserted article 3(11) therefore requires that EU member states enact measures to deal with the risks posed by non-face to face banking.¹¹²

3.6 Third Anti-Money Laundering Directive (2005)

The 2005 Directive which was enacted to combat terrorist financing, was adopted by the EU legislature on 26 October 2005.¹¹³ It is a detailed instrument whose provisions apply to the same eight service providers that were also subjected to the provisions of the 2001 Directive.¹¹⁴ Although the content of the 2005 Directive was to a large extent copied from the 1991 Directive as amended by the 2001 Directive,¹¹⁵ the provisions of the 2005 Directive are substantially more detailed.

The amended scope of the 2005 Directive introduces a paradox. In contrast to the legal definition of money laundering that criminalises specific conduct in relation to the benefits of

¹¹² Article 11(1)(a)–(b) of the 2001 Directive.

¹¹³ See in general KPMG *Global Report-2007* 55; De Vries *Summary of Remarks* 5.

¹¹⁴ Article 2(1)–(3) of the 2005 Directive.

¹¹⁵ Or ‘Repealed Directives’.

crime,¹¹⁶ the 2005 Directive now criminalises *legally*¹¹⁷ acquired money if destined for terrorism.¹¹⁸ In verity, although the 2005 Directive steered clear from semantics it might just as well have provided that legally acquired money converts into the benefits of crime when used for terrorism, and therefore will be subject to its provisions. The Council's acknowledgment in the 2005 Directive that legally derived money is subject to preventative measures on account of future association with terrorism, is significant.¹¹⁹ It supports the proposition made elsewhere in the study that unlawful activities may be linked to money as a result of its owner or possessor's criminal intention which designates the money as the benefits of crime.¹²⁰

Further of note, the 2005 Directive steers clear from the concept 'KYC standard' as commonly referred to in international AML measures.¹²¹ Instead, the concept 'customer due diligence' is used as an umbrella concept to denote customer identification and verification duties, suspicious transaction reporting, record-keeping and training.¹²² In all likelihood it was felt that the KYC standard is restrictive and leads to uncertainties pertaining to the extent of knowledge that a bank must acquire about a customer in order to satisfy the requirement. In contrast, the concept 'customer due diligence' is broad and includes a variety of measures depending on the risks involved in conducting business with a particular person. It is submitted that in the near future the international community will replace the KYC standard measure of money laundering control across the board with the customer due diligence measure simply because the latter far better denotes the duties expected from banks to control money laundering.

In contrast to the Repealed Directives, the 2005 Directive provides that a business relationship may begin while customer identification procedures are still in progress.¹²³

¹¹⁶ See par B.3.2, paras B.3.4–3.5 above.

¹¹⁷ In contrast to income that was acquired through crime and requires laundering to conceal its criminal connection.

¹¹⁸ Article 3(5)(a) of the 2005 Directive.

¹¹⁹ The practice of employing legally acquired money for a criminal purpose such as terrorism, is known as reversed money laundering (see ch 4.D.4).

¹²⁰ See ch 2.C.5.3.1–5.3.3, par D.

¹²¹ See ch 5.B.3.2.2–3.2.4, paras B.3.3.2, D.4–5.

¹²² Article 8(a)–(d) of the 2005 Directive. See also ch 5.B.3.2.5, par B.3.3.4.

¹²³ Article 9(2) of the 2005 Directive. The issue of when and how often customer information should be verified has not yet been sufficiently addressed by the international community. While the FATF touched on the matter in its Revised Recommendations (see FATF *Revised Recommendation 2003 Revised Recommendation 5* - ch 5.B.3.3.4), there remained room for more guidance. This is where the 2005 Directive shines. The Commission

Established accounts should, however, be examined again in instances where a money laundering risk exists.¹²⁴ A bank that is unable to identify and verify a customer or the nature of his business is forbidden to continue with the business relationship and may file a STR report to a FIU.

The single most important provision of the 2005 Directive concerns the two categories of due diligence measures.¹²⁵ The 2005 Directive introduces the concept ‘simplified due diligence’ in scenarios where a reduced risk of money laundering exists and the concept ‘enhanced due diligence’ where there is a high risk of money laundering. Examples are provided in both instances. The 2005 Directive further requires that banks exercise particular care in matters where the risk for money laundering is greater. In this regard the 2005 Directive specifies three scenarios, namely: where there is no face-to-face contact with a customer, in across-border correspondent¹²⁶ bank relationships and relationships with politically exposed persons.¹²⁷ Provisions in the 2005 Directive as regards third party¹²⁸ introductions are likely to assist banks in deciding whether customer identification procedures are in fact required.¹²⁹

The potential benefits of the 2005 Directive’s due diligence measures are twofold. First, EU member states that still needs to enact AML legislation may emulate the 2005 Directive’s two categories of due diligence. Secondly, the Commission set a uniform due diligence standard for banks operating in the EU to follow which if adopted have the ability to streamline the money laundering control effort of the region.

The use of FIUs to assist in the money laundering control effort has thus far received much international attention.¹³⁰ EU member states must ensure that FIUs have access to all the

treated the issue in a different vein. Since the 2005 Directive distinguishes between established relationships and new relationships and between simplified and enhanced due diligence measures, banks are given plenty of guidance of how to determine if a certain relationship poses a money laundering risk and the extent of the identity verification that is subsequently required.

¹²⁴ Article 9(6) of the 2005 Directive.

¹²⁵ Articles 11–12, article 13(2) (a)–(c) of the 2005 Directive.

¹²⁶ See also ch 4.D.2.

¹²⁷ Article 3(8) of the 2005 Directive. See also ch 5.B.3.2.5.

¹²⁸ Which is defined as institutions and persons to which the 2005 Directive apply (article 2 read together with article 16 of the 2005 Directive).

¹²⁹ Articles 14–19 of the 2005 Directive.

¹³⁰ See paras C.3.4.1–3.4.2 below; ch 6.B.4.3.4, par D.5; ch 8.E.1.

information that it requires to fulfill its duties.¹³¹ The 2005 Directive also affords safe-harbour¹³² protection to banks. Accordingly, banks that filed STRs to a local FIU will be protected against civil and/or criminal liability.¹³³ In this regard the Commission included a new provision pertaining to the safety of employees whose reports could result in an investigation or prosecution. EU member states are urged to take ‘all appropriate measures’ to prevent employees from being victimised.¹³⁴ The bank may furthermore not inform a customer that it filed a STR.¹³⁵

The 2005 Directive differs in two key aspects from the Repealed Directives. It, namely, covers terrorist financing and replaces the KYC standard with enhanced and simplified due diligent measures. Many positive comments can be made about the 2005 Directive. The amended structure is commendable and so are large chunks of its provisions. It is conspicuous that the Commission investigated AML trends that in combination with aspects identified by the FATF in 2003,¹³⁶ have been addressed in the 2005 Directive.

It is submitted that the main problem with due diligence rules is that they are usually vague and therefore contribute to uncertainty rather than uniformity in their application. The Commission extended itself to address these negative aspects by devising an AML model that comprises straightforward principles and unambiguous examples of the scope of AML measures. In this sense, EU member states are afforded the freedom to decide the fashion in which specific due diligence measures should be formulated in national AML laws. Notwithstanding the positive elements of the 2005 Directive, some criticism could also be levelled against it. First, while it is understandable that terrorist financing is included in a directive that pertains to money laundering, more guidance on how to distinguish terrorist funds from ordinary money as well as from benefits

¹³¹ Article 21(3) of the 2005 Directive.

¹³² See paras B.2.2, B.3.2 above.

¹³³ Article 23 of the 2005 Directive. Of note, the 1991 Directive exempted banks from ‘legislative, regulatory or administrative’ liability only where STRs were filed in *good faith* (article 9(2)- cf par B.3.4 above). In the 2005 Directive the Commission went further. It not only omitted the requirement of ‘good faith’ from the 2005 Directive’s safe-harbour provision, but it also specifically excluded *any* type of liability resulting from filing a STR ‘in accordance with the provisions’ of the 2005 Directive. It follows that litigation against a EU bank on the basis of breach of bank confidentiality is precluded if the bank has acted within the perimeters set by the 2005 Directive.

¹³⁴ Which is the so-called ‘anti-tipping off’ provision (article 27 of the 2005 Directive).

¹³⁵ *Idem* articles 28–29.

¹³⁶ See ch 5.B.3.3.4.

of crime would have been helpful. At present, banks are left to determine for themselves how to make this distinction. Secondly, the latitude the Council affords EU member states as regards the imposition of AML measures cuts both ways. On the one side, a broadly worded directive affords EU member states the flexibility to mold it to fit their own AML models. The key point here is that banks operating in the EU will not be allowed to close their proverbial eyes when accepting new customers or when conducting unusual transactions. On the other side, the few lacunas¹³⁷ that remain as regards money laundering control will undoubtedly have to be dealt with individually by EU member states. Resulting divergent measures, however, may undermine the envisaged regional uniformity of money laundering control.

In the next section the extent to which EU law may assist a victim of fraud or theft with instigating a civil claim against a bank as recipient of the benefits of fraud or theft is determined. In addition, civil forfeiture falls under the spotlight. The following section emphasises the point that any notion of EU legal uniformity as regards civil litigation is fractured by the absence of an EU *ius commune*.¹³⁸ Moreover, it will be illustrated that as a result of procedural complexities instigating a civil action against a bank domiciled in a different EU member state is not an endeavour to be undertaken by the faint hearted.

4. Civil Remedies

4.1. EU Legislation

4.1.1 Introduction

One of the syntheses of this study holds that civil liability may be imposed on a bank as former recipients of the benefits of fraud or theft.¹³⁹ The claimant is a victim of fraud or theft who

¹³⁷ For example, the degree to which a bank should exert itself to satisfy due diligence measures, the amount of information that is sufficient for identity verification and the options available to a bank when it appears that it has unwittingly cooperated in a money laundering operation and that the benefits of crime have subsequently vanished.

¹³⁸ It is important to mention that since 1998 various projects have been underway to formulate rules aimed at establishing an EU common-law. However, no *ius commune* has been adopted yet (Van Rhee *Ius Commune* 217–232).

¹³⁹ See ch 1.B.

attempts to recover loss suffered from the bank where the benefits of the fraud or theft were deposited and subsequently withdrawn by the fraudster or thief who either disappeared with the funds or who is the proverbial man of straw.

At this point it is important to reiterate that the status of EU law in the union is a sensitive issue because EU member states are autonomous as far as enacting laws.¹⁴⁰ Consequently, EU member states may decide individually how to resolve civil claims between parties that reside in different EU member states. Since EU law prevails over national law, the question arises whether an individual has access to any effective remedy to redress loss he suffered. There is no statute that advises specifically on the enforcement of civil remedies in the EU. The EU Court of Justice, however, relies on article 10 of the Maastricht Treaty to remedy an infringement of EU law.¹⁴¹

In the EU a system of cooperation is employed by a EU member in which EU law and municipal or national law operate in combination.¹⁴² It follows that legal national remedies are applicable only if EU remedies are not less favourable than the remedies already existing under national law, and if the latter do not render the use of a EU legal right impossible. To complicate matters even further EU law has specific rules as regards jurisdiction and conflict of laws. The Brussels Convention, Brussels Regulation and the Rome Convention determine jurisdiction in legal matters arising *ex contractu* whilst the Rome II Regulations regulates non-contractual matters where a conflict of laws exists. The content of the legal instruments above is considered next.

4.1.2 Brussels Convention (1968)

Initially, the Brussels Convention of 1968¹⁴³ governed all contractual claims between residents of EU member states. However, since the adoption of the Brussels Regulation, the Brussels Convention is applicable only to matters involving residents of non-EU members who are party to it.¹⁴⁴

¹⁴⁰ See par B.1 above.

¹⁴¹ Norman *Tracing* 99; Brealey & Hoskins *Remedies* 172–173.

¹⁴² Hanlon *EC Law* 92–93; Davies *EU Law* 73–76.

¹⁴³ Council Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters of 1968 as Amended by EEC Convention on the Accession of the New Member States to that Convention of 1972 ('Brussels Convention').

¹⁴⁴ Takahashi *Restitution* 397. Cf Savona *Money Trails* 137.

In 1997, due to the fact that many claimants were prevented from commencing legal action in their own jurisdictions, the Commission began investigating various possibilities of harmonising the commercial law used by EU member states.¹⁴⁵ One of the legal instruments stemming from this effort is the Brussels Regulation of 2000.¹⁴⁶

4.1.3 Brussels Regulation (2002)

The Regulation came into force on 1 March 2002.¹⁴⁷ While it does not alter the structure of the Brussels Convention, it ensures that jurisdictional rules assist rather than impede cross-border commerce. The Regulation seeks to encourage consumer confidence in the EU through the improvement of rules under which legal action against service providers conducting cross-border business in the EU can be brought.¹⁴⁸ In the main, it determines jurisdiction in claims against persons domiciled¹⁴⁹ in EU member states. It follows that the jurisdictional rules of the Regulation are aimed at ensuring uniformity of jurisdiction in EU member states.¹⁵⁰

Articles 15 to 17 of the Regulation afford special status to claimants in *contractual* disputes. It therefore applies to scenarios where a customer who resides in one EU state endeavours to file suit against a bank which is incorporated in a different EU state based on breach of bank confidentiality. The suit against the bank would stem from the fact that it filed a STR which, so the customer would allege, breached its contractual confidentiality duty. Article 15(1)(c) determines that jurisdiction over a contractual dispute will be conferred on the courts of the customer's domicile where:

[t]he contract has been concluded with a person who pursues commercial or professional activities in the Member State of the consumer's domicile ... and the contract falls *within the scope* of such activities.

¹⁴⁵ EC *Proposal for Council Act* 20–36.

¹⁴⁶ Council Regulation 44/2000 of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgements in Civil and Commercial Matters ('the Regulation').

¹⁴⁷ Article 76 of the Regulation.

¹⁴⁸ Regulation Preamble Recital 1.

¹⁴⁹ The concept 'person' includes both entities and individuals (Regulation Recital 11, article 2(1)).

¹⁵⁰ The Regulation Preamble Recital 15.

The Regulation further abolishes the requirement¹⁵¹ that the customer as claimant must have taken steps necessary to conclude the contract in his home country so that he could file suit in the latter. For this reason, article 15(1)(c) provides that the contract between the parties must fall ‘within the scope’ of the activities that the defendant carried out in the claimant’s EU member state without specifying that the claimant must have contracted from that specific country. As mentioned above, some of the provisions of the Brussels Convention were repealed by the Regulation.¹⁵² Article 2(1) of the Regulation, which sets out the general rule for determining jurisdiction, is analogous to article 2 of the Brussels Convention and provides that the bank must be sued in the EU state where it domiciles.

The domicile of a legal entity such as a bank is determined with reference to one of the following:¹⁵³ place of incorporation, location of its central administration or location of its headquarters. The Regulation further outlines rules that apply only in designated scenarios. A key rule in this regard determines that a party in a contractual dispute may be sued in the courts of the place where the obligation in terms of the contract is or should have been performed.¹⁵⁴ It follows that a customer may file suit against an EU bank in the member state where the bank has been rendering services to him.

Significantly, article 5(4) of the Regulation requires that a party which is domiciled in another EU member state must be sued:

[in] a civil claim ..., or restitution which is based on an act giving rise to criminal proceedings,¹⁵⁵ in the court seized of those proceedings, to the extent that the court has jurisdiction under its own law to entertain civil proceedings.

Article 5(4) therefore implies that a court has jurisdiction to adjudicate a civil matter if criminal charges were filed against the defendant bank in that same jurisdiction. In the context of money laundering control and contractual breach of confidentiality article 5(4) holds a three-fold consequence for a customer seeking to hold a bank liable for breach of bank confidentiality. First, the customer as claimant must ascertain prior to filing suit against the defendant bank whether the AML laws of the EU member state where the defendant bank will be sued affords safe-harbour

¹⁵¹ See article 14 of the Brussels Convention.

¹⁵² Article 68(1)–(2) of the Regulation.

¹⁵³ *Idem* article 60(1)–(3).

¹⁵⁴ *Idem* article 5(1)(a).

¹⁵⁵ For example, on account of a money laundering violation.

protection to the bank. Secondly, if the AML laws of the member state contain no safe-harbour provisions or if the defendant bank has acted contrary to the safe-harbour provisions when it made the disclosure, the customer needs to ascertain whether the defendant bank will also be facing criminal charges as a result of its conduct. It follows thirdly, that if criminal proceedings are under way against the defendant bank the customer must file suit against the bank in the same EU member state where the criminal matter will be adjudicated.¹⁵⁶

Ultimately, the Regulation broadens the jurisdictional rules of the Brussels Convention. The Regulation has not been accepted without criticism despite improving existing EU jurisdictional rules. It has been argued¹⁵⁷ that banks are likely to be exposed to legal proceedings throughout the EU and therefore, they will need to be cognisant of the civil procedure rules of every EU member state. In addition, while the courts in the customer's home country may have adjudicated the matter, the customer may nevertheless experience difficulty in enforcing a judgement in a foreign court if the defendant bank does not have a presence in the customer's home country. It is evident that this outcome will prevail in every civil matter where the parties to the dispute are domiciled in different EU member states.

4.1.4 Rome Convention (1980)

The Rome Convention of 1980¹⁵⁸ purports to adjudicate disputes where parties contracted that one of them may determine the law applicable to a dispute.¹⁵⁹ Its provisions therefore apply to contractual obligations that stipulate a choice between the laws of different countries.¹⁶⁰ If no choice as regards the law governing the contract was made, it will be governed by the law of the country to which it is most closely connected.¹⁶¹ However, contracts pertaining to the supply of banking services are governed by the laws of the country in which the consumer resides.¹⁶²

¹⁵⁶ To reiterate, the Regulation applies only to claims arising *ex contractu*, for example, where a customer sues a bank that filed a STR for breach of bank confidentiality.

¹⁵⁷ Anning et al *E-Finance* 287.

¹⁵⁸ As Council Convention on the Law Applicable to Contractual Obligations of 1980 ('Rome Convention') is known. It entered into force in 1991.

¹⁵⁹ Article 3(1) of the Rome Convention.

¹⁶⁰ Article 1(1) of the Rome Convention. A number of exceptions to the rule exist (cf article 1(2)(a)–(h)), none of which is relevant to the discussion at hand.

¹⁶¹ *Idem* article 4(1); Council *Green Paper on Contractual Obligations* par 8.

¹⁶² Article 5(2) of the Rome Convention.

In 2000, the Commission initiated a consultation process on a proposal for new regulations pertaining to the law that governs *non-contractual* obligations.¹⁶³ On 14 January 2003 the Council adopted a proposal which was aimed at converting the Rome Convention into a community instrument.¹⁶⁴ The amended version¹⁶⁵ of the proposal was enacted in 2007.¹⁶⁶

4.1.5 Rome II Regulation (2007)

The Rome II Regulation applies to cases where a conflict of laws exists as regards non-contractual obligations in civil and commercial matters.¹⁶⁷ It is applicable to all non-contractual matters where loss was suffered as a result of the defendant's conduct.¹⁶⁸ The Rome II Regulation applies, for example, to the scenario where a bank failed to identify deposited money as the benefits of fraud or theft or continued with a suspicious transaction. It subsequently paid the benefits of fraud or theft to the account holder who absconded with the money. Consequently, the victim of the fraud or theft has little choice but to claim loss suffered on account of the fraud or theft from the bank which parted with the money. He therefore looks to the Rome II Regulation to determine which law applies to adjudicate the claim.

In this scenario, the victim's claim against the bank will be based on the law that applies in the EU member state where the matter is adjudicated.¹⁶⁹ However, article 10 of the Rome II Regulation contains a core provision in this regard. In matters where the law applicable to the claim cannot be determined and the parties reside in the same EU member state where the event¹⁷⁰ giving rise to the victim suffering loss occurred, the law of that state applies.¹⁷¹ Thus, if the victim

¹⁶³ See Council *Proposal for a Regulation on Non-Contractual Obligations*.

¹⁶⁴ Which could either be a directive or a set of regulations (Council *Green Paper on Contractual Obligations* par 2.5).

¹⁶⁵ See Council *Amended Proposal for a Regulation on Non-Contractual Obligations*.

¹⁶⁶ Council Regulation 864/2007 of 11 July 2007 on the Law Applicable to Non-Contractual Obligations (Rome II) ('Rome II Regulation').

¹⁶⁷ Article 1 of the Rome II Regulation.

¹⁶⁸ *Idem* article 2(1).

¹⁶⁹ For example, in England a victim of fraud or theft, depending on the surrounding circumstances, may base his claim against the bank which paid the benefits of fraud or theft to the fraudster or thief on certain restitution principles (see par C.2–3 below).

¹⁷⁰ That is, the bank paid the benefits of fraud to the account holder whilst suspecting that the latter may not be entitled to payment.

¹⁷¹ Article 10(2) of the Rome II Regulation.

of fraud or theft and the bank reside in different states the law applicable to the dispute is the law of the state where the event giving rise to the claim occurred.¹⁷² However, if it is evident from the circumstances of the matter that the conduct of the bank is more closely connected with one state than with another and the aforementioned provisions do not apply, the law of the latter country applies to adjudicate the victim's claim.¹⁷³ The victim of fraud or theft and the bank as parties to the dispute, however, may reach consensus beforehand of which law to apply to the litigation at hand.¹⁷⁴

To recap, the Rome II Regulation applies where there is no contractual relationship between the parties to a civil dispute. It may be used by a victim of fraud or theft to determine where he must file his claim against the which bank received the benefits of fraud or theft and paid the funds to the fraudster or thief who was not entitled to receive payment. Since the fraudster or thief absconded with the money or is a pauper, the victim of the fraud or theft is left to look to the bank to compensate him for the loss he suffered. Consider the scenario where a bank unwittingly participated in a money laundering scheme with the result that the benefits of fraud were successfully laundered. The bank and the victim of fraud reside in different EU member states. The victim therefore must file suit against the bank in the EU member state where the bank paid the benefits of fraud to the fraudster.

This is likely to cause a twofold hardship for the victim of fraud as claimant. First, he needs to ascertain what happened to his money after it was embezzled which may prove impossible. Secondly, even if he is able to follow the benefits of fraud to a specific bank account, he will then have to demonstrate that he suffered loss on account of the fact that the bank paid the money to the fraudster who was not entitled to payment. It is submitted that a victim of fraud's chance of success appears minimal simply because of all the elements that he must establish before the claim will be adjudicated in his favour. Moreover, imagine having to follow the benefits of fraud or theft and establish a cause of action where the defendant bank resides in an EU state which is not the state where the victim of fraud or theft resides. The matter is further complicated if the fraudster or thief used different banks to launder chunks of the victim's money. It is submitted that the likelihood of the victim obtaining a payment order against the defendant bank

¹⁷² *Idem* article 10(3).

¹⁷³ Article 10(4) of the Rome II Regulation.

¹⁷⁴ *Idem* article 14(1)(a).

on account of every element that he has to establish is close to zero. In reality, if a professional money laundering scheme was used to sever the connection between the benefits of fraud or theft and the fraud or theft, the Rome II Regulation will offer little assistance to an EU national to recover loss suffered, not so much because it is deficient but rather because of the nature of EU law and the deviousness of criminals.¹⁷⁵

In summary, in civil claims arising *ex contractu* the customer as claimant is less likely to encounter the difficulties that were spelt out above. The reason is that the customer and the bank are likely to have determined contractually which law to use to adjudicate a potential dispute. Where no law has been specified the law of the state where the customer resides will apply to the claim. Significantly, the aforementioned rules on jurisdiction and conflict of laws apply only where the parties to a dispute are unable to reach consensus as regards the jurisdiction of the court or which law to apply to adjudicate a matter. However, it is more than likely that the parties would have provided *ex contractu* for jurisdiction and, or conflict of law situations in the event of a dispute.

In contrast, a victim of fraud or theft who has no contractual relationship with the bank where a fraudster or thief successfully laundered the benefits of fraud or theft which were consequently paid away by the bank as instructed by the fraudster or thief, is likely to have limited success in holding the bank liable for loss suffered. The victim's claim against the bank is further likely to be frustrated where organised crime syndicates were involved in the money laundering scheme and the said money was moved between accounts and across borders. For this reason it is submitted that EU legislation is unlikely to avail a victim of fraud or theft with any measure of success against a bank as former recipient of the benefits of fraud or theft.

4.2 Civil Forfeiture

4.2.1 Introduction

During the late 1980s EU member states were alerted to the fact that an average of 90 percent of confiscated the benefits of crime had to be returned to criminals on account of a lack of

¹⁷⁵ For an analysis of the money laundering process, see ch 4.B.4, par D.

evidence.¹⁷⁶ As a result the Strasbourg Convention¹⁷⁷ was adopted in an effort to address the problem of divergent EU forfeiture laws. The Schengen Agreement, which came into effect in 1990¹⁷⁸ provides for civil forfeiture applications among the Schengen states. As a public law remedy civil forfeiture is aimed at depriving criminals of the fruit of their illegal conduct.

A bank may become embroiled in civil forfeiture proceedings in two ways. First, it may become indirectly involved in civil forfeiture proceedings due to the fact that the benefits of crime were deposited with the bank. Secondly, a bank as an innocent owner of an interest in property that is subjected to a civil forfeiture order, may become directly involved in a civil forfeiture application.¹⁷⁹

4.2.2 Strasbourg Convention (1990)

At the outset it is worth pointing out that the Strasbourg Convention caters for both criminal and civil forfeiture.¹⁸⁰ Therefore, a guilty verdict against a defendant need not be obtained prior to commencing forfeiture proceedings. However, in as far as the national law of the requesting party so determines, cross-border freezing of assets may not occur without a formal justice procedure.¹⁸¹

In general, the Strasbourg Convention comprises measures that can be taken on national level to confiscate the ‘proceeds of crime’.¹⁸² Apart from promoting international cooperation with respect to confiscation related matters, the Strasbourg Convention also compels parties to adopt national legislation to enable them to confiscate the proceeds of crime and assume any other

¹⁷⁶ Vlogaert (2001) *J of Fin Crime* 22.

¹⁷⁷ As the Council’s Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime of 1990 is referred to (see par B.3.2 above).

¹⁷⁸ See par B.1 above.

¹⁷⁹ See par B.4.2.2 below.

¹⁸⁰ See article 1 of the Strasbourg Convention where the concept ‘confiscation’ is defined as a measure ‘ordered by the court *following* proceedings’. Since the concept ‘proceedings’ is not defined in the Strasbourg Convention, it is understood to include both criminal and civil court actions (cf Council *Explanatory Report* 214).

¹⁸¹ Article 13(1) of the Strasbourg Convention.

¹⁸² *Idem* article 2. The concept ‘proceeds of crime’ is defined as (article 1): ‘[a]ny economic advantage from criminal offences. It may consist of any property as defined in ... this article.’

measures necessary for a confiscation order.¹⁸³ Parties are advised to cooperate with one another to enforce the provisions of the Strasbourg Convention.¹⁸⁴ Cooperation must extend from the investigation of criminal activity to the freezing of the proceeds of crime and other proceedings aimed at confiscation.¹⁸⁵ EU member states are required to afford upon request the widest possible assistance¹⁸⁶ to the requested country in:¹⁸⁷

[t]he identification and tracing of instrumentalities, proceeds and other property liable to confiscation.

Cooperation may include securing evidence, freezing bank accounts or seizing property.¹⁸⁸

Article 13(3) contains the core of the Strasbourg Convention as regards civil forfeiture applications.¹⁸⁹ Pursuant to article 13(3) it is irrelevant whether a requested confiscation is a value confiscation or a property confiscation.¹⁹⁰ Both types of application must be entertained by EU member states where possible.¹⁹¹ It follows that EU member states must entertain two types of requests:¹⁹² requests for the confiscation of specific items that constitute instrumentalities of crime¹⁹³ and requests pertaining to items that must be confiscated first because they represent a sum of money that corresponds with the value of criminally obtained property. Consequently,

¹⁸³ Article 3 of the Strasbourg Convention.

¹⁸⁴ Nilsson (1991) *Crim. LF* 433; Alford (1994) *North Carolina J of Internat L & Comm. R* 425.

¹⁸⁵ Article 7 of the Strasbourg Convention.

¹⁸⁶ *Idem* articles 13–17.

¹⁸⁷ Article 8 of the Strasbourg Convention.

¹⁸⁸ *Idem* articles 7–12. In *Denilauler* ([1980] ECR 1553), a French plaintiff sued a German company in France. In the course of the proceedings the French court authorised the freezing of the German company's funds held at the Frankfurt branch of a French bank (1553–1554). Since the order was *ex parte*, the plaintiff sought to have the order enforced in Germany. The court found that although it is empowered to recognise protective measures in the country of origin, this finding did not apply where the protective measures were ordered *ex parte* (1557). The plaintiff was therefore ordered to inform the German company of its intention to allow it the opportunity to contest the matter.

¹⁸⁹ Article 13 of the Strasbourg Convention.

¹⁹⁰ Note that English civil forfeiture laws do not distinguish between value and property forfeitures (see paras C.4.4.2.2–4.4.2.3 below).

¹⁹¹ See article 18(1)–(8) of the Strasbourg Convention where various grounds for refusal to cooperate with a request are listed.

¹⁹² Keyser-Ringnalda (1992) *European LR* 510; Banach *European Norms* 51.

¹⁹³ Note in this regard section 50 of POCA which uses the concept 'instrumentality of an offence' (see ch 8.D.4.2.1.4).

property that a defendant acquired legally may nevertheless be confiscated if the application for a value confiscation is successful. It is submitted that the Council by distinguishing between the two types of properties above that could be forfeited established a civil forfeiture model that has the widest possible application.

Significantly, EU member states may not employ bank confidentiality rules for a refusal to cooperate.¹⁹⁴ In addition, they are obligated to provide *bona fide* third parties¹⁹⁵ with legal remedies to prevent forfeiture of their property.¹⁹⁶ The rights of innocent third parties who are involved in a civil forfeiture matter are protected in terms of article 22(2)(a) of the Strasbourg Convention. It determines that applications to freeze bank accounts may be refused if the so-called ‘innocent owner’ was not afforded adequate opportunity to assert his rights to the money in issue.¹⁹⁷ Although the Strasbourg Convention refers exclusively to bank accounts in this regard, it is submitted that the rights of innocent third parties with respect to any property subject to a civil forfeiture application must be protected if grounds for it exist.

Clearly, the EU legislature widely coined the innocent owner protection afforded by article 22(2)(a) of the Strasbourg Convention. It affords an opportunity to *any* person who has, or once had, an interest in an ‘economic advantage’ obtained through crime to establish its interest in court before the property is forfeited to the state. This means that if the provision has been ratified, a person, for example, from whom money was stolen and subsequently deposited with a bank may use the corresponding section of his national legislation to recover the money before the court can declare the balance in the account forfeited to the state. Even so EU member states may decide individually what kind of protection to afford to innocent owners in civil forfeiture disputes.

In summary, it is submitted that the Strasbourg Convention imposes diverse and far-reaching obligations on EU member states in an effort to create practical yet enforceable cooperation.

4.2.3 Schengen Agreement (1990)

¹⁹⁴ Article 18(7) of the Strasbourg Convention.

¹⁹⁵ *Idem* articles 21–22.

¹⁹⁶ For example, when a foreign court order is served to an individual the requesting country must indicate which legal remedies are available to the defendant under its law (article 21(3) of the Strasbourg Convention).

¹⁹⁷ See also par C.4.4.3 below; ch 7.D.4.3; ch 8.D.4.3 as regards the innocent owner defence.

The Schengen Agreement of 1990 provides not only for a relaxation of immigration control between certain EU member states, but also for various kinds of police action and cross-border police cooperation with respect to the confiscation of the benefits of crime. In terms of the Schengen Agreement parties may implement measures that will enable them to seize and confiscate financial profits deriving from illegal drug trafficking in accordance with national laws.¹⁹⁸

In addition, the Schengen system of cooperation establishes two registration and surveillance databases, namely, the Schengen Information System and the SIRENE database, both providing information about the whereabouts of specific EU nationals.¹⁹⁹ Both databases are part of the European Information System that is linked to Europol, an inter-state law enforcement agency like Interpol.²⁰⁰ The Schengen Agreement envisions wide cooperation among designated EU member states.²⁰¹

It is curious that law enforcement-related provisions were included in an agreement concluded for the purpose of facilitating freedom of movement in the EU. The reason for the inclusion most likely relates to the practical implications of cross-border cooperation among EU member states, one of which is a suspect's right to free movement. However, other countries such as England and the US have established special bodies to monitor the movement of suspects and to oversee information dissemination as regards money laundering.²⁰² Even South Africa which only recently joined the international effort against money laundering put a FIU in place solely for the purpose of monitoring money laundering activities.²⁰³ It is therefore submitted that the Council should consider amending the Schengen Agreement so that law enforcement provisions are transferred to a directive pertaining solely to law enforcement matters in the EU.

5. Individualised Anti-Money Laundering Measures

5.1 Background

¹⁹⁸ Article 72 of Schengen Agreement; Elvins *Europe's Response* 30.

¹⁹⁹ Mathiesen *Surveillance in Europe* 9.

²⁰⁰ See ch 5.D.3.

²⁰¹ Article 46(1) of the Schengen Agreement.

²⁰² See par C.5 below, ch 7.E.1 respectively.

²⁰³ See par B.5.3 below.

Although the Council's desire to become involved in the fight against money laundering was voiced in the 1991 Directive,²⁰⁴ various problems existed within the EU as regards the establishment FIUs.²⁰⁵ It follows that action was soon taken by the Council to address this and some other difficulties that EU member states were experiencing with the dissemination of crime-related information. Two actions in particular by the Council contribute to the region's fight against money laundering. They are, namely, the formation of an EU²⁰⁶ policing agency and action plans to combat organised-related crime and money laundering.²⁰⁷

5.2 Europol

The creation of an EU policing agency that would facilitate information exchanges among EU member states, was envisioned long before its actual inauguration in 1995. Two other forums, namely, the Trevi Group²⁰⁸ and the European Drugs Unit,²⁰⁹ preceded the establishment of an European police office,²¹⁰ and provide EU member states the opportunity to access information relating to law enforcement issues.

Europol became effective in October 1998 although the convention²¹¹ under which it operates was already signed in 1996. Its primary objective is to promote cooperation among law enforcement agencies of EU member states so that terrorism, drugs trafficking and other forms²¹² of international crime can be addressed effectively. To this end, national units of Europol were established in EU member states that have ratified the Convention. Europol is essentially tasked

²⁰⁴ The expectation was reproduced in the 2005 Directive (see articles 38–41).

²⁰⁵ See article 6 of the 1991 Directive and article 21(1) of the 2005 Directive.

²⁰⁶ In contrast to the international police agency Interpol (see ch 5.D.3).

²⁰⁷ See *Council Action Plan 1997*.

²⁰⁸ The Council established the Trevi Group in 1985 to promote police cooperation and the exchange of information relating to terrorist activities (*Benyon Police Cooperation* 157).

²⁰⁹ This unit was established by the Trevi Group in 1993 as an entity to replace the latter until a blanket European police bureau could be established (*Benyon Police Cooperation* 162).

²¹⁰ Or 'Europol'.

²¹¹ Council Treaty on the Establishment of a European Police Office of 1995 ('the Convention').

²¹² Cf article 2(2) of the Convention; Ashe & Reid *Money Laundering* 29.

to²¹³ obtain and analyse information, inform national law enforcement agencies via national Europol units of information, assist in investigations and maintain a computerised system of collected information. Safeguards were inserted in the Convention to ensure that access to information held by Europol is strictly controlled.²¹⁴

Europol may further become involved with activities aimed at combating money laundering provided three requirements are met:²¹⁵ an organised criminal organisation is involved, its activities affect two or more EU member states in such a way that joint action is required and joint action is required due to the scale, and the significance and consequences of the offences concerned. The Convention does not define money laundering, but instead refers to the definition included in the Strasbourg Convention.²¹⁶

5.3 Action Plan to Combat Organised Crime

In 1997 the Council adopted recommendations relating to money laundering in an action plan to combat organised crime.²¹⁷ The recommendations were subsequently reiterated in the Council's millennium strategy against organised crime.²¹⁸ The 1997 Action Plan accentuated²¹⁹ the importance of EU member states developing 'wide ranging'²²⁰ legislation for the purpose of confiscating the benefits of crime as well as combating the laundering thereof. It further suggests that EU member states ratified international conventions²²¹ as well as the Council's conventions in an effort to combat money laundering effectively. Some of the difficulties include ineffective

²¹³ Article 3(2) of the Convention.

²¹⁴ *Idem* articles 11-14.

²¹⁵ Article 2(3) of the Convention.

²¹⁶ See article 1 of the Convention which provides that money laundering refers to criminal offences listed in article 6(1)–(3) of the Strasbourg Convention (see par B.3.2 above).

²¹⁷ See Council Action Plan 97/ C 251/01 of 28 April 1997 to Combat Organised Crime ('1997 Action Plan').

²¹⁸ See Council *Millennium Strategy*.

²¹⁹ Council *Action Plan 1997* Part II action point 8(1); Vlogaert (2001) *J of Fin Crime* 23; Elvins *Europe's Response* 32.

²²⁰ Council *Action Plan 1997* action point 8(1).

²²¹ *Idem* Recommendations 13–14.

information exchanges²²² and opportunities presented to criminals by new technologies in the area of monetary products.

In 1998 the Council formulated a second joint action plan that dealt specifically with money laundering was formulated by the Council.²²³ In the main, the 1998 Joint Action Plan promotes closer cooperation among enforcement agencies²²⁴ in the implementation of the Strasbourg Convention and other legal instruments of the Council and the Commission. Aforementioned action plans accentuate both accentuated that the fight against money laundering should be concentrated on harmonising definitions and sanctions of the different AML enactments. To this end, the Council adopted a strategy paper²²⁵ on how to implement these and other²²⁶ projects to combat crime in the EU in March 2000.

A final issue that should be mentioned concerns the creation in 2003 of two networks to facilitate cooperation among judicial authorities of EU member states. To this end, the European Judicial Network²²⁷ and Eurojust²²⁸ were established to demonstrate to the international community the emphasis the Council places on transnational cooperation.

In summary, the Council initiated various programmes aimed mostly at the dissemination of information. EU member states are required to put FIUs in place pursuant to national AML legislation.²²⁹ As soon as these bodies are established the Council's various AML programmes will become crucial because they provide guidance as regards the functions of the individual FIUs.

²²² Council *Action Plan 1997* action point 26(a). Europol (see par B.5.2 above) may provide valuable assistance in this regard.

²²³ See Council Joint Action 98/428/JHA of 29 June 1998 on the Creation of a European Judicial Network ('1998 Joint Action Plan'); Council *Joint Action Plan 1998*.

²²⁴ For examples in this regard, see Banach *European Norms* 55.

²²⁵ See Council *Tampere Conclusions 2000*. The Tampere Council refers to a Council meeting held in 1999 in Tampere, Finland, to discuss justice issues within the EU.

²²⁶ For example, in March 2000 the Council adopted a special strategy against organised crime due to the dangers it poses to the EU as a region (Council *Millennium Strategy* 6).

²²⁷ Council *European Judicial Network*. The European Judicial network is a Belgium initiative that means to improve cooperation among judicial authorities (Council *European Judicial Network* par 4).

²²⁸ Eurojust comprises a team of judges and prosecutors of EU member states who sit together on a permanent basis (Europol *Judicial Cooperation* par 2(b)). Eurojust aims to facilitate cooperation with Europol towards the improved prosecution of crimes such as money laundering which have international ramifications.

²²⁹ This obligation is mentioned in the 2005 Directive (see par B.3.6 above).

Eventually EU member states should all have statutory bodies in place with similar goals that could perform similar functions. Ultimately, action of this kind may determine the effectiveness in the EU of the collective money laundering prevention effort.

6. Summary

The first part of Chapter 6 evaluated the EU's AML regime to demonstrate how money laundering control has been configured to benefit states functioning within one geographical area. It was shown that the Council adopted various legal instruments in an effort to combat money laundering in the union. Pertinent legal instruments and other AML measures that act in support of the EU AML regime may be delineated as follows:

Figure 6.1

Date	Legal Instrument
1957	* Council Treaty Establishing the European Economic Community
1977	* Council First Banking Directive
1980	* Council Recommendation R(80) Measures Against the Transfer and Safekeeping of Funds of Criminal Origin * Council Convention on the Law Applicable to Contractual Obligations
1989	* Council Second Banking Directive
1990	* Council Schengen Acquis Convention * Council Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime
1991	* Council Money Laundering Directive on the Prevention of the Use of the Financial System For the Purpose of Money Laundering
1995	* Council Treaty on the Establishment of a European Police Office
1997	* First Council Action Plan to Combat Organised Crime
1998	* Council Joint Action on Money Laundering, the Identification, Tracing, Freezing, Seizing and Confiscation of Instrumentalities and the Proceeds From Crime
2000	* Council Millennium Strategy * Council Regulation on Jurisdiction and the Recognition and Enforcement of Judgements in Civil and Commercial Matters
2001	* Council European Strategy to Prevent Organised Crime * Council Money Laundering Directive on the Prevention of the Use of the Financial System For the Purpose of Money Laundering * Council Convention on Mutual Assistance in Criminal Matters

2003	* Council European Judicial Network * Eurojust
2005	* Council Money Laundering Directive on the Prevention of the Use of the Financial System For the Purpose of Money Laundering and Terrorist Financing
2007	* Council Regulation on the Law Applicable to Non-Contractual Obligations

It was seen that the basic principle of international law which holds that a country can only act against offences within its own territory,²³⁰ applies to the AML efforts of the Council. Its efforts has been mainly geared towards securing cooperation among EU member states in combating money laundering. Great emphasis was placed on cooperation and information dissemination among EU member states.

The section established that in the EU bank-customer relationships are governed by contract. The analysis revealed that although attempts were made to harmonise bank confidentiality principles among EU member states, most states continue to support a policy of non-disclosure. This attitude does not bade well for money laundering control within banks which mostly hinges on the identification of suspicious account activities and the subsequent filing of STRs. It was also seen that despite the explicit safe-harbour provision of the 2005 Directive, EU member states may resolve individually how to address the tension that exists between bank confidentiality and the reporting duty of banks. This may ultimately undermine any notion of harmonisation in the union in this regard.

An overview was then given of the EU's AML legislation. It became clear that the Council established panoptic AML legislation that could be used as template by member states. Although the 1991 Directive implemented 15 of the 40 Forty Recommendations of the FATF, its detailed yet blunt provisions still came as a surprise. Even more surprising was the provisions of the 2005 Directive which comprise original due diligence measures that singlehandedly raise money laundering control to a new level. Unfortunately, the 2005 Directive is unable to address the lack of uniformity that exists in the EU as regards money laundering control. Under EU law states are required to comply with directives by implementing only the requirements of the directive into national law instead of incorporating the *exact* wording of the directive. Consequence, the lack of uniformity as regards money laundering control in the EU is likely to persist. Ultimately, the

²³⁰ See ch 5.B.1.

effectiveness of the 2005 Directive is weakened by the imposition of marginal national AML measures.

The discussion then focussed on the assistance afforded by EU law in civil matters. It was seen that in the absence of an EU common-law claimants, whether a customer of a bank or a victim of fraud or theft, must use the rules that govern certain aspects of jurisdiction and conflict of laws. In the context of claiming from a bank it means that claimants may file suit against a bank situated in a different EU member state pursuant to EU law only. In the absence of a contractual agreement between the victim of fraud or theft and the defendant bank, the victim will have to rely on the Rome II Regulation to resolve the issue of jurisdiction. However, the Rome II Regulation does little to address the practicalities of suing a bank that resides in a different EU member state.

Ultimately, the analysis imparted that a victim of fraud or theft's chance of success when filing suit against a bank that resides in a different EU member state is slim for two reasons. First, the victim is unlikely to follow the benefits of fraud or theft across borders with any measure of success if an organised crime group member perpetrated the fraud or theft. Secondly, even if the victim managed to pinpoint the bank account where the money was last deposited before the fraudster or thief absconded with it, the unwillingness of EU member states to yield to EU law instead of national law is likely to sabotage his claim against the bank if it resides in a different EU state. Not even the threat of regional money laundering control infestation seems likely to deter EU unity detractors.

It was further illustrated that the Strasbourg Convention sets a perfect example for other jurisdictions to follow as regards the inclusion and wording of an innocent owner defence. The creation of Europol and the Council's strong support of FIUs further fortify efforts to confiscate the benefits of crime that are located outside the borders of a specific EU member state.

In conclusion, the real benefit of the EU's money laundering control initiatives is that they provide an impetus by EU member states to join the global money laundering effort as well as a template for the adoption of national AML legislation. If money laundering control is a failed endeavour in the EU region it will have less to do with the well-rounded AML regime of the Council and more with the unwillingness of EU member states to yield to EU law.

C. ENGLAND

1. Introduction

1.1 Background

In the second part of Chapter 6 the money laundering control regime of England is explored. Although the statutory segment of the regime is analysed at great length, it is the common-law segment that holds the key to one of the syntheses of this study, namely, that at English common-law certain legal remedies exist that could be used to impose civil liability on a bank as former recipient of the benefits of fraud or theft.

However, before considering the English AML regime it is important to consider first the interaction between EU law and English law.

1.2 EU Law in England

One of the research objectives of this chapter is to ascertain the extent to which the AML measures of the EU have been incorporated by English law.³³² The Treaty of Rome is the main law of England and takes precedence over parliamentary statutes.³³³ Section 2(1) of the European Communities Act of 1972 subjects English law to EU law. In addition, English judiciary is required to construe legislation that implements EU legal measures in such a fashion that it is consistent with EU law.³³⁴ Accordingly, the position of EU law in relation to English law may be summarised as follows:³³⁵

[t]he role of directives ... in litigation has become increasingly complex, and clarification of the case law is needed in the interests of judicial protection ... Direct effect ... ensure[s] that Community law can be invoked in the UK courts, and prevail over inconsistent UK law.

Nevertheless, it is evident that the precise legal status of EU law and its application by English courts are still in need of some refinement.³³⁶

³³² See par A above.

³³³ *Stoke-on-Trent City Council v B & Q* [1990] 3 CMLR 31 paras 7–8.

³³⁴ See, for example, *Lister v Forth Dry Dock and Engineering Co Ltd* [1990] 1 AC 546; *Webb v Emo Air Cargo* [1993] 1 WLR 49 (HL).

³³⁵ Boch *EC Law* 100–101. See also Brealey & Hoskins *Remedies* 55–57.

³³⁶ See generally Usher *EC Law* 152–156; Boch *EC Law* 165–171 as regards the challenges associated with the application of EU law in England.

2. Bank-Customer Relationship

2.1 Debtor and Creditor Relationship

The concept ‘bank-customer relationship’ refers to the legal relationship created by the opening and operation of a bank³³⁷ account.³³⁸ The relationship between the bank and the customer³³⁹ is contractual³⁴⁰ in nature, and when money is deposited into a bank account a debtor-creditor relationship is established between the parties.³⁴¹ The customer, therefore, loans the money to the

³³⁷ No complete definition exists for the concept ‘bank’ under English law. The Banking Act 1987 regulates the practice of ‘deposit taking’ by ‘authorised institutions’ and in general, avoids the concept ‘bank’ (Wadsley and Penn *Domestic Banking* 90; Hapgood *Paget’s Law of Banking* 107–110). The concept ‘authorised institution’ employed by English legislation holds the same meaning as the concept under EU legislation (see Banking Coordination (Second Council Directive) Regulation of 1992). The Annex to the 1989 Banking Directive (see par B.2.1 above) determines which activities are regarded under English law as ‘deposit taking’ (see, for example, also *United Dominions Trust v Kirkwood* [1996] 2 QB 431 where the court reasoned that a bank is an institution that ‘traffics in money’ (445).

³³⁸ Blair *England* 12; Hapgood *Paget’s Law of Banking* 115.

³³⁹ Any person who opens an account is regarded as a ‘customer’ of the bank (Wadsley and Penn *Domestic Banking* 97; Hapgood *Paget’s Law of Banking* 110).

³⁴⁰ See in general Hapgood *Paget’s Law of Banking* 115; Wadsley and Penn *Domestic Banking* 104–105; *Tayeb v HSBC Bank plc and another* [2004] All ER 1024 [*Tayeb*]1050; *Joachimson v Swiss Bank Corporation* [1921] 3 KB 110 (CA) [*Joachimson*] 127; *K Ltd v National Westminster Bank & Ors* [2006] 2 Lloyd’s L Reports 569 [*K Ltd*] par 22; *Barclays Bank v Quincecare* [1992] 4 All ER 363 [*Quincecare*] 375; *Baden Delvaux & Lecuit v Societe Generale pour Favoriser le Developpement du Commerce et de l’ Industrie en France S.A* [1993] 1 WLR 509 [*Baden Delvaux*] 591; *Bank of Scotland v A Ltd and others* [2001] 3 All ER 58 (CA) [*Bank of Scotland*] 67. In *Lipkin Gorman (A Firm) v Karpnale Ltd and another* [1991] 2 AC 548 (HL) [*Lipkin Gorman I*] the court confirmed (528–529) that: ‘[t]he relationship of the bank with the solicitors was essentially that of debtor and creditor.’ In contrast, Ellinger et al (*Modern Banking Law* 96) argue that the contract between a bank and its customer is *sui generis* and incorporates elements of well-defined contracts.

³⁴¹ *Joachimson* 118. In *Libyan Arab Foreign Bank v Bankers Trust Co* ([1989] QB 728 [*Libyan*] 749) the court agreed that a request for repayment must be one which the bank is compelled to comply with. In this case the plaintiff’s current account, kept in the US, was frozen due to sanctions imposed on Libya by the country. A similar account was kept at the defendant bank in London. Since repayment of the funds to the plaintiffs was illegal in the US, the court had to pronounce on the law governing the defendant bank’s obligation to repay the money in the account. The court held that even though only one contract existed in respect of both accounts, the rights and obligations of the parties as regards the accounts were

bank which loan must be repaid to the customer on demand.³⁴² But the contract between a bank and the customer does not merely concern a loan agreement. It also includes a variety of implied concepts describing, *inter alia*, the duties of the parties to the contract.³⁴³

In *Bank of Scotland* the court explained³⁴⁴ that the relationship between a bank and a customer is a commercial relationship based on contract. Significantly, the court warned that equitable doctrines, for example, constructive notice³⁴⁵ may adversely effect this relationship and the business of banking alike.

The bank-customer relationship further comprises various separate contracts that stipulate the business transacted between the parties.³⁴⁶ Most notably, money paid into a bank account ceases to be the money of the depositor³⁴⁷ and instead, becomes the money of the bank.³⁴⁸

governed by the law of the place where each account was held (746). Since the account in London was governed by English law, repayment of the moneys in the account was legal.

³⁴² *Bank of Scotland* 70.

³⁴³ *Joachimson* 127. A pertinent issue in this regard concerns the duty of a bank to follow the instructions of the customer. In *Tayeb* the court considered whether a bank may decline an incoming transfer to the credit of a customer's account where it entertained suspicions as regards the legality of the funds. As a result of these suspicions the defendant bank returned the transfer to the payer's account. The plaintiff accordingly sought to hold the defendant bank liable for the debt it owed him plus interest, or alternatively for breach of contract. The defendant bank's argument was threefold. First, it was required pursuant to AML legislation not to receive money that may be from suspicious origin. Secondly, nothing in the bank-customer relationship required it to accept suspicious funds via CHAPS. Thirdly, no debt in favour of the customer was created until it accepts the transfer, which it has not done (1035–1036). As regards the defendant's contractual duty to accept a CHAPS transfer, the court referred to *Royal Products Ltd v Midland Bank Ltd and Bank of Valetta Ltd* ([1981] 2 Lloyd's Rep 194 [*Royal Products*] 198) where it was found that a customer need not obtain the permission of his bank before the bank could receive funds to the customer's credit (*Tayeb* 1050–1051). In this case the bank had no reason to decline the transfer on grounds that its suspicion would render such receipt illegal (1052). As regards the debt that was owed to the plaintiff, the court found that once his account was credited with the amount the bank became contractually indebted to him. The court therefore held the bank liable to the plaintiff for payment of the claimed amount as well as interest from the date that the funds were credited to his account.

³⁴⁴ *Bank of Scotland* 67. See par C.3.4.3.3 below for the facts of the matter.

³⁴⁵ See par C.4.2 below.

³⁴⁶ *Blair England* 12. For example, loan and safety box agreements will be included in separate contracts.

³⁴⁷ The concept 'depositor' is defined by sections 58 and 60 of the Banking Act 1987. Accordingly, it should be construed to imply a person who made a deposit.

³⁴⁸ *Foley v Hill* (1848) 2 HL Cas 28 (HL) [*Foley*]; *Foskett v McKeown* [2001] 1 AC 102 (HL) [*Foskett*] 128 (see par C.4.3.4 below); *Bank of Scotland* 67.

Sometimes banks may have to assume a fiduciary function.³⁴⁹ Ultimately, the relationship entails that the bank must exercise its duty towards the customer with reasonable skill and diligence.³⁵⁰ What is reasonable will depend on the relationship between the parties as well as on the relevant facts of the matter.³⁵¹ The issue of how far a bank should extend itself to protect the interest of a customer was considered in *Selangor United Rubber Estates (a bankrupt) and others v Cradock (No. 3)*.³⁵² The court found that at common-law a bank has a duty to exercise reasonable care and skill in executing the customer's transactions.³⁵³

³⁴⁹ *Bristol v West Building Society v Mothew* [1996] 4 All ER 698–712 [*Mothew*]; *Baden Delvaux* 590.

³⁵⁰ *Mothew* 710, 712; *Baden Delvaux* 610; *Royal Products* 196; *Quincecare* 376. *Quincecare* was a company that was defrauded by its chairman. On behalf of the company it was argued that the bank acted in breach of its implied duty of care because the circumstances in which the fraudulent transaction was conducted would have been suspicious to the reasonable bank. The court confirmed that the bank should have exercised reasonable care and skill in executing the instructions of the customer (375–376). A reasonable standard of care is based on the 'likely perception of an ordinary prudent banker' who is expected to protect both customers and third parties from fraud.

³⁵¹ *Lipkin Gorman (A Firm) v Karpnale Ltd and another* [1992] 4 All ER 409 [*Lipkin Gorman II*] 435. In this matter one Cass, a partner in the law firm, withdrew money from the client account of the firm to finance his gambling addiction at the Playboy Club. Since the bank where the firm's account was held knew of Cass's gambling, the firm sought to hold it and the Playboy Club liable for neither inquiring about the withdrawals nor for informing the other partners of the firm about the withdrawals. The court *a quo* dismissed the law firm's claim against the club for money had and received due to the fact that the gaming contract was void and that the club did not have knowledge of Cass's conduct (see par C.4.2.4 below). In turn the change of position defence was successfully invoked by the defendant bank (see par C.4.3.6 below) The law firm appealed the finding but did not pursue its claim based on dishonest knowledge against the club. Instead, it based its claim against the club on the common-law tracing action of money had and received (see par C.4.3.2 below). Although the court (*Lipkin Gorman II* 449) found the club liable in conversion (see par C.4.1 below), the firm's claim based on the action for money had and received failed again. Consequently, the firm appealed the matter to the House of Lords. The House of Lords reversed the ruling of the Court of Appeal and found the club liable based on money had and received (*Lipkin Gorman I* 524–540 - see par C.4.3.2 below).

³⁵² [1968] 2 All ER 1073 [*Selangor*]. In this matter the plaintiff's money was misappropriated and used in a take-over transaction to acquire some of its own shares. The plaintiff subsequently sought to hold two of the company directors and the bank where the account was held liable as constructive trustees (1073–1074 - see also par C.4.2 below). The court allowed the claims against both defendants (1155,1118) and found the bank in breach of contract for failure to exercise reasonable skill and care as regards the affairs of the customer (1119,1138).

³⁵³ *Selangor* 1118. The court pointed out that such an inquiry should be conducted with the aim of getting an answer and not to perform 'some ritualistic mumbo-jumbo' (1145).

In *Baden Delvaux* the court evaluated the scope of the duty of care owed by the bank to its customers in respect of money held in a trust account. It asserted that the bank must exercise reasonable care and skill in transacting banking business relating to that account.³⁵⁴ Ultimately, trust should be the deciding factor guiding the conduct of the bank.³⁵⁵ Of significance, a bank will not incur liability when it fails to execute an order from its customer whom it suspects to be involved in money laundering activities.³⁵⁶

A pertinent issue as regards a bank's duty to a customer relates to the liability of a bank that allowed a customer to transfer money from that account after the bank had been served with a freezing order pertaining to the customer's account. In *Customs and Excise Commissioners v Barclays Bank plc*³⁵⁷ the court found that the defendant bank did not owe a duty of care to a non-customer to prevent payments from the account unless it had assumed a responsibility to the former to take reasonable care to prevent disposal of the customer's funds.³⁵⁸ In coming to the decision the court asserted that nothing in the relationship between the parties would render it fair or reasonable that a bank should owe a duty of care in circumstances that did not relate to the customer. Since the defendant bank did not assume responsibility to take reasonable care to

³⁵⁴ *Baden Delvaux* 610–611. In issue was whether the defendant bank was liable for negligence because it failed to inquire whether the instruction it received to make a fund transfer was genuine. The court found that although the defendant bank owed the company as customer a duty of care as regards the funds in the account, the duty ended on the date that it received instructions to transfer the money to Panama (612). The defendant bank was, therefore, not negligent in making the transfer. It is submitted that this ruling is in part incorrect, because the court's finding that the defendant bank's duty of care ended when it received instruction to transfer trust money cannot be accepted. The bank has a duty of care towards the former until the customer terminates the relationship with a bank. Surely when a bank receives an instruction from a customer it acts by virtue of the still existing relationship and in that context the instruction is carried out. It follows that at the point when the money in issue was transferred, the bank was still obligated to act in terms of its duty of care until the transaction was completed.

³⁵⁵ See *Quincecare* 377; *Lipkin Gorman II* where the court described the duty of the bank as 'largely automatic or mechanical' (433).

³⁵⁶ See par C.3.4.2.2 below.

³⁵⁷ [2004] 2 All ER 789 [*Customs and Excise*]. The plaintiff obtained freezing orders against two companies which prohibited the defendant bank from allowing disposal of funds held in companies' accounts. Two hours after the bank was served with the orders the two companies transferred large amounts of money from the accounts, which transfers the defendant bank failed to stop. The court subsequently had to decide whether the defendant bank owed a duty of care to the plaintiffs, who were not customers of the defendant bank, to prevent the transfers.

³⁵⁸ *Customs and Excise* 814–819.

prevent the disposal of funds subject to the freezing order, it cannot be held liable on the basis of negligence.

The relationship between a bank and customer is terminated by the death or mental incapacity of a customer or liquidation of the bank.³⁵⁹ However, where money is frozen in an account due to the imposition of economic sanctions, a bank's obligation to repay the money is merely suspended instead of terminated.³⁶⁰ Should a bank wish to terminate the relationship it must give reasonable notice to the customer of its intention.³⁶¹

To conclude, at English law the contract between bank and customer is governed by the law of the place where the account is kept in absence of an agreement to the contrary.³⁶²

2.2 Bank Confidentiality

At English common-law a bank's duty of confidentiality is regarded as an integral part of the bank-customer relationship.³⁶³ It follows that a bank operating in England owes a duty of confidentiality to the customer not to disclose details about his private affairs without obtaining permission first.³⁶⁴ This duty is often an implied term of the contract between a bank and the customer and relates not only to issues that are secret, but extends to all information pertaining to the customer and his account which the bank acquires in its capacity as a banking institution.³⁶⁵

³⁵⁹ Hapgood *Paget's Law of Banking* 122.

³⁶⁰ See *Libya* 772; par C.4.4.4 below.

³⁶¹ Blair *England* 34; Wadsley and Penn *Domestic Banking* 230–231.

³⁶² *Libya* 749; *X AG and others v A Bank* [1983] 2 All ER 464 [X AG] 474–475.

³⁶³ See in general Wadsley & Penn *Domestic Banking* 138–140; Ellinger et al *Modern Banking Law* 135–136; Hapgood *Paget's Law of Banking* 127–130; Graham *Money Laundering* 166–168; Griffiths *England* 218; Alldridge *Money Laundering Law* 270–271; Levi (1990) *International Business L* 130 125; the British Banking Code which dictates that banks must observe a duty of confidentiality (BBA *Banking Code* par 11.1–11.2, 13.4).

³⁶⁴ See ch B.2.3 as regards the historic development of a bank confidentiality.

³⁶⁵ *X AG* 470; *Tournier v National Provincial & Union Bank of England* [1924] 1 KB 461 [*Tournier*] 484. In *Loyds Bank Ltd v Bundy* ([1975] QB 326 (CA)) the bank was forced to use its security against Bundy who subsequently had to leave his son's property after it was sold by the bank. The court asserted that a relationship of trust and confidence existed between the bank and Bundy, a father who acted as surety for his son's indebtedness in the form of an overdraft (341). It emphasised the reliance of Bundy on the bank and criticised the bank's failure to disclose the true state of his son's affairs to him.

The Proceeds of Crime Act 2002³⁶⁶ requires banks to assist in money laundering control.³⁶⁷ Some of their duties include disclosing to the National Criminal Intelligence Service³⁶⁸ knowledge or suspicions about money laundering and assisting with investigations into the crime.³⁶⁹ As pointed out already,³⁷⁰ a bank's reporting duty conflicts with its confidentiality duty. Consequently, a bank that files a STR could have been sued by the customer for breach of contract if not for the fact that at common-law its duty of confidentiality is not absolute.

The *Tournier*³⁷¹ decision remains the *locus classicus* on English bank confidentiality despite the more than 80 years that elapsed since the ruling was handed down. In *Tournier* the court found that a bank's confidentiality duty is an implied term of the contract between bank and customer.³⁷² A bank may violate a customer's confidentiality only where the disclosure is mandated by law,³⁷³ in the interest of the public,³⁷⁴ in the interest of the bank³⁷⁵ or if express or

³⁶⁶ Or 'PCA'.

³⁶⁷ This is because banks are 'important source(s) of valuable information' (*C v S and others* [1999] 2 All ER 343 [C v S] 346).

³⁶⁸ Or 'NCIS' which was established in 1987 to receive, analyse and disseminate STRs (NCIS *Annual Report 1997–1998* 20; *C v S* 346).

³⁶⁹ See section 330 of the PCA; par C.3.4.3.3 below.

³⁷⁰ See par B.2.2 above; ch 3.B.2.3.

³⁷¹ See also ch 3.B.2.3.2.

³⁷² As confirmed by *Scrutton LJ* (480) and *Atkins LJ* who reasoned that a bank enters into a 'qualified obligation' to maintain secrecy about the customer's affairs (484).

³⁷³ For example, a bank may be compelled to disclose information by subpoenas or by a disclosure order (*Tournier* 473). In *Omar v Omar* ([1995] 3 All ER 571) the plaintiffs obtained a disclosure order against a bank in a quest to recover money that were missing from their father's estate. After the information was supplied, they approached the court again to amend the order so that the bank may disclose additional information. The court granted the order explaining that the 'other' purposes requiring disclosure were legitimate in relation to the principal tracing claim (572).

³⁷⁴ For example, where the bank has a duty to the state (*Tournier* 473–486; *Libyan* 770). More recently the court accepted that public interest justified the disclosure of confidential information to an inquiry that reviewed the performance of the Bank of England (*Price Waterhouse v BCCI Holdings (Luxembourg) SA* [1992] BCLC 583). In contrast, in *Pharaon v BCCI* ([1998] 4 All ER 455 [*Pharaon*]) the court held that any disclosure should be limited to what was reasonably necessary to accomplish the public interest exception.

³⁷⁵ For example, where a bank is suing a customer for payment of an overdraft and needs to disclose the amount in issue in the legal action (*Tournier* 481). In *X AG* customers of various English banks approached the court for an injunction to prevent their banks from disclosing information in compliance with subpoenas obtained by banks based in the US. The English banks argued that it was in their interest to disclose the requested information (469–470). The court agreed that the English banks found themselves in a predicament. On the one hand, they were obliged to comply with the US subpoenas. On the other hand, they were

implied consent was given by the customer.³⁷⁶ However, a bank is most likely to disclose confidential information about the customer where it is ordered by court or pursuant to legislation.³⁷⁷ Ostensibly, the public's interest in the bank observing its duty of confidentiality may be overridden by the public's interest in the prevention of crime.³⁷⁸ Breach of confidentiality is limited by what is reasonably necessary for the public to know and exists even where the 'confider can point to no specific detriment to himself.'³⁷⁹

Since the issue of confidentiality is not simply governed by English common-law but also by legislation that warrants disclosure, a corresponding protection exists against *prima facie* liability where such disclosure would otherwise be in breach of contract. The PCA provides that a disclosure in compliance with the Act is not a breach of a bank's confidentiality duty.³⁸⁰ Like the international safe-harbour principles,³⁸¹ the PCA offers protection to a bank that discloses information to the NCIS. Section 337(1) of the PCA stipulates that a disclosure that satisfies three conditions does not breach any duty of confidentiality. Therefore, a person who disclosed confidential information will not be criminally or be *otherwise* liable if³⁸² first, the information came to him in the course of his profession, secondly, if the information caused him to know or

subjected to a duty of confidentiality. In determining whether the subpoenas should be continued, the court considered three factors (471–480): 1. the fact that the New York court's subpoenas violated the confidentiality duty of the English banks, 2. the impact of the subpoenas on the banks should the subpoenas be continued, and 3. the absence of evidence that suggested that a delay in producing the documents in terms of the subpoena would be detrimental to the US investigation. The court found that in the circumstances the balance of convenience favoured the plaintiffs and, therefore, it granted the injunction which prohibited the English banks from disclosing information to the US banks.

³⁷⁶ An example of such consent is where a customer gives a bank a reference (*Tournier* 481).

³⁷⁷ See, for example, section 330 of the PCA which requires banks to file STRs to the NCIS.

³⁷⁸ *Pharaon* 456. In *K Ltd* the court reasoned that a limited interference in the relationship between a bank and the customer is preferable than allowing the 'evil of money laundering to run rife in the commercial community' (par 22).

³⁷⁹ *AG v Guardian Newspapers Ltd (No 2)* [1988] 3 WLR 766 782. See also *X AG* 467–469.

³⁸⁰ See sections 337(1) and 338(4) of the Act. But in *Mahon v Rahn* ([1998] QB 424 [*Mahon*]) the court was not prepared to grant immunity to a bank against potential civil liability. This is because the information the bank had disclosed was subsequently used in a criminal matter against the customer and, therefore, was no longer confidential (448–449). See below for the facts of *Mahon*.

³⁸¹ See par B.2.2, par 3.6 above; and ch 7.C.

³⁸² Section 337(2)–(4) of the PCA.

suspect, or gave him *reasonable* grounds for knowing or suspecting that another is engaged in money laundering and thirdly, he discloses the information to the NCIS as soon as is practical after it was received.

The safe-harbour protection awarded under section 337 of the PCA is pivotal to banks in light of the tension that exists between their confidentiality duty and their reporting duty. As a result of the safe-harbour provisions of the PCA a bank that filed a STR should be protected against civil claims based on breach of confidentiality.³⁸³ However, this protection is not cast in stone. Irrespective of the protection afforded by the PCA a bank may still be sued in civil court by a customer if it disclosed information to the NCIS without knowing or suspecting money laundering or where it did not have *reasonable* grounds for knowing or suspecting money laundering. It follows that like the safe-harbour protection provided in the 2005 Directive,³⁸⁴ the protection afforded by the PCA to banks is far from perfect.

A final issue as regards bank confidentiality concerns the procurement of evidence in connection with a bank account held abroad.³⁸⁵ In *Mackinnon v Donaldson Lufkin and Jenrette Securities Corpn*³⁸⁶ the plaintiff sought documents from the defendant's bank which was based in the US.³⁸⁷ He, therefore, sought a subpoena that required Citibank's London branch to produce documents pertaining to the defendant's bank account. In recognition of the confidentiality duty of banks the court found that the confidentiality duty of banks had to be determined pursuant to the national laws of the country where the accounts were kept. The court ruled that since there was a territorial limit to the matters on which it could apply court rules, the evidence should instead be required from a New York court.

³⁸³ But note the ruling in *Mahon*. The matter concerned a purchase order for stock placed by the bank on behalf on the plaintiffs. As a result of information that the defendant bank disclosed to the Serious Fraud Office, the plaintiffs were prosecuted for fraud and eventually acquitted. The plaintiffs subsequently claimed damages for libel from the bank which claim was dismissed by the court *a qua* (428–431). On appeal, the court found that the disclosure was not covered by an undertaking of the prosecutor which precluded its future use in civil claims against the bank (432–433). The court, therefore, allowed the civil claim against the defendant bank (448). Significantly, this matter was decided before the PCA was enacted. It follows that at present, banks that disclose information to the NCIS pursuant to the PCA will be protected from civil liability.

³⁸⁴ See par B.2.2 above. See ch 3.B.2.3.3 sa regards FICA's safe-harbour provision.

³⁸⁵ See paras B.3.2, B.4.2.3 above as regards the methods for obtaining internationally cooperation in a legal matter.

³⁸⁶ [1986] Ch 482 [*Mackinnon*] 493.

³⁸⁷ *Mackinnon* 483–494.

It is therefore evident that regardless of the disclosure provisions of the PCA, English courts will seldom order disclosure of confidential customer information pursuant to foreign court orders. Instead, the issue is often referred back to the foreign courts for adjudication.

2.3. Bank as Owner of Deposited Moneys

Ownership of the benefits of crime that are deposited into a bank account for the purpose of money laundering is key in as far as establishing the civil liability of the bank as recipient thereof. At English law the concept ‘owner’ is defined as ‘one who has the right to possess, use, and convey something; a proprietor.’³⁸⁸ Ownership is the collection of rights allowing one to use and enjoy property and transfer it to some other. Ownership further consists of five components which includes possession, management and control, income and capital, transfer *inter vivos* and on death and legal protection of property.³⁸⁹

Some explanations of ‘owner’ include ‘beneficial owner.’³⁹⁰ Sometimes the distinction between a ‘legal owner’ and a ‘beneficial owner’ may become blurred.³⁹¹ The concept ‘beneficial ownership’ is often used to describe the ability of a person or group of persons to control the activities and assets of a corporate entity.³⁹² Control over property may be exercised by natural or juristic persons such as the shareholders of a company. Despite being often used, there is still no established legal definition of beneficial ownership. In the sphere of international banking, ‘beneficial ownership’ or ‘beneficial interest’ has been described as the entitlement to receive some or all of the benefits of ownership of a security or other financial instrument.³⁹³

As mentioned already,³⁹⁴ at English law a bank becomes owner of money that is deposited with it. In *Foskett* the court confirmed that:³⁹⁵

³⁸⁸ Campbell & Garner *Black’s Law Dictionary* sv ‘owner’; Collins *Dictionary* sv ‘owner.’

³⁸⁹ Collins *op cit* sv ‘ownership.’

³⁹⁰ Leff (1985) *Yale LJ* 2149; Chambers *Tracing* 277.

³⁹¹ Brown (2003) *Canadian Tax J* 402.

³⁹² HM Treasury *Beneficial Ownership* paras 4.1--4.2.

³⁹³ BIS *Payment 2003* par 9; Megarry & Thompson *Law of Real Property* 64.

³⁹⁴ See par C.2.1 above.

³⁹⁵ 128. This position matches the position at South Africa’s common-law (see ch 3.C.3).

[m]oney paid into a bank account belongs legally and beneficially to the bank and not the account holder.

This was also the finding in *R v Preddy*³⁹⁶ where at issue was whether money in a bank account that was electronically transferred to the account belonged to the bank. The court asserted that as a result of commingling that occurred in a bank account, the bank acquired ownership of the whole amount. Money in a bank account, therefore, does not belong to an account holder but to the bank where the account was held. An account holder has a 'chose in action'³⁹⁷ to demand payment of the amount of money that stands to his credit.³⁹⁸ The account holder's chose in action is extinguished as soon as a sum of money leaves his account. Up until that point the bank remains owner of deposited money, even money that was acquired through criminal means. It follows that when a civil forfeiture application is brought against an account holder, it is not the originally deposited benefits of crime that are the subject of the application, but instead the debt that the bank owes to the customer as owner of that debt.³⁹⁹

A bank as owner of the benefits of crime may face prosecution and civil liability despite being ignorant about the criminal nexus of the funds. The potential prosecution of a bank for money laundering offences is henceforth investigated.

3. Anti-Money Laundering Legislation

3.1 Background

The importance of England in early 1980s to the international criminal was threefold.⁴⁰⁰ First, English banks had a reputation for discretion and providing a range of financial services, secondly,

³⁹⁶ [1996] AC 815 841.

³⁹⁷ The concept 'chose in action' refers to the benefit of a contractual undertaking (Gray (1991) *Cambridge LJ* 274). It follows that a customer has *ex contractu* a chose of action as regards money deposited with the bank (see par C.2.1 above).

³⁹⁸ See also *Libyan (750)* where the court used the concept 'chose in action' in reference to the rights of an account holder to the funds deposited with a bank.

³⁹⁹ See par C.2.1 above; ch 2.C.5.3.3; ch 3.C.3 for a similar conclusion pursuant to South African common-law. See par C.4.4.2 below as regards civil forfeiture applications.

⁴⁰⁰ Bosworths-Davies & Saltmarsh *Money Laundering* 17; Fisher & Bewsey [2000] *JIBL* 11.

certain English professionals⁴⁰¹ acquired a reputation for failing to enquire about the affairs of customers and thirdly, England held an international reputation among global criminals for its lenient fiscal regulatory structures. In combination the factors above rendered London an ideal place to criminals from which to conduct transnational money laundering. The political and economic circumstances in England at the time could be blamed for this.

During the 1970s Conservative politicians laid the foundation to what was called ‘monetarism’, a philosophy that aimed to defeat the power of the trade unions.⁴⁰² At the same time, English banks were pressured by international capitalists to accommodate trading whilst defending their dominance in world markets over other EU financial services providers. In addition, the policies of ‘Reaganomics’⁴⁰³ led to politicians accepting promises of wealth in the place of regulatory controls.⁴⁰⁴ Ironically, it was the unabated inflow of illegal drugs that resulted in the enactment of the Drug Trafficking Offences Act 1986.⁴⁰⁵ The adoption of the 1986 Act had an undesired effect: drug traffickers adopted more sophisticated methods to launder the proceeds of illegal drug trafficking. A review by the Home Affairs Committee of the House of Commons⁴⁰⁶ found that more than 1800 million pounds⁴⁰⁷ derived from drug trafficking, were circulating within the banking system.⁴⁰⁸ As a result, the Committee recommended amendment of the 1986 Act and supporting initiatives to combat money laundering.

Following the adoption of the PCA in 2002 two types of AML laws exist in England: crime money laundering laws⁴⁰⁹ and terrorist money laundering laws.⁴¹⁰ Most notably, since some

⁴⁰¹ For example, lawyers, accountants and bankers.

⁴⁰² For a detailed analysis of the economic circumstances in England in the early 1980s, see Deakin & Morris *Labour Law* 33, 50–51, 888–889; Wedderburn *Change, Struggle* 1–3, 16.

⁴⁰³ The concept ‘Reaganomics’ describes the economic policies of US President Reagan in the early 1980s. It accentuated strategies that were aimed at lowering taxes and regulations, and decreasing the size of government (Smithin *Macroeconomics* xii, 17–19).

⁴⁰⁴ Bosworths-Davies & Saltmarsh *Money Laundering* 18–19.

⁴⁰⁵ Or ‘1986 Act’.

⁴⁰⁶ Or ‘the Committee’ (see in general Smith & Owen *Asset Recovery* 10–12).

⁴⁰⁷ In 2000, this number was estimated to be at around 8.5 billion pounds annually (NCIS *Serious and Organised Crime* par 11).

⁴⁰⁸ HM Home Affairs Select Committee *Drug Trafficking* paras 28–29, 290–293.

⁴⁰⁹ Namely, the PCA and the Money Laundering Regulations 2003 (see paras C.3.4–3.5 respectively below).

⁴¹⁰ Terrorist money laundering offences are criminalised by the Terrorism Act 2000. However, since the topic of terrorism falls beyond the scope of this study, these offences are not evaluated in this section.

of the provisions of Criminal Justice Act 1993 and the Drug Trafficking Act 1994 still apply to offences which occurred *before* 24 March 2003, the latter two statutes and the PCA co-exist side by side. It is, therefore, important to briefly evaluate salient provisions of all three AML statutes.

3.2 Criminal Justice Act 1993

Pursuant to the Criminal Justice Act 1993⁴¹¹ banks were for the first time under a statutory obligation to establish KYC standard procedures. Some of the procedures included verification of customer identities, suspicious transaction reporting, AML training for employees and the appointment of an internal money laundering reporting officer.

Section 93 of the 1993 Act establishes four money laundering offences, namely,⁴¹² assisting some other to retain the ‘proceeds of criminal conduct’,⁴¹³ acquiring property whilst aware that the property was acquired through criminal means, concealing the nature or ownership with respect to property that was the proceeds of crime and informing a suspect of a money laundering investigation. A bank commits an assisting offence if it knows or suspects that the customer is a criminal who benefits from crime. It follows that a bank that knowingly received the benefits of crime committed an offence under this section.⁴¹⁴ In determining the guilt or innocence of the bank the courts consider the following factors:⁴¹⁵ the circumstances under which the bank was introduced to the customer, the nature of the customer’s needs for offshore secrecy facilities, the form of the transactions and the source and the type of assets which were transferred

⁴¹¹ Or ‘1993 Act’.

⁴¹² Section 93A–D of the 1993 Act.

⁴¹³ Section 93A(2) defines ‘proceeds of criminal conduct’ to include any property that represented the proceeds of crime.

⁴¹⁴ For example, in *Tayeb* the court had to decide, *inter alia*, whether a bank in accepting a suspicious payment via CHAPS would contravene section 93A–B of the 1993 Act (for the facts of the matter, see par C.2.1 above). The court found that the provisions of section 93 and CHAPS transfers were reconcilable, especially as regards the finality of a transfer (1044). After considering the ruling of the Court of Appeal in *Bank of Scotland* (see par C.3.4.2 below), the court agreed that procedural options existed which enabled a bank to accept a CHAPS transfer whilst avoiding prosecution for a money laundering offence (*Tayeb* 1045–1046). See par C.3.4.2 where these procedural options are discussed.

⁴¹⁵ Bosworth-Davies & Saltmarsh *Money Laundering* 131–132; Bell (2000) *J of Money Laundering Control* 12–25; Gleeson *Involuntary Launderer* 116.

to the company's offshore accounts. Section 93D of the 1993 Act creates the so-called 'tipping-off'⁴¹⁶ offence which renders it an offence to inform a suspect of an investigation.

The greatest contribution of the 1993 Act to the AML regime of England is that it appeased the fears of the Council that the inconsistent enactment of AML legislation by EU member states could instigate criminals to abuse the freedom of capital movement in the EU region.⁴¹⁷ However, it soon became evident that the provisions of the 1993 Act were too narrow to cover all money laundering eventualities, a situation which necessitated enactment of the 1994 Act.

3.3 Drug Trafficking Act 1994⁴¹⁸

Drug money laundering offences are crimes that involve the laundering of the proceeds of illegal drug trafficking. The 1994 Act specifies five types of money laundering offences. For the most part they imitated the content of the 1993 Act. Significantly, section 50 of the 1994 Act established the offence of assisting⁴¹⁹ some other to retain illegal drug proceeds. To commit a section 50 offence the defendant must know or suspect⁴²⁰ that the person to whom money belongs was engaging in drug trafficking. It follows that a bank employee who knows or suspects that a customer's income derives from illegal drug trafficking and fails to report it, commits a section 50 money laundering offence.

3.4 Proceeds of Crime Act 2002

3.4.1 Background

⁴¹⁶ See par B.4.2 above; par C.3.4.3.3 below.

⁴¹⁷ See Preamble Recital 6 of the 1991 Directive which was reiterated in the Preamble Recitals 2–3 of the 2005 Directive.

⁴¹⁸ Note that the 1994 Act repealed the 1986 Act.

⁴¹⁹ The 1994 Act employed the words 'to enter into an arrangement which facilitated the retention, or control' of another's proceeds of crime' (section 50).

⁴²⁰ Which knowledge or suspicion is qualified by what would be considered 'reasonable' based on facts (Wadsley & Penn *Domestic Banking* 156; Rider (1996) *J of Fin Crime* 242).

In essence, the PCA aims to ensure that STRs are made to the NCIS.⁴²¹ Principal money laundering offences⁴²² are contained in Part 7 of the PCA. These offences are so concisely formulated that definitions⁴²³ pertaining to each of them appear deceptively elementary. In contrast to the 2005 Directive,⁴²⁴ the PCA defines money laundering as conduct that is either an offence in terms of its provisions, or conduct that constitutes an offence when committed in relation to these offences. The PCA establishes three main money laundering offences and four related offences.⁴²⁵ They are, namely, concealing⁴²⁶ criminal property,⁴²⁷ involvement in money laundering activities,⁴²⁸ and acquiring, using or possessing criminal property.⁴²⁹ The PCA further criminalises failure to disclose possible money laundering activities, invalid permission to conduct a money laundering transaction, tipping-off and prejudicing an investigation.⁴³⁰

The element of knowledge is at the heart of both the main money laundering offences and two of the four auxiliary offences⁴³¹ established by the PCA. This is where the ruling in *Baden*

⁴²¹ See Smith & Owen *Asset Recovery* 19–20; Millington & Williams *Forfeiture* 5.

⁴²² Note, money laundering is not defined by specific offences only, but also extends to inchoate offences pertaining to the latter. Accordingly, money laundering is an act which (section 340(11) of the PCA): '[c]onstitutes an offence under sections 327, 328 or 329 ; ... constitutes an attempt, conspiracy or incitement to commit an offence ... [which] constitutes aiding, abetting, counselling or procuring the commission of an offence ... if done in the United Kingdom.'

⁴²³ Most of which appear in section 340 of the PCA (see below).

⁴²⁴ Which defines concepts in broad terms only (see paras B.3.4–3.6 above).

⁴²⁵ See in general Graham *Money Laundering* 43–44; Griffiths *England* 232–234; Smith & Owen *Asset Recovery* 500–501; Millington & Williams *Forfeiture* 534–342.

⁴²⁶ Section 327 of the PCA.

⁴²⁷ In contrast to other AML legislation that use the concept 'proceeds of crime', the concept 'criminal property' is used by the PCA. The concept 'property' includes money, all forms of real or personal property, movable and immovable things, inheritable things and in intangible objects (section 340(9)). Property is regarded as 'criminal' if two requirements are fulfilled (section 340(3)(a)–(b)): first, it must *derive* from criminal conduct, and secondly, the offender must know (or suspect) that the property represents a 'criminal benefit.' The concept 'benefit' includes any pecuniary advantage as a result of, or in connection with, criminal conduct (section 340(5)–(6) of the PCA). Therefore, England has an 'all crimes' criterion of determining the criminal conduct from which the benefit must derive as opposed to the US Money Laundering Control Act which lists specific unlawful activities (see ch 7.C.3.1).

⁴²⁸ Section 328 of the PCA.

⁴²⁹ *Idem* section 340(3).

⁴³⁰ See sections 338, 336, 333 and 342 of the PCA respectively.

⁴³¹ Which are disclosure and tipping-off offences (see paras C.3.4.3.1, C.3.4.3.3 below).

*Delvaux*⁴³² is of particular relevance because the court in deciding whether the defendant bank was liable as constructive trustee, distinguished among five mental states of knowledge.⁴³³ This categorisation of knowledge is the primary hallmark of the matter and has been acknowledged by different courts in relation to criminal as well as civil liability based on knowledge.⁴³⁴ However, in reality attempts at pinpointing the exact meaning of ‘knowledge’ may be a mere academic exercise for two reasons.⁴³⁵ First, suspicion, a ‘lesser concept’ than knowledge, has also been introduced by the PCA. Secondly, the objective test of ‘reasonable grounds’⁴³⁶ provokes an evaluation of the circumstances of a matter and, therefore, extends beyond the knowledge of the accused bank. It follows that the knowledge required pursuant to the PCA is directed at the criminal property and the conduct of a money launderer alike. Moreover, it is evident that exact rules on the scope of knowledge required for a conviction do not exist in money laundering cases.⁴³⁷

3.4.2 Principal Money Laundering Offences

⁴³² See ch 5.B.3.1. The facts of the matter are complex and involve the financial troubles of a multinational company, its subsequent rearrangement and transactions which involved fund transfers carried out without permission (511–571). The plaintiffs sought to recover more than 4 million US dollars from the defendant, a French bank situated, *inter alia*, in London. The defendant bank received the money in a trust account on behalf of a customer which was a Bahamian bank. Believing that the customer instructed transfer of the money, the defendant bank transferred the money to an account at a Panama bank. In actual fact permission to transfer the funds was fraudulently obtained. The plaintiffs alleged that since the transferred legally money belonged to them, the defendant bank became a constructive trustee (see par C.4.2 below) hence liable in equity (571). Alternatively, the plaintiff contended that the defendant bank was negligent in making the transfer and, therefore, breached its duty of care (see par C.2.1 above).

⁴³³ Namely, actual knowledge, willful ignorance, wilfully and negligently failing to enquire as a reasonable person would do, knowledge of facts that may indicate certain information to a reasonable person and knowledge of circumstances that would lead a reasonable person to enquire (*Baden Delvaux* 575–576).

⁴³⁴ See, for example, *Re Montagu* 319; *Royal Brunei Airlines v Tan KKK Ming* [1995] 2 AC 378 [*Royal Brunei*] 392; *Bank of Credit and Commerce International (Overseas) Ltd (in liquidation) and another v Akindale* [2000] 4 All ER 221 (CA) [*Akindale*]; *Agip (Africa) Ltd v Jackson* [1991] Ch 547 [*Agip*] 567.

⁴³⁵ *Graham Money Laundering* 38.

⁴³⁶ See section 330(8) of the PCA; par C.3.4.3.1 below.

⁴³⁷ A fact that was recognised by the court in *Akindale* (229).

3.4.2.1 Concealing Criminal Property

Under section 327 of the PCA a person⁴³⁸ commits a money laundering offence if he conceals, disguises, converts, or transfers criminal property. These acts must be conducted in relation to the nature, source, location, disposition, movement, or ownership or any rights as regards criminal property.

Money is deemed as ‘transferred’ as soon as it is moved between two accounts whether the latter are located in England or not.⁴³⁹ Ordinary business conduct may, therefore, become a money laundering offence as soon as the money represents ‘the benefits’ of a crime and the transferor knows or suspects this fact. A bank employee accused of concealing criminal property may use appropriate consent,⁴⁴⁰ a reasonable excuse,⁴⁴¹ or enforcement of the PCA⁴⁴² as statutory defenses to charges relating to aforementioned conduct. The defenses above must be raised as soon as the bank realised that he is under suspicion.

3.4.2.2 Involvement in Money Laundering

In terms of section 328(1) of the PCA a person is guilty of a money laundering offence if he:

[enters into ... an arrangement which he knows or suspects facilitates ... the acquisition, use or control of criminal property by or behalf of another person.

The concept ‘entering into an arrangement’ is understood as being like the concept of conspiracy.⁴⁴³ The types of arrangements between money launderers and facilitators are subject

⁴³⁸ Which includes natural persons and legal persons (section 340(3)). Cf Smith & Owen *Asset Recovery* 504–505; Graham *Money Laundering* 39.

⁴³⁹ Section 340(9) of the PCA.

⁴⁴⁰ Section 335(1) of the PCA. The defence of appropriate consent may apply, for example, where a bank obtained consent from the NCIS to complete a suspicious transaction (section 338(1) of the PCA). See also *K Ltd* where the defendant bank refused to make a payment from an account unless consent was obtained from the NCIS (paras 1–8). This was because the bank suspected that money in the customer’s account was criminal property

⁴⁴¹ Whether an excuse is reasonable will depend on various factors such as the nature of the transaction and the type of customer involved (Smith & Owen *Asset Recovery* 511).

⁴⁴² This defence is provided to, for example, assist the police which may need to take possession of criminal property such as money pending further investigation (section 327(2) of the PCA).

⁴⁴³ Alldridge *Money Laundering Law* 193; Crabb (2003) *J of Fin Crime* 179.

to what is perceived by criminals as possibilities to get around AML measures. Banks may either become unwittingly involved in a money laundering scheme or may be used by an employee to assist⁴⁴⁴ criminals with money laundering schemes. The PCA provides three statutory defenses⁴⁴⁵ which an accused charged with a section 328(1) offence may raise. A bank will be innocent of entering into an arrangement to launder money if it, for example, obtained consent for the transaction from the NCIS or its conduct was in relation to a provision of the PCA.

3.4.2.3 Acquiring, Using or Possessing Criminal Property

In term of section 329(1) of the PCA a bank commits a money laundering offences if it uses or possesses criminal property. The definition of the concept ‘criminal property ‘ means that it is impossible to commit the offence unknowingly.⁴⁴⁶

Consent, a reasonable excuse, conduct sanctioned by the PCA, or acquiring the property for adequate consideration⁴⁴⁷ may be used as defenses to this offence.⁴⁴⁸

3.4.3 Auxiliary Money Laundering Offences

3.4.3.1 Failure to Disclose⁴⁴⁹

⁴⁴⁴ On occasion the court held that the proper interpretation of section 328(1) of the PCA confirms that it is not intended to cover ordinary conduct by, for example, lawyers (*Bowman v Fells* [2005] EWCA Civ 226 [*Bowman*] par 83). It follows that a lawyer who is employed by a bank could unwittingly become involved in a money laundering scheme where he, for example, advises a customer about the legal ramifications of a monetary transaction. In general, the act of giving advice is not considered as aiding a money launderer (in contrast, see article 2A of the 2001 Directive - par B.3.5 above). However, it is submitted that both the intention of the lawyer and the circumstances in which the advice was given should determine the legality or illegality of his conduct.

⁴⁴⁵ Section 328(2) of the PCA (see par C.3.4.2.1 above).

⁴⁴⁶ *Smith & Owen Asset Recovery* 513–514; Crabb (2003) *J of Fin Crime* 179.

⁴⁴⁷ Which is determined according to the value of the property, or the value of the use or possession thereof (section 329(2)(c)).

⁴⁴⁸ See section 329(2) of the PCA.

⁴⁴⁹ See generally Mitsilegas *EU Counter-Measures* 137–140; Millington & Williams *Forfeiture* 553–559. The failure to disclose offence is synonymous to the internationally known suspicious reporting duty in terms of the KYC standard although the verb ‘ to report’ is not used in the PCA.

Prior to 2002 the failure to disclose suspicions of money laundering offence was generally phrased.⁴⁵⁰ In contrast, the PCA distinguishes among three types of failure to disclose offences:⁴⁵¹ an offence for persons employed in the regulated sector,⁴⁵² an offence for nominated officers⁴⁵³ working in the regulated sector and an offence for other⁴⁵⁴ nominated officers. Therefore, an employee of a bank commits a disclosure offence if each of the following three conditions has been satisfied:⁴⁵⁵ first, he knew or suspected or had reasonable grounds to suspect⁴⁵⁶ that some other engages in money laundering, secondly, the information on which his knowledge or suspicion is based came to him ‘in the course of a business in the regulated sector’⁴⁵⁷ and thirdly, he failed to file a STR to the NCIS.

The PCA further specifies three defenses in respect of the disclosure offence.⁴⁵⁸ It follows that a bank employee will not be guilty of a disclosure offence if he has a reasonable excuse for failing to file a STR, if he is a legal advisor⁴⁵⁹ or if he was unaware⁴⁶⁰ that some other was engaging in money laundering.

3.4.3.2 Invalid Permission to Execute Transaction

⁴⁵⁰ See paras C.3.2–3.3 above.

⁴⁵¹ See sections 330–332 of the PCA respectively.

⁴⁵² A business is in the regulated sector if it engages in one of various designated activities (Schedule 9 item 2(a)–(g) of the PCA). This includes the business of accepting deposits (see par C.2.1 above).

⁴⁵³ A nominated officer is a person appointed by an employer to receive internal reports of suspected money laundering (section 330(9) of the PCA).

⁴⁵⁴ Section 332(1). This section refers to person who are employed by businesses that engage in activities that are not listed in Schedule 9 of PCA.

⁴⁵⁵ Section 330(1)–(4).

⁴⁵⁶ Which means that a person may commit a money laundering offence negligently (Millington & Williams *Forfeiture* 554). It is, however, unclear whether the required negligence refers to the act of being unaware or of being unsuspecting of certain facts.

⁴⁵⁷ It follows that a bank employee is not required to file a STR where the information is received in circumstances that have no connection with his employment (Graham *Money Laundering* 50).

⁴⁵⁸ Section 330(6)(a)–(c) of the PCA.

⁴⁵⁹ See section 330(6)(b) of the PCA as opposed to article 2A of the 2001 Directive (see par B.3.5 above).

⁴⁶⁰ Section 330(6)(c) of the PCA.

Pursuant to section 336(5) of the PCA the nominated officer of a bank commits an offence if he allows an employee to conduct a money laundering transaction in contravention of the statute. A nominated officer who receives notice of likely money laundering activity may find himself in one of three situations. First, he filed a STR to the NCIS and receives permission to continue with the transaction.⁴⁶¹ Secondly, he filed a STR to the NCIS without receiving notice that consent for the transaction was refused.⁴⁶² Thirdly, the nominated officer filed a STR to the NCIS and receives notice that consent for the transaction was refused whilst the ‘moratorium period’⁴⁶³ for receiving the refusal has already expired.⁴⁶⁴ It follows that a nominated officer who furnishes an invalid consent for a transaction will not be guilty of a money laundering offence but instead, may be guilty of an auxiliary money laundering offence.

3.4.3.3 Tipping-Off Offence

The auxiliary money laundering offence of tipping-off is committed where a person knows that a STR was filed and then discloses information to a third party that may prejudice an investigation. Three statutory defences are provided by the PCA in respect of this offence, including lack of knowledge that the disclosure was likely to prejudice an investigation, the disclosure was made pursuant to legislation; or the disclosure was made by a legal advisor in the course of giving legal advice.⁴⁶⁵

For banks the tipping-off offence poses a dual difficulty.⁴⁶⁶ A bank that filed a STR to the NCIS will have to take care not to inform the customer about the investigation into his affairs. However, should the bank be ordered by court to disclose information about a customer to a third party pending civil proceedings, it may inadvertently commit a money laundering offence

⁴⁶¹ Idem section 336(2)(a)–(b).

⁴⁶² Section 336(3)(a)–(b) of the PCA.

⁴⁶³ The moratorium period consists of 31 days starting on the day that the nominated officer receives notice that consent for the transaction was refused (section 336(8)).

⁴⁶⁴ Section 336(4)(a)–(c) of the PCA.

⁴⁶⁵ Section 333(3) of the PCA. In *R v Derby Magistrate’s Court, ex parte B* [1996] AC 487 the court confirmed that legal privilege’s application is limited to the facts of a matter (507). Feldman (*Civil Liberties* 631–632) argues that in civil litigation legal privilege acts as ‘a shield against compulsory disclosure.’ It is fair to state that legal privilege seems to ‘shield’ potential money launderers against prosecution.

⁴⁶⁶ Mitselegas *Money Laundering* 144–145; Alldridge *Money Laundering Law* 203.

pursuant to section 333(1) of the PCA. This was the legal problem that presented in *C v S*.⁴⁶⁷ As the Court of Appeal importantly remarked:⁴⁶⁸

[t]his case demonstrates how statutory provisions, designed to achieve the highly commendable objective of combating serious crime, can interfere with the individual's rights.

The court believed that guidance for future cases was required and criticised the insensitivity of NCIS in handling the matters.⁴⁶⁹ The court, therefore, proceeded to establish principles to be applied in future matters. First, as regards the conduct of the NCIS the court pointed out that the centre's lack of concern for the plight of the bank could have led other banks in similar situations to avoid filing STRs.⁴⁷⁰ Secondly, as regards the fashion in which the situation should be resolved, the court tasked the NCIS to decide how a bank should deal with a disclosure order.⁴⁷¹ The court proceeded to discuss the choices the NCIS could have had in analogous situations. It recognised that sometimes the NCIS may not mind that a customer became aware of an investigation into his affairs. In some other matter the NCIS may have to specify which information could be disclosed by the bank. Should doubt exist as regards how to deal with a situation, the court had to be approached for instructions, in which case the onus would rest on the NCIS to convince the court that disclosure would likely prejudice an investigation.⁴⁷² The court further instructed both parties on dealing with the practical implications of the NCI's decision as well as the devices to apply in future.⁴⁷³

⁴⁶⁷ See also par C.2.2 above. The facts of the matter are straightforward (*C v S* 344–345). After filing a STR to the NCIS, the bank was ordered by court to disclose documents to the plaintiff who was investigating fraud charges against the bank's customer. The bank attempted to obtain a guarantee from the NCIS that it would not be committing a tipping-off offence in complying with the court order which guarantee was not forthcoming. The bank, therefore, approached the court for advice. The court *a quo* declined to order the bank to disclose documents on grounds that the order might subject the bank to prosecution for a tipping-off offence. This decision was successfully appealed by the plaintiff.

⁴⁶⁸ *C v S* 348. The court believed that the NCI's investigation created tension between the interest of the state in combating crime on behalf of the public and the right of private bodies to obtain assistance from the courts.

⁴⁶⁹ 346. The court directed the NCIS to be 'more sympathetic and helpful' in future.

⁴⁷⁰ *C v S* 346–347.

⁴⁷¹ *Idem* 349–351.

⁴⁷² 349–350.

⁴⁷³ In contrast, in *K Ltd* (par 13) the court resolved that the involvement of the courts in disclosure matters is only appropriate where the customer is unable to establish that the money in the account was legitimately earned.

Thirdly, the court asserted⁴⁷⁴ that it had a responsibility to protect the interests of the bank on account of bank confidentiality. It follows that a court would have to pronounce on the degree of the bank's involvement and the extent the issues could be resolved in open court.⁴⁷⁵ In this matter a sealed letter from the NCIS containing the documentation in issue would suffice. Similarly, in *Bank of Scotland*⁴⁷⁶ the Court of Appeal was called upon to consider the steps that a bank should take to protect itself from prosecution. The court held that a bank that finds itself in a predicament as regards whether to disclose information should first contact the authority⁴⁷⁷ conducting investigations for guidance.⁴⁷⁸ Only if the bank and the authority are unable to agree on which information to disclose to a customer, should the bank approach the court for directions.⁴⁷⁹ The court may also grant an interim order which would specify the information that the bank may disclose to the customer.

Finally, note that a legal advisor will not commit the offence of tipping-off where legal advice information is given to a client.⁴⁸⁰

3.4.3.4 Prejudicing an Investigation

⁴⁷⁴ *C v S* 350.

⁴⁷⁵ *C v S* 349, 351. This ruling was confirmed by the Court of Appeal in *Bank of Scotland* (66).

⁴⁷⁶ In this case the bank, after receiving information about a customer, applied to the court for guidance of whether it should heed the instruction of the customer to repay the money in his account. The bank was afraid that in refusing the customer's instruction to repay the money, it would commit a tipping-off offence. The court *a quo* granted an interdict restraining the bank from making payments to the customer without its approval (*Bank of Scotland* 65–67). Consequently, the customer applied for an order that would direct the bank to transfer the money in issue to his attorney's account. The court lifted the interdict of the court *a quo* which order the bank unsuccessfully appealed (see also par C.4.2.4 below).

⁴⁷⁷ Note that in this matter it was still the Serious Fraud Office whose function was subsequently taken over by the NCIS pursuant to the PCA.

⁴⁷⁸ See *Bank of Scotland* where the court acknowledged that 'the bank was, however, in a genuinely difficult position. There was a dilemma as to what it should do' (71). Only after filing a STR to the authorities or approaching the court for guidance may a bank continue with a transaction without fear of prosecution.

⁴⁷⁹ *Bank of Scotland* 72.

⁴⁸⁰ Section 333(3) of the PCA. In *C v S* the court criticised the scope and purpose of this exception to the tipping-off offence (350). In *Bowman* the court investigated the extent and nature of a lawyer's duty of privilege. It found that a lawyer in the ordinary course of his duties will not be subject to the liability created by the PCA (see also par B.3.6 above).

The last auxiliary offence that may be committed in connection with money laundering is one of prejudicing an investigation. A person may be guilty of this offence in respect of money laundering investigations, confiscation of criminal property or civil recovery.⁴⁸¹ The prejudicing offence can be committed in two ways by any person who knows or suspects that an investigation is being conducted and then either inform a third party of the fact or dispose of documents that are relevant to the investigation.⁴⁸²

A person who did not know or suspect that his disclosure may prejudice an investigation, or made the disclosure in compliance to legislation or as a legal representative to a client in connection with legal advice, will not be guilty of a section 342(2)(a) offence.⁴⁸³

3.5 Anti-Money laundering Regulations

England's first anti-money laundering regulations⁴⁸⁴ were released in 1993 pursuant to the 1991 Directive⁴⁸⁵ and revised in 2003.⁴⁸⁶ Following the EU's enactment of the 2005 Directive,⁴⁸⁷ updated regulations were required. As a result, the Money Laundering Regulations 2007⁴⁸⁸ came into effect on 15 December 2007.

Broadly regarded the 2007 Regulations are a reproduction of the 2005 Directive. They replaced the 2003 Regulations with a detailed AML framework comprising customer due diligence measures,⁴⁸⁹ record-keeping and the training obligations. It follows that 2007 Regulations comprise the original KYC standard obligations which have evolved into due diligence measures.

⁴⁸¹ Section 342(1) of the PCA.

⁴⁸² *Idem* section 342(2)(a)–(b).

⁴⁸³ Section 342(3) of the PCA.

⁴⁸⁴ See Money Laundering Regulations 1993; Bennett *Money Laundering* 14–17; Fisher & Bewsey [2000] *JIBL* 19.

⁴⁸⁵ See section 2(2) of the European Communities Act 1972.

⁴⁸⁶ See Money Laundering Regulations 2003.

⁴⁸⁷ See par B.3.6 above.

⁴⁸⁸ Or '2007 Regulations'.

⁴⁸⁹ Which are divided in simplified and enhanced customer due diligence akin to the 2005 Directive (see regulations 13 and 14 respectively of the 2007 Regulations).

Regulation 3(1) provides a list of ‘relevant persons’⁴⁹⁰ to which the 2007 Regulations apply. Strict liability money laundering offences are created⁴⁹¹ and failure to implement AML measures is criminalised. A person that forms a business relationship in the course of business and fails to apply customer due diligence measures,⁴⁹² preserve transaction records⁴⁹³ and fails to ensure that employees are adequately trained in money laundering control commits a money laundering offence.⁴⁹⁴

In short,⁴⁹⁵ the due diligence measures of the 2007 Regulations advise banks to: identify customers and obtain sufficient information for that purpose,⁴⁹⁶ monitor account activities on an ongoing basis,⁴⁹⁷ and to apply simplified or enhanced due diligence measures in certain situations.⁴⁹⁸ Most notably, failure to comply with the 2007 Regulations has a two-fold consequence for a bank. First, the Financial Services Authority⁴⁹⁹ may impose a civil penalty on the bank. Secondly, it may consider the bank’s failure to heed due diligence measures when deliberating whether a bank meets the criteria for authorisation under the Financial Services and Markets Act 2000.⁵⁰⁰

4. Civil Remedies

4.1 Introduction

⁴⁹⁰ The 2007 Regulations apply to, *inter alia*, banks (called ‘credit institutions’), financial institutions and legal professionals.

⁴⁹¹ Regulation 45 of the 2007 Regulations.

⁴⁹² Regulations 7–9, 13–14 of the 2007 Regulations.

⁴⁹³ *Idem* regulation 19.

⁴⁹⁴ Regulation 21(a)–(b) of the 2007 Regulations.

⁴⁹⁵ See par B.3.6 above as regards customer due diligence measures.

⁴⁹⁶ Identification verification must take place as soon as is ‘practicable’ after contact is first initiated (regulation 9(1) of the 2007 Regulations).

⁴⁹⁷ *Idem* regulation 8.

⁴⁹⁸ For example, a bank may use simplified due diligence measures where the customer is another bank (regulation 13(2)) as opposed to enhanced due diligence measures when dealing with non-face-to-face customers (regulation 14(2)).

⁴⁹⁹ See par C.5.1 below.

⁵⁰⁰ See regulations 42 and 3(2) respectively of the 2007 Regulations.

The use of banks in money laundering schemes has been considered elsewhere in the study.⁵⁰¹ To recap, banks have been used by criminals as vehicles to move the benefits of crime around or simply to warehouse the money. The PCA recognises and addresses this fact and, therefore, it imposes various statutory obligations on banks for the purpose of preventing the use of the banking system by criminals for money laundering purposes. However, the PCA does not purport to compensate victims of financial crime such as fraud or theft whose money was deposited into a bank account by the fraudster or thief - hence the need for an appropriate remedy. In this section restitution and civil forfeiture as remedies to address the consequences of depositing the benefits of crime with a bank are explored. By way of introduction, the following comment is significant as it explains why certain English restitutions remedies are well-suited to address the consequences of using banks to warehouse the benefits of crime:⁵⁰²

[i]nternational fraud is a growing business. ... Since the claim [against a bank] is usually the result of a criminal fraud ..., it is not immediately evident why equity should have any contribution to make. The answer which is here suggested is that the common-law remedies are *inadequate and their jurisprudence defective* ... [and] in all but the simplest cases recourse to the common-law should be abandoned ... attempt should be made instead to developed a unified *restitutionary remedy based on equitable principles*.

Broadly speaking the purpose of restitution⁵⁰³ is to prevent unjust enrichment of a person by returning to the claimant the benefits which the former unjustly obtained. Civil forfeiture also concerns the restoration of a benefit, but in contrast to restitution which benefits an individual only, civil forfeiture is aimed at the restitution of the benefits of crime to the government as representative of the public at large in the absence of an identifiable victim of fraud or theft. It follows that civil forfeiture is a public law remedy as opposed to restitution which is a private law

⁵⁰¹ See ch 4.C–D.

⁵⁰² Millett (1991) *LQR* 71. Although lengthy this passage is quoted in full due to its significance in the present context.

⁵⁰³ Restitution is defined as an area of the law that reverses unjust enrichment on the part of a defendant (Tettenborn *Restitution* 1; Schrage *Enrichment* 3–4; Smith [1992] *Canadian BR* 673). Restitution originated with Moses when the law was handed to him on Mount Sinai (Schrage *Unfair Enrichment* 3). Medieval canon lawyers interpreted the 8th Commandment (‘thou shalt not steal’) as a prohibition against keeping what was in fact due to someone else. Aristotle also supported the notion that justice requires that a person has and enjoys, or be entitled to request, what was due to him (cf Hedley *Restitution* 5–8; Jones *Recent Developments* 43–44). Some authors (see, for example, Tettenborn *Restitution* 2 and Ibbettson *Enrichment* 52) prefer the concept ‘unjustified’ enrichment whilst others (for example, Birks *Enrichment* 40–45 and Schrage *Enrichment* 4 support use of the concept ‘unjust’ enrichment.

remedy. If a civil forfeiture application is successful the account holder (i.e. criminal) will be deprived of the funds by virtue of the fact that he was ‘unjustly enriched’⁵⁰⁴ as a result of his criminal activity.

Ironically, a bank that complies with the PCA’s AML duties may expose itself to two types of civil liabilities. First, civil liability based on breach of contract⁵⁰⁵ and, or civil liability based on the fact that the benefits of fraud or theft were deposited with it.⁵⁰⁶ The second possibility of civil liability may best be illustrated with an example. Consider the scenario where X followed money that was stolen from him by Y to Y’s bank account at B Bank. X as a victim of theft whose money was deposited with B Bank has two options to recover the loss he suffered as a result of the theft. First, he may claim loss *directly* from the thief, Y, who unlawfully appropriated his money.⁵⁰⁷ If Y is a pauper who withdrew the stolen money from his account and gambled it away X’s attempts to recover the stolen money will be a futile exercise.

Secondly, X may attempt to recover loss from B Bank as former recipient of the stolen money. This is because X has *ex lege* rights over the stolen money even if Y withdrew the money

⁵⁰⁴ Although unjust enrichment is not an element that has to be established in a civil forfeiture action (see par D.4.4 below).

⁵⁰⁵ See par C.2.2 above where the likelihood of civil liability on the basis of breach of bank confidentiality is explored.

⁵⁰⁶ See paras C.4.2–4.3 below.

⁵⁰⁷ However, in *AG for Hong Kong v Reid* ([1994] 1 AC 324 [*Reid*]) the court asserted that it is seldom possible to hold a criminal liable in a civil action because the latter usually has disappeared to ‘some Shangri La’ leaving behind the bank to account for the misappropriated money (339). At present, misappropriated money can be recovered directly from a fraudster only with a claim in conversion because there is usually no fiduciary relationship between the claimant who suffered loss and the criminal (Hapgood *Paget’s Law of Banking* 457–458; Cox & Taylor *Cheques* 483–533; Fox *Property Rights* 307–311). A claim in conversion is for the ‘*wrongful* interference with possession of goods ... [it] is a claim at common-law for *damages* ... from interference with the claimant’s possession of property’ (Cox & Taylor *op cit* 483–484). There are two reasons why claims based on conversion are not explored in this setting. First, the likelihood of a bank being sued for wrongful conduct and damages in relation to the benefits of fraud or theft is slim due to the fact that the claimant must establish that the bank intentionally or negligently participated in, for example, a money laundering scheme (but see claims based on dishonest assistance - par D.4.2.4 below). However, the issue of a bank’s potential delictual liability on account of receiving the benefits of fraud or theft money falls beyond the scope of the study. Secondly, since money cannot be converted when it becomes currency (*Lipkin Gorman I* 559), two specific remedies have developed at English common-law to assist a claimant in recovering loss from the bank where misappropriated money was deposited and subsequently withdrawn by the account holder (see paras C.4.3.2–4.3.3 below).

from his bank account. English literature suggests that X's civil claim against B Bank as recipient of the stolen money may, depending on the circumstances, be based on any of the following four common-law restitution actions, namely:

1. knowing receipt;
2. knowing assistance;
3. common-law tracing; or
4. tracing in equity.

Liability under the first and second civil actions above is based on breach of constructive trust and possible even in cases when the benefits of fraud or theft were deposited with a bank and subsequently withdrawn by the fraudster or thief who absconded with the money. The tracing remedies are usually regarded as a means to an end and can be used by a victim of fraud or theft to find out what transpired to his property.⁵⁰⁸ A victim of fraud or theft who traced the benefits of fraud or theft to a bank account may file suit against the bank based on one of the tracing actions provided that the funds remain under the bank's control.

In turn, civil forfeiture allows the government to confiscate and forfeit the benefits of any type of criminal activity including fraud, theft and drug trafficking. Civil forfeiture is therefore especially relevant in cases where there the deposited money derived from crimes such as drug trafficking and corruption where there is no readily available victim who has a claim to the money that is the subject of civil forfeiture proceedings. A bank usually becomes directly involved in civil forfeiture proceedings in two instances. First, where it has an interest in money that is the subject of the civil forfeiture application, for example, where it was stolen from the bank and deposited with some other bank. Secondly, where the bank is the mortgagor of property earmarked for civil forfeiture. In both cases the bank may use the innocent owner defence⁵⁰⁹ to protect its interest against civil forfeiture. Under which circumstances and by whom the remedies above may be used are henceforth considered.

4.2 Constructive Trust

4.2.1 Background

⁵⁰⁸ See par C.4.3 below.

⁵⁰⁹ See par C.4.4.3 below.

The concept ‘trust’ derived from ancient Anglo-Saxon laws and was adopted by a number of civil law jurisdictions.⁵¹⁰ A trust is the assumption of a specific duty that the trustee owes to a beneficiary that is enforced through the application of various equitable principles.⁵¹¹

A constructive trust is a trust created by a court and imposes a trust relationship.⁵¹² For a constructive trust to be imposed the constructive trustee, which in this setting is a bank, must have acted in a certain manner. However, a precise definition of the concept ‘constructive’ trust is difficult to provide because English law offers no clear definition of the concept.⁵¹³ What is certain is that a constructive trust implies the imposition of strict liability on a defendant bank to make good loss suffered by a victim of fraud or theft.⁵¹⁴ A constructive trust, therefore, arises regardless of the intention of the parties on whom the relationship of trustee-beneficiary is imposed because it is created by virtue of their *conduct*.⁵¹⁵ Generally, a constructive trust arises in two situations, namely where:⁵¹⁶

1. property was received by the defendant in breach of trust which is known as knowing receipt; or
2. assistance was given by the defendant in breach of trust which is known as dishonest assistance.

Although both of the actions above are analysed in detail below, it is important to make a few introductory remarks already at this point in the discussion. A bank may incur constructive trust liability in two instances where the benefits of fraud or theft were deposited into a bank account

⁵¹⁰ Baker *English Legal History* 290–292; Curzon *Legal History* 121–122.

⁵¹¹ Moffat *Trust* 3; Hinterseer *Criminal Finance* 294. The notion of ‘equity’ derived from the doctrines of the English Court of Chancery which attempted to address some of the defects of the common-law (Barton *Equity* 139; York et al *Remedies* 11–13).

⁵¹² Wadsley and Penn *Domestic Banking* 286; Oakley *Trusts* 28.

⁵¹³ *Carl-Zeiss Stiftung v Herbert Smith (No. 2)* [1969] 2 Ch 295 300. In *Re Montagu’s Settlement Trust* ([1992] 4 All ER 308 [*Re Montagu*]) the court explained that constructive trust liability is about personal rather than proprietary remedies (321).

⁵¹⁴ *Bank of Scotland* 67; *Westdeutsche Landesbank Girozentrale v Islington BC* ([1996] AC 669 (HL) [*Westdeutsche Landesbank*]) 714.

⁵¹⁵ *Chase Manhattan Bank v Israel-British Bank (London)* [1979] 3 All ER 1025 [*Chase Manhattan*] 1026. See Fox *Property Rights* 140 as regards the history of constructive trust liability.

⁵¹⁶ See in general Reid *Civil Law and Money Laundering* D1/4; Hinterseer *Criminal Finance* 295–296; Norman *Tracing* 103–106; Hapgood *Paget’s Law of Banking* 459–460; Wadsley and Penn *Domestic Banking* 288; Hooley & Taylor *Payment by Fund Transfer* 182–185; Rotherham *Proprietary Claims* 46–52; Passmore & Sieve (1995) *NLJ* 1379; Birks (1989) *LMCLQ* 298 ev; Grantham (1999) *NZU LR* 389–395.

and subsequently paid away by the bank as instructed by the account holder.⁵¹⁷ In an action for *knowing receipt* both a proprietary and a personal remedy are available⁵¹⁸ as opposed to an action for *dishonest assistance* where only a personal remedy is available to the victim who seeks to recover loss suffered from the bank as recipient of the misappropriated money.

There is one primary difference between the two actions above. In the case of knowing receipt the victim of fraud or theft needs to establish that the bank used the fraudulently acquired or stolen money for its own benefit, for example, to repay the customer's overdraft. It is, therefore, liable for the amount that it has used rather than being potentially liable for the whole of the amount lost by virtue of the fraud or theft as in a claim based on knowing assistance. Use by the bank of the benefits of fraud or theft is not a requirement for a claim based on dishonest assistance. Significantly, in both actions the presence of knowledge is pivotal to establish liability on the side of the bank.⁵¹⁹

As illustrated already,⁵²⁰ a bank has various fiduciary duties in relation to deposited money. This places it in a difficult position. On the one hand, the bank must know when further inquiries are necessary instead of merely obeying an account holder's instruction as regards the deposited money. On the other hand, the bank must attempt not to offend the customer by refusing to conduct a transaction on his behalf.⁵²¹ The duty of banks to inquire has been further complicated by the PCA which imposes certain AML duties on banks.⁵²² The irony is that a bank which filed a STR pursuant to the PCA⁵²³ may inevitably have assisted a victim of fraud or theft to establish the required degree of knowledge in order to impose civil liability on it as former recipient of the benefits of fraud or theft. It follows that a bank may be exposed to potential civil liability simply because it heeded its AML obligations.

4.2.2 Concept of Knowledge

⁵¹⁷ Hinterseer *Criminal Finance* 298; Smith [2000] *LQR* 436.

⁵¹⁸ Even though the remedies are mutually exclusive. Therefore, in an action for knowing receipt the victim must decide to rely on either the one or the other remedy (see par D.4.2.3 below).

⁵¹⁹ Hooley & Taylor *Payment by Fund Transfer* 183; Hibbert (2000) *J of Internat Banking L* 138. See paras C.4.2.1–4.2.2 below.

⁵²⁰ See paras C.2.1–2.3 above.

⁵²¹ Wadsley and Penn *Domestic Banking* 287–288.

⁵²² See par C.3.4 above.

⁵²³ See par C.3.4.3.1 as re the failure to disclose offence; section 330 of the PCA.

Based on what was discussed elsewhere in this chapter,⁵²⁴ it is correct to state that a bank employee's guilty knowledge and his liability for a money laundering offence go hand in hand. But the concept of knowledge poses difficulty in as far as establishing liability on the side of a bank that received the benefits of fraud or theft because it implies an awareness of relevant facts. Since the legal definition of knowledge differs from the concept's general meaning, it poses a threefold problem for a victim who attempts to hold a bank liable for paying the benefits of fraud or theft to the fraudster or thief who was not entitled to receive payment.⁵²⁵ First, it is difficult to ascertain the degree of knowledge that is required of the bank employee before the bank can be held liable as a constructive trustee. Secondly, whether knowledge should be judged according to an objective standard or subjective standard remains unclear. Thirdly, whether a bank employee must have acted dishonestly before constructive trust liability can be imposed on the bank is also a matter clouded in ambiguity.

In *Baden Delavaux* the court laid down five categories of knowledge to determine the *prima facie* civil liability of a defendant bank.⁵²⁶ It is submitted that knowledge within any of the five categories will be sufficient to impose constructive trust liability on the bank. The knowledge requirement was further analysed in detail by the court in *Agip*.⁵²⁷ One of the salient issues in *Agip* concerned the degree of knowledge required to impose liability on the accounting firm. The court

⁵²⁴ See paras B.3.6, C.3.4 above where the KYC standard provisions are analysed.

⁵²⁵ Fisher & Bewsey *Law of Investor Protection* 27-015–27-016; McCormack [1995] *Business LR* 177.

⁵²⁶ See par C.3.4.3 above.

⁵²⁷ 567–570. The facts of the matter involved money laundering and read like a movie script. Agip was a French oil company that employed an accountant who joined a Parisian crime syndicate. A French lawyer who was another member of the syndicate approached the accounting firm of Jackson & Co and requested them to create and register a number of offshore companies in the Isle of Man as well as to open bank accounts in England. The accountant employed by the Agip company used this network to defraud Agip and to launder the proceeds of fraud. Since the proceeds of fraud were successfully laundered, it was pointless to claim loss from the accountant who was a man of straw. Agip, therefore, focussed on the accounting firm that was the sole director and shareholder of one of the companies used by the accountant to launder the proceeds of fraud. Agip claimed, *inter alia*, that the accounting firm had knowingly assisted in a fraudulent breach of trust. It, therefore, approached the court to impose personal liability on the firm in the form of a constructive trust so that it could be held liable to make restitution in the amount of 518,822.92 US dollars. Agip also filed a common-law claim against the accounting firm for money had and received (see par C.4.3.2 below). Ultimately, the court found in favour of Agip and awarded the amount claimed as well as interest.

based its liability finding on the presence of dishonesty⁵²⁸ and imputed knowledge about fraud and money laundering activity to the firm because it was evident that the firm should have known that they were concealing the proceeds of fraud on behalf of their clients.⁵²⁹ The court further found that turning a blind eye to obviously dishonest conduct was tantamount to having actual knowledge of fraud.

In *Agip*⁵³⁰ the court therefore addressed some of the difficulties of proving knowledge on the side of a defendant by changing the basis of liability from knowledge to dishonesty, a decision that was approved in *Royal Brunei*. In *Royal Brunei* the court concluded as follows:⁵³¹

[d]rawing the threads together ... dishonesty is a necessary ingredient of accessory liability ... 'Knowingly' is better avoided as a defining ingredient of the principle

The court agreed with the *Agip*⁵³² court that the distinction between honesty and dishonesty is one of fact. It further addressed the third problem mentioned above, namely, the legal meaning of the concept of knowledge. The court held that the defendant's state of mind is a determining factor in any investigation.⁵³³ Even if the defendant acted innocently, he nevertheless may be liable for breach of trust. However, if his liability was fault-based, the nature of the fault will become relevant.⁵³⁴

It has been proposed that the interpretative difficulties of the English courts as regards the degree of knowledge required for civil liability is attributable to the ruling in *Selangor*.⁵³⁵ In *Selangor*, the court confirmed that a constructive trust may present a remedy to a victim of fraud

⁵²⁸ *Agip* 569.

⁵²⁹ 568. The court reasoned that the defendants as professional men had to know that they were laundering money for their clients.

⁵³⁰ 567–569.

⁵³¹ *Royal Brunei* 392. In this matter the plaintiff, an airline company, approached BLT, a travel agency, to account to it for money that BLT received from ticket sales. BLT had acted as trustee for the airline. The money was paid into BLT's account and was used by one Tan for his own purposes (382). The airline subsequently sued Tan in an effort to recover the misappropriated money. In issue was whether Tan was liable as a constructive trustee to the airline. The court reasoned that liability based on dishonest assistance could be established by the plaintiff because the defendant clearly acted with dishonestly (see also paras C.4.2.3–4.2.4 below).

⁵³² 569.

⁵³³ *Royal Brunei* 389.

⁵³⁴ *Idem* 387.

⁵³⁵ *Royal Brunei* 386 (for a detailed analyses of the *Selangor* case, see Panesar [1995] *BLR* 252–253). For the facts of *Selangor*, see par C.2.1 above.

where money was misappropriated. The defendant bank was held liable in equity as if it were a trustee even though it was merely negligent.⁵³⁶ This ruling which accentuated the use of equitable remedies in scenarios where money was misappropriated, has been applied by other courts as if it were a statute.⁵³⁷ From the following evaluation it should be obvious that establishing knowledge for the purpose of determining civil liability on the side of a bank which received and payed away the benefits of fraud or theft is all but clear cut.

4.2.3 Knowing Receipt

4.2.3.1 General Principles

A victim of fraud or theft must establish the following three elements before liability based on knowing receipt will vest against the bank that received the benefits of fraud or theft:⁵³⁸ first, the bank received money beneficially which is traceable as representing money that was fraudulently acquired or stolen from him, secondly, the bank payed the benefits of fraud or theft away in breach of trust, and thirdly, the bank *knew* that the money it received is traceable to a breach of trust.

Two scenarios, therefore, can arise where a bank may face civil liability based on knowing receipt. In the first scenario the bank received a deposit of the benefits of fraud or theft for its own

⁵³⁶ *Selangor* 1137. In *Selangor* the defendant bank was found liable for dishonest assistance even though dishonesty was never present on the side of the bank (see par C.4.2.4 below). The court ruled that the defendant bank should have made further enquiries because the prevailing circumstances would have indicated to a reasonable and honest bank the necessity for further information (1148). The defendant bank also incurred liability for breach of its contractual duty of care because it failed to make further inquiries about the customer's affairs.

⁵³⁷ *Royal Brunei* 386. The ruling was accepted by the courts in *Agip* (569) and in *Westdeutsche Landesbank* (705).

⁵³⁸ As formulated in *El Ajou v Dollar Land Holdings plc and another* ([1994] 2 All ER 685 [*El Ajou*]) 700. *El Ajou* concerned the selling of worthless shares (see also par C.4.3.3 below). The proceeds of the shares were paid into various accounts prior to being bought back in different currencies and finally invested in property situated in London (689–692). Ultimately, the court allowed the plaintiffs to rescind the transaction which enabled them to claim their loss from the defendants.

benefit⁵³⁹ whilst aware⁵⁴⁰ or suspicious that it was transferred to it in breach of trust.⁵⁴¹ To impose liability on the bank the victim of fraud or theft must establish that the bank received the money whilst aware or suspicious that the money presented the benefits of fraud or theft.⁵⁴² A bank that received the benefits of fraud or theft without any suspicions as regards the source of the funds, but subsequently found out that the money was criminally acquired, may also be liable for knowing receipt.⁵⁴³

The second scenario where a bank may face civil liability based on knowing receipt is where it received the benefits of fraud or theft and dealt with it in a manner that suggests that it knew or suspected that the money was criminally acquired by the customer.⁵⁴⁴ In both scenarios above dishonesty or actual knowledge by the bank as regards the source of the money is not a requirement for liability.⁵⁴⁵ Liability is strict as long as the bank received the benefits of fraud or

⁵³⁹ Since money that is paid into a bank account belongs to the bank ‘to do with as [it] pleases’ (*Foley* 37 - see par C.2.1 above), it should not be difficult for the victim of fraud or theft to prove this requirement. However, it is submitted that the ‘own benefit’ element of the action may pose a problem in situations where a bank merely received money on behalf of a customer which is credited to his bank account before being transferred to some other as instructed by the customer (as was the case in *Agip*). Essentially, the defendant bank must have acquired the property *beneficially* to incur liability. Therefore, it may be impossible to establish liability based on knowing receipt unless the bank applied the money it received, for example, in reduction of the customer’s overdraft or outstanding mortgage payment.

⁵⁴⁰ Which awareness may be either actually or constructively (*Agip* 567–568).

⁵⁴¹ The concept ‘breach of trust’ is used by some courts to denote ‘breach of a fiduciary duty’ (see, for example, *El Ajou* 700; *Westdeutsche Landesbank* 716).

⁵⁴² *El Ajou* 700; *Akindale* 234.

⁵⁴³ For example, in *Chase Manhattan* money was paid by mistake via a fund transfer. The court found that since the defendant bank could not have retained the money in good conscience, a trust arose as soon as the money was received by the bank (1026). The court further recognised the plaintiff’s equitable title to the wrongly paid money and, therefore, allowed it to trace the money to the defendant bank (1027 - see par C.4.3.3 below). Note that although the *Chase Manhattan* case did not concern the benefits of fraud or theft, it is nevertheless noteworthy in this context due to the court’s reasoning as regards the moment when constructive trust liability could be imposed on a bank.

⁵⁴⁴ *El Ajou* 700.

⁵⁴⁵ *Polly Peck International plc v Nadir (No 2)* ([1992] 4 All ER 769 [*Polly Peck*]) 777; Turgendhat *Common Law* 139; Birks *Enrichment* 157. In contrast, see *Twinsectra v Yardley* ([2002] 2 AC 164 (HL) [*Twinsectra*]) (see par C.4.2.4 below) and *Royal Brunei* where the court required dishonesty as standard for liability. It is submitted that dishonesty and knowledge are two different concepts and, therefore, different tests should be applied to determine the potential liability of the bank (cf below).

theft with the required degree of suspicion.⁵⁴⁶ Therefore, the degree of knowledge of the bank at the time when it received the money is pivotal in determining its potential liability.⁵⁴⁷ With reference to a remark made by the court in *Re Montegu*,⁵⁴⁸ the court in *Akindale*⁵⁴⁹ asserted that the categorisation of knowledge served little purpose because there ought to be only a single test of knowledge for knowing receipt. This test demands that the defendant's knowledge must be such that it renders it unconscionable for him to keep the benefit of fraud or theft that he received.

In *Royal Brunei* the court inquired whether a bank may be held liable for knowing receipt where it assisted in a breach of trust of which he would only have been aware if he had exercised reasonable diligence and made reasonable inquiries.⁵⁵⁰ It found that in general beneficiaries could not reasonably expect that 'all the world' dealing with the trustees owed them a duty to take care for fear that the trustees were behaving dishonestly. The court further agreed that a bank could sometimes owe a duty of care to the beneficiaries of a trust but refrained from specifying when that would be the case. It follows that in *Royal Brunei* the court changed liability for knowing receipt from knowledge to dishonesty.

4.2.3.2 Evaluation

A claim based on knowing receipt instigated by a victim of fraud or theft against the bank that received the benefits of the fraud or theft and used the money.

⁵⁴⁶ *Lipkin Gorman II* 435; *Norman Tracing* 104; McCormack [1995] *Business LR* 180.

⁵⁴⁷ *El Ajou* 695, 701–703; *Baden Delvaux* 575.

⁵⁴⁸ The court remarked that to determine liability based on knowing receipt it is necessary to investigate whether the defendant's conscience was sufficiently affected by the receipt of the property (324).

⁵⁴⁹ 235. The *Akindale* case concerned a fraudulent share scheme that enabled officers of the BCCI to conceal loans made to the bank to buy its own shares (223–225). The plaintiffs in their capacity as liquidators of the BCCI contended that the defendant, a Nigerian citizen, was liable to them as constructive trustee because he initiated the purchase agreement between himself and the BCCI officers. The court *a quo* held that the defendant was unaware of the fraud and, therefore, did not act with dishonesty. On appeal, the plaintiffs raised two issues for the court to consider: first, the type of knowledge required for liability based on knowing receipt, and secondly, whether dishonesty was an element to be proved in such a claim. The court found that since the defendant did not have any knowledge as regards to the fraud that was perpetrated, he was not liable for dishonest assistance (229, 231). In addition, since the defendant did not have knowledge that made it unconscionable for him to keep the BCCI shares, he was not liable for knowing receipt (238).

⁵⁵⁰ *Royal Brunei* 382.

It is submitted that since banks are in the business of receiving deposits from the public and using the deposits to engage in financial transactions, they are mostly to become embroiled in claims based on knowing receipt.⁵⁵¹ The foregoing discussion underlines the fact that a bank will be liable for knowing receipt only where it received money which was applied to the bank's own benefit whilst an employee was aware or suspicious that the money was fraudulently acquired or stolen by the customer. The bank employee's knowledge as regards the deposited money will determine whether the court will hold the bank liable to the victim of fraud or theft.

The fact that the defendant bank filed a STR pursuant to section 330 of the PCA may assist the victim of fraud or theft to establish the necessary degree of knowledge or suspicion in order to fix constructive trust liability on its side. Banks can avoid this type of potential liability by ignoring the PCA's reporting obligation.⁵⁵² Consequently, the victim of fraud or theft will be unable to establish the required knowledge or suspicion on the bank employee's side. This is, however, not a viable option due to the fact that the PCA criminalises failure to disclose knowledge or suspicions of money laundering. A bank that uses the customer due diligence measures of the 2007 Regulations,⁵⁵³ however, should be able to identify suspicious transactions or form a suspicion that money it received may be the benefits of fraud or theft which belong to someone other than the account holder. It is submitted that the courts should use an objective measure to determine whether the bank employee had knowledge or suspicions that the bank received the benefits of fraud or theft. The prevailing circumstances of the matter may delineate the level of knowledge that can be expected from a bank employee. Most notably, the importance of bringing an action for knowing receipt against a bank as recipient of the benefits of fraud or theft lays in the fact that the victim of fraud or theft may recover that part of the benefits of fraud or theft that the bank had used.

4.2.4 Dishonest Assistance

4.2.4.1 General Principles

⁵⁵¹ See par C.2.1 above.

⁵⁵² See par C.3.4.3.1 above.

⁵⁵³ See par C.3.5 above.

Civil liability based on dishonest assistance requires that a bank (employee) actively assisted in dishonest or fraudulent conduct.⁵⁵⁴ The danger for a bank is that individual bank employees may assist criminals with their money laundering schemes which see the benefits of fraud or theft being moved around among bank accounts and banks despite the bank having stringently imposed AML policies in place. As a result, the bank may be held liable for the dishonest conduct of its employees.

Like civil liability based on knowing receipt, guilty knowledge by a bank employee about the nature of the transaction and the fact that the benefits of fraud or theft are used in a transaction, are pivotal elements that a victim of fraud or theft must establish before civil liability based on dishonest assistance will vest in the bank. A victim of fraud or theft must establish four elements before a bank which received the benefits of fraud or theft and parted with the money is likely to incur liability based on dishonest assistance.⁵⁵⁵ First, there must be a breach of trust or fiduciary duty by someone other than the bank. Secondly, a bank employee must have assisted in the breach, which is a question of fact. Thirdly, the assistance must have been dishonest. Fourthly, the bank employee's conduct resulted that the victim of fraud or theft suffered loss. In *Baden Delvaux* the court explained that the level of knowledge required to impute liability to a bank for dishonest assistance must be:⁵⁵⁶

[a]ctual knowledge or knowledge which it would have obtained but for shutting its eyes to the obvious or wilfully and recklessly refraining from making such inquiries as the reasonable banker would have made from the circumstances known.

However, it is evident that the *degree* of assistance which the bank employee provided to the fraudster or thief in conducting a transaction with the benefits of fraud or theft will be a determining factor before the bank can incur liability for dishonest assistance.⁵⁵⁷ In *Bank of*

⁵⁵⁴ See in general Halliwell *Modern Equity* 84–85; Hapgood *Paget's Law of Banking* 464; *Royal Brunei* 385–385; Norman (1992) *Legal S* 334; Harpum (1995) *LQR* 548.

⁵⁵⁵ *Grupo Torras v Al Sabah* [1999] CLC 1469 663; *Baden Delvaux* 573–575.

⁵⁵⁶ 587.

⁵⁵⁷ See, for example, *Brinks Ltd v Abu-Saleh (No 3)* [1996] CLC 133 [*Brinks*] where the court held that a wife who accompanied her husband on a visit to Switzerland in what she believed was an effort to evade taxes because her husband carried a huge amount of cash with him, was not liable for dishonest assistance. This is because she did not provide the requisite degree of assistance to him in executing his plan (149–151).

Scotland the court asserted that the *Royal Brunei* decision provided the clearest guidelines to determine a bank employee's degree of knowledge.⁵⁵⁸

In *Royal Brunei* the court held that the defendant must have *prima facie* acted dishonest if it is to incur constructive trust liability based on dishonest assistance. The court further considered the meaning of the concept of honesty and suggested that it should be judged objectively.⁵⁵⁹ Although it includes subjective elements, the court pointed out that honesty was not an 'optional scale' with lower and higher weights according to the ethical standards of a person. The court subsequently cautioned banks against taking risks where doubts existed of whether a transaction was legitimate or not, because such conduct may be indicative of dishonesty.⁵⁶⁰

The *Royal Brunei* dictum was also applied in *Twinsectra v Yardley*.⁵⁶¹ In *Twinsectra* the court had to decide which standard to use for determining whether the defendant acted dishonesty. It considered three possible standards to establish dishonesty, namely:⁵⁶²

1. a subjective standard⁵⁶³ in terms of which a defendant will only be regarded as dishonest if it breaches its own standard of dishonesty;
2. an objective standard in terms of which a defendant will be regarded as dishonest if its conduct is dishonest if it breaches the ordinary standards of reasonable and honest people; and
3. a combined standard that comprises both subjective and objective elements. First, it must be established that the defendant's conduct was dishonest by using the objective standard, whereafter secondly, it must be proved that the defendant realised that its conduct was dishonest in terms of the subjective standard.

⁵⁵⁸ 67–68.

⁵⁵⁹ *Royal Brunei* 389. This view is accepted by Hapgood (*Paget's Law of Banking* 464).

⁵⁶⁰ *Royal Brunei* 391.

⁵⁶¹ [2002] 2 AC 164 (HL) [*Twinsectra*].

⁵⁶² *Twinsectra* 171–172.

⁵⁶³ This standard was ingeniously named the 'Robin Hood' test of dishonesty (Halliwell *Modern Equity* 93) because of the court's formulation thereof (see *Twinsectra* 171).

The court preferred the combined standard of testing to determine whether a defendant was dishonest. It follows that dishonesty required knowledge by a bank employee that honest people would regard his conduct as dishonest.⁵⁶⁴

4.2.4.2 Evaluation

A claim based on dishonest assistance instigated by a victim of fraud or theft against the bank that received the benefits of the fraud or theft and parted with the money.

From the analysis above, it is evident that a bank may find itself in either one of two situations.⁵⁶⁵ In the first situation the bank may avoid being held liable to a victim of fraud or theft on the basis of dishonest assistance by asserting that its employee believed that the benefits of fraud or were legitimately earned by the alleged fraudster or thief.⁵⁶⁶ Information kept by the bank pursuant to the 2007 Regulations as regards the nature of the account holder's business and transactions is likely to be a determining factor for establishing the reasonableness of the employee's belief.⁵⁶⁷

In the second situation the court will inquire whether the bank employee discharged his obligations and duties as regards the transaction in good faith, or whether he failed to make the inquiries that an honest and prudent bank employee would have made in the prevailing circumstances. Either way, a bank employee that filed a STR about the transaction in issue may find it impossible to establish that he lacked knowledge and, therefore, that constructive trust liability based on dishonest assistance should not be imputed to the bank. It is further evident that a bank employee's negligence is insufficient for imposing liability based on dishonest assistance on the bank.⁵⁶⁸

4.3 Tracing

4.3.1 Background

⁵⁶⁴ 174.

⁵⁶⁵ See also *Royal Brunei* 382.

⁵⁶⁶ See, for example, *Bank of Scotland* 71–72.

⁵⁶⁷ See par C.5 above as regards the 2007 Regulations.

⁵⁶⁸ Wadsley and Penn *Domestic Banking* 295; Gardner [1996] *LQR* 84–85.

The legal concept ‘tracing’ refers to:⁵⁶⁹

[a] set of equitable rules and principles that are used to identify specific assets derived from a breach of trust so that legal remedies can be imposed.

It follows that tracing is more a means to an end than a remedy.⁵⁷⁰ At best it informs a person when the value of one asset has been used to acquire some other asset. In this sense tracing should assist a victim of fraud or theft to recover either money that is retained in the hands of a bank,⁵⁷¹ or money that the bank had control over and paid to the fraudster or thief.⁵⁷² In simple terms the purpose of tracing is to identify the person that is liable to the victim of fraud or theft.⁵⁷³ Since tracing merely informs a the victim of fraud or theft what has transpired to his money, the claim can be either personal or proprietary in nature.⁵⁷⁴

In general, common-law rules that govern tracing have been disregarded due to the practical problems associated with their use. For this reason tracing in equity is used more often

⁵⁶⁹ Hinterseer *Criminal Finance* 306. This definition correlates with definitions offered by Wadsley and Penn (*Domestic Banking* 302); Matthews (*Common Law Tracing* 30); and Chambers (*Tracing* 263). See also par C.4.1 above.

⁵⁷⁰ See in general Chambers *Tracing* 306; Birks *Enrichment* 289–300; Birks *Unitary Law* 239–258; Nolan *Change of Position* 144, 189; Rotherham *Tracing* 75; Hedley *Restitution* 292; Nebhrajani *Money Laundering* 197; Norman *Tracing* 107–115; Tettenborn *Restitution* 213; Rotherham *Tracing* 57; *Polly Peck* 781; *Foskett* 128; Evans [1999] *LQR* 470; Vaswani (1997) *J of Financial Crime* 44; Grantham (1999) *NZU Law R* 398–399. Smith (*Tracing* 287; *Electronic Transfers* 121–122) argues that to designate tracing as a ‘remedy’ obscures the notion of a trust whilst the court in *Boscawen v Bajwa* ([1995] 4 All ER 769 [*Boscawen*]) proposed that tracing is neither a claim nor a remedy, but a process to determine what has happened to specific assets (776). For an evaluation of various theories on the nature of tracing, see Evans [1999] *LQR* 472–504.

⁵⁷¹ See par C.4.C.3.3 below where tracing in equity is considered.

⁵⁷² *El Ajou* 693.

⁵⁷³ *Burrows Review* 30–31; *Re Montagu* 329.

⁵⁷⁴ The *Westdeutsche Landesbank* case cleverly illustrates the difference between personal and proprietary claims. The matter arose as a consequence of an interest swap arrangement that involved certain local authorities. Since the local authorities were prohibited from engaging in swap arrangements, the swap transactions were declared void *ab initio* by the court (671–673). The bank argued that a proprietary remedy arose in its favour entitling it to compound interest instead of simple interest on the money that was transferred among the local authorities. Although the court agreed that the bank was entitled to bring an action for money had and received (see par C.4.3.2 below) to recover the value of the money that it had transferred, it rejected its proposition that failure of consideration generated an equitable interest in that money in the bank’s favour. This is because the bank elected to be an unsecured or concurrent creditor under the interest swap arrangement (704, 683–684).

because its rules are more flexible. Tracing in equity allows a victim of fraud or theft to trace⁵⁷⁵ the benefits of the fraud or theft as the money is transferred between bank accounts and countries. Most notably, the money in issue may be followed through different forms of property. For example, stolen cash that was spent on a work of art that was subsequently purchased by some other may be followed into the retail price the seller received and deposited with a bank even if it is represented by electronic ‘particles.’⁵⁷⁶

Tracing, therefore, enables a victim of fraud or theft to bring an action in respect of the exchanged product or substitute of his money. In this sense, tracing is the opposite of money laundering because whereas money laundering purports to conceal the fact that money is the benefits of fraud or theft, tracing attempts to ensure that the taint remains so that the benefits of fraud or theft can be identified as belonging to the victim of fraud or theft.⁵⁷⁷ Significantly, the main difference between claims based on constructive trust and claims based on tracing is that a victim of fraud or theft may claim loss from a bank based on constructive trust where it paid the benefits of fraud or theft to the fraudster or thief. In contrast, for a tracing claim to succeed the victim must establish that the money in issue or its substitute remains under the bank’s control. As soon as the right to trace has been established and the benefits of fraud or theft were traced into the hands of the bank, the bank may use any of three defences to avert the victim’s claim. It may counter that it received the benefits of fraud or theft without knowledge of their criminal acquisition,⁵⁷⁸ or that the specific benefits of fraud or theft ceased to exist, hence no compensation is payable to the victim of fraud or theft, or that it would be inequitable in the situation to require that compensation is paid.⁵⁷⁹

Tracing has another function beyond restitution. It allows a victim of fraud or theft to follow the benefits of fraud or theft up to where the fund disappeared or became commingled with

⁵⁷⁵ Note, in relation to money the concepts ‘follow’ and ‘trace’ are not synonyms. In fact, the right to follow money differs from a tracing claim. The process of ‘following’ money involves tracking the *same* money as it is transferred from person to person (Smith *Tracing* 6; *Foskett* 127). In contrast, tracing supposes the identification of a *new* asset as a substitute for the original one, for example, cash in one currency that is substituted for other currency. Tracing, therefore, involves asserting a ‘new title’ to money that has been substituted for the original funds.

⁵⁷⁶ For an analysis of the various concepts of money, see ch 2.B–C.

⁵⁷⁷ Hinterseer *Criminal Finance* 306.

⁵⁷⁸ Which is known as the *bona fide* purchaser defence (see par C.4.3.4 below).

⁵⁷⁹ Which is known as the change in position defence (see par C.4.3.4 below).

other funds in a bank account and then it assists in identifying a target for litigation. The following discussion illustrates why tracing in equity is the preferred remedy instead of common-law tracing.

4.3.2 Common-Law Tracing

Traditionally, common-law tracing is referred to by the name of the action money had and received. The action is available to a victim of fraud or theft whose money was misappropriated because it enables him to claim his loss from the bank that received the money by bringing a personal⁵⁸⁰ claim against it bank for money had and received. Significantly, the elements of knowledge or dishonesty are unimportant in a common-law tracing claim.

The victim of fraud or theft must establish the following four requirements to succeed with a claim for money had and received against a bank as recipient of the benefits of fraud or theft.⁵⁸¹ First, he once had a legal title to the benefits of fraud or theft in issue, secondly, the defendant bank received the money, and thirdly, the defendant bank did not give consideration for the money and was, therefore, unjustly enriched. Fourthly, the plaintiff must established that the benefits of fraud or theft are *identifiable* in the hands of the bank.⁵⁸² It follows that difficulties are likely to arise where the a victim of fraud or theft seeks to trace the benefits of fraud or theft that were deposited into a bank account where the funds commingled with other funds in the account.⁵⁸³

⁵⁸⁰ Tettenborn *Restitution* 218; Matthews *Common Law Tracing* 32–33, 64.

Conversely, tracing in equity is a proprietary claim (see par C.4.3.3 below).

⁵⁸¹ Birks *Restitution* 1; Tettenborn *Restitution* 215–219; Rotherham *Proprietary Claims* 38; Smith *Tracing* 75–76.

⁵⁸² Hapgood *Paget's Law of Banking* 433; Smith *Tracing* 278; Hedley *Restitution* 295–297; Fox *Property Rights* 239–241.

⁵⁸³ See *Re v Diplock (Diplock v Wintle and Associated Actions)* [1948] 1 Ch 465 [*Diplock*] where the court held that common-law tracing was impossible where money had commingled in a bank account. The court attributed this limitation to the ‘materialistic approach’ of common-law tracing in contrast to the ‘more metaphysical approach’ of tracing in equity (520). The facts in *Diplock* are straightforward. The defendants were executors who had wrongly distributed a deceased’s estate to various charities. One of the beneficiaries of the Diplock estate was a hospital that had applied the money they received to build a new ward. The next of kin of the deceased brought a proprietary claim in respect of the traceable proceeds against the hospital and other charities (470–474). As regards the claim against the hospital, the court ruled that it would be unjust to give the plaintiffs a lien over the hospital’s

The situation presented itself in *Agip* where the court gave two reasons for refusing the victim of fraud's claim for money had and received.⁵⁸⁴ First, it is impossible to treat money that was transferred via telex instruction to a bank account as being received by the bank because the source of the mixed money cannot be established.⁵⁸⁵ Secondly, money received via an EFT cannot be traced at common-law because this would involve tracing the money through a number of accounts after it had been mixed with the money held in the account. It follows that the money's identification as money *in specie* was impossible due to commingling in the account.⁵⁸⁶

In *Lipkin Gorman I* the court asserted in relation to common-law tracing that although the law firm did not have a title to the money itself, it did have a title or chose in action to the debt that was owed by the bank to the firm by virtue of the deposit made at the bank.⁵⁸⁷ The chose in action meant that the firm had the right to trace the stolen money that was drawn from the account by the firm's partner into the hands of the Playboy Club.⁵⁸⁸ The court confirmed that a victim of theft who enjoyed a title to one asset can assert the same rights over the substitute asset. Once the Playboy Club received a traceable asset, the victim would be in a position to bring an action against him for money had and received.⁵⁸⁹

It is important to point out that in *Lipkin Gorman I* the court ignored the identifiability requirement for common-law tracing and instead based its finding on the right of the law firm as victim of the theft to trace the value of the money into the hand of the defendants. However, it must be emphasised that usually when the benefits of fraud or theft are deposited into a bank account, they will commingle with other funds in the account. It is therefore submitted that it is

land to secure its personal claim against it (546).

⁵⁸⁴ *Agip* 565–566.

⁵⁸⁵ *Idem* 566. Note that the facts of the case dictated this finding. In *Agip* the plaintiff's Tunisian bank debited his account with the amount in issue and instructed its correspondent bank, Lloyds Bank, to credit the account of a company controlled by a fraudster, one Baker. Baker's company transferred the money to Jackson, the defendant. The victim of the fraud instigated action against Jackson for money had and received. The fact that the commingling occurred in the bank account due to the transfers led to the failure of the victim's claim against Jackson.

⁵⁸⁶ See also par B.2.3 above re the ownership of bank of money deposited into an account.

⁵⁸⁷ *Lipkin Gorman I* 528–529. For the detailed facts of the matter, see par B.2.1 above.

⁵⁸⁸ *Lipkin Gorman I* 529. The plaintiffs managed to reclaim only part of the money that was stolen from their trust account from the Playboy Club.

⁵⁸⁹ *Ibid.*

unlikely that a bank which received the benefits of fraud or theft can be held liable on an action based on common-law tracing.⁵⁹⁰

In conclusion, should a bank be called on to defend itself against a common-law tracing claim it may avoid liability by raising either change of position or *bona fide* purchaser for value as defence.⁵⁹¹

4.3.3 Tracing in Equity

In contrast to common-law tracing a claim against a bank based on tracing in equity is more likely in relation to the benefits of fraud or theft that were deposited with a bank. This is because the tracing in equity claim gives rise to:⁵⁹²

[a] proprietary remedy which depends on the *continued existence* of the trust property in the hands of the defendant [bank].

In a tracing in equity claim the victim of fraud or theft must demonstrate that he has a beneficial interest in the substitute property and that equity can be raised against the bank which received the benefits of the fraud or theft.⁵⁹³ Once the process of tracing has established the victim's interest in the money, an order for payment provides the remedy.

A victim of fraud or theft must prove the following three requirements before the court will allow him to trace into substitute assets, namely:⁵⁹⁴ first, a claim to money held by the defendant bank, secondly, a proprietary right to trace, and thirdly, that a nexus exists between the money held by the defendant bank and the money that was fraudulently acquired or stolen from him to enable him in order to establish that the one represents the other. In general, the only limitation on the right to trace in equity is the existence of an initial fiduciary relationship between

⁵⁹⁰ See also Norman *Tracing* 113; Gleeson *Involuntary Launderer* 121.

⁵⁹¹ See par C.4.3.5 below.

⁵⁹² Millet (1991) *Law QR* 80. See also Fox (*Property Rights* 247) who explains that the equity courts are willing to apply a presumption of identification to mixtures of money. This approach leads to a degree of flexibility in the property rights which can be created over the mixture.

⁵⁹³ Nebhrajani *Money Laundering* 195; Wadsley and Penn *Domestic Banking* 303–304; Hedley *Restitution* 298; Grantham (1999) *NZU Law R* 403–405; Gleeson *Involuntary Launderer* 122.

⁵⁹⁴ *Agip* 566–570.

the defendant bank and the account holder.⁵⁹⁵ However, whether the ability to trace in equity is in fact restricted to a fiduciary relationship is a controversial issue. It is evident that regardless of criticism from academic circles,⁵⁹⁶ the judiciary requires the existence of a fiduciary relationship before an equitable tracing claim will be entertained.⁵⁹⁷

A victim of fraud or theft must further establish that the said money existed *continuously* in the hands of the defendant bank.⁵⁹⁸ This means that the victim can use tracing in equity as basis for a claim only where the bank exercises control over a amount similar to what was fraudulently acquired or stolen from him which he traced to the bank. Where the benefits of fraud or theft are mixed in a joint account, the courts are likely to apply either the ‘first in, first out’ rule⁵⁹⁹ or the *pari passu* rule⁶⁰⁰ to determine the order in which money was withdrawn from the mixed account.

4.3.4 *Foskett v McKeown*

The seminal ruling of the House of Lords in *Foskett* is of primary importance to banks as regards their potential civil liability in respect of the benefits of fraud and, therefore, it requires separate

⁵⁹⁵ *Diplock* 540; *Boscawen* 776.

⁵⁹⁶ See, for example, Dahan et al *Corporate Law* B8/2; *Moffat Trusts* 423; Reid *Civil Law and Money Laundering* D1/3. Smith (*Tracing* 120–130) denounces this requirement as ‘absurd’ and warns that as long as this requirement exists there will be ‘fictitious’ attempts to establish the existence of a fiduciary relationship where none exists (128).

⁵⁹⁷ See, for example, *Agip* 566–567; *Diplock* 540; *El Ajou* (701); *Westdeutsche Landesbank* 714, 716; *Boscowan* 335.

⁵⁹⁸ *Moriarty Tracing* 93–94.

⁵⁹⁹ As established by the court in *Devaynes v Noble, Clayton’s Case* (1816) 1 Mer 529, referred to in Hapgood *Paget’s Law of Banking* 237; *Moriarty Tracing* 76; *Fox Property Rights* 257–258. For example, (see *Diplock* 552–553) if money which was misappropriated from two different plaintiffs, was deposited in one bank account and the account holder withdrew some of it with the result that the balance is insufficient to cover two claims, ‘the first in, first out rule’ dictates that the money withdrawn first constitutes the money of the first plaintiff. It follows that the second plaintiff will be able to identify the balance of the money left in the account as his own whilst the first plaintiff may only bring a *personal* claim against the account holder for repayment of the money which he withdrew.

⁶⁰⁰ The rule was applied by the court in *Barlow Clowes International Ltd v Vaughan* [1992] 4 All ER 22 (CA). In issue was the liquidation of an investment company that had misappropriated money of two investment funds. The court affirmed that (33): ‘[as a] general rule of practice ... *Clayton’s case* is to be applied where several beneficiaries’ moneys have been blended in one bank account and there is a deficiency.’

evaluation. The *Foskett case* demonstrates how the judiciary can disagree on the legal principles of tracing which prove to be all but straightforward.

The facts in brief form are as follow; a fraudster was given money that he was supposed to spend on purchasing Portugese real estate.⁶⁰¹ Instead he spent the money on paying premiums on a life insurance policy for one million pounds on his own life. After his death, the purchasers of the real estate claimed ownership of the insurance proceeds in proportion to the trust money that was paid towards the policy's premiums. In particular, one of purchasers claimed that he could trace that share of the misappropriated money that belonged to him into the proceeds of the policy on the grounds that his money kept the policy alive. This amount came to a 40 percent share in the policy proceeds. The purchasers were not, as contended on behalf of the fraudster's children in whom the beneficial interest in the policy was vested, limited to a charge in respect of the premiums of the policy. In the end, the case ended before the House of Lords where the majority ruling differed from the ruling of the minority.

In the minority Steyn LJ outlined four considerations that collectively affected his view of the purchasers' claim.⁶⁰² Only the first consideration that pertained to the claim of the children and the purchasers is relevant in this context. The court asserted that the claim of the purchasers was not supported by considerations of fairness or justice.⁶⁰³ Hope LJ, also in the minority, also considered the fairness of the purchasers' claim. He argued that the purchasers had managed to recover some of their money into consideration.⁶⁰⁴ It follows that the equities laid with the children and, therefore, it was fair and just to restrict the purchasers's claim to a lien over the land that the fraudster should have bought with the money.⁶⁰⁵

Browne-Wilkinson LJ, Hoffman LJ and Millett LJ, in the majority, disagreed with this finding. Browne-Wilkinson LJ described the matter as one of 'hard-nosed property rights'⁶⁰⁶ and

⁶⁰¹ *Foskett* 106–108.

⁶⁰² 112–115. The considerations were: 1. the moral claims of the purchasers and the children; 2. the date on which some of the premiums were paid; 3. the fact that the purchasers had no substantive claim in unjust enrichment to some of the premiums; and 4. the fact that the children were innocent parties as far as the payment of the premiums were concerned.

⁶⁰³ 115.

⁶⁰⁴ 120–121.

⁶⁰⁵ 125.

⁶⁰⁶ 109.

did not find that consideration should be given to principles of fairness. Millett LJ agreed with the latter view and said that.⁶⁰⁷

[t]he transmission of a claimant's property rights from one asset to its traceable proceeds is part of our law of property, not of the law of unjust enrichment.

The majority court, therefore, reasoned that property rights are determined by fixed rules. The House of Lords clearly shared different views of why there should be divergences between the rules of common-law tracing and tracing in equity.⁶⁰⁸ Millett LJ was further of the opinion that the differences between common-law tracing and tracing in equity could not be justified.⁶⁰⁹ Once an asset had been identified in the tracing process the question arose which rights a plaintiff may have against the asset or the person who received it.⁶¹⁰ The majority in *Foskett* found that the plaintiffs were entitled to claim a share in the life insurance policy in proportion to which their money had contributed to it. Since the payments of the premiums were tantamount to the payment of money into a mixed account,⁶¹¹ the plaintiffs were awarded a *pro rata* share of the proceeds of the policy,⁶¹² a compromise that appears the finest solution for all parties involved.

Millett LJ explained that tracing involved three steps.⁶¹³ First, a plaintiff has to establish what had happened to his property, secondly, he must identify both the property's proceeds and the person who handled them and thirdly, he needs to justify the claim by demonstrating that the proceeds could be regarded as a substitute for his property. Tracing in equity, therefore, permits substitution of the original asset for its proceeds. It does not affect the plaintiff's claim, but may expose potential defences to his claim. Ultimately, the tracing process was successfully completed when either a personal claim or a proprietary claim to a legal or equitable right was established.

Millett J further evaluated the meaning of the phrase 'money at a bank'⁶¹⁴. Money paid into a bank account belongs legally and beneficially to the bank that gave value for it.⁶¹⁵ When an account holder is sued, the plaintiff is claiming the money in the hands of the bank. However,

⁶⁰⁷ *Foskett* 127. This view was supported by Browne-Wilkinson LJ and Hoffman LJ (idem 108, 132 respectively).

⁶⁰⁸ *Foskett* per Browne-Wilkinson LJ 109, Millett LJ 128.

⁶⁰⁹ 128.

⁶¹⁰ *Foskett* 113, 128.

⁶¹¹ *Foskett* 110 per Browne-Wilkinson LJ.

⁶¹² 127 per Millett LJ.

⁶¹³ 128.

⁶¹⁴ *Ibid.*

⁶¹⁵ See also par C.2.3 above.

the process of tracing money held in a bank account involved in actual fact not money *in specie* but instead a *debt* that represented the credit balance of the account holder. Where the bank balance shows a credit balance the bank stood as debtor against the account holder.⁶¹⁶ It follows that due to the nature of e-money and EFTs money does not pass through the banking system. It is merely a series of debits and credits that had been linked to the transaction.⁶¹⁷ Consequently, when money is traced it is not a physical asset that is being traced but its underlying value. Millett LJ pointed out that a plaintiff who had established a right to trace, is also entitled to claim any profits that the defendant had earned with it.⁶¹⁸ Most notably, funds that were incorrectly transferred could be claimed from both the recipient of the funds and the bank that made the error. Finally, Millett LJ suggested that the only defence to a proprietary claim in respect of traceable assets would be that of a *bona fide* purchaser for value.⁶¹⁹

It is evident from the *Foskett* ruling that equity rules are renowned for their unpredictability. For this reason, English courts are unable to provide fixed guidelines that can promote certainty. For the most part the *Foskett* ruling provides a fine summary of key tracing principles. Finally, if the view of Lord Millet, who importantly asserted that the distinction between common-law tracing and tracing in equity was superfluous, is followed by the judiciary it could serve to simplify, even unify, the various tracing rules which may result in more predictable and reliable outcomes.

4.3.5 Evaluation

A claim based on tracing instigated by a victim of fraud or theft against the bank that received the benefits of the fraud or theft.

The question of whether a claim based on common-law or tracing in equity is more likely to succeed against a bank that received the benefits of fraud or theft should be answered with reference to the *Foskett* ruling. The importance of the *Foskett* decision in tracing issues is two-fold. First, the court established that tracing concerns property rights which renders the divergence between common-law and equitable tracing unnecessary. Secondly, once money has been

⁶¹⁶ *Foskett* 128.

⁶¹⁷ *Ibid.*

⁶¹⁸ *Foskett* 130.

⁶¹⁹ 129. See par C.4.3.6 below as regards the *bona fide* purchaser for value defence.

identified in the tracing process the question arises which rights a victim of fraud or theft may have against the bank which received the funds. Ultimately, tracing in equity allows substitution of the original asset for its proceeds. This point is key as regards the benefits of fraud or theft which commingled with other money in a bank account. It is evident that a victim of fraud or theft need not to identify money *in specie* that was fraudulently acquired or stolen from him, but instead can claim its value as substitute from the bank.

So regarded, a victim of fraud or theft does not need to use common-law tracing that requires, *inter alia*, that money claimed must remain identifiable in the hands of the bank. If the benefits of fraud or theft were deposited with a bank and commingled with other funds in the account, identification of the money *in specie* is unlikely.⁶²⁰ On account of the reasons above it is evident that a claim against a bank as recipient of the benefits of fraud or theft based on equitable tracing is likely to succeed only if the victim of fraud or theft can establish all the requirements spelt out above.

Of significant, tracing can be used by a victim of fraud or theft only against a bank which still exercise control over the money. If the benefits of fraud or theft were subsequently withdrawn by the fraudster or thief, the victim will be unable to use tracing as basis for the claim.

4.3.6 Defences to Restitution Claims

There are mainly three defences able to avail a defendant bank against a restitution claim instigated against it by a victim of fraud or theft. They include the defence of:⁶²¹

1. *bona fide* purchaser for value;
2. change of position;⁶²² or
3. ministerial receipt.

A defendant bank must establish the following four requirements before it can successfully invoke the defence of *bona fide* purchaser for value:⁶²³ first, it is a purchaser in good

⁶²⁰ See, for example, the *Agip* case above.

⁶²¹ See in general Wadsley and Penn *Domestic Banking* 326–328; Fung *Defences* 11/1–11/24; Cox & Taylor *Cheques* 542–543; Hedley *Restitution* 304; Birks *Restitution* 439–441; Tettenborn *Restitution* 25–27; Birks *Enrichment* 240–245.

⁶²² For a review of the historical development of the defence at English law, see Krebs *Change of Position* 296–302; Fox *Property Rights* 274–275.

⁶²³ Fox *op cit* 278–301; Burrows *Restitution* 588; Smith *Tracing* 389; Polly Peck 781.

faith, secondly, for a valuable consideration, not by gift, thirdly, with no actual or constructive notice of any alleged or real deficiencies in the title of the money, and fourthly, who would be prejudiced by recovery of the money. Consider the scenario where a bank received stolen money and used it to reduce the overdraft of the account holder. As a result, it may be able to raise the defence of *bona fide* purchaser for value because using the money to reduce the overdraft of the account holder amounted to a full consideration except if the bank's conduct was *mala fide*. If the bank received the stolen money while knowing that it was stolen it would be unable to resort to the *bona fide* purchaser for value defence.

In *Lipkin Gorman I* the court considered, *inter alia*, whether the defendant had given consideration for the stolen money it received through gambling.⁶²⁴ Since gaming contracts are illegal and hence void, the court held that the club had no legal obligation to honour the bets⁶²⁵ and, therefore, it could not be a *bona fide* purchaser for value.⁶²⁶ It follows that a bank can only raise the defence of *bona fide* purchaser for value defence where it acquired the benefits of fraud or theft in good faith and without knowledge of the victim of fraud or theft's claim.

Whether the bank should have known or suspected that the money in issue was criminally acquired may further determine the outcome of the matter. The degree of knowledge or suspicions of the bank will depend on the circumstances of the matter and whether there was any reason for it to be suspicious about the source of the money or the purpose of the transaction. In this regard the bank's conduct will be judged according to the five categories of knowledge as laid down by the court in *Baden Delvaux*.⁶²⁷

It is submitted that actual or constructive knowledge on the part of the bank, for example, of the criminal source of the funds or the impropriety of a transaction should be as much a

⁶²⁴ *Lipkin Gorman I* 529–532.

⁶²⁵ *Idem* 530: '[w]hen Cass placed a bet, he received nothing in return which constituted valuable consideration. The contract of gaming was void.'

⁶²⁶ *Lipkin Gorman I* 534. Note, the defence of *bona fide* purchaser for value applies only where the defendant bank acquires a *valid* title to the money in question (Vaswani (1997) *J of Financial Crime* 46). It follows that a defendant bank as recipient of the benefits of fraud (see par C.2.3 above) should be able to successfully invoke the defence if the mentioned requirements have been met. Conversely, where the benefits of fraud were traced, for example, to a work of art, the defendant will be unable to use the defence of *bona fide* purchaser for value because he could not have obtained a valid title to a work of art from the seller. This is because of the principle *nemo dat quod non habet* which means that the seller could have never obtained a valid title himself to give in return to the defendant.

⁶²⁷ See par C.4.2.2 above as regards the knowledge requirement.

requirement of tracing as it is for constructive trust claims. The real question for the court to decide should be whether the circumstances in which the benefits of fraud or theft were received by the bank should have raised its suspicions about the source of the money or the purposes of the transaction. The bank could have questioned, for example, the character of the customer and its source of income. The question of whether the bank did or did not have an honest belief as regards the aforementioned arises after the bank becomes suspicious. Unless grounds for suspicions exist, no one at the bank would have a relevant belief for the purpose of imposing liability on the bank. It is further submitted that the fact that a bank received the benefits of fraud or theft without any knowledge of the funds' origin should bar claims on either knowing receipt or dishonest assistance as well as tracing.⁶²⁸

Change of position as a defence involves balancing the interests of the parties involved in the claim.⁶²⁹ A defendant bank which faces a claim based on any of the restitution actions above⁶³⁰ may invoke change of position as a defence but must establish that it has changed its position in good faith in such a way that it would suffer an injustice if ordered to repay the amount in issue.⁶³¹ Although only available in exceptional circumstances, the defence enables fairness in cases where a right of restitution has been recognised.⁶³² The change of position defence was successfully invoked by the defendant bank in *Lipkin Gorman I*.⁶³³ The court in analysing the nature of the change of position defence remarked that it is better to allow the law on the subject to develop on a case by case basis.⁶³⁴

It is evident that the change of position defence will succeed only if the defendant bank's change of position is causally linked to the money it received from the fraudster or thief.⁶³⁵ The

⁶²⁸ See paras C.4.2.3–4.3.4, C.4.3 respectively above.

⁶²⁹ *Lipkin Gorman I* 533.

⁶³⁰ See paras C.4.2–4.3 above.

⁶³¹ See in general Smith *Tracing* 34–38, 383; Birks *Enrichment* 173, 208–209; Fox *Property Rights* 317–318.

⁶³² *Lipkin Gorman I* 532–532. In *Boscawen* the court referred to *Diplock* and proposed that the decision of the court, which found it unjust to allow the plaintiffs a lien over the grounds of a hospital, is analogous to an application of the defence of change of position (782).

⁶³³ The club was therefore required to repay only part of the gaming winnings to the plaintiffs (*Lipkin Gorman I* 536).

⁶³⁴ *Idem* 534.

⁶³⁵ Cox & Taylor *Cheques* 547; Nolan *Change of Position* 146; Krebs *Change of Position* 301. Sadly, by virtue of the requirement it seldom will be possible for a bank to rely on this defence.

defendant bank must also have acted in good faith and without knowledge of the facts leading to the victim of fraud or theft's claim.⁶³⁶ It follows that honesty on the side of the bank employee enables the bank to rely on the defence; dishonesty precludes its use.⁶³⁷ The judiciary seems willing to interpret the defence broadly.⁶³⁸ In *Phillip Collins*⁶³⁹ the court asserted that the defendants had an evidential burden to establish their defence and that one should be 'beware of applying too strict a standard.'⁶⁴⁰ The court accepted that if the defendants were paid the correct amount in royalties their expenditure would have been lower.⁶⁴¹ As a result, the plaintiff's claim was reduced by one-half.

The third defence to a restitution claim is ministerial receipt.⁶⁴² The defence is available to an agent who transferred money to his principal by mistake, and enables the victim of the mistaken transfer to sue the principal instead of the agent for repayment of the money. It follows that a bank that received the benefits of fraud or theft and paid the funds away by mistake must prove three elements in order to escape liability. First, that it received the benefits of fraud or theft in good faith which entails that it had no knowledge of the victim's claim before the money was paid away. Secondly, payment was indeed made, and thirdly, the bank must prove that it acted as a principal during the transaction. A bank which paid the benefits of fraud or theft to the

⁶³⁶ *Birks Burden* 208; *McInnes Enrichment* 198.

⁶³⁷ *Birk Enrichment* 207–208, 231; *Birks Restitution* 410.

⁶³⁸ See *Scottish Equitable plc v Derby* [2000] 3 All ER 793 [*Scottish*]; *Phillip Collins Ltd v Davis* [2000] 3 All ER 808 [*Phillip Collins*]. In *Scottish* the defendant received overpayments in terms of a pension policy. Despite assuring the defendant that the amounts he received were indeed correct, the plaintiff nevertheless filed suit against him for repayment of the money it paid out incorrectly (793–794). The defendant explained that he changed his position, *inter alia*, by using some of the money to reduce his mortgage and to improve his lifestyle. The court accepted the defence only as regards the money he spent on amending his lifestyle and found that he was enriched with the balance of the money.

⁶³⁹ This case concerned a group of musicians who accompanied the singer, Phil Collins, on a world tour. Their royalties earned on an album made of this tour were incorrectly calculated resulting in overpayments that continued for years. When the plaintiff tried to claim back the money the defendants cited change of position as a defence and contended that the money was spent on living expenses (*Phillip Collins* 808–810).

⁶⁴⁰ 827.

⁶⁴¹ *Phillip Collins* 830.

⁶⁴² See in general Reid *Civil Law and Money Laundering* D1/34; Hooley & Taylor *Payment by Fund Transfer* 168–170 who discuss the defence in relation to fund transfers; Birks (1989) *LMCLQ* 303–304; Swadling *Ministerial Receipt* 244–245; Watts (1995) *Restitution LR* 69; Bryan *Recovering Money* 167–169; *Birks Burden* 208; *Birks Enrichment* 245–247.

wrong recipient without realising its mistake will also not be liable for money had and received.⁶⁴³ However, a bank that was aware of the victim's claim and proceeded to pay the money in issue away would be precluded from invoking the defence of ministerial receipt.⁶⁴⁴ Instead, the defence of change of position could be raised.⁶⁴⁵ Reid⁶⁴⁶ correctly points out that in most cases the defence of ministerial receipt will not be available to banks, because a bank as recipient of the benefits of fraud or theft becomes owner of the money and may do with it as it pleases.⁶⁴⁷

It is submitted that under ordinary circumstances only the defence of *bona fide* purchaser for value is likely to avail a bank as recipient of the benefits of fraud or theft against a claim based on one of the restitution actions evaluated above. However, the success of the defence will obviously depend on whether the bank can establish that it acted in good faith when it received the benefits of fraud or theft. Conversely, the defence of change of position may avail a bank only in specific circumstances, for example, where the bank paid the benefits of fraud or theft away in good faith which renders repayment to the plaintiff unfair. It should be noted that as a minimum condition the change of position defence requires like the *bona fide* purchaser for value defence that the bank acted in *good faith*. It follows that neither defences can be raised against a victim of fraud or theft whose claim against the bank is based on dishonest assistance.

In summary, key questions to determine a bank's potential civil liability to a victim of fraud or theft may include the following: did the bank use due diligent measure to establish the source of the deposited funds, did the bank have knowledge and/or suspicions as regards the nature of the customer's instructions, did the bank approach the court for guidance on how to deal with requests for disclosure of account information, are there any equitable rules that preclude a ruling against the bank and are there any defences available which render a ruling in favour of the plaintiff inequitable under the given circumstances? It is evident that while the courts are willing to entertain civil claims against banks as recipients of the benefits of fraud or theft, civil claims based on knowing receipt, dishonest assistance, common-law or equitable tracing do not

⁶⁴³ See *Burrows Restitution* 599; par C.4.3.2 above.

⁶⁴⁴ *Hooley & Taylor Payment by Fund Transfer* 170; *Bryan Recovering Money* 169.

⁶⁴⁵ *Birks Burden* 214.

⁶⁴⁶ *Civil Law and Money Laundering* D1/35–36.

⁶⁴⁷ See par C.2.3 above as regards the bank's ownership of deposited money.

always bring in predictable results. As in most civil claims a court's ruling is likely to depend on the prevailing circumstances of the matter.

4.4 Civil Forfeiture

4.4.1 Action *in Rem*

The second remedy which is available to redress the consequences of crime is civil forfeiture. To reiterate, civil forfeiture is a remedy that aims to deprive a criminal of the fruits of his unlawful conduct.⁶⁴⁸ Civil forfeiture is further a suitable remedy to address the consequences of criminal conduct in instances where there are no clear victims of crime which have suffered a loss.⁶⁴⁹ The government as representative of the public acts as claimant against a criminal in civil forfeiture proceedings. In contrast, the restitution remedies analysed above may be used only by a victim of crimes such as fraud or theft to claim loss from a bank as recipient of the benefits of fraud or theft which were unlawfully acquired from him.⁶⁵⁰

Significantly, although title to the benefits of fraud or theft passes to the bank when a deposit is made, the account holder is owner of the debt that the banks owes to him on account of the deposit.⁶⁵¹ It is that debt and not the benefits of crime *in specie* which the government seeks to forfeit when it brings a civil forfeiture application against funds in an account. It follows that it is the account holder and not the bank that is the party whose property is being seized and, therefore, the party to contest the forfeiture application.

The Strasbourg Convention advises that EU member states adopt national legislation to enable them to confiscate the benefits of crime and to assume any other measures required for such an order.⁶⁵² England codified broad statutory forfeiture measures that provide for both criminal and civil forfeiture. Under the PCA the concept 'confiscation'⁶⁵³ is used to denote proceedings that follows after a conviction has been attained. In contrast, civil forfeiture denotes

⁶⁴⁸ See also paras B.4.2.1, C.4.2.1.1 above.

⁶⁴⁹ See ch 1.A.3, par B.

⁶⁵⁰ See paras C.4.2.3–4.2.4, C.4.3 above.

⁶⁵¹ See par C.2.3 above.

⁶⁵² Article 3 of the Strasbourg Convention.

⁶⁵³ Note, at English law the concept 'confiscation' refers to the act of calculating how much money a criminal has made from criminal activity (sections 6–37 of the PCA).

the removal of so-called ‘recoverable property’ without first establishing in criminal court the guilt or innocence of a defendant in relation to a crime.⁶⁵⁴ The director of the Asset Recovery Agency⁶⁵⁵ is tasked with retrieving recoverable property from a defendant.

4.4.2 Proceeds of Crime Act 2002

4.4.2.1 General Provisions

Two distinct civil forfeiture law systems have been codified in the PCA to deprive criminals of the benefits of crime. The first system is known as civil recovery.⁶⁵⁶ It deals with bank accounts and other assets and involves High Court proceedings. The second is a cash forfeiture system that pertains to cash discovered by the police during searches.⁶⁵⁷ This system holds risks particularly for banks that offer safe-deposit facilities. The concepts ‘recoverable property’⁶⁵⁸ and ‘associated property’⁶⁵⁹ are key in civil forfeiture proceedings. The PCA defines the concept ‘property’ broadly to include all types of property, including property that is situated outside England.⁶⁶⁰ According to the PCA⁶⁶¹ property is obtained by unlawful conduct⁶⁶² if it is either received by such conduct, or in return for such conduct. Property remains recoverable by the state even when it is impossible to link it with a particular criminal act.

⁶⁵⁴ Sections 243, 302(1) of the PCA. See in general Smith & Owen *Asset Recovery* 237–242; Alldridge *Money Laundering Law* 232–240; Kennedy (2004) *J of Fin Crime* 8–12.

⁶⁵⁵ Whose mandate is described in sections 1–5 of the PCA.

⁶⁵⁶ Section 243 of the PCA (see par C.4.4.2.2 below).

⁶⁵⁷ Section 298 of the PCA (see par C.4.4.2.3 below).

⁶⁵⁸ Which is any property obtained through unlawful conduct (section 304(1) of the PCA). Interest on stolen money paid into a bank account is also regarded as recoverable property (Graham *Money Laundering* 87).

⁶⁵⁹ Which is property that is non-recoverable (section 245(1) of the PCA). Where property was purchased partly with the benefits of crime and partly with legitimately earned money, the latter part will not be not recoverable, hence the concept ‘associated property’ (Smith & Owen *Asset Recovery* 251).

⁶⁶⁰ Section 316(4)–(7) of the PCA..

⁶⁶¹ *Idem* section 242(1)–(2).

⁶⁶² The PCA fails to list offences to which the Act applies. Instead, conduct is unlawful if it occurred in England and it is unlawful under English criminal law, or if it occurred abroad and was unlawful under both the criminal law of that country and under English law had it transpired in England (section 241(1)–(2) of the PCA; Millington & Williams *Forfeiture* 345).

Significantly, civil forfeiture proceedings do not need to be brought against the perpetrator of crime, but may be brought against any person holding recoverable property at that time whether they themselves have acted unlawfully or not. Banks, in particular, should take notice of the PCA's provisions that concern recoverable money. Three sections of the PCA are important in this regard.⁶⁶³ First, section 304 of the PCA allows for the benefits of crime to be followed into the hand of some other person. For example, if stolen money is given to a third-party to deposit into the latter's bank account, it remains recoverable property despite the fact that it commingled in the bank account with legally acquired money. Secondly, section 306 of the PCA provides that where a person mixes the benefits of crime with legitimately earned money, the proportion of the mixed property representing the benefits of crime is recoverable property. This section effectively addresses the difficulty presented by the identification of criminally acquired money that were deposited into a bank account and mixed with other funds in the account.⁶⁶⁴

Thirdly, section 305 of the PCA provides for the situation where a person disposed of the benefits of crime and received property in return for it. This is called 'representative' property and may also be recovered by the state despite the fact that the acquirer was a *bona fide* purchaser for value.⁶⁶⁵

4.4.2.2 Civil Recovery Proceedings

The director of the Assets Recovery Agency is responsible for investigating the potential criminal nexus of property and for commencing civil recovery proceedings. It should be reemphasised⁶⁶⁶ that civil recovery proceedings are not aimed at establishing the guilt of the defendant, but instead is aimed at retrieving recoverable property. The standard of proof in civil recovery proceedings is the balance of probabilities⁶⁶⁷ which means that the court may apply a flexible standard of proof

⁶⁶³ Sections 304–306 of the PCA.

⁶⁶⁴ See par D.4.3.2 above.

⁶⁶⁵ Section 305(1)–(2) of the PCA. See also par C.4.3.6 above.

⁶⁶⁶ See par C.4.4.1 above.

⁶⁶⁷ Section 241(3) of the PCA.

and grant a recovery order where the probability exists that the property was acquired through crime.⁶⁶⁸

If the court is satisfied that property is ‘recoverable’,⁶⁶⁹ it will issue an order vesting the property in the trustee for civil recovery.⁶⁷⁰ The order may split recoverable property from any associated property.⁶⁷¹ However, the court is precluded from making recovery orders that are incompatible with the European Convention on Human Rights and Fundamental Freedoms of 1950⁶⁷² or that are detrimental to a person who received recoverable property in good faith and for value and without knowledge that it was recoverable property.⁶⁷³

4.4.2.3 Cash Forfeiture Proceedings

The second civil forfeiture system codified in the PCA is aimed at the recovery of criminally acquired cash.⁶⁷⁴ Banknotes and foreign currency found during an investigation must be seized⁶⁷⁵ and detained⁶⁷⁶ before a civil forfeiture application is filed in court.⁶⁷⁷

A person such as a victim of fraud or theft who claims ownership of the cash may apply for its release prior to the application. Cash will be released only if two conditions have been met.⁶⁷⁸ First, the cash belongs to the applicant who was unlawfully deprived of it, and secondly, the cash was not recoverable property before he was deprived thereof. It therefore follows that civil forfeiture of cash will be ordered only where it is recoverable property or where it was

⁶⁶⁸ For example, in *B v Chief Constable of the Avon and Somerset Constabulary* ([2001] 1 All ER 562) the court asserted that a civil standard of proof does not always signify a balance of probability (573). In fact, the civil standard of proof is a flexible standard that can be applied according to the seriousness of what needs to be proved and the implications thereof (574).

⁶⁶⁹ Section 266(1)–(2) of the PCA.

⁶⁷⁰ The trustee of recovery is a person who was nominated by the Director of the Recovery Agency (section 267(1)) and subsequently appointed by the High Court.

⁶⁷¹ Section 266(7) of the PCA.

⁶⁷² *Idem* section 266(3)(b).

⁶⁷³ Section 308(1) of the PCA.

⁶⁷⁴ Section 289(6)–(7) of the PCA defines the concept ‘cash’ as including notes and coins in any currency, postal orders, cheques of any kind, banker’s drafts, bearer bonds and bearer shares, and any kind of monetary instrument.

⁶⁷⁵ Section 289(2)–(3) of the PCA.

⁶⁷⁶ *Idem* section 297(2)–(3).

⁶⁷⁷ Cf section 298(1) of the PCA.

⁶⁷⁸ Section 301(1)–(3) of the PCA.

intended for criminal use. It is submitted that these provisions provide fair protection to a victim of fraud or theft who has followed the fraudulently acquired or stolen cash to the bank account of the fraudster or thief. It is evident that cash will not be forfeited to the state where there is a victim of fraud or theft who is able to establish his right to the money.

4.4.3 Innocent Owner Defence

Section 266 of the PCA is designed to protect innocent third parties such as banks that unknowingly acquired an interest in recoverable property. The applicant must establish four requirements before the court will make an order that it just and equitable that the property in issue may not be recovered by the Assets Recovery Agency. The four requirements are:⁶⁷⁹ first, the applicant acquired the property in issue in good faith, secondly, it took action before or after obtaining the property which it would not have taken if it had not acquired the property, thirdly, it had no knowledge that the property was recoverable when he took the action and fourthly, a recovery order will be detrimental to it on account of the action that it has taken in relation to the property.

If, for example, a bank as mortgagor learns that a residence in which its interest vests was confiscated because it was used for criminal purposes, it may approach the court as innocent owner for an order to the effect that it will not be just and equitable to make a recovery order in relation to its interest in the property. Both the degree of detriment that the applicant is likely to suffer as well as the Director's interest in receiving the realised proceeds of the recoverable property will be considered by the court in deciding whether a recovery order would be just and equitable. It is submitted that the court will need to balance the two interests to decide what would be just and equitable in the prevailing circumstances.

It is, however, clear that the protection afforded by section 266 of the PCA to innocent owners of recoverable property is limited to certain innocent owners only. They include banks which acquired an interest in property that is earmarked for civil forfeiture. It is submitted that in contrast to the wide protection afforded to persons who was unlawfully deprived of cash, a victim of fraud or theft who followed the fraudulently acquired or stolen money to a bank account and attempts to recover the money before it is forfeited, may have limited success. This is

⁶⁷⁹ *Idem* section 266(5).

because he will be unable to establish the requirements of section 266 as stated above. It is therefore further submitted that the protection afforded under section 301 should be extended so that it may be used by any person who claims ownership of recoverable property that is earmarked for civil forfeiture.

4.4.4 Interim Recovery Orders

Prior to commencing civil recovery proceedings, the Assets Recovery Agency may apply to the court for an interim receiving order.⁶⁸⁰ This is an order for the detention or preservation of property that is claimed to be either recoverable property or associated property.⁶⁸¹ The purpose of the order is to prohibit a person whose property is subjected to the order from dealing with the property pending the outcome of the trial.

An injunction may be serve on the bank where a bank account that is subject to civil forfeiture proceedings is being held. Five facts must be established by the state before the court may freeze a bank account.⁶⁸² First, there is a real risk that the account holder will withdraw funds in the account to avoid execution of a judgment, secondly, it is likely that the state will secure judgment against the account holder, thirdly, if it allows the account holder to withdraw funds from the account there is a serious risk that such withdrawal removal will result in economic loss for state, fourthly, the state has undertaken to pay the bank's expenses in administrating the order and fifthly, if the bank mistakenly allowed withdrawal of the funds by the account holder it may be held liable for contempt of court. Note, the bank does not owe a duty of care towards the party who obtained the order.⁶⁸³

An interim recovery order usually calls for the appointment of an interim receiver who must take any steps that the court deems necessary⁶⁸⁴ to secure the detention, custody, or the

⁶⁸⁰ Section 246(1) of the PCA; Alldrige *Money Laundering Law* 237–239.

⁶⁸¹ Note, the order is also known as a Mareva injunction which is an injunction that limits the disposal of assets pending trial or the execution of a judgment. See in general Collins *Court Orders & Banks* 94; Aslett [2003] *J of Fin Crime* 230–231; Thomas *Maritime Liens* 75; *The Rena K* [1979] QB 377 410.

⁶⁸² *Customs and Excise* 813.

⁶⁸³ See par C.2.1 above.

⁶⁸⁴ Section 251 of the PCA; Counsell *Freezing Assets* H1/15–17; Alldrige *Money Laundering Law* 239.

preservation of property which is subjected to the order.⁶⁸⁵ The defendant need not be informed of the application and any order may be given by the court.⁶⁸⁶ If the court has granted an interim receiving order and subsequently fails to conclude that the property is recoverable or associated property, the defendant may apply to the court for compensation.⁶⁸⁷ If successful, the court will order the Director of the Assets Recovery Agency to pay compensation that is reasonable in light of the relevant circumstances and the loss that was suffered. Before 1988 it has been accepted that interim injunctions were limited to assets situated in England and could not be granted in relation to assets situated abroad. This position was confirmed in *Ashtiani v Kashi*⁶⁸⁸ where the court found that an injunction was limited to assets situated within the court's jurisdiction.⁶⁸⁹ Consequently, the court refused to order disclosure ancillary to the Mareva injunction in relation to assets situated outside its jurisdiction. However, in subsequent judgments the Court of Appeal held that disclosure orders relating to foreign assets could be made after judgment had been given against the defendant.⁶⁹⁰ Of note, in *Republic of Haiti v Duvalier*⁶⁹¹ the court established that the conduct of the defendants would determine whether an injunction in aid of foreign proceedings should be granted. A key question in the above cited matters relates to the effect of interim injunctions on third parties. An applicant approaching the court for permission to enforce a

⁶⁸⁵ See section 247(1) of the PCA.

⁶⁸⁶ *Idem* section 246(4)–(6).

⁶⁸⁷ Section 283 of the PCA.

⁶⁸⁸ [1986] 2 All ER 970 [*Ashtiani*].

⁶⁸⁹ *Ashtiani* 977.

⁶⁹⁰ See, for example, *Maclaine Watson & Co. Ltd v International Tin Council (No 2)* [1989] Ch 286. In *Babanaft International Co SA v Bassatne* ([1989] 1 All ER 433 (CA) 444) judgment was given against debtors in the amount of 15 million US dollars. The debtors were foreign nationals who resided in Switzerland and in Greece. The court *a quo* ordered the debtors to disclose the whereabouts of their assets and granted an injunction to prevent them from dissipating assets held outside its jurisdiction. The debtors subsequently appealed against the court's orders. The Court of Appeal considered the nature of the Mareva injunction over assets situated abroad. It further referred to the *Ashtiani* case (*idem* 976, 979 - see above) where the court asserted that Mareva injunctions should be limited to assets situated in the jurisdiction of the court. The court remarked that the *Ashtiani* judgment did not intend to restrict the application of the Mareva injunction, but instead, intended to prevent discrimination against persons who are domiciled outside its jurisdiction (447). It therefore rejected the debtors' appeal and ordered them to disclose the said information.

⁶⁹¹ [1990] 1 QB 202 216–217.

freezing order abroad must show a ‘real prospect’⁶⁹² of assets existing in the country in which the enforcement was to take place.

A final issue for consideration in this section pertains to the attachments of English bank accounts in support of foreign proceedings. Article 24 of the Brussels Convention of 1968⁶⁹³ provides that an application of this kind may be made to the courts of a contracting country for any preventative or protective orders as may be available under the law of that country. It follows that an English court may freeze a bank account in support of the foreign proceedings.

5. Individualised Anti-Money Laundering Measures

5.1 Financial Services Authority

The Financial Services Authority⁶⁹⁴ was established pursuant to the Financial Services and Markets Act 2000⁶⁹⁵ to assume a regulatory position in England. The 2000 Act and the political interest in combating money laundering in the EU alike accentuated to the FSA the importance of effective AML measures. At present, the FSA has four priorities as regards combating money laundering. They include:⁶⁹⁶ ensuring that the senior management of regulated firms accepts responsibility for implementing AML measures, monitoring compliance with the 2007

⁶⁹² See, for example, *Dadourain Group International Inc and others v Simms and others* [2005] 2 All ER 651 664. This case concerned a family dispute and prior litigation that arose due to an agreement with a company that went sour. The plaintiffs who were family members of the defendants, obtained a worldwide freezing order against the company and other family members. The order contained an undertaking that precluded its enforcement abroad without the permission of the court. The plaintiff had traced trust assets comprising foreign currency, bank guarantees, and safe boxes in Switzerland which ostensibly belonged to the defendants and successfully approached the court for permission to enforce the freezing order in Switzerland (652–660). The defendants subsequently applied to the court to have the order set aside and asserted that the plaintiffs were unable to prove that the assets in Switzerland belonged to them and that a risk of dissipation existed (655–656). The court agreed that enforcement of a foreign freezing order could be oppressive, (662–663). However, in this case sufficient evidence was presented to grant permission to enforce the freezing order in Switzerland (664).

⁶⁹³ See par B.4.1.2 above.

⁶⁹⁴ Or ‘FSA’.

⁶⁹⁵ Or ‘2000 Act’. Prior to the enactment of the 2000 Act the FSA was regulated by the Bank of England Act 1998.

⁶⁹⁶ *Sergeant Money Laundering Conference* par11.

Regulations as well as identifying weaknesses in AML measures, assessing the risk of money laundering in certain industries and providing training and support for these regulated industries.

The FSA's greatest contribution to the AML efforts in England is in its money laundering rules.⁶⁹⁷ The Rules state, *inter alia*, that when the FSA needs to determine the compliance of a bank with customer due diligence measures, compliance to the guidance notes of the Joint Money Laundering Steering Group⁶⁹⁸ shall be taken into consideration.⁶⁹⁹ The Rules further sanction prosecution for non-compliance violations whilst the 2000 Act⁷⁰⁰ provides that private persons may take civil action to recover losses suffered due to breaches of the Rules. Pursuant to section 146 of the 2000 Act, the Rules of the FSA apply only to authorised persons carrying on regulated⁷⁰¹ activities - hence banks fall under their scope. Key rules parallel statutory provisions and in general advise on compliance with statutory AML requirements, the determination of money laundering risks and internal systems aimed at money laundering prevention.⁷⁰²

5.2 Joint Money Laundering Steering Group

The Joint Money Laundering Steering Group⁷⁰³ was established in 1990 to offer guidance on money laundering prevention to firms operating in various financial sectors. It consists of 16 trade associations from the financial sector and is chaired by the British Bankers Association.⁷⁰⁴ The Steering Group issued a set of guidance notes⁷⁰⁵ in 2001 which advocate good practices in relation to the 2003 Regulations.⁷⁰⁶ The guidance notes were updated in 2004 and again in 2007⁷⁰⁷ to conform⁷⁰⁸ with the 2007 Regulations.⁷⁰⁹ The 2007 edition of the guidance notes comprises

⁶⁹⁷ See FSA *AML Instrument* (the Rules).

⁶⁹⁸ See par C.5.2 below.

⁶⁹⁹ FSA *AML Instrument* 3.2.6.E.

⁷⁰⁰ See section 150 of the Act.

⁷⁰¹ Which is any regulated activity (see par C.2.1 above) excluding activities relating to insurance (FSA *AML Instrument* 1.1.3).

⁷⁰² See FSA *AML Instrument* 3.2.6D, 3.2, 3.2.6G and 3.2.7 respectively.

⁷⁰³ Or 'Steering Group'. See in general Salter *Remedies For Banks* 36 ev.

⁷⁰⁴ See in general Griffiths *England* 235; Bennett *Money Laundering* 16.

⁷⁰⁵ See JMLSG *Guidance Notes*.

⁷⁰⁶ See par C.3.5 above.

⁷⁰⁷ See JMLSG *Revised Guidance Notes* and JMLSG *Prevention of Money Laundering* respectively.

⁷⁰⁸ JMLSG *Consultation Paper* par 2.1.

⁷⁰⁹ See par C.3.5 above.

comprehensive and detailed information that brings to mind the AML recommendations issued by the FATF.⁷¹⁰ The purpose of the guidance notes is fourfold:⁷¹¹ outlining the AML legal framework, interpreting relevant laws, indicating AML practices and assisting FSA regulated firms to design controls necessary to mitigate the risks of money laundering.

Significantly, a court may consider the guidance notes to determine whether a bank has complied with the 2007 Regulations and whether reasonable grounds existed for its suspicion of money laundering.⁷¹² However, since the guidance notes function as industry-related guidelines, failure to comply with them is not an automatic indication that a bank has breached either the 2007 Regulations or the FSA's Rules. This is because banks may adopt internal AML rules in accordance to the risk-profiles and businesses of customers.⁷¹³

In line with the 2005 Directive and the 2007 Regulations the guidance notes accentuate the implementation of customer due diligence measures⁷¹⁴ as well as the adoption of a risk-based approach to the application of these measures. The remaining three elements of the KYC standard are also included in the guidance notes.⁷¹⁵ Adequate identification⁷¹⁶ of customers features as a crucial aspect in the guidance notes. Banks are advised to take appropriate steps to obtain identification evidence from customers, and are precluded from transferring money to a third party until the identity of the customer has been established.⁷¹⁷ The guidance notes further assist bank with determining whether reasonable grounds⁷¹⁸ exist for suspecting money laundering. Central to recognising or forming a suspicion about a money laundering scheme is possessing sufficient information about the customer and his business in order to determine what normal

⁷¹⁰ See ch 5.B.3.3.

⁷¹¹ JMLSG *Prevention of Money Laundering* par 2.

⁷¹² See section 330(8) and section 330(1)–(2) of the PCA respectively.

⁷¹³ JMLSG *Prevention of Money Laundering* paras 14–16.

⁷¹⁴ *Idem* chapters 4–5 (see also ch 5.B.3.2.5).

⁷¹⁵ See JMLSG *Prevention of Money Laundering* chapter 6 (suspicious transaction reporting), chapter 7 (staff training) and chapter 8 (record-keeping).

⁷¹⁶ The concept 'identity' refers to attributes that collectively identify a natural or legal person (*idem* par 5.3.2.5). See also Baxley & Foster *Money Laundering* 18.

⁷¹⁷ JMLSG *Prevention of Money Laundering* paras 5.1.5–5.1.14.

⁷¹⁸ *Idem* 5.2.8. The guidance notes describe the concept 'knowledge' with reference to section 330 of the PCA (see paras C.2.1, C.3.4.3.1 above), which description encompasses the first three categories of knowledge set in *Baden Delavaux* (see par C.3.4.1 above). A suspicion of money laundering is more subjective than possessing actual knowledge, but some foundation for the suspicion must exist (JMLSG *Prevention of Money Laundering* paras 6.9–6.10).

activities the customer is likely to conduct.⁷¹⁹ No actual knowledge of money laundering is required, merely knowledge or a suspicion that a person is engaging in money laundering.

It is evident that all the various AML rules, guidance notes, and regulations function collectively conjointly to advise banks on how to meet the required standards of money laundering prevention. The positive side of this is that the aforementioned information may serve to guide banks in dealing with ambiguous situations as regards a customer or his account activity. However, on the negative side, too much information may result in uncertainty, especially in situations that fall outside set frameworks.

5.3 Money Laundering Advisory Committee

The Money Laundering Advisory Committee was formed in 2002 to ensure the effectivity of the English AML regime. To this end, its aims are fourfold, namely to: improve coordination of the AML regime, review the effectiveness of the AML strategy, provide a platform for comments and advice as regards international money laundering developments and to make recommendations that are subsequently referred to Parliament for approval.

The Money Laundering Advisory Committee therefore unites various role players in an effort to combat money laundering. This additional level of expertise may render valuable assistance to the Treasury in devising money laundering related advice of importance to banks.

D. CHAPTER COMMENTARY AND SUMMARY

The first part of the chapter was devoted to the AML regime of the EU whilst the English AML regime was evaluated in the second part. Various commonalities between the EU legal position and the English legal position were revealed. It soon became evident that in both jurisdictions the relationship between a bank and customer is based on contract with the obligation to observe customer confidentiality is being imposed *ex contractu* on a bank. Significantly, it was apparent that regardless of some loopholes, both jurisdictions provide safe-harbour protection to banks that could resolve the tension that exists between the confidentiality duty of banks and their reporting duty. However, due to the wording of the provision banks may still face civil claims on account

⁷¹⁹ *Idem* par 5.2.8.

of breach of bank confidentiality. It was further evident that in both jurisdictions a bank becomes owner of the benefits of crime after the funds were deposited with a bank which renders it vulnerable to criminal and civil liability alike.

A review of the EU and English's AML legislation established that in both jurisdictions the Subjective Model of Money Laundering Control is followed which means that banks may decide individually which transactions are suspicious and, therefore, reportable. The analysis importantly emphasised that in both jurisdictions erstwhile KYC standard provisions have been replaced by advanced customer due diligence measures that could assist banks in identifying potential money launderers before they could gain access to the banking system.

It was further seen that the English Parliament favoured a risk-based approach to the identification of the benefits of crime which compares favourably with the provisions of 2005 Directive. However, since the PCA was promulgated three years prior to the 2005 Directive, it is more likely that the PCA emulated the provisions of the 2001 Directive. It was soon evident that the PCA has been much more detailed and broadly formulated than the 2001 Directive. It is, therefore, submitted that instead of using the 2001 Directive as blueprint, the English Parliament used US AML legislation⁷²⁰ as template for its own money laundering control statute. It follows that whilst the English Parliament took notice of the EU's AML directives, it nevertheless established an AML regime that has a distinct EU law flavour with a US statutory twist.

The chapter further illustrated that the PCA provides generously for the deterrence, detection and prosecution of money laundering offences. Of significantly, it was seen that except for a few provisions the PCA requires few amendments to elevate it to the standard of the 2005 Directive. In fact, only the 2005 Directive's two categories of customer due diligence measures must be inserted into the PCA.

The evaluation considered the extent to which EU and English law provides for civil claims filed by a victim of fraud or theft against a bank as former recipient of the benefits of fraud or theft. Clear divergence between EU and English law was evident. It was asserted that since EU member states retain the right to decide individually how to deal with civil suits stemming from money laundering, EU legislation on jurisdiction would come into play only where parties to a civil action were situated in different EU member states. However, due to the nature of EU law and the absence of an *ius commune* EU law is unlikely to render assistance to a victim of fraud

⁷²⁰ See ch 7.C.2–3.

or theft in instigating civil action against a bank as former recipient of the benefits of fraud or theft.

It was further seen that in the absence of an EU *ius commune* English courts use common-law remedies to address the consequences of using banks to warehouse of launder the benefits of fraud or theft. Further in this regard, an argument was made that the English judiciary attempted to provide clarity of fundamental legal principles, for example, whether claims based on restitution principles were personal or proprietary in nature. With this in mind, it is submitted that most of the arguments put forward in this regards are of academic value only. These arguments overlap in many ways because often little doubt existed of whether the bank should be held accountable to the victim of fraud or theft. It was subsequently illustrated that defendant banks more often than not have to make good to victims of fraud or theft to the value of loss suffered and whether a personal or proprietary remedy should be applied depends solely on the circumstances of a particular matter.

Further in this regard, it was illustrated that a victim of fraud or theft has two potential remedies against the bank which received the benefits of fraud or theft. Which remedy will be most suitable depends on the circumstances of the matter. It was submitted that the constructive trust remedy of knowing receipt is more likely to succeed against a bank which received and parted with the benefits of fraud or theft than a claim based on dishonest assistance. Tracing in equity can be used with success by a victim where the bank to which it followed the benefits of fraud or theft exercised control over the money at the time of *litis contestatio*. Reasons for these syntheses were spelt out in great detail in the text. The investigation, however, revealed that despite the availability of the three defences, where the facts of a matter demonstrated that it is equitable courts would not hesitate to impose civil liability on the bank.

The evaluation also considered the civil forfeiture provisions of the two jurisdictions. It was indicated that English law as opposed to EU law provides widely for civil forfeiture. The common-law origin of the English civil forfeiture model was accentuated in the chapter because irrespective of its inherent unfairness, the English Parliament enacted detailed civil forfeiture provisions. In contrast to EU law that accentuated transborder cooperation in relation to civil forfeiture orders, English civil forfeiture law provides a variety of procedures that cater for the civil forfeiture of different types of criminally derived property. However, it was seen that whilst the PCA affords only limited protection to certain innocent owners of deposited money that is the subject of civil forfeiture proceedings, the Strasbourg Convention extends its protection to

any person who has an interest in the said money. This means that a victim of fraud or theft who was unlawfully deprived of money which ended up being deposited into the bank account of the fraudster or thief, may use the innocent owner defence if the EU state where he resides incorporated a similar provision to the one in the Strasbourg Convention in its national civil forfeiture legislation. Clearly this was not done by the English Parliament. For this reason it was recommended that the PCA should be amended in order to rectify the current position. It was further evident that English courts had no problem to enforce foreign civil forfeiture orders in relation to recoverable property.

Ultimately, the analysis revealed that both EU and English AML legislation requires banks to obtain a great amount of information about potential and existing customers. It is submitted that the greater the amount of information that banks are required to obtain about potential and existing customers, the more onerous their responsibilities are likely to become, both in complying with legislation as well as in preventing civil liability. However, since the onus to remedy related AML problems does not lay solely with the courts, it is proposed that the banking industry should become more involved with the AML effort. Unambiguous industry guidelines coupled with assistance from customers could contribute to assuage some of the burdens that banks bear in this regard. To this end, it was evident that the various AML measures of the EU legislature coupled with the AML efforts of key English role players could offer much needed guidance to banks operating in the EU region as regards improving existing money laundering control measures.

In conclusion, this chapter commenced with a chess quotation that suggests that White by adopting a refined combination of chess moves should be able to achieve Checkmate over Black. To draw from the chess analogy, this chapter illustrated that divergent combinations of money laundering control measures exist. Both the EU and English AML regimes comprise straightforward yet detailed AML measures aimed at achieving maximum results. Significantly, the imposition of advanced customer due diligence measures must be one of the best moves made recently to counter the use of banks to facilitate money laundering. Not only should banks be able to identify the benefits of crime with greater efficacy, but this may in turn protect them against civil claims by customers and victims of fraud and theft alike.

In Chapter 7 the AML regime of the US falls under the spotlight. The analysis will show that while the US AML regime has connecting points with the English AML regime, it does not conform to any of the AML regimes analysed in this study. In fact, it will soon become evident

that despite detailed provisions and far-reaching AML measures, the fragmented nature of US AML legislation poses the greatest threat to the regime's overall efficiency.

(Chapter 7 to follow)

PTO

CHAPTER 7

COMPARATIVE POSITION RE MONEY LAUNDERING II - THE UNITED STATES OF AMERICA

In order to achieve the Checkmate the King must be driven into the corner ... the principle of the hunt for the King is this: the King, the Bishop and the Knight ... must apportion different tasks to each other, thus aiding each other; they must not perform any task doubly which would amount to an unnecessary competition between each other and would be a useless effort.

LASKER Chess 20

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A. INTRODUCTION

1. Overview

Chapter 6 illustrated that the AML regimes of the EU and England include simplistically phrased legislation that is supplemented by rules and individualised AML measures. It was established that a victim of fraud or theft can employ the traditional English common-law remedy of constructive trust against a bank that paid deposited benefits of the fraud or theft to the account holder whilst suspecting that he was not entitled to the fund. Significantly, banks that heed statutory AML obligations are not protected against potential civil liability of this kind.

Following the enactment of the Currency and Foreign Transactions Reporting Act¹ in 1970 to sanction the tracing of the benefits of crime, many other AML statutes were enacted by the US Congress² to outlaw money laundering. The forthcoming analysis emphasises the complex nature of the US AML framework which comprises a myriad of AML statutes, regulations and individualised AML measures. The US AML authorities and other role players evidently believe in the effectiveness of the system that was refined over a period of more than three decades. Yet, whether such a complex model of AML control is necessary when compared to the more simplistic models of money laundering control of the EU and England³ is one of the key questions underpinning the chapter.

With this in mind, this chapter sets forth the AML regime of the US as well as potential civil remedies that may address the consequences of using banks to warehouse or launder the benefits of fraud or theft. This chapter commences with an outline of US federalism and in particular, the manner in which the legislative authority and dual judicial system of the US interact with each another. Thereafter the AML regime of the US is evaluated within the context of the following critical aspects: (I) the consequences that money laundering and money laundering control carry for the bank-customer relationship; (II) AML legislation in so far as it concerns the KYC standard; (III) the extent to which US law allows for civil claims filed by a victim of fraud or theft against a bank as recipient of the benefits of fraud or theft; (IV) the mechanics of civil forfeiture as codified remedy; and (V) individualised US AML measures. This chapter concludes with a summary and some comments about the aforementioned aspects. But before analysing the

¹ 31 U.S.C. The Currency and Foreign Transactions Reporting Act is known as the Bank Secrecy Act ('BSA') - see par C.2 below.

² Or 'Congress' which constitutes the legislative body of the US.

³ See ch 6.B, par C respectively.

structure of the US money laundering control regime, it may be useful to highlight briefly some of the intricacies of the US legal system.

2. Legal System of the United States

The US is a federal republic which means that its legal authority is divided between a single national government and the governments of the 50 states and the District of Columbia.⁴ Under the US Constitution,⁵ the federal government has the authority to make and enforce laws pertaining to issues of national concern.⁶ Most notable is the power of the federal government to regulate both interstate and foreign commerce.⁷ Its authority extends to include most issues that the federal government considers important except those that have local importance.⁸

Federal laws regulate subjects such as banking and securities, to mention but a few.⁹ Crucially, federal statutes overrule state laws which are incompatible with federal designs.¹⁰ There are a number of areas in which Congress has elected not to use its legislative authority¹¹ and which are governed by state law. These include, for example, contract law and the law of tort.¹² In such cases the common-law of the US applies.¹³ So, two parallel judicial systems exist in the US: a federal court system and a state court system. Since money laundering prevention is regarded as a matter of national importance, federal case law is central to the discussion at hand and is

⁴ Sager *Legal Authority* 27.

⁵ Entitled the United States of America Constitution ('US Constitution').

⁶ Article VI section 2 of the US Constitution. Cf Sager *Legal Authority* 31.

⁷ Article I clause 8 of the US Constitution.

⁸ Born & Westin *Civil Litigation* 5–8; Born et al *US Courts* 53.

⁹ Rapson *Commercial Law* 365. The two main federal statutes dealing with banking issues are the Federal Bank Holding Company Act of 1956 (12 U.S.C.) and the National Bank Act of 1863 (12 U.S.C.).

¹⁰ Article VI clause 2 of the US Constitution.

¹¹ *Idem* article I section 8(3).

¹² Born et al *US Courts* 53; Knapp *Contract Law* 202. The law of torts concerns wrongful conduct that gives rise to a civil action 'either at law or in equity under the principles of the law of torts' (section 128 comment (a) of the Restatement of Restitution - *ALI Restatement of Restitution* 526). Cf Rogers *Restitution* 3.

¹³ In contrast to England which has uniform common-law principles, the US have a general common-law that is applied differently by each state. The common-law of the US derives from English common-law principles which were exported from England to the US during early colonisation (Hughes *Common Law* 13).

therefore referred to most often.¹⁴ However, when necessary rulings of state judiciaries are referred to.

Finally, two issues are imperative in relation to US law. First, when a federal court decides over issues arising under federal statutes, it will apply federal law.¹⁵ Since money laundering has been criminalised, *inter alia*, by federal statutes, most of the decisions referred to in this chapter were adjudicated by federal courts interpreting federal AML laws. Regardless, most US states in an effort to prevent confusion in relation to the different state laws have adopted the Uniform Commercial Code.¹⁶

The second issue concerns US common-law.¹⁷ In 1923 the American Law Institute¹⁸ was organised to prepare an:¹⁹

[o]rderly statement of the general common-law of the United States, including ... not only the law developed solely by judicial decision, but also the law that has grown from the application by the courts of statutes that have been generally enacted and have been in force for many years.

Therefore, since 1923 restatements of the various common-law disciplines have been issued by the ALI. Three common-law restatements are referred to in this chapter, namely restatements of the foreign relations law, law of restitution and the law of trusts.

B. _____ BANK -CUSTOMER RELATIONSHIP

1. Debtor and Creditor Relationship

¹⁴ Note, this also constitutes the reason for analysing in this chapter the federal AML statutes instead of the AML statutes of the individual states.

¹⁵ *Schroeder Financial Institutions* 14-03. In *Barnett Bank of Marion County, NA v Nelson* (517 US 25 (1996)) the court was called upon to decide whether a federal statute that allows national banks to sell insurance pre-empts a state statute that forbids them to do so. The court affirmed that (30): '[u]nder ordinary pre-emption principles, the federal statute pre-empts the state statute.'

¹⁶ The Uniform Commercial Code ('UCC') was adopted by 49 of the 50 US states with the exception of Louisiana (Sager *Legal Authority* 36; Clark *Law* 50).

¹⁷ See also par D.1 below.

¹⁸ Or 'ALI'.

¹⁹ *ALI Restatement of Restitution* ix.

At common-law the relationship between a bank²⁰ and a customer-depositor²¹ is that of debtor and creditor.²² A fiduciary relationship is seldom established.²³ In general, a customer stands in the

²⁰ Note that the legislation evaluated in this chapter applies to ‘financial institutions’ which include banks, security dealers, currency exchangers, funds transmitters, casinos and anyone subject to federal banking authority. The concept ‘bank’, however, is used for the purpose of narrowing the issue at hand, but the law is not so limited.

²¹ Significantly, in comparison to other aspects of a bank’s business, the acceptance of deposits is not regulated by statute (Klausner *Banks* 570). Section 24 of the National Bank Act of 1863 merely provides that national banks may engage in traditional and banking activities and incidental activities necessary to carry on the ‘business of banking’ (cf Williams & Jacobsen (1995) *Business L* 783). Banks have three core functions, namely accepting deposits, lending money and cashing cheques (Klausner *Banks* 569). Therefore, the acceptance and handling of money as deposits constitute only a part of legitimate banking business (*Community Bankers Association v Clarke* 766 F Supp 1519 (1990) 1522). In general, ‘deposit’ implies ‘a sum of money placed in the custody of the bank, to be withdrawn at will of [the] depositor’ (*United States v Jenkins* 943 F 2d 167 (2nd Cir 1991) 169). Therefore, a deposit is only established once money or its equivalent is ‘put into’ a bank (*Betz v FDIC* 99 F 3d 904 (9th Cir 1996) [*Betz*]). But the manner in which a customer treats a bank account is not in itself an overriding factor in deciding whether the account constitutes a deposit account (*Betz* 907).

²² *Lexus Michie on Banking Vol 5A* 3; *Schroeder Financial Institutions* 18-1, 18-5; *Norton & Whitley Banking* 11-28; UCC section 4-201; *Selby v DuQuoin State Bank* 223 Ill App 3d 104 (1991) [*Selby*] 108. In *United States v Monostra* (125 F 3d 183 (3rd Cir 1997) [*Monostra*]) the court confirmed that when a customer deposits money into a bank account, it becomes a creditor of the bank. In general, the bank is not a custodian of money that was deposited into the bank account (*idem* 186–187). In *Hopewell Enterprises, Inc v Trustmark National Bank* (680 So 2d 812 (Miss 1996) [*Hopewell Enterprises*]) the court distinguished between ordinary depositors and mortgagors who are customers of a bank. It found that the relationship between a bank and a person to whom it extended a mortgage loan is simply one of debtor and creditor (815 - cf par B.2 below).

²³ *Schroeder Financial Institutions* 18A-54; *Norton & Whitley Banking* 11-32. Special circumstances, however, may impose the fiduciary duty of disclosure upon a bank, for example, if a bank has knowledge of facts which concern the customer, it may have a duty to disclose them. Conversely, in *Rubenstein v South Denver National Bank* (762 P 2d 755 (Ct App Col 1988) [*Rubenstein*]) the court ruled that due to the fiduciary relationship existing between the bank and the customer, the former is obligated to keep confidential information concerning the affairs of the latter (756). The complexity of a transaction may create a relationship of trust between the bank and the customer and therefore the bank may have a fiduciary duty to disclose certain facts to the latter. The court explained that the relationship between the bank and the customer is neither that of an agent and principal nor of trustee and beneficiary. Since title to deposited money is transferred from the customer to the bank, the bank also does not receive a deposit as a bailee. Significantly, in *United States v Banco Cafetero Panama* (797 F 2d 1154 (2nd Cir 1986) [*Banco Cafetero*]) the court agreed that in most instances a bank is not a bailee of deposited money with the result that a depositor may not follow the money as chattel (see ch 2.A.1) into the hands of another customer (*Banco*

position of a creditor²⁴ to the bank which in turn, stands as a debtor to the customer.²⁵ This is similar to the position under EU, English and South African law.²⁶

The bank-customer relationship is based on a contract,²⁷ implying that the nature of the relationship between the parties may be altered *ex contractu*²⁸ or due to the nature of the deposit.²⁹ A bank as recipient of money is under an obligation to credit the account of the customer and to repay the money upon receiving written authorisation to do so.³⁰ As soon as a customer deposits money into a bank account,³¹ title to the funds passes to the bank with the effect that the customer receives a *contractual*³² claim against the bank for an amount equal to the balance of the account. The deposited money becomes part of the funds of the bank, ownership vests in the bank and the

Cafetero 1157. For the facts of the matter, see par D.3.3 below.). A bank would only receive money as a bailee where the bank-customer relationship is the result of the rental by the bank to the customer of a safe deposit box.

²⁴ In *Monostra* the court held that a bank does not become a custodian of funds deposited into a bank account (187). Instead, the customer becomes a creditor of the bank in the amount of the deposit.

²⁵ However, the nature of the relationship will depend on whether the customer opens a general or specific account at the bank (Norton & Whitley *Banking* 11-8). Significantly, the bank becomes the owner of money deposited into a general account because it commingles with other funds held by the bank.

²⁶ See ch 6.B.1, par C.1; ch 3.B.2.1–2.2 respectively.

²⁷ *National Bank of Monticello v Quinn* 126 Ill 2d 129 (1988) [*Monticello*] 134. In the absence of an agreement to the contrary, the UCC will also govern the contract between the bank and a depositor. Note, the law governing the contract between a bank and a customer is the *lex loci contractus* (*Wells Fargo Asia Ltd v Citibank* 660 F Supp 946 (1987) 948).

²⁸ Norton & Whitley *Banking* 11-28. The rights and obligations of both the bank and the customer are determined *ex contractu*. Ambiguous contractual terms are interpreted against the bank.

²⁹ *APOCOA Inc v Fidelity National Bank* 703 F Supp 1553 (1988) 1557. Contracts between banks and customers may cover some but not all aspects of an EFT (Scott (1983) Columbia LR 1668). See also Hughes (1992) *Indiana LR* 316 and Ballen & Diana (1990) *Business L* 1399 who discuss the bank-customer relationship.

³⁰ *Tenark Construction Corporation v Great American Mtg Investors* 566 F 2d 105 (1978) 107–108. The obligations of the parties are implied terms of the contract between them.

³¹ In evaluating the nature of a bank account, the court in *Citizens Bank v Strumpf* (116 S Ct 286 (1995)) declared that a bank account does not comprise money that is held by the bank for the customer (289). Instead, it comprises a *promise* from the bank to the customer to pay the amount of money in the account on demand.

³² *In re Bakersfield Westar Ambulance Inc* 123 F 3d 1243 (9th Cir 1997) [*Bakersfield*] 1248.

latter may deal with the money as it pleases.³³ In this sense an ordinary debt is created. In addition, a mutual obligation exists between the parties resulting in the bank's right of set-off.³⁴

Similar to South African and English common-law,³⁵ a bank is bound by an implied contractual term to repay the same amount deposited by a customer on his demand. In this context the contract between the parties is unlike other money lending contracts. By virtue of the special relationship that exists between a bank and the customer and the fact that the bank gains the confidence of the customer, it is expected that the bank will act with fairness towards the customer.³⁶ The duties of the bank to act in good faith³⁷ and to take ordinary care with respect to the affairs of its customer, are likewise implied contractual terms of the agreement between the

³³ Lexus *Michie on Banking Vol 5A 15*.

³⁴ *In re Nat Warren Contracting Co* 905 F2d 716 (4th Cir 1990) 718. The right of a bank to set off a deposit against the indebtedness of its customer stems from the debtor-creditor relationship that exists between a bank and its customer. A customer exchanges his title to money deposited with a bank for a debt owed to him by the bank (*In re Bennett Funding Group Inc* 146 F 3d 136 (2nd Cir 1998) [*Bennett*] 139).

³⁵ See ch 3.B.2.1.1 and ch 6.C.2.1 respectively.

³⁶ *Monticello* 135.

³⁷ See section 1-203 of the UCC which imposes an obligation of good faith in the performance of every 'contract or duty within [the UCC].'

parties.³⁸ Moreover, a bank is compelled to act with the ‘utmost fidelity and care’³⁹ as regards deposits made with it.

A bank may be liable in tort⁴⁰ when it acts negligently in handling the affairs of a customer. Negligence consists in the failure to observe the care of a reasonable person in similar circumstances which is an objective standard.⁴¹ This means that a plaintiff seeking to hold a bank liable based on tort must establish that the act or omission of the bank is one that a reasonable

³⁸ Schroeder *Financial Institutions* 18-9; Bernstein *Contracts* 182–185. However, a bank does not owe a duty to exercise care when accepting a deposit where the depositor does not have a bank account with the bank and is not one of its customers (*Swiss Baco Skyline Logging Inc v Haliewicz* 567 P 2d 1141 (1977) [*Swiss Baco*] 1147). In *Swiss Baco* the plaintiff sought to hold the defendant bank liable on the basis of negligence because it paid proceeds of timber sales into the wrong account (1142–1143). The court found that no breach of the bank’s duty to exercise care when receiving deposits has occurred (1146). It asserted that since no contract existed between the bank and the plaintiff, the bank did not owe the plaintiff a duty of care (1147).

³⁹ Lexus *Michie on Banking Vol 5A* 31. However, in *Betty Bryant, Personal Representative of the Estate of Everal Grace Nichols v Community Choice Credit Union* (Colorado Court of Appeals No 05CA0910, 25 January 2007) [*Betty Bryant*] 1) the court found that a credit union had a duty to exercise *ordinary* care in the handling of deposits and was liable for damages arising from breach of the duty (13). This matter concerned a fiduciary’s improper use of a credit union account, the credit union’s duties to the principal and its potential civil liability based on constructive trust. The court *a quo* found in favour of the defendant which ruling the Appeal Court reversed in part. The facts of the matter are complex (2–4). In short, the plaintiff, Nichols, an 81 year old woman who assisted by her agent Lynch, opened an account with the Community Choice Credit Union (Credit Union). A year later she learned that the account was closed and that Lynch had transferred funds out of the account to finance personal loan transactions between himself and the Credit Union. The plaintiff, acting on behalf of Nichols consequently sued the Credit Union for breached of duty of good faith, money had and received and constructive trust (see par D.2 below). The court *a quo* found in favour of the defendant explaining that it owed no duty to Nichols as regards Lynch’s use of the money in the account. The plaintiff took the ruling on appeal. The Appellate Court found that since the Credit Union was aware that Lynch was acting in breach of trust when he withdrew money from Nichols’s account for personal use, it was liable for breach of trust (16).

⁴⁰ Schroeder *Financial Institutions* 18-09; York et al *Remedies* 5; Dobbs et al *Torts* 165. However, it is a root principle of US negligence law that a person is only liable for neglecting the interests of others if the result caused harm to them (Gergen *Enrichment Symposium* 29). As mentioned elsewhere in this study (see ch 1.C), the potential civil liability of banks based on delict, which at US law is called ‘torts’, falls beyond the scope of the study and is therefore not considered in this setting.

⁴¹ A bank breaches its duty of reasonable care towards a customer when it fails to ensure that repayment of deposited money is made to the person whose signature appears on the signature card (Norton & Whitley *Banking* 11–29).

bank would have recognised as posing a risk to the customer.⁴² The customer must establish the existence of a duty of care on the side of the bank before the bank will incur liability due to its carelessness.⁴³ Whether such a duty exists between the parties is a question of law. Significantly, it appears as if the courts are seldom willing to impose civil liability on a bank in a situation where no contract exists between the bank and the plaintiff. Therefore, victims of fraud or theft seeking

⁴² Zekoll & Fleming *Torts* 193.

⁴³ *Software Design & Application Ltd v Hoefer & Arnett Inc* (56 Cal Rptr 2d 756 (Ct App 1996) [*Software Design*] 759; *Eisenberg v Wachovia Bank NA* 301 F 3d 220 (4th Cir 2002) [*Eisenberg*] 224. In light of current AML legislation, the rulings in the latter cases cannot be supported and are in fact peculiar. In *Software Design* a financial advisor defrauded the plaintiff of various securities and investments (757–758). He opened a fictitious bank account with a brokerage firm and transferred funds electronically from the firm to the fictitious accounts. The plaintiff sought to recover the money, *inter alia*, from the banks on the basis of their negligence in opening and administering the accounts for the fraudster. The court ruled that banks did not have a duty to inquire in relation to the fund transfers because nothing could have indicated to them that the plaintiff, a non-customer, had an interest in the funds which were transferred (759). Under the circumstances the banks had no specific duty to conduct further enquiries as regards the legitimacy of the transfers and therefore they were not liable for negligence. More recently, a similar ruling was handed down in *Eisenberg*. The plaintiff, Eisenberg, was the victim of a fraudulent investment scheme, operated by one Reid (221–222). As instructed by Reid Eisenberg electronically transferred one million US dollars to a branch of the defendant bank for deposit in an account with the name ‘Douglas Walter Reid dba bear Stearns’, ‘For Further Credit to BEAR STEARNS.’ Wachovia Bank accepted the transfer and deposited the funds to the credit of the specified account. Reid subsequently withdrawn almost all of Eisenberg’s money. Eisenberg sought to impose liability on Wachovia Bank based, *inter alia*, on Wachovia Bank’s negligence for allowing Reid to open a bank account and failing to detect fraud. The court declined to hold Wachovia Bank liable mainly because it found that the bank did not owe Eisenberg a duty of care as the latter was not one of the bank’s customers (225). The court first established that a federal rule that preempted negligence did not apply because it did not create a conflict with the relevant state law (223). Secondly, it considered whether a bank owed a duty of care under North Carolina law to a noncustomer such as Eisenberg. Whether Wachovia Bank owed a duty of care to Eisenberg depended on the relationship between them (224). In this case Eisenberg had no *direct* relationship with Wachovia Bank and never conducted business with the bank. The court was therefore unable to find a precedent under the law of North Carolina as well as from other jurisdictions which would hold Wachovia Bank liable to a non-customer. In fact, courts in other jurisdictions have held that a bank does not owe a duty of care to a non-customer with whom the bank has no *direct* relationship. Eisenberg was neither a customer of Wachovia Bank nor the person in whose name the account was opened. The court therefore dismissed the negligence claims against Wachovia Bank because the latter did not owe Eisenberg a duty of care. In contrast, see above the ruling of the Colorado court in *Betty Bryant*.

to impose civil liability on banks in order to recover loss they have suffered as a result of fraud or theft will need to find some other cause of action to do so.

In general, a bank is not liable for loss suffered by a customer except if there is an established nexus between the conduct of the bank and the loss the customer suffered.⁴⁴ Should conflicting claims arise as regards money deposited with a bank, the bank becomes a mere stakeholder with respect to the money without having a lien or security over it.⁴⁵

2. Bank Confidentiality

Under US law,⁴⁶ bank confidentiality means that banks must keep information that they received about customers in the course of business secret and confidential.⁴⁷ Historically, Swiss bank secrecy laws⁴⁸ caused the negative perception that the US government holds of bank confidentiality.⁴⁹

⁴⁴ See in general Zekoll & Fleming *Torts* 193–194.

⁴⁵ In *United States v Central Bank* (843 F 2d 1300 (10th Cir 1988)) money deposited into a bank account turned out to be subject to a levy held by the Internal Revenue Service (IRS). The court was called upon to decide to whom payment of the money should be made. It ruled that the depositor of the money retained a chose of action with respect to the bank account at the time the defendant bank was informed of the IRS's levy (1305).

⁴⁶ Some of the constitutions of different US states restrict access to customer information by including rights to privacy in bank records (Schroth *Bank Confidentiality* 285). However, since federal AML statutes, which sanction the violation of privacy rights (see paras C.2–8 below), outrank state constitutions in cases where provisions conflict (see par A.2 above), no constitutional protection exists to protect customers against breach of privacy.

⁴⁷ Douglas & Lohr (2005) *Wisconsin LR* 1047; Schroth *Bank Confidentiality* 284–285.

⁴⁸ The role of Swiss bankers in advancing bank secrecy during World War II is evaluated elsewhere in this study (see ch 3.2.3.1). In short, the Swiss in an effort to foil attempts of the Nazis during World War II to repatriate funds of German nationals kept abroad, enacted official bank secrecy laws prohibiting disclosure of the identity of individuals who had Swiss bank accounts. When Germany invaded Poland during World War II, the Swiss moved their funds to the US (Note (1988) *Vanderbilt J of Transnational L* 66). In 1941, the US government, fearing that Nazis were hiding their money in Swiss accounts, tried to obtain the names of German account holders from branches of Swiss banks that were located in the US (Chambost *Bank Accounts* 6–7; Horowitz (1985) *Texas Internat LJ* 133). However, because some of the money held at US branches of Swiss banks was in the names of other Swiss banks, the government was unable to obtain the information it sought and therefore forbade the removal of Swiss funds out of the US.

⁴⁹ Anonymous bank accounts are available in countries such as the Bahamas and the Cayman Islands (Meyer ((1978) *New England LR* 43; Note (1986) *Syracuse J of Internat LC*

A number of legal doctrines founded in contract, agency and tort recognise and protect the rights of persons to financial privacy.⁵⁰ At common-law, the obligation of a bank to maintain the confidentiality of a customer is an implied term of the deposit contract between the parties. The obligation was recognised by the court in the English matter of *Tournier v National Provincial & Union Bank of England*,⁵¹ and subsequently became integrated in US law.⁵² Some privacy rights are codified in the Right of Financial Privacy Act of 1978⁵³ which protects a person's right to financial privacy from government interference.⁵⁴ Tort theory also has been interpreted as providing some protection to an individual's right to financial privacy.⁵⁵

But, despite establishing a foundation for protecting the financial privacy of customers of banks, US legal doctrines may be circumvented in two ways. First, by the government in 'pursuit of justice.'⁵⁶ Secondly, individuals seeking to file suit against a bank may in the process obtain a disclosure order against the bank which could potentially breach the confidentiality of the bank's customers. Ostensibly, banks are required in the first instance to comply with statutory disclosure provisions and disclosure orders. All other considerations come second, including the potential violation of bank confidentiality rules.

525–526; Comment (1987) *Houston J of Internat L* 58). The US government recognise the negative outcome of bank confidentiality and therefore it enacted the BSA (see par C.2.1 below).

⁵⁰ Gagnon (1990) *Vanderbilt J of Transnational L* 660n32; Kauffman (1985) *Vanderbilt J of Transnational L* 820. Privacy, an absolute right, is viewed by statisticians as the choice of an individual to refuse to provide information (Douglas and Lohr (2005) *Wisconsin LR* 1047). In contrast, confidentiality deals with protecting the information that has been provide by an individual to a financial institution (ibid).

⁵¹ [1924] 1 KB 461[*Tournier*] 472 (see also ch 3.B.2.3.2; ch 6.C.2.2).

⁵² Compendium (1979) *Internat BL* 281; Schroth *Bank Confidentiality* 284; Rutledge *Regulatory Law* O2-11.

⁵³ As Title XI of the Financial Institution Regulatory and Interest Rate Control Act of 1978 (12 U.S.C.) is known (cf Plombeck (1988) *Internat Lawyer* 94).

⁵⁴ Section 3402(1) of the Right to Financial Privacy Act prohibits a bank to disclose accounts records of a customer to a governmental agency without the customer's consent. There are three exceptions to this rule, key of which is that the disclosure is sanctioned by other federal statutes (section 3413). Cf Gouvin (2003) *Baylor L R* 965.

⁵⁵ Plombeck (1988) *Internat Lawyer* 69n3; Fisher *Financial Privacy* 71.

⁵⁶ Jones (1992) *Northwestern J of Internat L & B* 465. The relationship between the right to privacy and the need for public disclosure has been described as 'schizophrenic' (Pickholz et al *Civil Law* O1-1).

The first significant court ruling that dealt with a bank's obligation of secrecy is *Peterson v Idaho First National Bank*.⁵⁷ In this case the court recognised absolute secrecy as an inherent principle of the relationship between a bank and customer. It furthermore applied and extended the principles established in the English decision of *Tournier* to US law.⁵⁸ The court indicated⁵⁹ that the relationship between a bank and customer is sometimes based on agency and, therefore, the bank as agent has an obligation not to disclose information about his customer, the principal. Since confidentiality is an inherent aspect of this relationship, the bank was held liable for breach of an implied contractual term. On occasion, the judiciary distinguished between depositors and borrowers to whom banks made mortgage loans in relation to the duty of bank confidentiality.⁶⁰ In one case the court found that because a customer is obligated to disclose information when applying for a loan, the bank owes him a duty of confidentiality.⁶¹

In contrast, in *Hopewell Enterprises*⁶² the court regarded the relationship between a bank and a mortgagor as involving only debtor-creditor duties which exclude a duty of confidentiality. While it is therefore evident that concurrence is unlikely in the context of bank confidentiality, the finer solution in this regard is probably the one suggested by the court in *Rubenstein*.⁶³ In *Rubenstein* the court ruled that the facts of the matter should be investigated to determine whether a duty of confidentiality existed between a bank and a customer.⁶⁴ However, it is submitted that like the South African and English position,⁶⁵ a bank's duty of confidentiality should be an implied term of the contract between the bank and customer and therefore, any investigation to determine its existence is unnecessary and superfluous. As soon as the bank-customer relationship

⁵⁷ 367 P 2d 284 (1961) [*Peterson*]. Peterson sued his bank because it disclosed information about his account to his employer (286). The court found the bank liable as it breached the implied contract between itself and a customer to treat information concerning the latter as confidential (289–290).

⁵⁸ *Peterson* 289.

⁵⁹ *Peterson* 290–291.

⁶⁰ See, for example, *Jordan v Shattuck National Bank* (868 F 2d 383 (10th Cir 1989) [*Jordan*] where the court likewise ruled that a confidentiality duty arises during the loan application process rendering a bank which misuses information it obtained liable for damages (386).

⁶¹ *Jordan* 387.

⁶² 815.

⁶³ See also par B.1 above.

⁶⁴ 756.

⁶⁵ See ch 3.B.2.3 and ch 6.C.2.2 respectively.

commences the bank will be obligated to observe a duty of confidentiality in relation to the affairs of the customer.

US money laundering control legislation accentuates the reporting duty of banks.⁶⁶ The duty has been upheld by the judiciary despite protests as regards the infringement of the privacy rights of customers.⁶⁷ Records of transactions conducted by foreign banks based in the US as well as records kept abroad are subject to disclosure orders issued by US courts. In this sense, bank confidentiality principles have been disregarded in favour of the money laundering control effort.⁶⁸

In 1988, in an effort to balance the right of an individual to privacy with the disclosure provisions of AML legislation, Congress amended the Right to Financial Privacy Act.⁶⁹ In short, the Act was amended to redress certain problems that had arisen in money laundering investigations.⁷⁰ Accordingly, the government may access a customer's financial records only in three instances: firstly, after obtaining permission from the customer,⁷¹ secondly, in response to

⁶⁶ See paras C.2.2, par C.5 below.

⁶⁷ For example, *In re Grand Jury Proceedings, Bank of Nova Scotia* (691 F 2d 1384 (11th Cir 1982) [*Nova Scotia I*]) the court described the interest of the government in enforcing its laws as overwhelming and the ability of prosecutors to uncover evidence of criminal activity as essential (1391); *In re Grand Jury Proceedings, Bank of Nova Scotia* 740 F. 2d 817 (11th Cir 1984) [*Nova Scotia II*] the court made similar observations (829) (for the facts of the cases, see below). In *United States v Miller* 425 US 435 (1976) the defendant, Miller, attempted to suppress production by his bank of copies of cheques and other records. The bank where Miller had his accounts was subpoenaed to produce the documents. Even though the subpoenas were defective because they were issued by an attorney rather than by a court, the requested information was obtained and used for investigative purposes (438–440). The court reasoned that the records were the property of the bank, not of Miller. Miller may have been a party to the transactions recorded in the records but the bank was likewise a party thereto (441). According to the court, the BSA does not expand the concept of a 'protectable interest' in privacy beyond the notion of ownership. Although precedent exists for expanding the concept, such expansion is only justified where a 'legitimate expectation of privacy' exists (442). Moreover, since the bank owed the records, there was 'no legitimate expectation of privacy [by Miller] in the bank records].' (442).

⁶⁸ In 1986, Congress clarified the existence of privacy rights in electronic communications with the enactment of the Electronic Communication Privacy Act (18 U.S.C.) ('ECP Act'). The ECP Act protects individuals against unauthorised interception of electronic communications.

⁶⁹ See Right to Financial Privacy Act of 1988 (12 U.S.C.A) ('Privacy Act').

⁷⁰ Alford (1994) *North Carolina J of Internat L & Comm R* 459; Meltzer (1991) *Banking LJ* 254.

⁷¹ Section 3404 of the Privacy Act.

a formal written request to the bank⁷² or thirdly, after obtaining judicial permission.⁷³ The Privacy Act provides that where the government elects to approach the court for authorisation, it needs to comply with certain notice requirements and to certify to the bank that it has complied with the provisions of the statute. Should the government fail to fulfil these requirements, the bank is prohibited from complying with its request for disclosure. A customer is entitled to notification prior to making a disclosure to the government and, in addition, may challenge the pending disclosure in court.⁷⁴

Despite the safe-harbour provisions included in some US AML legislation,⁷⁵ the civil liability of a bank that discloses information about a customer remains a possibility. Although sympathetic to the plight of banks, it is generally felt by Congress that information disclosure is required to assess potential money laundering violations. A bank that discloses too much information may further be subject to a civil claim by the customer.⁷⁶

A final issue as regards bank confidentiality pertains to the obtainment of customer information for prosecutory purposes from foreign banks based overseas. In an effort to assist US courts to solve conflicts stemming from international secrecy laws, the ALI published the Restatement Second pertaining to foreign relations law.⁷⁷ Section 40 of the Restatement Second provides that where two courts have conflicting rules as regards jurisdiction, each court may weigh various factors when considering a disclosure order.⁷⁸ In effect, courts are required to apply a balancing test to address jurisdictional conflicts.⁷⁹

⁷² *Idem* section 3408.

⁷³ Sections 3405–3407 of the Privacy Act.

⁷⁴ See section 3408(4) and section 3410 of the Privacy Act respectively.

⁷⁵ See paras C.5, C.8.2 below.

⁷⁶ Meltzer (1991) *Banking L J* 254.

⁷⁷ See ALI *Restatement (Second), Foreign Relations Law of the United States* of 1965 ('Restatement Second') which was amended in 1987 by a third restatement (ALI *Restatement (Third), Foreign Relations Law of the United States* ('Restatement Third')).

⁷⁸ Cf section 40(a)–(e) of the Restatement Second (ALI *Restatement Foreign Relations (II)* 105–106); Jones (1992) *Northwestern J of Internat L & B* 485–486.

⁷⁹ For example, in *United States v First National Bank of Chicago* (699 F 2d 341 (7th Cir 1983)) [*Bank of Chicago*] the court adopted a balancing test in an effort to determine whether records should be disclosed in violation of Greek laws. The IRS requested the defendant bank to disclose records held at its branch in Athens (344). Since such disclosure is criminalised by Greek law, the bank contended that it could not provide the sought information. The District Court ordered the bank to comply with the request and the bank appealed. On appeal, the court assessed five balancing test factors included in the Restatement Second and accentuated the hardship factor under section 40(b). It found that the

The Restatement Third extends the jurisdiction of the courts to US citizens located outside their jurisdiction.⁸⁰ If a court has established that jurisdiction exists, it must consider additional factors before an order requiring the production of information can be granted.⁸¹ Regardless of the amount of consideration required by the courts when faced with an international disclosure order, it is submitted that it may be impossible to convince a bank that conducts business in a country that enforces strict bank secrecy laws, to comply with an order requiring it to violate national law. This is because ultimately the bank is left to face the consequences of its actions.

This point connects to another issue, namely the difficulty of obtaining information from banks with branches operating abroad. The government must subpoena a bank to disclose information about the affairs of a customer. Two judgments against the Bank of Nova Scotia demonstrate the difficulties associated with enforcing orders of this kind. In the first matter, *Nova Scotia I*,⁸² a grand jury subpoena was served on the Miami branch of the bank calling for the disclosure of bank records from branches of the bank situated in the Bahamas and Antigua.⁸³ The bank refused to comply with the government's request, countering that doing so would violate the bank confidentiality laws of the Bahamas, a defence that was struck down by the District Court. The Appeal Court upheld⁸⁴ the ruling of the District Court. It determined that the importance of an investigation by a US grand jury outweighed the interests of the Bahamas in protecting the confidentiality of bank customers.

hardship factor favoured the bank because should disclosure of the records be ordered, the bank's employees would suffer the hardship of criminal prosecution (345–446). Because other balancing factors likewise bent towards the bank, the court remanded the matter back to the District Court to determine whether the bank should be ordered to make a *good faith* effort to obtain the records (347).

⁸⁰ Section 442 (a)–(b) of the Restatement Third. In *Bank of Chicago* the court acknowledged the amendment to the Restatement Second even though it was not yet published at the time when the judgment was handed down (347).

⁸¹ Section 442(1)(c) of the Restatement Third.

⁸² The Bank of Nova Scotia was chartered in Canada.

⁸³ *Nova Scotia I* 1386.

⁸⁴ 1390–1391.

Two years later the Bank of Nova Scotia was served again under similar circumstances.⁸⁵ Once again the court ruled in favour of the government albeit on different grounds.⁸⁶ It acknowledged that the Grand Jury's subpoena for the bank records of a US citizen, who had accounts in the Cayman Islands and the Bahamas, could force the defendant bank to violate both the Grand Cayman and the Bahamas banking secrecy laws.⁸⁷ But the court did not consider it unfair to put the defendant bank in the position of being caught between inconsistent Caymanian and US law. The court further asserted⁸⁸ that since the bank elected to conduct business in the US, it was precluded from hiding behind its Canadian nationality to escape US laws. Therefore, the court upheld⁸⁹ the contempt-order fine against the defendant bank for its failure to turn over the subpoenaed documents.

It has been argued⁹⁰ that aggressive evidence gathering methods such as court orders, should be avoided out of respect for the sovereignty of a foreign country. But, this suggestion ignores international concerns about money laundering and consensus to combat the crime. Moreover, since 2001 when the International Money Laundering Abatement and Anti-Terrorist Financing Act⁹¹ was enacted to counteract terrorist financing, the extent of the cooperation expected from foreign banks as regards terrorist financing and money laundering has become non-negotiable. A finer, more efficient way to overcome the limitations for obtaining evidence in countries with strict bank secrecy rules could be found in a multilateral treaty designed specifically for the purpose of transnational evidence procurement⁹² that willing countries may sign and ratify. A treaty of this kind should provide for the whole process, the waiver of bank secrecy rules under

⁸⁵ The government demanded that the bank disclose records from its branches situated in the Bahamas, Antigua and the Cayman Islands (819–820). The District Court found in favour of the government and fined the bank for contempt because it ignored the subpoena (820).

⁸⁶ *Nova Scotia II* 829.

⁸⁷ 824.

⁸⁸ *Nova Scotia II* 828.

⁸⁹ 832. The Bank of Nova Scotia ultimately turned over the requested documents when it realised the fine would most likely be enforced (828).

⁹⁰ See Stessen *Money Laundering - Enforcement Model* 238; Blum *Offshore Banks* 234–237; Ogilvie *Banking Law* 621.

⁹¹ Or 'Patriot Act' which constitutes Title III of the Uniting and Strengthening America by Providing Appropriate Tools to Intercept and Obstruct Terrorism (US PATRIOT) Act of 2001, codified in scattered sections of 18 and 31 U.S.C. (see par C.8 below).

⁹² Knapp (1988) *Case Wes J Internat L* 410. See also ch 5.C.2.2 where the benefits of mutual legal assistance treaties are discussed.

certain conditions and expedient means for obtaining requested evidence. Nevertheless, whether a multilateral treaty instead of a court order will present a more effective way of obtaining international cooperation in issues pertaining to conflicting bank confidentiality rules, is an issue that should be considered at some length and further investigated.⁹³

3. Bank as Owner of Deposited Moneys

Under US law the concept ‘ownership’ is often used as a synonym for ‘property’ and no technical or precise definition for it exists.⁹⁴ However, each right of ownership has its own characteristics. The right of ownership confers on a person direct authority over a thing.⁹⁵ This implies that an owner may utilise, manage and dispose of the thing he owns within the limits of the law.⁹⁶ Ownership rights may exist only in favour of entities possessing legal personality. Since ownership denotes a bundle of rights over a thing, it is possible to divide the various rights among several persons.⁹⁷

The concept ‘property’ is used to denote objects of rights that have a pecuniary content or rights that a person has with respect to things.⁹⁸ Property rights are acquired, *inter alia*, by either original acquisition or derivative acquisition, a distinction that is key in light of the universal maxim of property law that no one can transfer more rights than what he possesses. This means that the transferor of property must be the owner thereof.⁹⁹ However, like most countries following

⁹³ Karzon (1983) *Vanderbilt J of Transnational L* 819.

⁹⁴ Yiannopoulos *Property* 214.

⁹⁵ Yiannopoulos *op cit* 224–225.

⁹⁶ It therefore follows that property rights to a thing are not absolute but subject to limitation. The purpose of the limitation is threefold (Singer *Property* 3), namely to protect the property rights of others, personal rights of others and the interests of the community as a whole. The requirement of ‘within the limits of the law’ is also crucial as regards civil forfeiture; property is forfeitable because its owner utilised it for criminal purposes.

⁹⁷ Singer *Property* 3.

⁹⁸ Yiannopoulos *Property* 209–210; Waldron *Property* 31. With the exception of Louisiana, the different states all follow common-law principles when determining the rights of a person to property.

⁹⁹ Therefore, the owner of property does not lose his title to it when it is stolen even if it was subsequently acquired by a *bona fide* person (Burke *Property* 257). The title of the thief is void and there is no right that can be transferred to some other person.

common-law principles, at US common-law property rights in chattels may be transferred by a non-owner to a *bona fide* purchaser for value by application of the *bona fide* purchaser doctrine.¹⁰⁰

In the absence of an agreement to the contrary, a bank becomes owner of moneys deposited with it as soon as the money is deposited into a bank account.¹⁰¹ The legal title to the deposited money as well as that of other funds in the bank account passes to the bank which may use it for its own benefit.¹⁰² Consequently, the customer forfeits any claim to the specific deposited money. He only has a claim on the bank for an amount of money equal to the amount of money that was deposited into his bank account. Therefore, the customer has a right of ownership in an intangible chose in action. So, when a deposit is made, liability in favour of the customer is created. The bank has rights in the accounts of customers either as a lienholder or by reason of the contractual right of set-off.¹⁰³

However, as pointed out elsewhere in the study,¹⁰⁴ money laundering control has resulted in a disregard for the ownership that a bank acquires of money after it has been deposited into a bank account. This is evident in the manner in which courts have allowed victims of fraud or theft to claim the loss suffered due to the fraud or theft from the bank where the benefits of the fraud or theft were deposited.¹⁰⁵ In addition, civil forfeiture legislation allows the deposited benefits of crime to be forfeited despite the fact that they are legally the property of the bank.¹⁰⁶ The benefits of crime become the property of the bank, *inter alia*, as soon as they are commingled with other funds in the bank account after being deposited which renders their identification as the benefits of crime impossible.¹⁰⁷ The bank is therefore owner of the whole amount in the bank account regardless of whether some of it comprises legitimately earned money. It is this ownership that

¹⁰⁰ See par D.3.6 below; ch 6.C.4.3.5 where the defence of *bona fide* purchaser for value is explored.

¹⁰¹ *Bakersfield* 1247; *Selby* 108; *Schroeder Financial Institutions* 18-01. As pointed out earlier (see par B.1 above) when a customer opens a special account the bank must keep the deposit separate from its other funds and is precluded from using it.

¹⁰² *Bennett* 139; *Bakersfield* 1248; *Monostra* 187.

¹⁰³ For a detailed review of a bank's lien, see Norton & Whitley *Banking* 11-34–11-50.

¹⁰⁴ See ch 6.C.4.2–4.3.

¹⁰⁵ See also paras D.2–3 below.

¹⁰⁶ See par D.4 below.

¹⁰⁷ See also ch 2.C.4–5 where the problem of distinguishing legitimately earned money from the benefits of crime is analysed.

is disregarded by civil forfeiture law regardless of the fact that money in a bank account legally belongs to the bank.¹⁰⁸

It follows that by mere execution of one of its main functions, namely accepting deposits from the public, a bank is likely to become embroiled in two types of civil actions. First, a civil action based on restitution which is initiated by a victim of fraud or theft and, secondly, civil forfeiture proceedings which are initiated by the government in respect of the confiscated benefits of crime. As is illustrated below, this onerous position of the bank is ignored by both AML and civil forfeiture statutes.

C. Anti-Money Laundering Legislation

1. Background

My name is Ozymandias, king of kings:
Look on my works, ye mighty, and despair!¹⁰⁹

The applicability of the above quoted command by Ramesses the Great, Pharaoh of the 19th dynasty of Egypt, in respect of the US money laundering control framework is one of the key issues that is explored in this section. Ramesses the Great foolishly believed that history would remember him with reverence, yet in contrast, ‘the decay of that colossal wreck’¹¹⁰ was all that remained of his statue.

Munroe¹¹¹ captures the spirit of US statutory AML initiatives with the following observation:

[i]n sum, under the United States, it is a money laundering violation to participate in any routine ... banking transaction which in fact involves dirty¹¹² money if the transaction includes even the most time honoured vehicle to respect the client’s confidentiality as

¹⁰⁸ See also par D.4 below where civil forfeiture is considered.

¹⁰⁹ Shelley *Ozymandias* 39 verses 10–11.

¹¹⁰ *Idem* verses 12–13. The gist of Shelley’s sonnet ‘Ozymandias’ is that arrogance comes to a fall. As regards the US AML framework, depending on the outcome of the analysis at hand, it is quite possible that irrespective of its comprehensive provisions, the US AML regime is no better at controlling money laundering than other more simplistic models analysed elsewhere in the study (see ch 6.B.3.6, par C.3.4, ch 8.C.4).

¹¹¹ *Money Laundering* 293.

¹¹² As regards the delineation of money as ‘dirty’, see ch 2.C.5.3.

long as the participant *knows* the money is dirty, or is *willfully blind* to the criminal source of the money.¹¹³

The beginning of 1970 was the turning point for Columbian drug cartels¹¹⁴ whose activities triggered the first AML initiatives in the US.¹¹⁵ Federal agencies including the Department of the Treasury and the Securities and Exchange Commission,¹¹⁶ received assistance from Congress in the form of the BSA¹¹⁷ which became the first AML statute of its kind to impose record-keeping requirements on banks. The next 38 years of statutory money laundering control has been characterised by the enactment of a spate of AML statutes, each designed to address specific money laundering-related loopholes.¹¹⁸

Unlike the AML statutory frameworks of the EU and England where money laundering offences are encompassed in a single piece of legislation,¹¹⁹ the AML regime of the US comprises a fragmented arrangement in terms of which money laundering offences are contained in various statutes and regulations. The statutory AML framework of the US comprises three types of laws which mostly concern the filing of transaction reports and asset forfeiture.¹²⁰ Despite countless federal AML statutes, only those which have particular significance to the banking sector are henceforth analysed.

¹¹³ The highlighted words in the citation are of importance in determining both the potential civil and criminal liability of a person involved in money laundering (see paras D below).

¹¹⁴ For a detailed account of the role of the Columbian black market in US money laundering activities, see Bruton (1999) *J of Money Laundering Control* 10–15; Serio (2004) *Internat R LCT* 437

¹¹⁵ Pieth *International Standards* 4–5. The word ‘launder’ was as far as could be ascertained coined in the 1920s when the New York Mafia under leadership of Al Capone used laundromats as fronts for criminal activities (cf ch 4.B.2). It received attention again in 1973–1974 due to the Watergate inquiry which resulted in the impeachment of US president Nixon (for a rivetting account of the Watergate investigation, see Robinson *Laundrymen* 6–8). The first time the concept ‘money laundering’ was used in a legal context was in 1982 in a civil forfeiture matter (Gilmore *Dirty Money II* 23; Shams *Legal Globalisation* 2).

¹¹⁶ Or ‘Treasury’ and ‘SEC’ respectively.

¹¹⁷ See paras C.2.1–2.3 below.

¹¹⁸ There is a myriad of AML statutes. See, for example, the Money Laundering Prosecution Improvements Act of 1988 (Pub L No 100-690, 102 Stat 4354), the Money Laundering and Financial Crime Strategy Act of 1998 (31 U.S.C section 5340) to mention a few.

¹¹⁹ See ch 6.B.3.6, par C.3.4.

¹²⁰ See par D.4 below.

2. Bank Secrecy Act (1970)

2.1 Background

The BSA is based on the premiss that it is easier to detect a potential money laundering scheme during placement¹²¹ in a bank account, an assumption that is based on two rationales. First, at the time of placement the money still has a nexus to the criminal activity. Secondly, it is possible to regulate banks used for placement through mandatory reporting requirements.¹²² It follows that the stated purpose of the BSA is to generate reports with a ‘high degree of usefulness in criminal, tax or regulatory investigations.’¹²³

As main federal AML statute, the BSA authorises the Treasury in its role as administrative agency to issue regulations¹²⁴ pertaining, *inter alia*, to the reporting requirements of banks¹²⁵ and to implement statutory KYC standard measures.¹²⁶ The BSA is denoted¹²⁷ as a regulatory and preventative statute, a description that is apposite in light of its initial purpose and provision. However, after various amendments the BSA has become a statutory instrument characterised by the international application of its provisions.

2.2 Primary Anti-Money Laundering Provisions (31 U.S.C. Sections 5311–5316)

¹²¹ Which is the first stage in the money laundering process where the benefits of crime are inserted into the banking system through a deposit or an ETF (cf ch 4.B.5).

¹²² Barbot (1995) *Tulane J of Internat & Comp L* 161; Abramovsky (1986) *Fordham L* 475. The endeavour is described as ‘splash detection’, because it aims to detect the benefits of crime before they are ‘splashed’ into the legitimate financial system (Barbot *op cit* 161).

¹²³ Section 5311 of the BSA.

¹²⁴ See, for example, the Procedures for Monitoring Banks Secrecy Act (BSA) Compliance Regulation of 2002 (12 C.F.R. section 21(21)(b)) - cf par C.9 below). The first implementing regulations in terms of the BSA were the Regulation Implementing Title II of the Bank Secrecy Act of 1970 (31 C.F.R. section 103).

¹²⁵ A detailed definition of the concept ‘bank’ is provided in the Meaning of Terms Regulation of 2002 (31 C.F.R. section 103(11)). Accordingly, the concept ‘bank’ refers to each agency within the US or any person doing business in one or more of the following capacities: a commercial bank, private bank, savings and loan association, a credit union, a savings bank, industrial bank, any other organisation subject to the supervision of US bank supervisory authorities, a bank organised under foreign law and any other national banking association.

¹²⁶ Sections 101 and 202 of the BSA.

¹²⁷ Shams *Legal Globalisation* 3; Rusch (1988) *Catholic U L R* 471n33.

The BSA authorises ‘indirect attacks’¹²⁸ on money laundering because it does not criminalise the practice of money laundering, but instead, imposes reporting¹²⁹ and record-keeping obligations on banks.¹³⁰ In this context the BSA fulfills two functions:¹³¹ first, it acts as a ‘warning system’ alerting the authorities to suspicious transactions. Secondly, the BSA assists the authorities to follow the benefits of crime so that they may be confiscated. Pursuant to the BSA banks are compelled to record¹³² financial transactions¹³³ for the purpose of identifying customers, the source of funds and the amount involved.¹³⁴ Section 5313 of the BSA encompasses its core reporting requirements. It requires that banks report all currency¹³⁵ transactions that exceed a set amount.¹³⁶ Only transactions of customers who regularly withdraw large amounts of cash for business purposes are exempted from this requirement.¹³⁷ Significantly, because section 5313 of the BSA requires only the filing of a currency transaction report¹³⁸ by, for example, a bank the authorities may be unable to enforce reporting requirements against individuals.¹³⁹

¹²⁸ See in general Welling (1989) *Florida LR* 292–293; Gallant *Money Laundering* 79; Byrne *Money Laundering* 354; Lee (1996) *Tulane J of Internat & Comp L* 210.

¹²⁹ The obligations are contained in Title 31 of the CFR (Adams (1993) *Alabama LR* 671).

¹³⁰ In *United States v Busey* (876 F.2d 1297 (1989) [*Busey*]) the court initially observed that the BSA does not impose liability on individuals, but subsequently agreed that (idem 1306n17): ‘[i]n response to the apparent inefficacy of the Bank Secrecy Act as a basis for imposing criminal liability on *individuals* engaged in money laundering, Congress enacted the Money Laundering Control Act of 1986.’

¹³¹ Hinterseer *Criminal Finance* 181.

¹³² The BSA specifies keeping four types of records (cf sections 5313–5316; Galli & Wexton *US Perspective* 366; Csoka (2001) *Annual R of B L* 314–315). See also Walter (*Secret Money: Tax Evasion* 245) who recounts the plight of the Bank of Boston which failed to file the required reports. It was subsequently found guilty of contravening the BSA.

¹³³ See, for example, *United States v Laurenzana* (113 F 3d 689 (1997) [*Laurenzana*]) where the payment of a cash bond of 2,500 US dollars was considered a ‘financial transaction’ in terms of the BSA (691–692).

¹³⁴ Section 5311 of the BSA.

¹³⁵ The rationale behind filing currency reports has been outlined by the judiciary. In *California Bankers Association v Schultz* (461 US 21(1974) [*Schultz*] 39) the court emphasised that Congress had recognised the importance of reporting currency transactions ‘in ferreting out criminal activity.’

¹³⁶ Section 5313(a) of the BSA.

¹³⁷ Section 103(22)(a)–(b) of the Reports of Transactions in Currency Regulation of 2002 (31 C.F.R.).

¹³⁸ Or ‘CTR’.

¹³⁹ Arrista *Money Laundering* 238. In contrast, in *Busey* the court was willing to hold an individual liable for violation of the BSA’s reporting provisions (1306). It is submitted that

2.3 Currency Transaction Reports (31 C.F.R. Section 103)

In terms of section 221 of the BSA, banks must report domestic transactions that involve the transfer in currency of more than 10,000 US dollars. In addition to CTRs, banks are required to report the transportation of monetary instruments into or out of the US if the instruments exceed 5,000 US dollars in value.¹⁴⁰ Initially, unhappiness existed about the reporting requirements of the BSA. In 1974 various plaintiffs brought a class action against the government challenging the constitutionality of the reporting requirements of the BSA.¹⁴¹ The result was a temporary restraining order granted by the District Court which was lifted when the Supreme Court upheld¹⁴² the constitutionality of the BSA.¹⁴³

The biggest drawback of filing a CTR where a transaction is above a set threshold is that criminals may attempt to circumvent such filing by structuring a transaction.¹⁴⁴ Prior to the BSA's amendment in 1994¹⁴⁵ it was possible to evade its reporting requirements by dividing a large

where a bank is involved in a financial transaction, it should be its duty as opposed to the duty of the customer to file the required report.

¹⁴⁰ Section 231 of the BSA.

¹⁴¹ In *Schultz* the plaintiffs included the Security National Bank, the California Bankers Association and the American Civil Liberties Union (Case Comment (1974) *Harvard LR* 188). The plaintiffs argued (*Schultz* 38, 45, 49) that the reporting and record-keeping requirements of the BSA violated the procedural protection guaranteed by the Fourth Amendment to the US Constitution (see also par B.2 above).

¹⁴² *Schultz* 33. The court believed that the record-keeping requirements of the BSA were reasonable, because Congress had reason to believe that currency aggregation was suspicious by nature (61). Therefore, it found that the violation of Fourth Amendment rights was justified because Congress had a justifiable interest in the reporting of account activity that could be considered inherently suspicious (65).

¹⁴³ *Schultz* 47–49, 61; Case Comment (1974) *Harvard LR* 191–193. In *Miller* (347) the court likewise ruled in favour of the government in relation to the right to privacy of a customer of a bank (see par B.2 above).

¹⁴⁴ Popham et al (1987/1988) *American J CL* 87; *Arista Money Laundering* 239. Cf ch 4.B.2.2, par D.1.

¹⁴⁵ The BSA was amended as a result of the court ruling in *Ratzlaf v United States* (114 S. CT 655 (1994) [*Ratzlaf*]) - see Morgan (1996) *Essays in Internat Financial & Economic L* 40–41). Here, the defendant was convicted of structuring transactions with the purpose of avoiding the reporting requirements of the BSA. The District Court indicated that the government did not have to prove that the defendant knew that structuring was illegal (656). On appeal, the court held that for a conviction under the anti-structuring law, proof is required that the defendant not only intentionally structured transactions to avoid reporting requirements, but also did so whilst aware that his conduct was illegal (661–663). The government must therefore establish that the defendant acted with knowledge that his

currency transaction into a number of smaller transactions so that no reports were necessary. Moreover, since the BSA did not criminalise money laundering *per se*, it was ineffective in preventing this practice of money laundering. Section 5321 of the BSA was eventually amended so that the government needs only to prove that the defendant knowingly¹⁴⁶ and intentionally structured transactions to avoid the reporting requirements of the BSA.¹⁴⁷

2.4 Suspicious Transaction Reports (31 C.F.R. Section 103)

The BSA provides that banks must file reports of suspicious transactions that exceed 5,000 US dollars in value.¹⁴⁸ According to Treasury's rules¹⁴⁹ a suspicious transaction concerns known or suspected money laundering activities, illegal funds or transactions without any business purpose. The obligation to file a STR apparently stems from the belief that banks have a 'deeply rooted social obligation'¹⁵⁰ to assist with money laundering control. The depiction may seem overdramatic yet it does justify the imposition of the reporting duty. Nevertheless, banks form an integral element of the AML effort because of the processes involved to launder money¹⁵¹ and, therefore, their involvement and cooperation with the AML authorities are expected.

Some measure of protection against liability is afforded to a bank when a STR is filed in good faith.¹⁵² After a STR has been filed, the bank is prohibited from informing anyone involved in the transaction that a report was filed.¹⁵³ Information pertaining to customers who are 'engaged

structuring conduct was illegal to give effect to the 'willfulness' requirement of the BSA's structuring provision (656).

¹⁴⁶ In this context the concept 'knowledge' implies a person's awareness of multiple transactions for the purpose of circumventing AML laws (Rusch (1988) *Catholic ULR* 481). In *United States v Jewell* (532 F 2d 697 (9th Cir 1976)) [*Jewell*] the court agreed that 'knowledge' also includes 'willful blindness' (700–702).

¹⁴⁷ Section 5321(a)(4)(A) of the BSA.

¹⁴⁸ Section 103(18)(a)(1) of the Reports by Banks of Suspicious Transactions Regulation of 2002 (31 C.F.R.).

¹⁴⁹ *Idem* section 103(18)(2).

¹⁵⁰ *Roberts v United States* 445 US 552 (1980) 558.

¹⁵¹ See ch 4.B.4, par D.

¹⁵² See, for example, section 103(18)(e), section 103(20)(d) and section 103(21) of the Reports by Banks of Suspicious Transactions Regulation of 2002 (31 C.F.R.).

¹⁵³ Section 5318(g)(2) of the BSA.

in or reasonably suspected of engaging in terrorist acts or money laundering', however, may be shared with other financial institutions.¹⁵⁴

3. Money Laundering Control Act (1986)

3.1 Background

In the early 1980s an essential AML development concerned the first legal use of the concept 'laundering' by a court of law.¹⁵⁵ In 1986, due to the ambiguities of the BSA,¹⁵⁶ the lackadaisical enforcement of the Act¹⁵⁷ and then US President Ronald Reagan's war on organised crime,¹⁵⁸ the Money Laundering Control Act¹⁵⁹ became the first US statute to deal directly with money laundering. Its main objective is to create a legal barrier to criminals transferring the benefits of crime to legitimate businesses.¹⁶⁰

The MLCA supplemented the BSA with two pivotal provisions. First, it expanded the BSA's reporting requirements, and secondly, the MLCA criminalised money laundering for the first time through the inclusion of so-called 'specific unlawful activities.'¹⁶¹ The MLCA comprises

¹⁵⁴ FinCEN *Information Sharing* (2002) 9879.

¹⁵⁵ \$4255 625,39 322, 324, 325 (see par C.1 above). Here, the government approached the court for a forfeited order against two large sums of money (315–316). The money originated from a money exchange business in Columbia that delivered it to a money exchange business in Miami named Sonal. Sonal subsequently deposited the money into its bank account at the Capital Bank in Miami. The court emphasised the criminal origin of the money and found that it was deposited with the bank for the purpose of money laundering (325).

¹⁵⁶ Short et al (1992) *Banking L J* 52; Noble & Golumbic (1997-1998) *NYU J of International Law & Politics* 98–99.

¹⁵⁷ Grilli (1987) *Syracuse J of International LC* 71.

¹⁵⁸ Low et al *US AML* 346–347; Baldwin (1997) *J of Fin Crime* 113; Schecter (1990) *Cornell LR* 1152.

¹⁵⁹ 18 U.S.C. sections 1956–1957 ('MLCA'). For a detailed recount of the history of the MLCA, see Adams (2000) *Georgia S ULR* 545–548.

¹⁶⁰ Jordan *Drug Politics* 208; Bruton (1999) *J of Money Laundering Control* 10; US Treasury 2000 *AML* 83; Gurule (1995) *American CLR* 825.

¹⁶¹ Noble & Golumbic (1997–1998) *NYU J of International Law & Politics* 100. The concept 'specific unlawful activities' ('SUAs') is employed in the Act with reference to predicate offences. In terms of section 1956(c)(1) a SUA is an activity that constitutes a felony under state, federal or foreign law - hence the use of the word 'unlawful' instead of 'criminal.' Section 1956(c)(7)(A) of the MLCA further stipulates more than 160 SUAs

two principal money laundering sections, namely section 1956 which pertains to the laundering of monetary instruments and section 1957 which concerns the execution of monetary transactions with ‘proceeds’¹⁶² derived from SUAs.

3.2 Money Laundering Offences

3.2.1 18 U.S.C. Section 1956

Under section 1956 of the MLCA money laundering means the conduct of a financial transaction¹⁶³ that involves ‘proceeds of an unlawful activity’¹⁶⁴ when the transaction is intended to conceal the source of ownership of the unlawfully obtained funds.¹⁶⁵ The use of real property

including federal crimes such as murder, gambling, arson, fraud, theft, embezzlement, robbery, white slave traffic, fraud in the sale of securities, the manufacture, importation, sale or distribution of illegal drugs, kidnaping, robbery, extortion, international banking fraud; tax offences; and counterfeiting. Foreign offences mentioned in the MLCA include, *inter alia*, schemes to defraud a foreign bank; drugs trafficking; robbery; and extortion (section 1956(c)(7)(B)(i)–(iii) of the MLCA). The list of SUAs was amended in 2001 by section 315 of the Patriot Act (see par C.8.2 below) to include terror activities.

¹⁶² The concept ‘proceeds’ is not defined by the MLCA. Therefore, the courts have relied on various dictionary definitions when defining the concept (Saler (2004) *Crim LB* 146–148). For example, in *United States v Morelli* (169 F 3d 789 (3 Cir 1999) 805) the court used the definition of ‘proceeds’ as supplied by Black’s Law Dictionary: ‘[t]hat which results, proceeds, or accrues from some possession or transaction’ whilst in *United States v Scialabba* (282 F.3d 475 (7th Cir 2002)) the court used the concepts ‘net income’ and ‘net profit’ interchangeably in reference to ‘proceeds’ (478). In contrast, note that in reference to civil forfeiture proceeds are defined by section 981(a) of the MLCA (see par D.4.2.2 below).

¹⁶³ In the context of a bank, a ‘transaction’ means (section 1956(c)(3)) a deposit, withdrawal or transfer between accounts of money, the exchange of currency, a loan, the extension of credit, the purchase, or sale of any stock, bond, certificate of deposit, or other monetary instrument, the use of a safety box or any other payment, transfer or delivery through or to a financial institution. In *United States v Bowman* (235 F 3d 1113 (2000)) the court concluded that the defendant intended to conceal the nature of stolen money by using multiple safety boxes (1116). Note as regards to EFTs, US legislation employs the concept ‘wire transfers’ instead of EFTs (but see article 4A of the UCC employing the concept ‘fund transfer’ rather than ‘wire transfer’ as transfers may be made in writing, by telephone or computer linkage. For the sake of uniformity the concept ‘EFT’ instead of ‘wire transfer’ will be used in the context of US law.

¹⁶⁴ As opposed to ‘*criminally* derived property’ as specified in section 1957 of the MLCA (see par C.3.4 below).

¹⁶⁵ See section 1956(a)(1) of the MLCA; Lawrence (1992) *Boston C LR* 841; Park *Anonymous Accounts* 334; Cuéllar (2003) *J of Crim L C* 340–341; FinCEN *AML Statutes*

or the transport of money with the intent to accomplish a SUA¹⁶⁶ is likewise criminalised.¹⁶⁷ Broadly regarded, section 1956(a)¹⁶⁸ creates penalties where a person deals with money which was obtained through a SUA with the purpose of advancing a SUA or concealing the source or ownership of the money in violation of the BSA.

Section 1956(a)(1) applies to *domestic* financial transactions. It creates four intent and knowledge requirements, namely the intent to promote or conceal¹⁶⁹ a SUA,¹⁷⁰ the intent to engage in conduct which violate the Internal Revenue Code¹⁷¹ of 1988,¹⁷² knowledge¹⁷³ by a defendant that a transaction is conducted to conceal or disguise the nature, location, source, ownership or control of a SUA¹⁷⁴ and knowledge that a transaction is conducted to avoid a statutory¹⁷⁵ reporting

5–7.

¹⁶⁶ By virtue of the ruling in *United States v Jackson* (935 F 2d 832 (7th Cir 1991) [*Jackson*]) where the court found that a financial transaction must ‘involve’ the proceeds of a SUA, the government is not required to prove that the proceeds derived solely from a SUA (836). If any part of a transaction comprises money which was obtained through a criminal activity, a section 1956 offence is committed.

¹⁶⁷ Section 1956(a)(2)–1956(a)(3) of the MLCA (see paras C.3.3–3.4 below).

¹⁶⁸ Money laundering offences created by section 1956(a) are categorised into ‘transaction offences’ and ‘transportation offences’ (cf Strafer ((1989) *American CLR* 161; FinCEN *AML Statutes* 5).

¹⁶⁹ In *United States v Villarini* (238 F 3d 530 (2001)) the court found that the government had to establish *intent* by the defendant to conceal the SUA and crucially, that the defendant’s conduct establishes such intent. In this matter the defendant, an employee of a bank, embezzled 83,000 US dollars from her employer (531–532). She deposited the money into her account in small amounts of less than 3,000 US dollars in intervals ranging between two to four weeks. The defendant was subsequently charged with fraud and a section 1956 money laundering offence. The court concluded that the defendant’s conduct (i.e. the various deposits over a period) gave rise to a reasonable inference that she was structuring the transaction to conceal the origin of the money (542).

¹⁷⁰ Section 1956(a)(1)(A)(i) of the MLCA. In *United States v Ross* (210 F 3d 916 (2000)) the court ruled that the defendant violated section 1956(a)(1)(A)(i) of the MLCA because he intended to use the proceeds of EFT fraud to facilitate the continuation of another ETF fraud scheme (921).

¹⁷¹ 26 U.S.C.

¹⁷² Section 1956(a)(1)(A)(ii) of the MLCA

¹⁷³ The meaning of the concept ‘knowledge’ is outlined by the MLCA (section 1956(c)(1)) and demonstrates the extensive reach of the MLCA. It is accepted that the judiciary favours a wide interpretation of the knowledge element (cf Kacarab (1991) *Akron T J* 5).

¹⁷⁴ Section 1956(a)(1)(B)(I) of the MLCA. In *Jackson*, a church minister deposited a large amount of money deriving from drug trafficking into the account of the church where he was employed. Since the money exceeded his legitimate earnings and was used by the defendant to pay rent, the court found that the minister had the intention to conceal the fact

requirement. It therefore follows that, depending on the offence, the existence of intent or knowledge is paramount before a section 1956(a)(1) conviction can be secured.¹⁷⁶ Negligent involvement in a money laundering scheme is not punishable.

There are further three steps to obtain a conviction under section 1956(a)(1) of the MLCA. First, the prosecution must establish that a financial transaction was conducted.¹⁷⁷ Secondly, it must prove that the transaction affected interstate or foreign commerce¹⁷⁸ as delineated in section 1956(c)(4) of the MLCA¹⁷⁹ and thirdly, it must establish three requirements which are identical for each of the four section 1956 offences. They are namely: the money derives from a SUA,¹⁸⁰ the money was used in a financial transaction and the defendant was aware that the money derived from a SUA. Only after establishing these three elements may the government proceed to establish the existence of the specific requirements of each of the four section 1956 offences.

that the money actually belonged to him (837).

¹⁷⁵ For example, the reporting requirements under the BSA (see paras C.2.2–2.4 above).

¹⁷⁶ For example, in *United States v Olaniyi-Oke* (199 F 3d 767 (1999)) the court declared the fraudulent use of some other person's credit card insufficient for establishing that the defendant intended to avoid some reporting requirement (770).

¹⁷⁷ A transaction of this kind includes, for example, depositing money in a bank account (*United States v Jolivet* 224 F 3d 902 (2000) 909).

¹⁷⁸ The 'commerce' requirement is intended to reflect the reach of the powers of Congress as provided for under the Commerce Clause of the US Constitution (article I section 8, clause 3).

¹⁷⁹ Only a minimum effect on interstate commerce is needed to satisfy the 'interstate' requirement included in the definition of 'financial transaction' (section 1956(c)(4) of the MLCA). In *Laurenzana* the court ruled that payment of a cash bond had an effect on interstate commerce because 'the money Laurenzana delivered to the officers did ... enter the flow of commerce' (693).

¹⁸⁰ In *United States v Blackman* (904 F 2d 1250 (1990) [*Blackman*]) the court agreed that section 1956 of the MLCA does not require that the government directly trace proceeds involved in a transaction to a particular sale of illegal drugs (1257). In this matter Blackman was charged with five counts of money laundering based on the violation of section 1956 of the MLCA. Four of the five charges were under section 1956(a)(1)(A)(I) (using the proceeds of SUAs in EFTs). The fact that the five transactions occurred a year prior to the defendant being found in possession of the illegal drugs was crucial. The government's evidence consisted of the defendant's involvement with illegal drug trafficking and his lack of a legitimate income (1256–1257). The court ruled that although the government was unable to identify a *specific* drugs sale that produced the proceeds of drug trafficking used to make the EFTs, it did not preclude the government from charging him under section 1956.

For the purposes of section 1956, the element of knowledge is interpreted widely to include actual¹⁸¹ and constructive knowledge as well as willful blindness¹⁸² as regards the criminal origin of the proceeds. Willful blindness occurs when:¹⁸³

[i]t can almost be said that the defendant actually knew. He suspected the fact ...but he refrained from obtaining the final confirmation because he wanted ... to be able to deny knowledge.

The knowledge requirement for section 1956 of the MLCA has been interpreted in *United States v Paramore*¹⁸⁴ to be tantamount to belief. According to the court it is irrelevant whether the proceeds in fact existed; paramount is the belief of the defendants that it existed and therefore the conviction stood.¹⁸⁵ In *United States v Giraldi*¹⁸⁶ the Supreme Court discerned five factors which demonstrated willful blindness by the defendant banker.¹⁸⁷ They are a disregard for set KYC standard procedures and untruthfulness about it, failure to investigate the customer although he had an obligation to do so, disregard of false statements made by his customer about the source of his money, failure to record transactions made by the customer and attempts to conceal the four aforementioned factors from the authorities. In other court rulings¹⁸⁸ wilful blindness was likewise

¹⁸¹ In *United States v Beddow* (957 F 2d 1330 (1992)) actual knowledge was found to exist in statements given by the defendant.

¹⁸² Goddard et al *Investigating Money Laundering* 25; Ashworth *Criminal Law* 184.

¹⁸³ Von Kaenel (1993) *Washington U LQ* 1189n60. See also the reasoning of the court in *Jewell* (700).

¹⁸⁴ 720 F Supp 799 (1989).

¹⁸⁵ 802.

¹⁸⁶ 86 F 3d 1368 (1996) [*Giraldi*]. The defendant, a private banker, was found guilty by the District Court of violating section 1956 of the MLCA (1372). He appealed and contended that the government failed to prove the degree of knowledge required for a conviction. The court upheld the conviction because the government had established 'willful blindness' instead of actual knowledge by the defendant.

¹⁸⁷ *Giraldi* 1373.

¹⁸⁸ See, for example, *United States v Wert-Ruiz* (228 F.3d 250 (2000)) where the defendant was operating a cheque-cashing and money-remitting business (250–251). She agreed to manage the business from a similar operation which was in fact a front for money laundering activities. The defendant issued false receipts whenever gym bags full of cash were handed to her, thereby creating a false paper trail suggesting that the money entered the banking system through legal channels. When charged with violation of section 1956 of the MLCA, the defendant contended that she was unaware that the cash she handled derived from SUAs. The court, however, disagreed and found that the defendant could not defend her conviction by claiming that she was unaware of the source of the funds (251).

recognised to constitute the requisite knowledge needed for a conviction under section 1956 of the MLCA.

The courts are further willing to impose strict liability on banks for failure to comply with CTR requirements. In *United States v Bank of New England*¹⁸⁹ the court found the bank guilty of a section 1956 offence because it had the required mental state when it deliberately avoided learning about CTR requirements.¹⁹⁰ Moreover, in *Bank of England* the government was able to establish the element of knowledge under section 1956 of the MLCA by combining the partial knowledge of bank employees under the theory of ‘collective knowledge.’ In terms of this theory it is possible to impute knowledge about a transaction to a bank if some of its employees had pieces of knowledge about a reportable transaction. Although the judiciary is willing to attribute constructive knowledge to a defendant, its use in the context of criminal law remains contentious. As a consequence, section 1956 of the MLCA applies only to defendants who intend to promote an illegal activity or who have knowledge of an illegal purpose.¹⁹¹

Section 1956(a)(2) of the MLCA creates a money laundering offence where money or monetary instruments are moved across borders. Any person who transfers monetary instruments or funds¹⁹² into or out of the US commits the offence if the transfer occurs under either one of two conditions.¹⁹³ First, the funds were transferred with the intention to promote a SUA or secondly, the funds were transferred whilst the bank was aware that they derived from SUAs with the intention of either concealing the nature of the funds or avoiding a transaction report requirement under state or federal law. In order to obtain a conviction under section 1956(a)(2)(B)(i) of the MLCA the government must prove that the defendant bank knew the funds involved in the transfer derived from an SUA and that the transfer concealed certain facts in respect of the funds.¹⁹⁴ The knowledge of a defendant prosecuted under section 1956(a)(2)(B)(ii) of the MLCA

¹⁸⁹ 821 F 2d 844 (1st Cir 1987) [*Bank of England*].

¹⁹⁰ 855–856.

¹⁹¹ This fact is viewed as limiting the application of the section (cf Villa (1988) *Catholic ULR* 497).

¹⁹² The concept ‘monetary instrument’ is defined by section 1956(c)(5) of the MLCA to include any US coin or currency or that of any other country as well as any type of negotiable instrument.

¹⁹³ See sections 1956(a)(2)(A) and 1956(a)(2)(B)(i)–(ii) of the MCLA respectively.

¹⁹⁴ *United States v O’Connor* 158 F Supp 2d 697 (2001) 699–700. In this matter, the court had to pronounce whether Congress intended to punish the underlying SUA and the laundering offence separately. The court asserted that an EFT scheme which involved the movement of funds which derived from SUAs across borders did not ‘merge’ with the

is pivotal to establish liability. However, the prosecution is not required to establish that the proceeds derived from a specific SUA.

3.2.2 18 U.S.C. Section 1957

Broadly regarded, section 1957 of the MLCA renders it illegal to engage in a monetary transaction with ‘funds that derive from crime.’¹⁹⁵ Section 1957(a) criminalises monetary transactions involving more than 10,000 US dollars which derive from a SUA where the person knew that the money is ‘criminally derived property.’¹⁹⁶ In the main, the section requires proof only that the defendant knowingly¹⁹⁷ engaged in a monetary transaction with the knowledge that the money derived from a SUA.¹⁹⁸ It is therefore fair to state that section 1957 criminalises *knowing receipt*¹⁹⁹ of the benefits of crime.

For a conviction under section 1957 of the MLCA at least 10,000 US dollars of the funds involved in a transaction must be traced back to some type of SUA.²⁰⁰ Where money was deposited into a commingled account the government needs only to prove that part of the funds represents benefits made through a SUA.²⁰¹ However, whether the government is required to connect the money to a specific SUA is unclear. In *United States v Rutgard*²⁰² the court ruled that section 1957 of the MLCA requires proof that some part of the money that was transferred into

international money laundering offence created by section 1956(a)(2)(B)(i).

¹⁹⁵ As opposed to ‘proceeds of unlawful activity’ which is the focus of section 1956 of the MLCA (ibid).

¹⁹⁶ Section 1957(a) of the MLCA. Section 1957(c) defines the concept ‘criminally derived property’ as: ‘[a]ny property constituting, or derived from, proceeds obtained from a criminal offence.’

¹⁹⁷ Similar to section 1956 of the MLCA (see paras C.3.2.1 above), the knowledge required in terms of section 1957 includes the standard of ‘willful blindness’ which is determined in accordance to the facts of a matter (Low et al *US AML* 360).

¹⁹⁸ Plombeck (1988) *Internat Lawyer* 79.

¹⁹⁹ See par D.2 below.

²⁰⁰ Cuéllar (2003) *J of Crim LC* 343; Csoka (2001) *Annual R of BL* 330.

²⁰¹ *United States v Wilkinson* (137 F 3d 211(1998)) 222.

²⁰² 116 F 3d 1290 (9th Cir 1997).

a commingled account was traceable to a SUA.²⁰³ Conversely, in *United States v Sokolow*²⁰⁴ the court asserted:²⁰⁵

[t]here is an absence of a legal requirement that the government trace the funds constituting criminal proceeds when they are ... [in a commingled account].

In addition to the primary offence established by section 1957(a) of the MLCA, section 1957(b)²⁰⁶ makes it unlawful for a person to intentionally avoid the 10,000 US dollars reporting requirements of the MLCA through structuring.²⁰⁷ The rationale for criminalising structuring is that the breaking down of transactions²⁰⁸ in an effort to avoid reporting has become, prior to legislation, the most common method of laundering money.²⁰⁹

The application of section 1957(b) of the MLCA was clarified by two court rulings, namely *United States v Scanio*²¹⁰ and *United States v Thakkar*.²¹¹ In *Scanio* the court²¹² recognised

²⁰³ 1291–1293.

²⁰⁴ 91 F 3d 396 (3rd Cir 1996) [*Sokolow*] (for the facts of the matter, see par D.4.3 below).

²⁰⁵ *Sokolow* 409. The court did not require that the government proved that the whole amount in a commingled bank account was the benefits of crime. Evidence that established the criminal origin of *some* of the money was sufficient to establish that the funds were the benefits of crime (402).

²⁰⁶ The intent requirement of the provision was explained in *United States v 316 Units of Municipal Securities* (725 F Supp 172 (1989)) [*316 Units*]. Although this matter chiefly concerned a civil application to forfeit money involved in illegal transactions (see par C.4.2.2 below), the court also addressed the issue of knowledge in terms of section 5324 of the BSA where section 1957 was codified. The facts of the matter were pertinent. The defendants after being told that their attempt to purchase a cashier's cheque in the amount of 200,000 US dollars would be reported to the authorities withdrew their request and instead, purchased 40 cashier's cheques, each for less than 10,000 US dollars. The cashier's cheques were deposited into an account with a brokerage firm and used to purchase 316 units of municipal securities (*316 Units* 175). Due to a lack of evidence that the defendants had actual knowledge of the anti-structuring provisions of section 5324, the indictment against them for money laundering was dismissed. The government then proceeded with a civil action under section 981 of the MLCA to forfeit the units as proceeds of the illegal transactions (see par D.4.2.2 below). As regards the knowledge requirement of section 5324 of the BSA, the court found that knowledge of the reporting requirements coupled with an intent to avoid them were necessary to violate the provision (176).

²⁰⁷ For a detailed recount of how Congress dealt with the problem of structuring, see Welling (1989) *Florida LR* 304–320; Rusch (1988) *Catholic ULR* 476–477.

²⁰⁸ For the purpose of structuring as a method of money laundering, see ch 4.D.1.

²⁰⁹ Shams *Legal Globalisation* 31; Csoka (2001) *Annual R of BL* 316.

²¹⁰ 705 F Supp 768 (1988) [*Scanio*]. In this matter the defendant was charged with structuring the repayment of a bank loan to avoid the reporting requirement of section

as regards the meaning of the word ‘structure’ that English words are to a certain extent vague but that the dictionary meaning of the word ‘structure’ was consistent and well known. The word simply referred to the manner in which a transaction is effected. In *Thakkar* the court confirmed that structuring is illegal regardless of the time period involved if it was done for the purpose of circumventing the reporting requirements.²¹³ The element of intent addresses any possibility of arbitrary enforcement.²¹⁴ Structuring transactions to avoid reporting requirements is illegal whether or not the structuring was *intended* to conceal other criminal activity.²¹⁵

Section 1957 of the MLCA put banks in a difficult position. This is because banks are compelled to weigh the obligation of refusing to deal with customers whose money may derive from SUAs against the potential liability for such a refusal. The matter of *Ricci v Key Bancshares of Maine, Inc*²¹⁶ illustrates the risks to a bank in a situation of this kind. Ultimately the court awarded 12.5 million US dollars to the plaintiff in punitive damages and six million US dollars in compensatory damages due to the defendant bank’s refusal to conduct business with the plaintiff.²¹⁷ On appeal, the defendant bank argued that an award of punitive damages was inappropriate.

The Appeal Court agreed with the bank and reasoned that the facts of the matter indicated reckless but not malicious conduct on the side of the bank. Therefore, the award of punitive damages was reversed whilst the award of compensatory damages was upheld. Sadly, despite allowing compensatory damages to the plaintiff, the court failed to clarify how the bank should

1957(b) of the MLCA (or section 534 of the BSA where section 1957(b) is codified). The defendant claimed, *inter alia*, that the absence of a precise definition for the word ‘structure’ made the terms of the provision so broad that it allowed for arbitrary enforcement (*Scanio* 774).

²¹¹ 721 F Supp 1030 (1989) [*Thakkar*]. In this matter the defendant contended that the structuring provision of section 1957(b) was vague because it failed to prescribe a time limit within which the structuring must occur (1032).

²¹² *Scanio* 776.

²¹³ *Thakkar* 1033.

²¹⁴ The court reasoned that (1033): ‘[t]he focus is on intend, not the method.’

²¹⁵ *Thakkar* 1032.

²¹⁶ 662 F Supp 1132 (1987) [*Ricci*]. The defendant bank discontinued the credit line of a customer, Ricci, after receiving information from the authorities that Ricci was involved with organised crime (1133). The bank further refused to discuss the situation with Ricci and failed to consider the damage its conduct has caused Ricci’s business. Ricci therefore sued the bank, *inter alia*, for damages arising from ‘severe emotional distress’ (1134).

²¹⁷ *Ricci* 1136.

have managed its obligations in terms of the MLCA *vis-à-vis* the risk of civil liability. In addition, it failed to explain what it expected of a bank under such circumstances or whether the fact that the bank elected to terminate an existing relationship as opposed to denying credit to a potential customer has influenced its decision to allow damages to be paid by the bank to the plaintiff. It has been suggested²¹⁸ that a bank, in an effort to avoid paying damages to customers, may have to allocate resources to investigate potential customers to determine whether transactions do in fact involve funds deriving from SUAs. If not, the bank may face both criminal liability under section 1957 and civil liability at common-law.²¹⁹

4. Racketeering Influence Corrupt Organisation Act (1970)

The Racketeering Influence and Corrupt Organisation Act of 1970²²⁰ originated from a report that delimited the threat posed to business by organised crime.²²¹ It was enacted in an effort to address the difficulties presented in tackling crime syndicates operating in the US.²²² The idea was that legally sanctioned action that targeted the economic means of criminals would eliminate the organised crime threat in the US.²²³

This was an apposite description before the enactment in 2001 of the Patriot Act which substantially amended RICO and other AML statutes.²²⁴ Nevertheless, the fact that RICO contains both civil and criminal provisions rendered it a novel statute at the time. Four of RICO's provisions are particularly relevant in the context of money laundering. They are namely section 1961, which defines the concept 'racketeering activity',²²⁵ section 1962 which criminalises specific conduct,²²⁶ section 1963 which sanctions forfeiture of the benefits of crime²²⁷ and section

²¹⁸ Short et al (1992) *Banking LJ* 56; Villa ((1988) *Catholic ULR* 508.

²¹⁹ See paras D.2–3 below.

²²⁰ 18 U.S.C. sections 1961–1968 ('RICO').

²²¹ Califa (1990) *Vanderbilt LR* 807.

²²² Palm (1991) *U of Pittsburg LR* 1; Califa *op cit* 806.

²²³ See also par D.4.1 below.

²²⁴ See par C.8 below.

²²⁵ A 'racketeering activity' is any activity listed in section 1961(1) of RICO.

²²⁶ Section 1962 first refers to the SUA listed in section 1961 and thereafter creates four specific offences (cf section 1962(a)–(d) of RICO).

²²⁷ See par D.4.2.1 below.

1964 which creates certain civil remedies that are available to both individuals and the government.²²⁸

In short, RICO punishes four types of activities, namely²²⁹ use of money that derives from racketeering to acquire an interest in interstate commerce, acquiring an enterprise involved in interstate commerce through racketeering, operating an enterprise involved in interstate commerce through racketeering and conspiring to commit any of the above mentioned activities. The relevancy of RICO in the context of money laundering is twofold. First, the racketeering offences listed in the Act constitute additional SUAs subject to the AML provisions of the BSA and the MLCA. Secondly, benefits acquired through RICO-created SUAs are subject to civil forfeiture.²³⁰

5. Annunzio-Wylie Anti-Money Laundering Act (1992)

The Annunzio-Wylie Anti-Money Laundering Act²³¹ was signed in 1992 as Title XV of the Housing and Community Development Act.²³² The main reason for its enactment was the failure of the Bank of Credit and Commerce International, coupled with the conviction of the bank's directors of, *inter alia*, money laundering.²³³

The Annunzio Act amends the BSA in two ways.²³⁴ First, it requires that *all* types of financial institutions²³⁵ instead of solely banks, report²³⁶ suspicious account activities to the authorities and, secondly, it compels the implementation of AML compliance programmes by all

²²⁸ Section 1964(a) sanctions a court to order a person to divest himself of an interest he may have in an object that can potentially be forfeited. However, in *Sedima, SPRL v Imrex Co* (473 US 479 (1985) 506) the court recognised that this remedy may be subject to exploitation.

²²⁹ Section 1962(a)–(d) of RICO.

²³⁰ RICO's civil forfeiture provisions are evaluated elsewhere in this chapter (see par D.4.2.1 below).

²³¹ Pub L No 102-550, 106 Statute 3672, 4044–45, 4048–4049, 4055–4056 ('Annunzio Act').

²³² 12 U.S.C. section 1730(d).

²³³ Cf Alford (1994) *North Carolina J of Internat L & Comm R* 460; par D.4.3 below. For a recount of the failure of the Bank of Credit and Commerce International, see ch 1.A.1; ch 4.D.1.

²³⁴ Low et al *US AML* 347.

²³⁵ Section 1511 of the Annunzio Act.

²³⁶ *Idem* section 1517(b)(1).

financial institutions.²³⁷ Although intended to motivate financial institutions to improve internal AML programmes, the Annunzio Act is favourable to banks because it protects them against liability based on negligence to the degree that the bank cooperates with bank regulators.²³⁸ Like the MLCA, a bank may find itself in a quagmire in relation to filing STRs, if it discloses too much information, a customer may file suit against it for breach of confidentiality, if it discloses insufficient little information, the government may allege that it has violated the BSA's provisions.

The Annunzio Act addressed the latter concern by providing that a bank shall not be liable under state or federal law for disclosing information to the Financial Crimes Enforcement Network,²³⁹ the federal agency to which STRs and CTRs must be submitted.²⁴⁰ The rationale behind the protection is to encourage suspicious transaction reporting.²⁴¹ Therefore, to gain the protection of the safe-harbour provision, the bank must file a STR. The safe-harbour provision extends to civil liability only and a bank will therefore not be protected if it knowingly²⁴² engages in money laundering activities. In addition, in the absence of clear parameters it is unclear to which extent a bank will be protected against civil liability on account of filing a STR.

It is significant that the Annunzio Act addresses an omission in previous AML statutes, namely that records of EFTs must be retained.²⁴³ Pursuant to the Annunzio Act, the Federal Reserve Bank as banking regulator may either revoke the licence and/or deposit insurance of a US bank on account of a money laundering conviction or it may appoint a conservator to manage the institution.²⁴⁴ Further, key to the effectiveness of the statute is the so-called 'death penalty'²⁴⁵ provision whereby a bank's charter and/or deposit insurance will be revoked if it is established,

²³⁷ Section 1534(b) of the Annunzio Act.

²³⁸ Powis *BSA* 13; Arend (1993) *ABA Banking J* 69–70.

²³⁹ Or 'FinCEN' (see par E.1 below).

²⁴⁰ Which is known as a 'safe-harbour' provision (cf par B.2.2 above; section 1517(b) of the Annunzio Act).

²⁴¹ Richards *Money Laundering* 88–89; Fischer *Financial Privacy* 4-5.

²⁴² Which is defined to include willful blindness or purposeful ignorance (see par C.3.2.2 above).

²⁴³ In terms of the Annunzio Act, the Treasury and the Federal Reserve Board jointly issued regulations relating to the keeping of EFT records (section 1511 and section 1515).

²⁴⁴ Section 1501(a) of the Annunzio Act.

²⁴⁵ Jordan *Drug Politics* 211; Powis *BSA* 13; Cuéllar (2003) *J of Crim LC* 350.

inter alia, that²⁴⁶ its management is involved in illicit activity, its management fails to cooperate when criminal allegations are filed and no policies are in place to prevent money laundering. To avoid rescission of its charter or deposit insurance a bank must show that it attempted to prevent money laundering. Therefore, the bank must establish²⁴⁷ a high degree of the involvement by senior management in preventing money laundering activity, the existence of preventative AML measures and the implementation of new internal measures to prevent money laundering.

Ultimately, the Annunzio Act warns banks of the consequences of failing to follow AML guidelines. Its provisions supplement existing AML statutes greatly, especially since violation of its provisions are likely to hold dire consequences for banks. It is therefore fair to state that the Annunzio Act contributes afresh to the Congress's AML effort because it comprises both AML and penal measures in the event that the AML measures are neglected. Moreover, a bank's directors and management are entrusted with shouldering the burden of ensuring compliance to the Annunzio Act's provisions. Consequently, the Annunzio Act assures a culture of money laundering prevention that goes beyond the efforts of individual employees but instead extends to the top of the bank's management.

6. Money Laundering Suppression Act (1994)

The BSA was amended in 1994 by Congress through the Money Laundering Suppression Act.²⁴⁸ The Suppression Act derived from an effort by the Treasury to simplify the requirements of the BSA and therefore purported to assist banks with, *inter alia*, complying with the BSA's reporting provisions.²⁴⁹ As such, the aim of the Suppression Act is threefold:²⁵⁰ it simplifies CTR under the BSA,²⁵¹ it promotes closer examination of potential money laundering operations²⁵² and money

²⁴⁶ Sections 1502, 1503 and 1507 of the Annunzio Act. A 'death penalty' provision is likewise included in section 1818 of the Civil Asset Reform Act of 2002 (see par D.4.2.2 below).

²⁴⁷ Section 1504 of the Annunzio Act.

²⁴⁸ Pub L No 103-325, 108 Stat 2160 ('Suppression Act').

²⁴⁹ Arrastia *Money Laundering* 252; Csoka (2001) *Annual R of B L* 317.

²⁵⁰ Morgan (1996) *Essays in Internat Financial & Economic L* 35–36; Gouvin (2003) *Baylor LR* 968.

²⁵¹ See section 103 in the Amendments to the Bank Secrecy Act Regulation - Exemptions from the Requirement to Report Transactions in Currency of 1996 (31 C.F.R.); Notice (1995) *Money L Alert* 1.

²⁵² Section 404 of the Suppression Act.

transmitting businesses²⁵³ and it elevates the practice of structuring²⁵⁴ by adding to the criminal penalties²⁵⁵ for the activity.

Pursuant to section 402 of the Suppression Act, the Treasury inserted in October 1994 a rule in the Federal Register²⁵⁶ that revoked the duty of banks to keep a monthly register of all monetary instruments which were issued by them. The rule²⁵⁷, *inter alia*, aims to eliminate the burden that CTR imposed upon banks and to focus the CTR system on transactions which are of interest to law enforcement. The main difference between a STR and a CTR is that before filing a STR the bank must determine whether a specific transaction is suspicious and therefore warrants reporting. In contrast, a CTR must be filed regardless of the nature of the transaction.

7. International Counter-Money Laundering and Foreign Anti-Corruption Act (2001)

The International Counter-Money Laundering and Foreign Anti-Corruption Act of 2001²⁵⁸ supplies the Treasury with extraterritorial powers to encourage countries and banks, identified as posing a money-laundering threat to the US, to alter their practices. Only the provisions of Titles I and III are relevant to the discussion at hand.²⁵⁹ In terms of Title I of the ICA the power of the Treasury to combat money laundering is extended in respect of offshore jurisdictions and certain financial transactions.²⁶⁰ Significantly, the ICA describes precisely what the Treasury may do should it be dissatisfied with the AML measures of, *inter alia*, a particular bank.²⁶¹

²⁵³ *Idem* section 408.

²⁵⁴ See par C.3.4 above.

²⁵⁵ See section 411(a) of the Suppression Act.

²⁵⁶ 59 Federal Register 52,250 (17 October 1994). Cf Galli & Wexton (*US Perspective* 372); Morgan (1996) *Essays in Internat Financial & Economic L* 36.

²⁵⁷ See Amendments to the Bank Secrecy Act Regulation - Exemptions From the Requirement to Report Transactions of 1996 (31 C.F.R. section 103).

²⁵⁸ Which is codified in scattered sections of 18 U.S.C. and 31 U.S.C. ('ICA').

²⁵⁹ Title II of the ICA contains administrative and technical measures only which amend the reporting requirements of the BSA.

²⁶⁰ Section 2(b)(2) of the ICA.

²⁶¹ Section 101(a)(1) of the ICA which was incorporated as section 5318A in the BSA (cf par C.8.3.1 below).

The Treasury, in determining whether a particular country poses a threat to the US, may consider various²⁶² measures whilst some²⁶³ inquiries are outlined in the ICA to establish whether a particular bank or transaction constitutes a money laundering threat. If it is established that a money laundering threat exists, the Treasury, after consultation with the Federal Reserve and other parties which it deemed necessary,²⁶⁴ may take action²⁶⁵ to address the threat. Title III of the ICA provides that in any discussion between the US and another country about issues relating to money laundering, four matters should feature namely,²⁶⁶ one, measures to address corruption within government; two, AML legislation, three, measures to assist the US with identifying the proceeds of corruption and return them to the country of origin (that is, the country where the corruption occurred) and four, policies to prevent governmental corruption.

Due to the purpose of extending the extraterritorial powers of the Treasury, the ICA has become controversial.²⁶⁷ But, since the purpose of the statute is to address particular weaknesses of the US AML regime, its enactment, albeit controversial, should be regarded as a way to protect the US financial system.

8. Patriot Act (2001)

8.1 Background

By 2001, the US had an AML regime in place that primarily focussed on banks' compliance with legislation which compliance was enforced by the FinCEN. The September 2001 terrorist attacks

²⁶² Cf section 5318A(c)2(A)(i)–(vi) of the BSA.

²⁶³ The following questions, *inter alia*, are considered to determine whether a bank or transaction is likely to pose a threat (section 5318A(c)(2)(B)(i)–(ii)): does the bank or transaction promote money laundering through the country in question and is the bank or transaction used for legitimate purposes in the country (cf Stern et al (2002) *Banking LJ* 5)?

²⁶⁴ Some of the measures that may be taken in consideration before a conclusion is made include the (adverse) impact of such action on the legitimate activities involving the country (cf section 5318A(a)(3)(B)(i)–(iii)).

²⁶⁵ Measures that may be implemented in terms of the ICA include additional reporting requirements and specific conditions for the opening and maintenance of particular accounts (section 5318A(b)(1)–(2)).

²⁶⁶ Section 301(a)(1)–(4) of the ICA.

²⁶⁷ Hinterseer *Criminal Finance* 176.

on the US²⁶⁸ initiated a new era in US AML history because it was discovered that international terrorists employ the financial system of the US to fund their activities.²⁶⁹ In response, two²⁷⁰ measures were taken by Congress to fight both money laundering²⁷¹ and terrorist financing²⁷² in the US, one of which was the enactment of the Patriot Act. Section 302(b) of the Patriot Act specifies thirteen specific goals of the statute.²⁷³ These goals can be summarised as to enhance transparency in financial transactions, protect international access to the US financial system and increase the awareness of US banks regarding potential money laundering and terrorist financial activities.²⁷⁴

²⁶⁸ On 11 September 2001 two hijacked US Airlines planes flew into the north and south towers, respectively, of the World Trade Centre in New York (cf Gouvin (2003) *Baylor LR* 958). The collapse of the two buildings resulted in the death of nearly three thousand people. Approximately an hour after these two plane disasters, a hijacked United Airlines plane crashed into the Pentagon in Washington DC. Minutes thereafter, a second United Airlines plane, speculated to be heading for the White House in Washington DC, crashed in Pittsburgh in the US.

²⁶⁹ Scott *International Finance* 619–620; Zagaris (2004) *Berkeley J of Internat L* 129–130. Subsequent probes by the FBI revealed that the hijackers, who were involved in the September attacks, opened 24 domestic bank accounts at four different US banks.

²⁷⁰ Namely the Uniting and Strengthening America by Providing Appropriate Tools to Intercept and Obstruct Terrorism (US PATRIOT) Act of 2001 (Pub L No 107-56, 115 Statute 272, 308-09), which was passed on 26 October 2001 and Executive Order No 13244 (66 Federal Register 49079 (25 September 2001)) issued by US President Bush. Under the order persons who commit or support terrorism may be designated as Specially Designated Global Terrorists ('SDGTs') (US Treasury *War on Terrorism* 3). The designation means that all the property of SDGTs could be frozen. Cf US Treasury *2003 AML Strategy* 1.

²⁷¹ At this point it is useful to distinguish between money laundering occurring in relation to terrorism and so-called 'reversed' money laundering. Money laundering involves conduct aimed at concealing the criminal origin of money (see paras C.2–7 above; ch 4.B.1; ch 6.B.3, par C.3; ch 8.C.4). Money laundering occurring in relation to terrorism refers to a process aimed at concealing illegally derived money's nexus to crime so that it can be employed to finance terrorism. In contrast, reversed money laundering is a concept coined to denote a process whereby *legitimate* money is, or will be utilised for terrorism purposes (Lauber (2004) *Terrorism Monitor* 1; Lilley *Dirty Dealing* 129–131). For a detailed description of what reversed money laundering entails, see Seigle *US Response III* paras 4–5, 14–15.

²⁷² US Treasury *2002 AML Strategy* 1–2. For a narration of the connection between money laundering and terrorism from a US point of view, see Sullivan-Butler (2004) *St Thomas LR* 397–398.

²⁷³ Section 302(b)(1) of the Patriot Act.

²⁷⁴ See US Treasury *War on Terrorism* 10; Healy et al *Internat L* 631.

The enactment of the Patriot Act in October 2001 coupled with the Treasury's adoption of regulations²⁷⁵ to implement the statute, saw new KYC standard obligations and restrictions being imposed on banks. The Treasury is empowered to take special measures against foreign countries,²⁷⁶ banks operating outside the US²⁷⁷ and international financial transactions and accounts that pose a 'primary money laundering concern'²⁷⁸ to the US. A key distinction is made in the Patriot Act between banks operating in the US²⁷⁹ and banks operating outside the US jurisdiction. In addition, the Patriot Act improved existing civil forfeiture legislation.²⁸⁰

It is worth pointing out that Title III of the Patriot Act for the most part amended existing AML Acts and, therefore, its provisions were integrated in them. Therefore, Title III does not constitute a separate AML act, but instead serves as an amendment act that amended relevant sections of existing AML Acts.

8.2 Money Laundering Offences

After studying the provisions of Title III of the Patriot Act, it is evident that Congress did not seek to enact new AML measures, but instead saw it fit to add volume to already existing measures. As mentioned already,²⁸¹ the Patriot Act requires banks to comply with special measures if it is determined that a foreign country, foreign bank, type of transaction or type of account poses a

²⁷⁵ Namely the Customer Identification Programmes for Banks, Savings Associations, Credit Unions and Certain Non-Federally Regulated Banks Regulation (as amended) of 2005 (12 C.F.R. Parts 208-211 section 103(121)) ('Patriot Act Regulation').

²⁷⁶ See section 311(b) of the Patriot Act; FinCEN *Information Sharing* (2002). Measures of this kind are irrelevant to the study at hand and will therefore not be explored in this section (for a detailed summary of the extraterritorial application of US AML laws, see Hagler (2004) *Syracuse J of Internat L&C* 235–238).

²⁷⁷ International Banking Operations (Regulation K) Regulation of 2003 (12 C.F.R.) Part 211; FinCEN *International Banking Operations* (2003).

²⁷⁸ Reports of Foreign Financial Accounts Regulation of 2002 (31 C.F.R.) section 24(1)(a). Cf FinCEN *Due Diligence for Foreign Accounts* (2002).

²⁷⁹ See, for example, FinCEN *AML for Financial Institutions* (2002) and FinCEN *Customer Identification Programmes- Banks*. Both documents pertain only to banks operating in the US.

²⁸⁰ See par D.4.2.3 below.

²⁸¹ See par C.8.1 above.

‘primary money laundering concern.’²⁸² Therefore, banks may be required to²⁸³ keep records of certain transactions, obtain information about customers who are permitted to use foreign correspondent accounts and abandon certain type of correspondent accounts entirely. The Patriot Act further extended the list of SUAs to include terrorism.²⁸⁴ Section 376 of the statute amended section 1956(c)(7) of the MLCA so that it is a SUA to provide any type of support to an organisation designated by the Secretary of State as a ‘foreign terrorist organisation.’²⁸⁵

Section 351 of the Patriot Act encapsulates two pivotal matters as regards the filing of STRs by banks, namely the scope of protection against civil liability afforded to banks filing STRs and the operation of a rule that precludes the bank from informing the customer that it submitted a STR.²⁸⁶ The first issue is addressed by section 515(a) of the Patriot Act which comprises three features that are particularly relevant in this context. First, the section extends the existing protection afforded to a bank that filed a STR to include any potential liability arising out of breach of contract,²⁸⁷ secondly, it also covers voluntary disclosures made to FinCEN and thirdly, it affords protection to both the person who filed the STR and anyone who requires another to make a disclosure. As regards the rule against ‘tipping-off’, section 315(b) of the Patriot Act unequivocally confirms that a bank that filed a STR may not disclose the fact to anyone.

Section 359 of the Patriot Act concerns underground banking systems.²⁸⁸ It has been recognised that underground banking systems are likely to be used by terrorists, because they provide them with financial means as well as an opportunity to infiltrate the US financial system in an indirect manner.²⁸⁹ Accordingly, the Patriot Act addresses this danger in a threefold manner.

²⁸² Section 311 of the Patriot Act; Scott *International Finance* 626 ev.

²⁸³ See in general Stern et al (2002) *Banking L J* 4–5; Gouvin (2003) *Baylor LR* 970–972; Sullivan-Butler (2004) *St. Thomas L R* 398–400; McEneney et al *Business L* 1288–1289.

²⁸⁴ Section 1956(c)(7) of the MLCA listing SUAs. Cf Gibeaut (2002) *ABA J* 48.

²⁸⁵ See section 1956(c)(7)(D) of the MLCA referring to section 2339A of the Anti-Terrorism and Effective Death Penalty Act of 1996 (28 U.S.C.A.) where assistance to terrorists is criminalised.

²⁸⁶ See section 351(a) and section 351(b) of the Patriot Act respectively.

²⁸⁷ See paras B.1–2 above as regards the bank-customer relationship and confidentiality. Thus, a bank may still face delictual liability if it filed a STR under circumstances where no reasonable grounds existed for its suspicions.

²⁸⁸ Which are also known as informal money transmitting systems (see ch 4.D.4.3.2).

²⁸⁹ Lacy & George (2003) *Northwestern J of Internat L & Business* 282–283; Silets et al (2003) *J of Fin Crime* 392.

First, section 359 of the Patriot Act amended the BSA's definition of the concept 'financial institution' to include underground banking operations.²⁹⁰ Secondly, the BSA's definition of a money transmitting business was extended to compel informal money transfer systems to register and report transactions as required pursuant to the statute.²⁹¹ Thirdly, relevant AML regulations²⁹² are made applicable to informal money transfer systems as well.²⁹³ Section 326 of the Patriot Act broadens the powers of the Treasury to issue supplementary regulations²⁹⁴ to deal with money laundering and terrorist financing.²⁹⁵

Finally, the Patriot Act amended the civil forfeiture provisions of US AML statutes in three ways.²⁹⁶ First, it establishes for the first time civil forfeiture for currency reporting offences. Secondly, the Patriot Act provides for the civil forfeiture of property that derived from crimes committed abroad and thirdly, it simplifies the process of facilitating foreign requests with respect to the forfeiture of property located in the US. These issues are analysed in detail elsewhere in the chapter.²⁹⁷

8.3 Special Measures of the Patriot Act

8.3.1 Measures Pertaining to Banks Operating *Outside* the United States

It has been suggested²⁹⁸ that Congress with the enactment of the Patriot Act envisioned an aggressive form of extraterritoriality since US banks operating outside the jurisdiction of the US are specifically targeted by the Patriot Act with respect to their AML measures. Section 311 of

²⁹⁰ Section 5312(a)(2)(R) of the BSA.

²⁹¹ Section 5330(d)(1)(A) of the BSA.

²⁹² See, for example, sections 103(20)(b)–(c) and 103(41) of the Reports by Money Services Businesses of Suspicious Transactions Regulation of 2002 (31 C.F.R. section 103(20)).

²⁹³ Section 359(c) of the Patriot Act.

²⁹⁴ See, for example, Reports by Banks of Suspicious Transactions Regulation of 2002 (31 C.F.R. section 103(18)) and Reports of Foreign Financial Accounts Regulation of 2002 (31 C.F.R. section 24).

²⁹⁵ Section 326 of the Patriot Act. Cf Healy et al *Internat L* 633; Van Cleef (2003) *J of Fin Crime* 84–85).

²⁹⁶ Section 806 of the Patriot Act.

²⁹⁷ See par D.4.2.3 below.

²⁹⁸ Norton & Shams (2002) *Internat L* 103–126.

the Patriot Act provides that US banks that operate outside the US may be required to furnish detailed records as regards certain overseas accounts.²⁹⁹ Evidently the purpose is to prosecute any US bank that commits a money laundering offence regardless of whether the offence is committed inside or outside of US.³⁰⁰

8.3.2 Measures Pertaining to International Financial Transactions and Accounts

Under section 326 of the Patriot Act, minimum standards for banks are established in respect of the identity of customers. The standards become applicable as soon as an account is opened at a bank. In terms of the Patriot Act Regulation banks are required to implement reasonable procedures for establishing the identity of a potential customer.³⁰¹ Banks must set up special due diligence procedures to identify the owners of private banking accounts.³⁰² The identities of both the nominal and beneficial³⁰³ owner of an account must be established as well as the source of the funds deposited into the account.

Therefore, pursuant to the Patriot Act 'long arm'³⁰⁴ jurisdiction is asserted over foreign banks and individuals in relation to money laundering. Banks that offer correspondent accounts are likewise required to monitor and report instances of money laundering by a non-US citizen who has a connection to that account.³⁰⁵ Banks must ascertain the identity of the owners of foreign banks³⁰⁶ for which the correspondent accounts are maintained. In addition, banks should pinpoint foreign banks that are using the accounts and peruse account activities.³⁰⁷ US banks are prohibited from providing correspondent accounts to foreign banks that have no physical

²⁹⁹ Section 311 of the Patriot Act.

³⁰⁰ Lacy & George (2003) *Northwestern J of Internat L & Business* 307–308.

³⁰¹ Section 103(121)(b)(2)(1)(i) of the Patriot Act Regulation. Cf FinCEN *AML for Financial Institutions* (2002) 21110(1)(b); par C.9 below.

³⁰² Section 312 of the Patriot Act. Cf FinCEN *Customer Identification Programmes-Banks* 25090(7)(a)–(g). Enhanced due diligence measures should be employed by banks as regards private bank accounts opened for foreigners (31CFR section 103(181)–(182); FinCEN *Due Diligence for Foreign Accounts* (2002) 48348).

³⁰³ See section 312 of the Patriot Act; FinCEN *Foreign Accounts* (2002) 37744.

³⁰⁴ Anning et al *E-Finance* 280. Cf Schudelar *Electronic Payments* 132–133.

³⁰⁵ Section 312 of the Patriot Act.

³⁰⁶ FinCEN *Correspondent Accounts for Foreign Banks* 79383.

³⁰⁷ FinCEN *idem* 78383(1)(a)–(d).

presence in any country³⁰⁸ and must terminate correspondent accounts of foreign banks that fail to heed their requests for records of transactions or other information.³⁰⁹

The final element of the KYC standard, namely training, is addressed in section 352 of the Patriot Act. Accordingly, banks must provide AML detailed training programmes to their employees.³¹⁰

To conclude, the main contribution of the Patriot Act to the US AML statutory regime is that it extends the scope of existing domestic legislation. Four features³¹¹ of the Patriot Act substantiate this point. First, section 311 of the Patriot Act makes a clear distinction between banks operating in the US and banks operating abroad. This provision allows for special due diligence on the side of a bank in respect of, *inter alia*, correspondent accounts. Secondly, US banks are prohibited from maintaining correspondent accounts with foreign shell banks even if the latter are registered in the foreign country.³¹² This prohibition effectively bans certain foreign banks from penetrating the US banking system.³¹³ Thirdly, since records pertaining to certain accounts held at foreign banks may be subpoenaed,³¹⁴ the Patriot Act ignores both US and foreign bank confidentiality rules in favour of disclosure. Fourthly, the recognition of foreign corruption as a money laundering offence³¹⁵ links the AML effort of the US to foreignly derived benefits of crime. The outcome is that foreign criminals are precluded from using the banking system of the US as hideout for the proceeds of their criminal activities.

The Patriot Act represents the most significant AML legislation for banks since the enactment of the BSA and the RICO in 1970.³¹⁶ Not only does it require that banks modify their AML programmes, but the Patriot Act impacts directly on the AML compliance duties of banks.

³⁰⁸ See section 313 of the Patriot. Banks without a physical presence are known as ‘shell banks’ and are recognised for their use as vehicles to launder money (cf ch 4.D.2, ch 5.B.3.3.4).

³⁰⁹ FinCEN *Correspondent Accounts for Foreign Banks* 78383(3).

³¹⁰ See section 352 of the Patriot Act. Cf FinCEN *Customer Identification Programmes-Banks* 25090(12)(a)–(d); Silets et al (2003) *J of Fin Crime* 393.

³¹¹ Preston (2002) *J of Financial Crime* 104; Gallant *Money Laundering* 81–82.

³¹² Section 313 of the Patriot Act.

³¹³ Whether the measure will prevent terrorist money from entering the US is a matter of opinion.

³¹⁴ Section 319(b) of the Patriot Act (see par C.8.2 above).

³¹⁵ Section 312 of the Patriot Act.

³¹⁶ Stern et al (2002) *Banking L J* 2; Zagaris (2004) *Berkeley J of Internat L* 124. See paras C.2, C.4 above respectively as regards the Bank Secrecy Act and the RICO.

It is submitted that the international reach of the Patriot Act renders it a legal instrument with far-reaching consequences. The Act initially purported to strengthen existing AML legislation. However, the fact that its provisions extend globally should act as a warning to internationally active criminals, especially those that escape prosecution in their own countries by moving funds abroad. The Patriot Act further affords the authorities access to funds hidden abroad by domestically active criminals. In this way, it is possible to attack the benefits of crime from two angles: from within the US and from outside its borders. Most notably, powers entrusted to the government by the Patriot Act, especially as regards foreign banks and foreign customers, amount to a ‘new phase’³¹⁷ in money laundering law. This is mainly due to the fact that the Patriot Act dealt with the loopholes in existing AML laws whilst extending their ambit internationally.

9. Anti-Money Laundering Regulations³¹⁸

The Treasury in cooperation with other supervisory agencies continuously issue regulations to implement the BSA’s AML measures. The first regulations have been updated to enforce the due diligence amendments of the Patriot Act.³¹⁹ In addition, four sets of rules were published by FinCEN in conjunction with the Treasury to supplement sector specific KYC standard programmes.³²⁰ In terms of the AML Acts banks must have effective compliance programmes in place.³²¹

Further, pursuant to the Patriot Act sector-specific organisations, for example, the American Banking Association and the Securities Exchange Commission, are likewise required to recommend ‘best practices’ rules to supplement relevant due diligence measures. To this end,

³¹⁷ Norton & Shams (2002) *Internat L* 104.

³¹⁸ It is pointless to evaluate the various sets of AML rules and regulations separately because key provisions should be appraised against relevant statutory provisions, as was done in the foregoing paragraphs (see paras C.2–8 above). Therefore, this section sets forth only a few salient remarks as regards the rules and regulations issued in support of money laundering control.

³¹⁹ See, for example, the Meaning of Terms Regulation of 2002 (31 C.F.R.) section 103(11) and Reports of Foreign Financial Accounts Regulation of 2002 (31 C.F.R.) section 24.

³²⁰ See, for example, FinCEN *Customer Identification Programmes-Banks* and FinCEN *Customer Identification Programmes-Brokers*.

³²¹ See, for example, the Procedures for Monitoring Banks Secrecy Act (BSA) Compliance Regulations of 2002 (12 C.F.R. section 21(21)(b)).

the American Bankers Association publishes guidelines for banks which concern the prudent identification of customers.³²²

In short, FINCEN and the Treasury's regulations and rules require banks to design specialised customer identification programmes that include risk-based procedures for establishing the identity of customers as far as it is reasonable and practical.³²³ The rationale is that banks must be able to form a reasonable belief that they know the true identity of their customers. Procedures that may be employed by a bank to design an identification programme must consider the risks involved in opening a certain type of account, different methods available to open an account and the types of identification verifications available.³²⁴

D CIVIL REMEDIES

1. Introduction

Elsewhere in the study,³²⁵ two types of civil remedies were explored which are particularly relevant where a bank receives a deposit comprising the benefits of crime. First, it was seen that a victim of fraud or theft may use the constructive trust remedy against the bank which paid the benefits of fraud or theft to the fraudster or thief whilst suspecting that the funds did not belong to him.³²⁶ The claim is substantiated by the bank's compliance with statutory AML obligations, in particular, the filing of a STR which provides the knowledge element required to succeed in the claim against the bank.

Secondly, it was seen that civil forfeiture constitutes an apposite remedy employed by the government to redress criminal conduct. The action is aimed at depriving criminals of the benefits of their crimes after the funds were deposited with a bank. The following section sets forth the application of the two aforementioned remedies in the context of US law. US restitution law

³²² See *ABA Resource Guide*.

³²³ *FinCEN Customer Identification Programmes - Banks 25109*.

³²⁴ Section 103(121)(b)(2)(B)(iii) of the Patriot Act Regulations; *FinCEN Customer Identification Programs - Banks 25110*.

³²⁵ See ch 6.B.4.2, paras C.4.2–4.3, C.4.4.

³²⁶ See ch 6.C.4.2–4.3.

derives from English common-law principles.³²⁷ Since the early days of Anglo-American common-law a person's unjustly receipt of benefits³²⁸ has supplied the foundation for imposing on him an obligation to repay the benefits he unjustly received.³²⁹ Therefore, the overriding purpose of the section at hand is to illustrate how US courts have dealt with and interpreted English common-law restitution principles.

At present, US restitution principles are contained in the ALI's Restatement of Restitution.³³⁰ The latter describes the purpose of restitution as to prevent a defendant's unjust enrichment³³¹ by returning to the plaintiff the gains that the former unjustly obtained in a transaction.³³² Therefore, unjust enrichment lies at the heart of liability in restitution.³³³ US courts, in an effort to measure unjust enrichment, will consider the benefits obtained by the defendant *vis-à-vis* loss suffered by the plaintiff.

³²⁷ See in general Hall et al *US History* 23–24; Knapp *Contract Law* 207; Re & Krauss *Remedies* 3; Dobbs *Remedies I* 18; Leavell *Restitution* 2–9; Gergen *Enrichment Symposium* 17; York et al *Remedies* 197; Kovacic-Fleischer (1983) *Syracuse LR* 743; Gergen *Enrichment Symposium* 13; Rogers *Restitution* 2; Beatson & Schrage *Enrichment* 31. York et al (*Remedies* 197) remark: '[t]he legacy of the English Chancery Courts to the American judicial system has been generous ... Our *inherited* equitable remedies carry with them certain well-known characteristics ... the remedies of equity become discretionary and therefore flexible.' English common-law thus became part of US law due to colonisation, albeit it on an informal basis. By the late 1700s English common-law was formally received in all the jurisdictions of the US with the exception of the state of Louisiana whose common-law is influenced by French common-law principles (see par A.2 above). By the end of the 18th century both England and the US accomplished a merger of general law and equity. In 1787 when the US Constitution was enacted, equity jurisdiction was recognised in the states. As a consequence, the states inherited the English division between law and equity (Leavell *Restitution* 8; Re & Krauss *Remedies* 3). This dual system of courts complicated the choice a plaintiff had of a remedy.

³²⁸ In the context of restitution, the concept 'benefit' is utilised as an umbrella term to denote the overall gains of the defendant as opposed to the loss suffered by a plaintiff (Dobbs *Remedies I* 566).

³²⁹ See in general Sherwin *Restitution Symposium* 2; Wonnell (1996) *Emory LJ* 153. The opening sentence of the Restatement of the Law of Restitution of 1937 (Restatement of Restitution) contains the governing principle of restitution, namely (ALI *Restatement of Restitution* 1): '[t]he Restatement of this Subject deals with situations in which one person is accountable to another on the ground that otherwise he would unjustly benefit or the other would unjustly suffer loss.'

³³⁰ ALI *Restatement of Restitution* 12, 15, 17, 640.

³³¹ Which is determined by enquiring whether the defendant was unjustly enriched by legal standards (Dobbs *Remedies I* 552).

³³² Section 1 of the Restatement of Restitution (ALI *Restatement of Restitution* 12).

³³³ Kull (1995) *Cal LR* 1193; Kull (2003) *Chicago-K LR* 17.

Significantly, under US law two forms of restitution are recognised.³³⁴ First, conventional restitution which redresses unjust enrichment by returning to the plaintiff benefits that another *legally* obtained at his expense, and secondly, specific restitution which seeks to restore misappropriated value to its original owner. The latter form of restitution is especially pertinent in light of money deposited into a bank account where it is not the actual physical money that is claimed back but rather the value³³⁵ it embodies.

Restitution is further an appropriate remedy where money was embezzled, stolen³³⁶ or converted into other property.³³⁷ In the main, conversion constitutes a remedy for interference with possessory rights in *specific* chattels.³³⁸ The action is available to the owner of a thing who, if successful, is entitled to the return of the full value of his chattel.³³⁹

At English common-law it is possible for a victim of fraud or theft to recover his loss from the bank as recipient of the benefits of fraud or theft irrespective of the fact that the bank parted with the money by, for example, paying it to the fraudster or thief on demand.³⁴⁰ Consider the scenario where X is the victim of fraud who followed the money that was fraudulently acquired from him to the bank account of the fraudster, Y. X is informed by the bank that Y emptied the account and left no forwarding address. X's only remedy in this type of scenario is to try and

³³⁴ Oh (2006) *Tulane LR* 881.

³³⁵ Cf ch 2.C.3.

³³⁶ Dobbs *Remedies I* 552–553, 558; Leavell *Restitution* 333; Gergen *Enrichment Symposium* 22.

³³⁷ For example, where stolen money was used by the thief to buy jewellery for his wife. Whether misappropriated money may be claimed back with a conversion action is a controversial issue. Under US law money cannot be recovered with a conversion action unless it is *identifiable* as a *specific chattel*. Most significantly, in *Belford Trucking Company v Zagar* (243 So D 646 (1970) 648) the court confirmed as follows: '[t]o be a property subject of conversion each coin or bill need not be earmarked, but there must be an obligation to keep intact or deliver specific money, so that such money can be *identified*.' However, apparently some courts are willing to interpret the concept 'specific chattel' broadly. For example, in *Republic of Haiti v Crown Charters Incorporated* (667 F Supp 839 (1987) [*Haiti*]) the court reasoned that separate bank accounts constitute specific chattels and: '[f]unds took on an identifiable character when they were withdrawn in specific amounts as represented by particular cheques or wire transfers' (845). Therefore, the requirement of identification was met by the plaintiff.

³³⁸ The ALI defines the concept 'chattel' as (section 128 comment (b) - ALI *Restatement of Restitution* 526): '[a]ny tangible, moving thing ... This term includes money.' For a general evaluation of the concept 'money as chattel', see ch 2.A.1.

³³⁹ Section 128 of the Restatement of Restitution (ALI *Restatement of Restitution* 526); Zekoll & Fleming *Torts* 201; Bogert et al *Trusts* 295.

³⁴⁰ See ch 6.C.4.2–4.3.

recover the loss he suffered at the hands of Y from the bank that received and subsequently used or paid the benefits of fraud to the fraudster. Whether he will be successful with his claim against the bank is the considered in detail in following section.

It is submitted that the following observation confirms that US codified common-law like English common-law may potentially be used by a victim of fraud or theft to claim loss from the bank as recipient of the benefits of the fraud or theft:³⁴¹

[b]y now it is uncontroversial (even in England) that the law of unjust enrichment is and ought to be open to novel claims.

Although it is at no time suggested that claiming loss from a bank is a novel endeavour, the observation does acknowledge one of the premises of this study, namely that the suspicious transaction reporting obligation of AML legislation³⁴² may expose a bank which parted with the money to a civil claim instigated against it by a victim of fraud or theft. In particular, at US common-law a victim of fraud or theft may based his claim against the bank which received the benefits of the fraud or theft on one of the following four codified restitution actions, namely:

1. constructive trust;³⁴³
2. the action for money had and received;³⁴⁴
3. tracing;³⁴⁵ or

³⁴¹ Gergen *Enrichment Symposium* 40. Dobbs (*Remedies I* 372) agrees with the statement reasoning that unjust enrichment has ‘the potential for resolving new problems in striking ways.’

³⁴² See paras C.2.4, C.3.2 above as regards suspicious transaction reporting.

³⁴³ The concept ‘constructive trust’ was adopted by US equity courts (Dobbs *Remedies I* 557). An action based on constructive trust is both a claim at law and one founded in substantive equity (see *In re Heston Oil Company* (63 BR 711 (1986)) [*Heston Oil*] where the court described a constructive trust as an ‘equitable fiction’ (716) (cf par D.3.3 below).

³⁴⁴ The action for money had and received is known under English law as common-law tracing (see ch 6.C.4.3.2). It is important to point out that unlike English restitution law which distinguishes between common-law tracing and tracing in equity, US statutory restitution law knows only a *general* tracing action. So-called ‘common-law tracing’ or the action for money had and received is utilised solely in the context of conversion. Yet despite the integration of law and equity in the US, Matthews (*Common Law Tracing* 32) asserts that a distinction between common-law tracing and equitable tracing is sensible.

³⁴⁵ Although the literature consulted does not employ the concept ‘tracing in equity’ the concept is apt in this setting due to the fact that equity principles lay at the heart of the tracing rules (see par D.3.3 below).

4. *replevin*.³⁴⁶

Notably, a restitution claim may fail against the bank if it interferes with the bank's own rights or where the claim is unjust or inequitable based on the particular facts of the matter. The bank may further avert a restitution claim by using one of the following two defences, namely³⁴⁷ *bona fide* purchaser of value and change of position. These issues are explored henceforth.

2. Constructive Trust

2.1 Background

At US common-law the right to ownership confers, *inter alia*, on an individual a certain amount of control or authority over his property.³⁴⁸ A person may elect to detach his right to manage his property from his ownership of the property. This is accomplished with the establishment of a trust, an arrangement that is defined as a legal relationship by which a trustee undertakes the obligation to deal with property over which he has control for the benefit of a beneficiary.³⁴⁹ Some of the rights of a trust beneficiary include following³⁵⁰ trust property that has been handled in breach of the trust in the hands of any person other than a purchaser for value who obtained it in good faith.³⁵¹

³⁴⁶ The *Replevin* action allows a victim of fraud or theft to recover personal property under certain circumstances (see par D.3.5 below). It is an *in rem* action because it operates directly on property.

³⁴⁷ See par D.3.6 below.

³⁴⁸ See par B.3 above.

³⁴⁹ Yiannopoulos *Property* 224–225; Singer *Property* 192; Bogert et al *Trusts* 2–3.

³⁵⁰ The process of 'following' property concerns a factual investigation to determine whether misappropriated trust property has in actual fact come into the hands of a person. It provides the proof that an asset was at a certain time at a certain place (Smith *Tracing* 10). Significantly, following does not impose liability (Oh (2006) *Tulane LR* 889). The process of following should therefore be distinguished from tracing. Tracing involve the substitution of value and enables a claimant to use specific rules to determine whether value in a person's possession is subject to the restitution claim (cf paras D.3.1–3.3 below).

³⁵¹ Yiannopoulos *Property* 225; Leavell *Restitution* 333. Cf par D.3.6 below.

Like English common-law³⁵² and in contrast to an ordinary trust which is created by choice, a constructive trust is implied by law.³⁵³ A constructive trust is therefore not a trust but rather a form of redress that can be explained with reference to trusts.³⁵⁴ In general, it constitutes a remedy for unjust enrichment whose application is not limited to cases of wrongdoing.³⁵⁵ Constructive trust establishes a ‘common-law remedial device that courts use to provide plaintiffs with an equitable right to a defendant’s *ill-gotten* gains.’³⁵⁶ A constructive trust is further a remedy that is not limited to instances where fiduciary duties exist. It is likely to apply to *all* instances where the facts call for relief.³⁵⁷

Constructive trusts are useful remedies in cases where a fraudster or thief used the benefits of fraud or theft to buy property. Consider the scenario where a thief steals 50,000 dollars from her employer and used the money to buy an apartment from her parents. The employer as the victim of theft can request the court to trace the apartment back to the money that was stolen from him. As a result, the court can deem the apartment to be held in trust for employer even if the value of the property had appreciated to 60,000 dollars. However, the situation would be different if the thief had mixed her own money with the stolen money, for example, where she added 20,000 dollars of her own money to the 50,000 dollars stolen from her employer to buy an

³⁵² See ch 6.C.4.2.1–4.2.3.

³⁵³ *Cundall v U.S. Bank* 122 Ohio St.3d 188 (2009) [*Cundall*] par 39; Singer *Property* 192; Bogert et al *Trusts* 287–288. The *Cundall* case concerned a claim by Cundall against the trustees and US Bank which administered a family trust of which he was a beneficiary. He alleged fraud, self-dealing, and other breaches of fiduciary duties by trustees of the trust in transacting the sale of stock held in a closely held corporation. Cundall therefore sought a constructive trust over the proceeds of the sales, a declaration of rights under the trusts and 300 million US dollars in damages. Both the court *a quo* and the Ohio Appellate Court found, *inter alia*, that the claim against the bank was barred as a result of the statute of limitations (*Cundall* par 17). Cundall appealed these rulings to the Ohio Supreme Court which ultimately affirmed the relevant parts of the Appellate Court’s ruling (*idem* paras 40–41).

³⁵⁴ Section 160 comment (a) of the Restatement of Restitution (ALI *Restatement of Restitution* 641–642); Dobbs *Remedies I* 599; Re & Krauss *Remedies* 671. In *Republic of the Philippines v Marcos* (806 F 2d 344 (2nd Cir 1986)) the court granted the Republic of the Philippines a preliminary injunction to prevent transfer of money that it claimed to be held under constructive trust.

³⁵⁵ *Simonds v Simonds* 380 NE 2d 189 (1978) [*Simonds*] 193.

³⁵⁶ Liebeskind (1994) *Annual SAL* 64.

³⁵⁷ *Betty Bryant* 9. In this matter the evidence suggested that a constructive trust could be imposed on money that was unlawfully withdrawn from the plaintiff’s account (12) - see also par B.2.1 above.

apartment for 70,000 dollars. Constructive trust as remedy would still be available, but in the proportions of the contributions.

2.2 Establishing Liability

2.2.1 General Principles

As noted above, constructive trust is a tool to address unjust enrichment. It has once been explained that a constructive trust is a:³⁵⁸

[t]rust by operation of law which arises against ... one who, by fraud, actual or constructive, ... or who in any way against equity and good conscience, either has obtained or holds the legal right to property which he ought not, in equity and good conscience, hold and enjoy.

In the context of money laundering and the deposited benefits of fraud or theft this means that a victim of fraud or theft may use constructive trust to claim the loss he suffered from the bank which received the funds. He may do so if he is able to demonstrate that the bank had either direct knowledge that it was assisting a criminal³⁵⁹ or if the bank used the benefits of fraud or theft for its own benefit.³⁶⁰ Most notably, a bank that filed a STR inadvertently may have assisted the victim of fraud or theft to establish the necessary degree of knowledge on its part in order to establish constructive trust liability in relation to the benefits of the fraud or theft.

In the main the philosophy of constructive trust liability serves to prevent unjust enrichment of the owner of property.³⁶¹ In *Beatty v Guggenheim Exploration Co*³⁶² the court reasoned that:³⁶³

[a] constructive trust is the formula through which the conscience of *equity* finds expression. When property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee.

³⁵⁸ *Estate of Cowling v Estate of Cowling* 109 Ohio St.3d 276 (2006) paras 18; *Ferguson v Owens* 9 Ohio St.3d 223 (1984) 225.

³⁵⁹ Which under English law is known as knowing assistance (see ch 6.C.4.2.4).

³⁶⁰ Which under English law is known as knowing receipt (see ch 6.C.4.2.3).

³⁶¹ *Simonds* 193; *Lathem v Hestley* 514 SE 2d 440 (1999) [*Lathem*] 442.

³⁶² 225 NY 380 (S Ct 1919).

³⁶³ 386. In *Simonds* the court declared (192): '[a] constructive trust is an equitable remedy.'

So, typically legal ownership of the property is not an issue. In a scenario where the benefits of fraud or theft are deposited with a bank, the bank is considered by law to be the owner³⁶⁴ of the money it received, yet notions of fairness or ‘equity’³⁶⁵ require restitution of the funds to the victim of the fraud or theft. A constructive trust is imposed on a bank which received the benefits of fraud or theft under such circumstances that the bank may not retain the beneficial interest therein without breaching equity principles.³⁶⁶ In addition, constructive trust liability calls for the victim of fraud or theft to be wrongly deprived³⁶⁷ of some right or title to deposited funds. The court may deprive the bank of its right as owner of the deposited benefits of fraud or theft and the bank may consequently be *deemed* to hold the money as a constructive trustee for the victim of fraud or theft who was unjustly deprived of his rights to the money.³⁶⁸

To impose constructive trust liability on a bank the victim of fraud or theft must establish that the bank as constructive trustee received a benefit as opposed to him as the trust beneficiary which is unjust for it to keep. Constructive trust liability is likely only where a bank has a right³⁶⁹ to particular property, namely money deposited into a general³⁷⁰ bank account. The money that is the subject of the action must further be *identified* as belonging in good conscience to the victim even though the bank may have a legal right to it. Significantly, the claim of the victim of fraud

³⁶⁴ The fact that a bank becomes owner of money deposited into an account does not exclude restitution claims against it for the recovery of the funds (see par B.3 above).

³⁶⁵ The meaning of the concept ‘equity’ in this context should be explained. The concept ‘equity’ refers to notions of fairness, morality and flexibility as well as to rules of the equity courts (cf Dobbs *Remedies I* 63–65). Two types of court systems once existed in Anglo-American Law. One type included courts known as law courts which were overseen over by judges. The second type included so-called ‘equity courts’ which were overseen over by chancellors. Not only did the chancellors invent substantive rules which equalled legal rules, but they also invented remedies which became known as *equitable* remedies.

³⁶⁶ See *Lathem* where the court found that a constructive trust is established where (442) ‘[t]he circumstances are such that the person holding legal title to property, either from fraud or otherwise, cannot enjoy the beneficial interest in the property without violating some established principle of equity.’

³⁶⁷ A person is likely to be wrongly deprived of property either by mistake, embezzlement; fraud or a breach of faith (Singer *Property* 192; Bogert et al *Trusts* 290).

³⁶⁸ Singer *Property* 192.

³⁶⁹ Section 160 of the Restatement of Restitution comments (i)–(j) (ALI *Restatement of Restitution* 648–649).

³⁷⁰ Cf par B.1 above.

or theft is not based on a legal right; he does not claim a legal right to the money but an *equitable interest*³⁷¹ in a particular fund.

2.2.2 Requirements

Based on its classification as an unjust enrichment action, a victim of fraud or theft seeking to impose constructive trust liability must establish first that the bank's assets were augmented by the benefits of fraud or theft.³⁷² Secondly, the victim must locate and identify the money or trace it into funds held in the account of the fraudster or thief. Thirdly, he must establish that the bank employee suspected³⁷³ that the deposited funds belonged to someone other than the account holder.³⁷⁴ Some courts require proof of a confidential or fiduciary relationship to justify imposing constructive trust liability whilst others do not limit the application of the doctrine.³⁷⁵

It is submitted that the first two requirements above may pose difficulty to a victim of fraud or theft in a scenario where the bank applied the deposited benefits of fraud or theft towards the payment of the fraudster or thief's debts. The bank is usually no better off than it was before using the money. In addition, it is usually impossible to identify money as the specific benefits of fraud or theft deposited with the bank.³⁷⁶ Consequently, constructive trust liability is unlikely under such circumstances. The victim of fraud or theft may be entitled to claim from the bank which received the benefits of fraud or theft but not on the basis of constructive trust.

³⁷¹ The reason is that the defendant bank has a legal title to the said funds (Dobbs *Remedies I* 598).

³⁷² Dobbs *Remedies II* 15.

³⁷³ See par D.2.3 below.

³⁷⁴ This is because a bank which received the benefits of fraud or theft whilst aware or suspecting that the account holder has no legal right to the money, becomes a *trustee ex maleficio* of the funds.

³⁷⁵ Singer *Property* 193.

³⁷⁶ This is because payment by the bank of an account holder's debts with the money in the account does not create 'wealth' for the defendant bank (see par B.1 above). In addition, money that is commingled in a bank account cannot be identified as the specific money deposited into the account (see ch 2.C.4). Instead, such money is regarded as part of the funds of the bank with the victim of fraud or theft having a claim against the bank for payment of the financial loss he suffered (see par B.3 above). Now, if the bank applies the funds to pay off the debts of the account holder, it is in fact reducing its liabilities and simultaneously reducing its assets. Therefore, no wealth is created and constructive trust liability is unlikely.

If the bank paid the funds to the fraudster or thief who absconded with the funds, the victim of fraud or theft who followed the misappropriated money to the fraudster or thief's bank account will be granted an *in personam* order that requires the defendant bank to transfer the rights and title of specific³⁷⁷ funds or their substitute to him. The reason for the *in personam* as opposed to an *in rem* order is that at US law, the bank cannot be held liable as constructive trustee if it no longer has control over the benefits of fraud or theft or a substitute.³⁷⁸ It will therefore be an ordinary debtor and the victim one of its unsecured creditors.³⁷⁹

2.2.3 Identifiability

The requirement of identifiability is crucial with respect to the benefits of fraud or theft deposited into a bank account and ultimately may have a negative influence on the ability of a victim of fraud or theft to establish constructive trust liability on the side of the defendant bank.

As mentioned above, constructive trust liability may be imposed only where the victim of fraud or theft's money is identifiable or where it can be traced into funds held at the defendant bank.³⁸⁰ Despite the fact that tracing does not ordinarily require proof that *specific* money belongs

³⁷⁷ Note that the identification can be made by tracing money into a substitute (cf paras D.3.2–3.3 below). Moreover, according to the rules for tracing money into a substitute, the victim may obtain not merely what he lost, but also gains received by the defendant bank from investment of the funds. The victim of fraud or theft, however, must trace his money to a particular fund. Sometimes it will be easy for a victim to demonstrate that money was unlawfully acquired from him, but he may have difficulty in identifying money that is commingled with other funds in the fraudster or thief's bank account. Special tracing rules apply in a situation like this (see par D.3.3 below). If the victim is unable to trace his money, the defendant bank will not be liable as a constructive trustee.

³⁷⁸ Dobbs *Remedies I* 591; *Aebig v Commercial Bank of Seattle* (674 P 2d 696 (1984)) [*Aebig*] 700–701. In *Aebig* the court found that deposits made with a travel agency as prepayments for overseas trips did not create an identifiable fund (701). Therefore, no constructive trust liability could be imposed on the bank. But the defendant bank may still incur personal liability for the repayment of the money. For the facts of the case, see below.

³⁷⁹ But see the ruling in *Betty Bryant* (see par B.1 above) where the circumstances of the matter dictated that the court imposed constructive trust liability on the bank.

³⁸⁰ The court in *United States v Benetez* (779 F 2d 135 (2nd Cir 1985)) recognised the principle and emphasised (138): '[i]t is hornbook law that before a constructive trust may be imposed, a claimant to a wrongdoer's property must trace his own property into a product in the hands of the wrongdoer.' Sometimes it, however, appears that the courts are willing to impose constructive trust liability despite the fact that it is impossible to trace money *in specie*.

to the victim, it does require proof that his money is identifiable in a specific account³⁸¹ or chose in action.³⁸² As pointed out already,³⁸³ the court will seldom impose constructive trust liability on the bank which received the benefits of fraud or theft in a commingled bank account.³⁸⁴ The reason is that it is impossible to be a constructive trustee of unidentified money. The court may recognise the claim of the victim of fraud or theft but not on the grounds of constructive trust.

However, if the victim of fraud or theft has established constructive trust liability the defendant bank will be ordered by the court to either apply the money claimed for the benefit of the victim of fraud or theft or to return it to the latter. Even if the bank is ordered by the court to return the benefits of fraud or theft to the victim of fraud or theft, it would be impossible for it to return the *exact* money that was deposited into the account. This is because the deposited benefits of fraud or theft commingled with other funds held in the bank account. The rules of tracing,³⁸⁵ however, may avail a victim in a situation like this.

³⁸¹ The facts and ruling of the court in *Connecticut General Life Insurance v Universal Insurance Company* (838 F 2d 612 (1st Cir 1988)) emphasise this point. In this matter a hotel used 12 separate accounts for its operations. Funds belonging to the plaintiff were deposited into one account which was subsequently depleted. The plaintiff attempted to establish a constructive trust based on the notion that the accounts of the hotel should be regarded as 'one general 'cash-in-banks' account' (613–614). The court disagreed with the contention and reasoned that the plaintiff had to trace and identify the *specific* funds otherwise constructive trust liability could not be imposed (616). Since the hotel had 12 separate accounts, one in which the funds of the plaintiff were deposited, the plaintiff was required to trace his funds into a *specific* account, something which he was unable to do (617).

³⁸² The court must be convinced that a source exists from which the 'debt' to the victim of fraud or theft can be paid and that the source constitutes the property of the victim or at least property which was substituted for his money. This point was made by the court in *Aebig*. The matter concerns deposits received by a travel agency from customers who were deposited into the agency's bank account (697–698). The agency owed money to the defendant bank hence the latter applied these deposits as partial payment of the agency's debt. Some of the customers of the agency sought to impose a constructive trust in an effort to prevent the defendant bank from utilising the money as payment for the agency's debt. Ultimately the matter turned on the issue of whether the customers had the right to recover from the defendant bank a specific account of funds. The court reasoned that the customers had the right to recover only an equal sum of money as a debt and, therefore, there were no grounds to impose a constructive trust (699). It explained that the customers paid money to the agency which paid the funds into its bank account. Accordingly, the customers were not entitled to particular funds but only to a sum of money because they were unable to trace the particular funds into the funds of the bank (*Aebig* 700).

³⁸³ See par D.2.1 above.

³⁸⁴ *Dobbs Remedies II* 13–14.

³⁸⁵ See par D.3.3 below.

2.3 Concept of Knowledge

To recap, English common-law distinguishes between two types of constructive trust liability, namely knowing receipt and dishonest assistance.³⁸⁶ At US law a similar yet more informal distinction is recognised.³⁸⁷ Therefore, constructive trust liability may be imposed either where the bank accepted a deposit of money whilst aware or suspecting that the money does not belong to the account holder³⁸⁸ or where an employee of the bank intentionally participated in defrauding³⁸⁹ the victim of fraud or theft.

A bank that accepts a deposit whilst aware that the money is the benefits of fraud or theft which are deposited in breach of trust, becomes liable as a constructive trustee³⁹⁰ to the victim of fraud or theft.³⁹¹ It follows that the bank will not be liable to the victim of the fraud or theft where the benefits of fraud or theft were deposited into an account and used by the bank without any knowledge that the funds did not belong to the account holder.³⁹²

In general, a bank has the right to assume that the person depositing money to his own credit has the right to withdraw it unless it receives knowledge that indicates the opposite.³⁹³ However, sometimes circumstances may require a bank to be suspicious about the origin of the

³⁸⁶ See ch 6.C.4.2.2–4.3.3.

³⁸⁷ Note that the concepts ‘knowing receipt’ and ‘dishonest assistance’ used at English common-law are not recognised at US codified common-law.

³⁸⁸ See section 168(1) of the Restatement of Restitution (*ALI Restatement of Restitution* 684); *Betty Bryant* 12. As determined by the ALI, the only exception to the rule is where the bank received the money as a *bona fide* purchaser for value (see par D.3.6 below).

³⁸⁹ Section 166 comment (b) of the Restatement of Restitution.

³⁹⁰ This is because the bank becomes owner of money that is deposited into a bank account (see par B.3 above). Therefore, the victim of fraud or theft needs to establish the liability of the bank based on constructive trust if he hopes to reclaim the misappropriated money from the bank.

³⁹¹ Section 10(2) of the Restatement of Restitution (*ALI Restatement of Restitution* 39).

³⁹² Section 22 comment (a) of the Restatement of Restitution (*ALI Restatement of Restitution* 98). In restitution claims the state of mind of the defendant is imperative (section 10 comment (d) of the Restatement of Restitution - *ALI Restatement of Restitution* 41). Knowledge by a defendant bank of the relevant facts coupled with failure to disclose the facts amount to fraud, renders it liable to the victim of fraud or theft. Conversely, a defendant bank is not liable as a constructive trustee if it had no *actual* knowledge of the victims’ interest in the deposited money (42).

³⁹³ Norton & Whitley *Banking* 11-29; *Software Design* 760 (cf par B.1 above).

customer's funds or the nature of a transaction. Evidently, whether mere suspicions by the bank are sufficient for constructive trust liability depends on the due diligence of the bank.

In *Hambleton v R.G. Barry*³⁹⁴ the court explained that in determining whether reasonable diligence should have led the bank to discover the fraud, one need to inquire if the facts known 'would lead a fair and prudent man, using ordinary care and thoughtfulness, to make further inquiry'. Applied to a bank this means that the bank is not required to possess concrete knowledge of that the deposited funds are the benefits of fraud or theft.³⁹⁵ Instead, only facts which are sufficient to alert a reasonable bank employee of the possibility of fraud or theft are necessary.³⁹⁶

The bank may furthermore not use the deposited money of the account holder after it became suspicious that the latter may have no legal right to the funds.³⁹⁷ If circumstances³⁹⁸ exist which suggest to a bank that the deposited funds may not belong to the account holder, it is precluded from using the money until the ownership issue has been adjudicated.³⁹⁹ A bank that uses the said money will be held liable to the victim of fraud or theft repayment thereof. A bank that has knowledge that money it received is the property of person other than the account holder, is further prohibited from dealing with the deposit in such a way as to disregard the rights of its rightful owner of the money.⁴⁰⁰ Moreover, where a bank receives notice of an adverse claim to

³⁹⁴ *Corp* 12 Ohio St.3d (1984) 179, 181. See also *Cundall* par 29.

³⁹⁵ *Palm Beach Co v Dun & Bradstreet, Inc.* 106 Ohio App.3d 167 (1995) 171; *Cundall* par 30; *Flowers v Walker* 63 Ohio St.3d 546 (1992) 549): 'constructive knowledge of facts, rather than *actual* knowledge of their legal significance.'

³⁹⁶ In *Cundall* the Supreme Court pointed out that Cundall knew or in the exercise of reasonable diligence should have known that the bank might have been working with the trustees in defrauding him and the other beneficiaries of the trust (par 37). Cundall further suspected that fraud was being perpetrated by the bank and the trustees four years before he filed the constructive trust claim against the bank and the trustees. The Supreme Court, therefore, affirmed the decision of the Appellate Court which found that Cundall's claim against the bank and the trustees were time-barred (par 41).

³⁹⁷ Section 166 comment (b) of the Restatement of Restitution (ALI *Restatement of Restitution* 674).

³⁹⁸ Suspicion differs from knowledge; a person who has knowledge of a fact should not doubt its existence whereas when a person has suspicions, he will realise that there is a 'substantial' possibility that the fact does not exist (section 10 comment (d) of the Restatement of Restitution - ALI *Restatement of Restitution* 42). Suspicion also differs from the concepts 'reason to know' and 'should know' both which do not preclude a bank from constructive trust liability (ibid).

³⁹⁹ Schroeder *Financial Institutions* 11-29; Norton & Whitley *Banking* 11-29.

⁴⁰⁰ Lexus *Michie on Banking Vol 5A* 213.

deposited money, it should inform the account holder of the claim and retain a sufficient amount of the money to meet the claim.

In order to impose constructive trust liability on a bank based on the fact that the bank had knowledge about the criminal origin of the deposited benefits of fraud or theft, the victim of fraud or theft must demonstrate that the circumstances surrounding the matter were such to justify a finding that the bank had reason to believe and in fact believed, that the deposited money did not belong to the account holder.⁴⁰¹ As pointed out above, a presumption exists that where money is deposited into a personal account, the bank may assume that the money does not belong to a trust and that there is no beneficiary who is entitled to it. This presumption will remain until such time as there is evidence to contradict it. Knowledge of the true nature of the money may result from the terms of the agreement governing the deposit or from information the bank received.

2.4 Evaluation

A claim based on constructive trust instigated by a victim of fraud or theft against the bank that received the benefits of the fraud or theft.

At US law the remedy of constructive trust applies to money that was acquired through fraud or theft. A constructive trust in favour of the victim of fraud or theft can be imposed on the money subject to one condition. This is namely that the money remains in the hands of the fraudster or thief or someone else to whom the criminal transfers it who is not a *bona fide* purchaser for value.

Applied to a bank this means that if the fraudster or thief deposited fraudulently acquired or stolen money into his bank account, the victim of fraud or theft who followed the money to the account may ask the court to impose a constructive trust over the deposited money provided that the bank did not give value for it. In short, the court may impose constructive trust liability on a bank to benefit a victim of fraud or theft who was unjustly deprived of his rights to the benefits of fraud or theft. However, in contrast to English courts which have applied extended principles of constructive trust liability on banks which parted with the benefits of fraud or theft, US law seems to need the security of set principles rather than to allow the judiciary to use their discretion and extend remedial constructive trust principles to cases where they normally would not find

⁴⁰¹ Section 166 comment (b) of the Restatement of Restitution (ALI *Restatement of Restitution* 674–675). Cf Bogert et al *Trusts* 291.

application. This means that the bank must have exercised control over the said money at the time that the victim files suit against it.

It is further evident that there are two practical consequences of invoking constructive trust liability.⁴⁰² First, a constructive trust allows a victim of fraud or theft to trace⁴⁰³ money taken from him unlawfully into any property that was substituted for his money. Secondly, a constructive trust allows for the victim of fraud or theft to recover either the specific benefits of fraud or theft taken from the him, or money that was substituted for it. All gains made with the benefits of fraud or theft, for example, interest made on the invested funds, may further be recovered.⁴⁰⁴

In *Marcus v Otis*⁴⁰⁵ the court found that the defendants as constructive trustees must pay at least the actual profits that were made from a sale of shares. Therefore, a successful action based on constructive trust enables the victim of fraud or theft to claim not only the loss he suffered, but also any benefits deriving from it from the bank that received the money from the fraudster or thief.

However, in view of the foregoing, a victim of fraud or theft is likely to face a couple of obstacles in establishing the requirements of identifiability, tracing into a specific fund and guilty knowledge by the bank which received the benefits of fraud or theft. Ultimately, it may be impossible for the victim to establish guilty knowledge on the side of the bank where it failed to file a STR. Moreover, due to the identifiability requirement it is unlikely that the victim can succeed in claiming loss from the bank where the benefits of fraud or theft commingled with other money in the bank account. Even if the victim of fraud or theft can establish the three requirements above for constructive trust liability, it is submitted that the claim against the bank will be successful only where the benefits of fraud or theft remain under the control of the bank. In other words, liability based on constructive trust will seldom vest in the bank if the fraudster

⁴⁰² Dobbs *Remedies I* 589.

⁴⁰³ Section 205 of the Restatement of Restitution (ALI *Restatement of Restitution* 836–837).

⁴⁰⁴ Dobbs *Remedies II* 8.

⁴⁰⁵ 168 F 2d 649 (2nd Cir 1948) [*Marcus*] 652. In this matter the defendants were directors of a company who wrongfully used corporate money to acquire for themselves stock from another company. They were found liable for misappropriating company money and the District Court imposed constructive trustee liability on them (650). On appeal the main issue concerned the amount of the recovery from the defendants.

or thief withdrew the money and absconded with it.⁴⁰⁶ Under these circumstances the victim of fraud or theft will be left with only a personal claim as opposed to an *in rem* claim against the bank.

Thus, unlike English common-law⁴⁰⁷ at US codified common-law constructive trust as remedy can be used only against a bank which received the benefits of fraud or theft where the money remains in the fraudster or thief's account. This means that although US law provides for constructive trust liability where a bank received the benefits of fraud or theft, it does not allow for extended liability like English common-law. The victim of fraud or theft will, therefore, be in the same position as an unsecured creditor of the bank if the fraudster or thief withdrew the funds and absconded before the victim can obtain an interdict to prevent the bank from paying the funds away. Ultimately, the a court will only impose constructive trust liability on the bank where the benefits of fraud or theft remained in the bank account, did not commingle with other funds held in the bank account and where the bank was aware the deposited money was acquired through criminal means.

3. Tracing

3.1 Background

At US common-law tracing⁴⁰⁸ is an action that precedes restitution claims.⁴⁰⁹ As such, it assists a victim of fraud or theft to establish what transpired with the benefits of fraud or theft. It, therefore, serves an evidential purpose.⁴¹⁰ Tracing provides a way to track money to a substituted

⁴⁰⁶ However, pursuant to the *Betty Bryant* (see par B.1 above) ruling this is clearly not a fixed rule, but rather one that depends on the circumstances of the case.

⁴⁰⁷ See ch 6.C.4.2.

⁴⁰⁸ For a historical account of the history of tracing and its reception into US law, see Oesterle (1983) *Cornell LR* 185–196.

⁴⁰⁹ See Oh ((2006) *Tulane LR* 858) who proposes that tracing enables a victim of fraud or theft to seek a claim forcing a wrongdoer to 'disgorge all proceeds from misappropriated value.'

⁴¹⁰ Cf ch 6.C.4.3 where it has been asserted that tracing is a *process* instead of an action. This view is likewise subscribed to by US law (see York et al (*Remedies* 338) who denotes tracing as 'simply investigative detective work to obtain the evidence').

'res' even if the latter has increased in value.⁴¹¹ As seen above,⁴¹² the purpose of restitution, *inter alia*, is to address unjust enrichment. The notion is that as the money of the victim of fraud or theft has been found with the defendant bank, the latter is obligated to restore it to the victim regardless of whether the bank acquired ownership thereof.⁴¹³ This is the position even if the bank altered the form of the money or substituted it for something else.⁴¹⁴ Tracing becomes particularly necessary in situations of the latter kind.⁴¹⁵

But before considering tracing under US law, it is necessary to emphasise one key point. The process of tracing money deposited into a bank account does not involve money *in specie*, but rather a *debt* which represents the credit balance of the account holder. Therefore, a victim of fraud or theft must establish which part of the debt owed by the bank to the account holder should be paid to him to counteract the loss he suffered.

3.2 Common-Law Tracing

Significantly, in contrast to English law, at US restitution law the action for money had and received is used only in tort actions for the conversion of chattels.⁴¹⁶ It therefore does not concern tracing *per se*. In fact, as was pointed out already⁴¹⁷ US restitution rules know only a generic tracing action, the content of which is evaluated below.

3.3 General Tracing Principles

⁴¹¹ Bogert et al *Trusts* 580. In *Marcus* the court investigated the measure of recovery against defendants who were found liable as constructive trustees of misappropriated money. It confirmed that the victim may trace his money into any substitute into which the wrongdoer may have changed it (653).

⁴¹² See par D.2 above.

⁴¹³ See par D.1 above.

⁴¹⁴ Section 209 of the Restatement of Restitution (*ALI Restatement of Restitution* 844).

⁴¹⁵ *Idem* section 215(1).

⁴¹⁶ *Idem* section 227.

⁴¹⁷ See par D.1 above.

In general, money that belongs to a victim of fraud or theft may be traced into a bank account if it can be established that the bank had knowledge that the money was misappropriated.⁴¹⁸ Therefore, money that was deposited into a bank account by a fraudster or thief who has no title to it, may be recovered by the victim from the bank if it was aware⁴¹⁹ that the account holder's title to the money was defective. Significantly, tracing focuses on value rather than specific assets or property and, therefore, it is a perfect method to be used to recover commingled money. What is then traced is the *value* inherent to things.⁴²⁰

The victim may trace and recover the value inherent to money that was fraudulently acquired or stolen from him from the bank even though it is impossible to identify it as the exact money that was deposited due to commingling that occurred.⁴²¹ In addition, the victim of fraud or theft may recover the benefits of fraud or theft as long as there are no equities created in favour of the defendant bank. If, under the circumstances⁴²² equity and good conscience demand that the bank should be absolved from liability to the victim of fraud or theft, the latter will be unable to recover loss from the bank.

Specific difficulties as regards the use of tracing in English cases pertaining to misappropriated money were evaluated elsewhere in the study.⁴²³ These difficulties are the result of the differences in application between the English common-law tracing action and the rules that exist for tracing in equity.⁴²⁴ At English common-law this type of problem has been addressed by the tracing in equity action whose rules are more flexible⁴²⁵ than the rules of common-law tracing.

⁴¹⁸ See *Hilliard v Fox* (735 F Supp 674 (1990) [*Hilliard*]) where the court acknowledged the role of tracing in ascertaining what happened to money that a defendant unjustly received (677). For the facts of the matter and the judgment of the court, see par D.3.6 below.

⁴¹⁹ See par D.2.3 above.

⁴²⁰ Oh (2006) *Tulane LR* 887. This view correlates with the view of Smith (*Tracing* 15) that tracing is about identifying value and not about the identification of specific assets (cf ch 6.C.4.3.3).

⁴²¹ Oh (2006) *Tulane LR* 881.

⁴²² Various factors, for example, the nature of the deposited funds and lack of knowledge of the origin thereof will be taken into account (*Lexus Michie on Banking Vol 5A* 216).

⁴²³ See ch 6.C.4.3.

⁴²⁴ To recap, English common-law tracing requires that the benefits of fraud or theft received by the bank remain identifiable, a requirement that is impossible to fulfil in instances where the money was deposited into a bank account where it commingled with other funds.

⁴²⁵ York et al *Remedies* 197.

At US law tracing the benefits of fraud or theft to a commingled fund does not present many difficulties.⁴²⁶ In general, a victim of fraud or theft whose money was deposited into a bank account is entitled to a lien⁴²⁷ on the commingled fund in the amount of the money traced to it. Usually the defendant bank carries the burden of proving which part of the fund belongs separately to the victim-claimant.⁴²⁸ If the bank applied the whole fund to cover its own expenses or towards a debt of the account holder, the victim may impose a constructive trust for a share in the property *proportionate* to his share in the funds.⁴²⁹

Although the victim of fraud or theft should have no difficulty in establishing a claim over part of the commingled funds, there are practical difficulties⁴³⁰ in determining whose money is left in the commingled account in a situation where some of the money was withdrawn from the account. Therefore, the courts have established four rules for tracing after withdrawals were made

⁴²⁶ Oh (2006) *Tulane LR* 884. In *Peirce v Sheldon Petroleum Corporation* (589 S W 2d 849 (1979) [*Peirce*]) the court summarised the mechanics of tracing as follows (853): '[w]hen the beneficiary can point to specific property that was purchased or inherited ... the tracing burden is met. When, however, tracing to specific property is impossible because the trustee has commingled the property, the right is not defeated if the beneficiary can trace to the commingled fund. If the commingling was wrongful, the burden is on the trustee to establish which property is rightfully the trustee's. If the trustee is unable to do so, the entire commingled property is subject to the trust. If the commingling is not wrongful, the beneficiary has the burden of establishing the nature and extent of the beneficial interest in the commingled fund.'

⁴²⁷ Norton & Castle *Banking* 11-44.

⁴²⁸ *Peirce* 853. The case of *Republic Supply Company of California v Richfield Oil Company of California* (79 F 3d 375 (9th Cir 1935) [*Republic Supply Company*]) concerned the balance of the bank account of Richfield Oil and in particular, the determination of the lowest intermediate balance upon which a lien was claimed (376–377). Richfield Oil was in equitable receivership because its directors wrongfully acquired 1.625 million US dollars in cash of another company, Universal Consolidated Oil. The cash had been gradually misappropriated, commingled in the general cheque account of Richfield Oil and withdrawn by Richfield Oil for operation purposes. Some of the funds were traced into specific assets which were consequently placed in the hands of Richfield Oil's receivers. Universal Oil claimed an equitable lien over property bought with the commingled funds. The court ruled that the impressment of the lien over the property was proper, because if a defendant is unable to show which part of the money belongs to it, the plaintiff may recover the entire fund (378).

⁴²⁹ See section 210 of the Restatement of Restitution (*ALI Restatement of Restitution* 845); Isaacson (1937) *Michigan LR* 1203; *Marcus* where the court confirmed (652) '[the defendant] is liable only for a proportionate part of the profits realised based upon the ration of the amount of money misappropriated to the commingled mass.'

⁴³⁰ *Heston Oil* 716.

from the account of the defendant. They are namely the first in first out rule; *Hallet* rule; evidence tracing to withdrawals rule; and the proportionate share rule.⁴³¹

The first in, first out rule derived from English law and determines the rights of a number of victims of fraud or theft to deposited money.⁴³² More specifically, under the rule the right of ownership to money depends on which of the victims' money was first deposited into the account. If the account holder first deposited an amount of his own money into the bank account followed by the money that belonged to a victim, the first withdrawal is subtracted from the money in the account which is the first deposit.⁴³³ The *Hallett* rule likewise pertains to rights as regards deposited money after withdrawals were made from the account.⁴³⁴ However, determining which of the victims' money was first withdrawn, is more uncomplicated than under the first in, first out rule. Under the *Hallett* rule money withdrawn from the bank account is presumed to be the money of the account holder regardless of the order in which deposits to the account were made.⁴³⁵ The third tracing rule developed by the judiciary is known as the 'evidence tracing to withdrawals' rule because it allows a victim of fraud or theft to trace his funds through withdrawals from the commingled account of the account holder.

⁴³¹ Dobbs *Remedies II* 18–21; ALI *Restatement of Restitution* 850–871.

⁴³² The rule was devised by the English court in *Devaynes v Noble, Clayton's Case* (1816) 1 Mer 529 (see ch 6.C.4.3.3) and subsequently adopted by the US judiciary.

⁴³³ Dobbs *Remedies II* 18; section 211(1) comment (a) of the Restatement of Restitution (ALI *Restatement of Restitution* 851–855). Of note, the first in, first out rule will not apply where a person *wrongfully* mingles money of another with his own (ALI *op cit* 851).

⁴³⁴ The rule was formulated by the court in the English matter of *Knatchbull v Hallett* 13 Ch Div 696 (1880) and later adopted by US courts (see *Peterson v Redpath* 402 NW 2d 648 (1987) [*Redpath*] and *C.O. Funk & Sons Incorporated v Sullivan Equipment Incorporated* 431 NE 2d 370 (1982) [*C.O. Funk*]). The *Redpath* matter concerned the commingling of stolen money with personal money in a bank account and the payment of insurance premiums from the commingled account (650). The victim of theft in an effort to trace the stolen money withdrawn to make the insurance payments, sought to trace the withdrawals into the insurance proceeds and impose a constructive trust over the money (371). This endeavour was rejected by the court. It reasoned that the withdrawals should be attributed to the money of the thief and therefore, the court allowed the conversion claim pertaining to the stolen money, but not the constructive trust sought against the insurance proceeds (373).

⁴³⁵ In *C.O. Funk* the court came to the conclusion that there is (373): '[a] presumption that proceeds remain in the account as long as the account balance is equal to or greater than the amount of the proceeds deposited.'

There are three approaches to tracing into a bank account.⁴³⁶ The first approach is to consider the active account to be ‘traceable proceeds’⁴³⁷ to the extent of the amount of benefits of fraud or theft that were deposited into the account. The approach, known as the *intermediate balance rule*,⁴³⁸ is possible only if the account balance never falls below the amount of the deposited benefits of fraud or theft. This rule is used to determine the rights of a victim of fraud or theft whose money was commingled with other money in the active account from which withdrawals were made and in which other money was deposited.

The second approach to trace into an active account is to consider the ‘traceable proceeds’ as a *pro rata* share of any withdrawal from the account or of *any* asset bought with such a withdrawal. The *pro rata* share can be determined by the ratio of the misappropriated money deposited into the account to the funds that were immediately available after the deposit. The rule, known as the *averaging rule*,⁴³⁹ is used to settle tracing problems where withdrawals are made from an account comprising commingled money. The third approach that may assist with the tracing exercise is to consider ‘traceable proceeds’ as a single withdrawal or asset bought with such a withdrawal to the extent of the deposited misappropriated money. This rule is called the misappropriated money-in, first out rule.⁴⁴⁰

The evidence tracing to withdrawals rule is generally applied only when the evidence of a matter requires its application. Since the rule concerns evidence available in a particular case, its application can be unsatisfactory. This is due to the evidence available in a matter and the fact that in tracing matters it is impossible to show which money belongs to which party.⁴⁴¹ The question in this regard is whether it would be fair to trace to withdrawals instead of to the balance remaining in the account. The fourth tracing rule, developed to assist a victim of fraud or theft with tracing money into commingled accounts, is the proportionate share rule which gives the

⁴³⁶ *Banco Cafetero* 1159. Here, the government sought to forfeit bank deposits traced to the sale of illegal drugs (1155–1156). The endeavour was complicated by the fact that the bank accounts were active and included non-drug related money. The court was called upon to determine, *inter alia*, whether tracing into an active bank account is possible, particularly in light of the evidence tracing to withdrawals rule.

⁴³⁷ *Banco Cafetero* 1159.

⁴³⁸ Section 202(1) comment (j) of the Restatement (Second) of Trusts (AML *Restatement of Trusts* 451).

⁴³⁹ *Idem* section 202(1) comment (i).

⁴⁴⁰ *Banco Cafetero* 1159.

⁴⁴¹ See par D.2 above.

victim the option of two restitution actions: he may impose either an equitable lien on the particular money or instead impose a constructive trust over it.⁴⁴² The constructive trust option holds two limitations though. First, it is imposed only to the extent of the victim's proportionate share of the money meaning that the account holder will be called upon to demonstrate which part of the money belongs to him.⁴⁴³ Secondly, if the account holder withdraws money from the commingled account and reinvests it, the victim of fraud or theft, regardless of the outcome of the investment, will only have a claim to his proportionate share of the proceeds and only if they can be traced. Similarly, he has a proportionate share only of the bank balance.⁴⁴⁴

In an effort to address the problems arising from situations where funds were deposited into a bank account, withdrawn and additional deposits made, the courts have applied the lowest balance rule.⁴⁴⁵ According to the rule a victim of fraud or theft is precluded from tracing to a sum greater than the lowest balance in the account between the time of the deposit and the time of the tracing.⁴⁴⁶ As opposed to the general rule of tracing which allows the victim to recover all the commingled money in a bank account should the account holder bank fail to establish which part of the fund belongs to him,⁴⁴⁷ the lowest balance rule determines that unless evidence exists to demonstrate the amount of the low balance, the victim will be *unable* to recover any of his money.⁴⁴⁸ This is because the victim of fraud or theft to identify his money in the commingled account and if he fails to do so, he cannot recover it. Since it is usually impossible to determine the lowest balance in an active account because the exact time of deposits and withdrawals are

⁴⁴² Restatement of Restitution sections 211–212 (*ALI Restatement of Restitution* 850–851, 856).

⁴⁴³ *Peirce* 853.

⁴⁴⁴ Isaacson (1937) *Michigan LR* 1204–1205; *Republic Supply Company* 378.

⁴⁴⁵ See section 212 comment (a) of the Restatement of Restitution (*ALI Restatement of Restitution* 856–857); *C.O. Funk* 372; *Republic Supply Company* 378.

⁴⁴⁶ The rule is also known as the 'lowest intermediate balance rule' (section 212 comment (a) of the Restatement of Restitution - *ALI Restatement of Restitution* 856).

⁴⁴⁷ *Republic Supply Company* 378.

⁴⁴⁸ A victim of fraud or theft will have a mere personal claim against the fraudster or thief, after the money of the victim was deposited, the account is wholly exhausted due to withdrawals made by the fraudster or thief and the victim is unable to trace his money further (see comment (a) of the Restatement of Restitution - *ALI Restatement of Restitution* 856).

difficult to establish, the courts have on occasion⁴⁴⁹ allowed victims of fraud or theft to use the daily closure balance of an account as measuring its lowest balance.

A final remark in relation to tracing concerns the scenario where the defendant bank commingled the funds of various victims of fraud or theft in one account. According to the Restatement of Restitution the victims are entitled to share proportionably in the commingled fund.⁴⁵⁰ However, it may be easier to use a class action to recover the funds and then divide it proportionally among the victims.⁴⁵¹ The reason for this suggestion is that funds can be traced and identified as belonging as a whole to a number of persons. In *Commodity Futures Trading Commission v Franklin*⁴⁵² the court allowed different a number of fraud victims to share with one another. It reasoned that because Franklin operated out of his briefcase, wrote cheques at random and made commodity purchases in the same way, the cheques were commingled the moment they

⁴⁴⁹ *Republic Supply Company* 378. In contrast, in *United States Department of Energy v Seneca Oil Company (In re Seneca Oil Company)* (906 F 2d 1445 (10th Cir 1990) the court treated a deposit as part of the account because it was reflected by the records of the bank but not posted until the next day. The victim of fraud traced its funds into Seneca's bank account, through a withdrawal and into a deposit certificate (1446–1447). The certificate matured on 11 March on which date approximately 750,000 US dollars were paid into Seneca's account. On 12 March, Seneca, withdrew on the account to buy a new deposit certificate, but in doing so effectively overdraw the account with almost 300,000 US dollars. The victim-plaintiff asserted that it traced its money to the new deposit certificate. In contrast, counsel for Seneca argued that the balance of the overdrawn account was in fact a negative balance on 11 March. Thus, the whole amount of 750,000 US dollars could not be traced into the new deposit certificate. The court disagreed with the assertion and reasoned that the 'depletion' shown by the bank statement is merely a 'booking device to avoid altering the concepts of the CD' (1449).

⁴⁵⁰ Section 213(1) (ALI *Restatement of Restitution* 859).

⁴⁵¹ The court in *Heston Oil* made the following suggestion (716): '[t]he result is not to reward Heston for its own wrong doing, for Heston remains liable to these claimants *as well* as to other creditors.'

⁴⁵² 652 F Supp 163 (1986). The defendant, Franklin, created a scheme by promising investors to invest their funds on their behalf (164–165). It was, in fact, a pyramid scheme that was funded with money obtained from other investors. Franklin lost the money and a receiver was appointed to seize and manage the funds that were regained. Nearly 600,000 US dollars out of a total of 1.5 million US dollars of the investors' funds were eventually recaptured. Despite a freezing order on Franklin's account, he managed to mail in almost 200,000 US dollars in cheques for deposit. The receiver asserted that the cheques were identifiable funds of some the investors and should be returned to them (165). The court disagreed.

were put into his briefcase, this despite the fact that they were not yet deposited.⁴⁵³ Therefore, there is no distinction to be made between particular fraud victims and Franklin's investors as a group.

3.4 Evaluation

A claim based on tracing instigated by a victim of fraud or theft against the bank that received the benefits of the fraud or theft.

Notwithstanding the availability of tracing rules to assist a claimant in tracing into a mixed bank account, their application is not straightforward. As Dobbs astutely points out:⁴⁵⁴

[e]very one of the methods for tracing commingled funds can present a problem on some set of facts.

It is evident that at US law tracing is a more straightforward exercise than at English common-law. Unfortunately, similar to the latter, the application of the rules under US law differs from case to case resulting in uncertain outcomes.

3.5 *Replevin* Action

The writ of *replevin* was originally employed to recover chattels that had been wrongfully taken.⁴⁵⁵ The right to recover the chattel was based on property concepts. In a *replevin* action the plaintiff may post a bond and recover possession of his chattel as soon as he filed a claim; he did not have to wait to obtain a ruling in his favour.⁴⁵⁶ The *replevin* action further allows plaintiffs to recover personal property to which he is entitled.⁴⁵⁷

⁴⁵³ 167–168.

⁴⁵⁴ *Remedies II* 884. The problem concerns the fungibility of money in a bank account (see ch 2.C.4.2) which creates a mixture of value. When funds in the account are mixed, a substitution in value occurs, which substitution must be traced (Oh (2006) *Tulane LR* 888). Rules of tracing do not always prevail in situations like these.

⁴⁵⁵ York et al *Remedies* 7; ALI *Restatement of Restitution* 523. Although the *replevin* action is classified as a tort action, it is also restitutionary in nature because it returns to the plaintiff the chattel or its value taken from him by the plaintiff (section 4 comment (a) of the Restatement of Restitution - ALI *op cit* 18).

⁴⁵⁶ Koffler *Common-Law* 253–254.

⁴⁵⁷ Dobbs *Remedies I* 571; section 42(2) comment (d) of the Restatement of Restitution (ALI *Restatement of Restitution* 170–171).

Central to the action is the existence of an *identifiable* object.⁴⁵⁸ The benefits of fraud or theft deposited into a bank account are intangible and therefore, unidentifiable from other moneys held in the account.⁴⁵⁹ This requirement renders the *replevin* action unsuitable to recover misappropriated money deposited into a bank account.⁴⁶⁰

3.6 Defences to Restitution Claims

A victim of fraud or theft in his endeavour to trace funds that once belonged to him and recover them from the bank that obtained a legal title to it, is often stymied by the application of specific rules or defences. Even when restitution is sought in actions at law, governing principles require fairness. Therefore, a restitution claim is subject to and limited by, equities in favour of the bank. In the main, there are two defences that may avail the defendant bank in a restitution action by virtue of the prevailing principles of fairness, namely:

1. *bona fide* purchaser for value; or
2. change of position.

The first defence that a defendant bank in a restitution action can raise is *bona fide* purchaser for value. The defence is pivotal as regards innocent third parties who obtain property in which the plaintiff has some kind of interest.⁴⁶¹ To understand the defence the general rule of ownership should be reemphasised. A person who acquires property from someone who does not have a legal title to it will be unable to acquire a title to the property himself because there is no title that can be transferred.⁴⁶² But, a person who is fraudulently convinced to sell his property to

⁴⁵⁸ Dobbs *Remedies II* 4.

⁴⁵⁹ See ch 2.C.4.

⁴⁶⁰ Some courts, however, have favoured a broad interpretation of the meaning of the concept 'specific chattel' and allowed the plaintiff the use of recovered money represented by a bank account (see, for example, *Haiti* 845 where the court reasoned that separate bank accounts amounted to specific chattels).

⁴⁶¹ The essence of the defence is found in the distinction between legal title and equitable interests (Dobbs *Remedies I* 659). Where a person has a legal title to property, he will prevail over an innocent third party holding a mere *equitable interest* in the property. Conversely, where the innocent third party obtained a legal title to the property, his right will prevail over the interest that a legal owner may have. Where both parties have interests in property as opposed to a legal right, their interests will be weighed to ascertain ownership. Where equal interests in the property exist, the first acquirer of the interest will prevail as determined by the legal rule 'first in time, first in law.'

⁴⁶² See par D.1 above.

a *bona fide* purchaser giving value for it, transfers legal title to the latter. Due to the fraud, the seller may always annul the transaction yet the fact remains that the purchaser obtained a legal title from the seller. Even though the seller has an equitable interest in the property, the legal title of the purchaser would prevail over the interest.

It follows that the right of a victim of fraud or theft to hold a defendant bank liable as constructive trustee is frustrated if the defendant bank is a *bona fide* purchaser for value, someone who is unaware of the victim's rights to the funds.⁴⁶³ The defendant bank must demonstrate the following three elements to satisfy application of the *bona fide* purchaser for value defence: one, it was unaware of any equitable interests in the money at the time when it received it, two, it received money by 'purchase' and three, it gave value in return for the funds.

The appeal matter of *Banque Worms v BankAmerica International*⁴⁶⁴ illustrates the application of the *bona fide* purchaser defence. In this case the court had to determine whether the recipient of money that was mistakenly transferred to its account by one of its debtors could use the *bona fide* purchaser defence to prevent recovery of the money. The court investigated whether the discharge for value rule, which provides that a creditor does not owe restitution if he used the funds to discharge a debt to him,⁴⁶⁵ was applicable.⁴⁶⁶ It explained that when the bank used the funds which were transferred by mistake by Security Pacific Bank to repay Spedley's debt, it in

⁴⁶³ *In re Seaway Exp. Corporation* 912 F 2d 1125 (9th Cir 1990) 1127. In this case Seaway Corporation granted a lender a security interest in its bank accounts. Seaway Corporation sold one of these accounts in return for real estate whereafter it declared bankruptcy. It then sold the real estate for one million US dollars which was placed in a different bank account. The court was called upon to determine the position of the trustee of the bankrupt estate of Seaway Corporation *vis-à-vis* the lender as its creditor (1127–1128). The court found that the trustee was a *bona fide* purchaser for value of Seaway Corporation's assets (1128).

⁴⁶⁴ 928 F 2d 538 (2nd Cir 1991) [*Banque Worms*]. A customer of Security Pacific Bank, Spedley, ordered the bank to transfer two million US dollars to the appellant bank, Banque Worms (540–542). The transfer would serve as partial payment of its debt to Banque Worms. Before the transfer was made, Spedley altered its instructions and ordered Security Pacific Bank to transfer the money to a different bank. Security Pacific Bank nevertheless and by mistake, transferred the money to Banque Worms. Spedley was later liquidated. As a result, Security Pacific Bank attempted to recover the transfer from Banque Worms. It ceded its claim to the defendant in whose favour the District Court found. On appeal Banque Worms countered that it used the money to pay off Spedley's debt.

⁴⁶⁵ Section 14 comment (a) of the Restatement of Restitution (ALI *Restatement of Restitution* 55).

⁴⁶⁶ *Banque Worms* 545.

fact exchanged its right to collect the debt for the funds. Banque Worms therefore ‘bought’ the money with the debt thereby paying ‘value’ for it. The bank was not unjustly enriched because one is not unjustly enriched when one received a payment that is due. So regarded, the discharge for value rule is a specie of the *bona fide* purchaser for value defence. Since the bank was unaware of the fact that the transfer was made by mistake, the court found that the rule was applicable to protect it from liability.⁴⁶⁷ It follows that Banque Worms was a *bona fide* purchaser of the funds that were transferred to its account.

The second defence that may avail a defendant bank in a restitution action is change of position. If, after receiving a benefit, the bank’s position reasonably changes due to the benefit in such a way that it would be inequitable⁴⁶⁸ to order restitution, the bank’s liability would be reduced or terminated accordingly.⁴⁶⁹ In the main, change of position is likely to be raised in three instances. First, where the defendant bank⁴⁷⁰ received the benefits of fraud or theft which it transferred to a person with a better claim to it than the victim of fraud or theft,⁴⁷¹ applied the money it received towards expenses and would not have done so if not for the money and received money which it is unable to return.⁴⁷² In the first instance, the bank is not liable to make restitution if it received money whilst acting as a representative for another customer and transferred the money to the ultimate beneficiary. The only requirement is that the bank must have acted in good faith on behalf of another.

⁴⁶⁷ *Banque Worms* 546.

⁴⁶⁸ The aim of finalising business transactions is sometimes used to demonstrate the principle of fairness in a defendant’s favour.

⁴⁶⁹ Sections 69 and 142 of the Restatement of Restitution (ALI *Restatement of Restitution* 284–285, 567 respectively). The change of position defence applies only in favour of an innocent defendant and not one who was aware that he was receiving a payment by mistake (section 142(2)(3)). Section 142(2) of the Restatement of Restitution (ALI *Restatement of Restitution* 567) precludes the application of the defence where the defendant was negligent.

⁴⁷⁰ *Dobbs Remedies I* 657–659; *Dobbs Remedies II* 763—762.

⁴⁷¹ For example, in *Federal Insurance Company v First National Bank of Boston* (633 F 2d 978 (1st Cir 1980)) the defendant bank paid a cheque that was fraudulently issued by the payee on behalf of the victim of fraud. The victim claimed the amount of the cheque from the defendant bank which raised the defence of change of position. The court allowed the defence and found that the victim of fraud could not recover what was loss due to ‘payment over’ (982).

⁴⁷² Section 142 comment (b) of the Restatement of Restitution (ALI *Restatement of Restitution* 568–571).

Secondly, a bank would seldom be allowed to raise the defence of change of position where the benefits of fraud or theft were consumed or spent.⁴⁷³ The reason is that in general a bank would still be unjustly enriched. However, the defence of change of position is likely to be justified in two instances. First, if the benefits of fraud or theft were spent in such a way as not to increase the bank's assets or decrease its liabilities or secondly, where the bank would under ordinary circumstances not have applied the money towards expenses.⁴⁷⁴ In fact, the defence can be raised only in circumstances where the bank consumed money that it ordinarily would not have done if it had not benefited from its conduct.⁴⁷⁵

In the third instance the bank would be able to raise the defence of change of position where the victim of fraud or theft has mistakenly given or transferred, money to the bank and the money is lost or stolen before it is claimed back.⁴⁷⁶ Although negligence is not an element of a restitution claim, negligence of the parties may be taken into consideration when the change of position defence is considered.⁴⁷⁷ The burden is on the bank to demonstrate a change in its position that would make it inequitable to demand restitution from it.⁴⁷⁸ The good faith of the bank is further crucial if the defence is to be successfully invoked.

⁴⁷³ Ibid.

⁴⁷⁴ For example, where a restitution order would cause hardship to a defendant (Dobbs *Remedies II* 769–770).

⁴⁷⁵ See, for example, the matter of *Hilliard* where the court ruled that restitution is not required where the defendant invested the money unwisely and ultimately lost part of it. The plaintiff was a stockbrokerage firm which mistakenly paid 19 877.20 US dollars to one of its clients, the defendant. Hilliard sought to claim the money back from Fox, contending that it has a right to restitution. Fox asserted that he invested the money he received from Fox which investment lost most of its value. Therefore, due to his change in financial position, it would be unjust to recover the money from him (676). One of the issues the court had to address was whether the change in position that the defendant raised terminated the plaintiff's right to restitution. The court reasoned that once a plaintiff established that the defendant received the money it is claiming, the defendant has the burden of proving a 'sufficient change of circumstances' that would make it inequitable for the court to order restitution. It concurred that the loss in value of an investment in a business venture, which was made with the money the plaintiff is claiming, constitutes a change of circumstances (ibid). The court therefore concluded that whether the money that the defendant received from the plaintiff was in actual fact invested, should be determined by tracing rules.

⁴⁷⁶ Section 142 comment (b) of the Restatement of Restitution (ALI *Restatement of Restitution* 569); *Hilliard* 678.

⁴⁷⁷ Section 142 comment (c) of the Restatement of Restitution (ALI *Restatement of Restitution* 573–564). Bad faith or turpitude on the side of the defendant will always count against him.

⁴⁷⁸ Idem comment (g); *Hilliard* 677.

What conclusions can be drawn from all of this? A bank that accepts a deposit of the benefits of fraud or theft which it subsequently paid away as instructed by the account holder is unlikely to succeed with the defence of *bona fide* purchaser for value. The reason is that the bank will be unable to establish that it gave value for the money. The same synthesis is true in relation to the defence of change of position. If the benefits of fraud or theft were not applied by the bank to, for example, pay off the debt of the account holder, it is unlikely that it would be able to counter a civil claim by a victim of fraud or theft with any measure of success.

4. Civil Forfeiture

4.1 Action in Rem

The second remedy relevant in the context of money laundering and the benefits of crime is civil forfeiture which under US law is a codified remedy that derives from English common-law.⁴⁷⁹ Analogous to England's principal AML statute, the PCA,⁴⁸⁰ US AML legislation affords the government a civil cause of action against persons who violated, *inter alia*, money laundering laws. In *State v Shack*⁴⁸¹ Weintraub CJ explained as regards the fairness of civil forfeiture that:⁴⁸²

[a]n owner must expect to find the absoluteness of his property rights curtailed by the organs of society, for the promotion of the best interests of others for whom these organs also operate as protective agencies.

Civil forfeiture may therefore be regarded as an action taken by the government as an 'organ of society' to redress the damage incurred by society due to the criminal conduct of one of its

⁴⁷⁹ Jensen & Gerber (1996) *Crime and Delinquency* 422–423; Fried (1988) *J of Crim L and Criminology* 335n34; Rosenberg (1988) *Columbia LR* 391; *Austin v United States* 509 US 602 (1993) [*Austin*] 611. See also ch 8.D.4.1.

⁴⁸⁰ See ch 5.C.4.1.

⁴⁸¹ 277 A 2d 269 (1971) 372.

⁴⁸² 373. As support for his view Weintraub CJ cited (373) Rohan (*Real Property* 494) who construed the limitation of ownership rights as follows: '[a]s one looks back along the historic road traversed by the law in England and America, one sees a change from the viewpoint that he who owns may do as he pleases with what he owns, to a position which hesitatingly embodies an ingredient of stewardship; which grudgingly, but steadily, broadens the recognised scope of social interests in the utilisation of things.'

members.⁴⁸³ It is an ancient tool employed to confiscate the benefits of crime. Historically, US forfeiture law distinguished three types of forfeiture, namely⁴⁸⁴ attainder,⁴⁸⁵ statutory forfeiture and *deodand* forfeiture.⁴⁸⁶ The laws of *deodand* forfeiture was subsequently used to justify the enactment of the first US forfeiture laws.⁴⁸⁷ *In rem*⁴⁸⁸ or civil forfeiture dates back to admiralty cases in which the government seized ships that were involved in criminal activities to augment its income.⁴⁸⁹ Initially, the notion of *in rem* forfeiture was disliked in the US because of the historical abuses of the English government to control and punish US colonies.⁴⁹⁰ Later, during the US Civil War many Southern rebels held land in the North and fled South to avoid punishment for treason.⁴⁹¹ As a result, the government passed legislation forfeiting property held in the North by Confederates to the government.⁴⁹²

⁴⁸³ For an analysis of the purposes of civil forfeiture in an US constitutional context, see Nelson *Property* 268; Speta (1990) *Michigan LR* 182–196; Osgood (1996) *Washington LR* 490n10; Neuborne *Bill of Rights* 107; Williams & Whitney *Federal Money Laundering* 546–547.

⁴⁸⁴ Kasten (1991) *George WLR* 198–199; *Austin* 611.

⁴⁸⁵ Under attainder children were unable to inherit the forfeited property of their parents by virtue of ‘corruption of blood.’ In the late 1700s the US Constitution (Article I section 9 clause 3) forbade this type of forfeiture as it deprived innocent heirs of their inheritance (Maxeiner (1977) *Cornell LR* 779; Canavan (1990) *Pace LR* 488).

⁴⁸⁶ *Deodand* forfeitures embodied the notion that the value of an object which caused the death of one of the king’s subjects, should be forfeited to the Crown. Cf Baldwin (1997) *J of Fin Crime* 114; Saltzburg (1992) *Boston ULR* 220.

⁴⁸⁷ Holmes *Common Law* 25–30; Baldwin & Munro *United States* 5; Schecter (1990) *Cornell LR* 1153.

⁴⁸⁸ The concept ‘*in rem*’ means ‘against the object.’ In relation to civil forfeiture ‘*in rem*’ refers to an action directed solely against property which became tainted after being used in a criminal offence (Rosenberg (1988) *Columbia LR* 391; Cheh (1991) *Hastings LJ* 1340). See also ch 2.C.5.3.2 as regards the tainted theory.

⁴⁸⁹ Justification for using civil forfeiture in US admiralty cases was based on the premise of collecting income in the form of security when dealing with foreigners (Vecchi & Sigler *Assets Forfeiture* 43; Ronner (1996) *Buffalo L R* 672; Davis (1997) *Nova LR* 690–691).

⁴⁹⁰ Maxeiner (1977) *Cornell LR* 776–777; Kurisky (1988) *Hous J of Internat L* 250–251.

⁴⁹¹ Gallant *Money Laundering* 83; Kasten (1991) *George WLR* 200–201.

⁴⁹² Warren *US History* 138–139.

In the early 20th century, due to success of *in rem* forfeiture matters, *in personam*⁴⁹³ forfeiture actions nearly disappeared in the US.⁴⁹⁴ However, *in personam* forfeiture actions were favoured again in 1970 with the enactment of RICO.⁴⁹⁵ Constitutional challenges to the forfeiture provisions of the Act were justified under vicarious liability.⁴⁹⁶ For example, in *Coin & Currency* the court rationalised the forfeiture of criminally derived property as follows:⁴⁹⁷

[s]imply put, the theory has been that if an object is ‘guilty’, it should be held forfeit. In the words of a medieval English writer, ‘Where a man killeth another with the sword of John at Stile, the sword should be forfeit as *deodand*, and yet no default is in the owner.’

In other words, peculiar as it may be the court reasoned that the sword as the instrument used to kill a person should be punished and therefore, forfeited in the place of the actual perpetrator of the crime. At present, civil forfeiture provisions are spread across the federal law. However, in the main there are two civil forfeiture systems, namely,

1. a system designed for the civil forfeiture of proceeds stemming from illegal drug trafficking; and
2. a system that was established by the Civil Asset Forfeiture Reform Act of 2000⁴⁹⁸ and the Patriot Act.⁴⁹⁹

The aforementioned two statutes amended the forfeiture provisions of the MLCA⁵⁰⁰ substantially. It is against this backdrop that the provisions of key civil forfeiture statutes are reviewed.

⁴⁹³ Which denotes a criminal action brought against a person that may result in personal liability. Conversely, an *in rem* action is directed against an object that derives from crime.

⁴⁹⁴ In *J.W. Goldsmith-Grant Co v United States* (254 US 505 (1921) [*Goldsmith*]) the court explained that proceedings against the property of a defendant is: ‘too firmly fixed in the punitive and remedial jurisprudence of the country to be now displaced’ (511).

⁴⁹⁵ 18 U.S.C. section 1961 (as to which, see par C.4 above).

⁴⁹⁶ See, for example, *United States v United States Coin & Currency* 401 US 715 (1971) [*Coin & Currency*]. A broad version of this theory was adopted in 1921 by the *Goldsmith* court. In this matter the court relied on the notion that the property of an offender could be forfeited by virtue of the property’s (guilty) association with its owner (*Goldsmith* 510–512).

⁴⁹⁷ 719–720.

⁴⁹⁸ Pub L No 106-185 114 Statute 202 (codified in scattered sections of Title 18 and Title 21 of the U.S.C.) (‘CAFRA’) - see par D.4.2.2 below.

⁴⁹⁹ See par D.4.2.3 below.

⁵⁰⁰ See par C.3 above.

4.2 Civil Forfeiture Legislation

4.2.1 Racketeering Influence Corrupt Organisation Act (1970)

As mentioned elsewhere,⁵⁰¹ RICO sanctioned for the first time the forfeiture of any property obtained through racketeering⁵⁰² and other predicate offences. It provides for both in *personam* or criminal forfeiture and *in rem* or civil forfeiture, fashioning it the most ingenious statute to date. The purpose of the forfeiture provisions of RICO is twofold.⁵⁰³ First, RICO purports to prevent crime by limiting funds of criminals through forfeiture. Secondly, RICO is aimed at apprehending crime syndicates leaders by criminalising involvement in racketeering.

RICO combines elements of criminal and civil forfeiture by providing, *inter alia*, for a criminal forfeiture action⁵⁰⁴ with the procedural and standard of proof requirements of a civil action.⁵⁰⁵ Section 1963(a) of RICO provides for the forfeiture of:

[a]ny property constituting, or deriving from, any proceeds which the person obtained directly or indirectly, from racketeering activity or unlawful⁵⁰⁶ debt collection in violation with Section 1962.⁵⁰⁷

Section 1963 is therefore directed at several types of interests. Forfeitable interests are categorised either as fruits or as instrumentalities of crime.⁵⁰⁸ Fruits of crime assets include any interest the defendant acquired through a RICO violation as well as proceeds of racketeering activity and property derived therefrom.

At present, RICO sets forth a detailed mechanism for forfeiture.⁵⁰⁹ After the proceeds of a racketeering activity were seized, a customary process must be followed to determine the type of forfeiture process that must be followed.⁵¹⁰ It is unnecessary for the government to prove a

⁵⁰¹ See par C.4 above.

⁵⁰² The meaning of which was amended in 2001 by section 813 of the Patriot Act (see par C.8.1 above, par D.4.2.3 below) to include terrorism.

⁵⁰³ Sections 1961–1968 of RICO.

⁵⁰⁴ *Idem* section 1963.

⁵⁰⁵ Section 1964(c) of the RICO.

⁵⁰⁶ Note that the word ‘unlawful’ testifies to the civil nature of the section.

⁵⁰⁷ See par C.4 above.

⁵⁰⁸ Brickey (1990) *Villanova LR* 914.

⁵⁰⁹ Section 881(b) of the RICO.

⁵¹⁰ *Idem* section 881(d). Cf Carberry & Adams (1988) *Corporate CQ* 98, 100; Saltzburg (1992) *Boston ULR* 225–226; Stahl (1992) *J of Crim LC* 284–285.

nexus between money earmarked for forfeiture and the underlying criminal activity.⁵¹¹ Section 881 creates two innocent owner defences which enable an innocent owner to recover confiscated property.⁵¹² In summary, RICO allows the forfeiture of proceeds associated or connected to racketeering. This provision severely limited the application of a RICO civil forfeiture action. These limitations were addressed by Congress when it inserted civil forfeiture provisions in the MLCA.

4.2.2 Money Laundering Control Act (1986)

In 1986, section 1366 of the MLCA inserted chapter 46 to Title 18 of the United States Code and with it, the current principal civil forfeiture section of US law, namely section 981. Pursuant to section 981 of the MLCA the ‘proceeds’⁵¹³ that are *traceable* to a section 1956 or section 1957 money laundering offence may be forfeited to the government using a civil process.⁵¹⁴ In addition, all rights, titles and interests in such property will vest in the government where an offence pursuant to the section has been committed.⁵¹⁵

The definition of the concept ‘traceable’ proceeds is problematic where the government attempts to seize the benefits of crime that were deposited in a commingled account comprising also legally derived money.⁵¹⁶ In *Banco Cafetero* the court held that the government is not required to make ‘dollar-by-dollar’⁵¹⁷ tracing of the money in the account to specific deposits of the benefits of crime. Instead, the government could utilise accounting methods to determine the extent of the traceable proceeds.⁵¹⁸ Conversely, more recently it was established that the government must

⁵¹¹ *United States v \$5,644,540. 00 in United States Currency* 799 F 2d 1357 (1986).

⁵¹² See section 881(a)(4)(A)–(B) of RICO; par D.4.3 below.

⁵¹³ Section 981(a)(1)(c) of the MLCA defines ‘proceeds’ as ‘[a]ny property, real or personal, which constitutes or is derived from proceeds *traceable* to a violation’ of or conspiracy to commit certain listed offences as well as any offence that is a specified unlawful activity.’

⁵¹⁴ *Idem* section 981(a)(1)(A). Section 981(a)(1)(B) of the MLCA provides for the civil forfeiture of property in the US which represents proceeds of a violation of a foreign drug law. Section 981(a)(1)(C) sanctions civil forfeiture of property that represents proceeds traceable to SUAs involving persons and banks.

⁵¹⁵ Section 981(f) of the MLCA.

⁵¹⁶ Carberry & Adams (1988) *Corporate C Q* 95–96.

⁵¹⁷ *Banco Cafetero* 1158.

⁵¹⁸ *Idem* 1159. The court described two accounting methods that can be applied (cf 1160–1162). See also par D.3.3 above as regards tracing.

establish probable cause with respect to *all* of the money in a bank account.⁵¹⁹ If a portion of the bank account is not traceable to a crime, probable cause will not be established with respect to that portion of the money.

A civil forfeiture case pursuant to section 981 may involve either an administrative or a judicial process or both.⁵²⁰ The choice to instigate administrative or judicial civil forfeiture proceedings depends on two factors: the value⁵²¹ and type of the property that is subject to forfeiture and whether the action is contested.⁵²² In terms of section 981(b) of the MLCA property subject to a civil forfeiture action may be seized by the Attorney General pending proceedings. If, however, the Treasury is still investigating money laundering offences,⁵²³ only property that is traced to a SUA may be seized by it.⁵²⁴ The latter property may be seized without any process if, *inter alia*, a probable cause exists.⁵²⁵ It therefore follows that all the government must do to obtain a civil forfeiture order pursuant to section 981(a)(1) of the MLCA is to present an affidavit to a court showing probable cause of a money laundering violation and that the property, for example money deposited into a bank account, which is the subject of the forfeiture action, can be traced to the violation. Once the forfeiture warrant is signed, the government may seize the bank account where the funds are being kept.

After the government has established probable cause, a defendant has two choices: one, he may disprove probable cause by a preponderance of the evidence or two, he may establish innocent ownership⁵²⁶ of the property. Once the seized property is forfeited, it will be transferred

⁵¹⁹ *United States v All Funds on Deposit (Great Eastern Bank)* 804 F Supp 44 (1992) 446 448–449.

⁵²⁰ Low et al *US AML* 368; Shelly (2000) *Maastricht J of European & Comp L* 44. In contrast to administrative proceedings which are conducted by the seizing agency, the judicial process is conducted in a court and before a judge. Property may be seized without issuing a warrant for a lawful arrest of the defendant (cf Comisky *Money Laundering Forfeiture* 14–15).

⁵²¹ In general, property with a value of less than 500,000 US dollars may be forfeited by using administrative proceedings (section 1697(a) of the MLCA).

⁵²² For a detailed outline of the civil forfeiture process, see Comisky *Money Laundering Forfeiture* 13–56.

⁵²³ Which are offences in terms of sections 1956 and 1957 of the MLCA (see par C.3.2 above).

⁵²⁴ Section 981(b)(1)(c) of the MLCA.

⁵²⁵ *Idem* section 981(b)(2).

⁵²⁶ See par D.4.3 below.

to local enforcement agencies that are participating in the investigation or the seizure.⁵²⁷ In addition, forfeited property located in the US may be transferred to a foreign country pursuant to the MLCA.⁵²⁸ Under the doctrine of constructive control US courts are granted control over property located abroad.⁵²⁹ In *United States v All Funds Deposited in Any Accounts in the Names of Heriberto Castro Meza or Esperanza Rodriques de Castro*,⁵³⁰ the government obtained a District Court civil forfeiture order which was appealed by the defendant on grounds that the court lacked constructive control over the funds.

The Appeal Court confirmed the judgment of the District Court. It considered whether US courts have *in rem* jurisdiction over property located outside its borders. The court reasoned that in order to initiate a civil forfeiture action against funds located abroad, the latter must be within the ‘actual or constructive control’ of the court in which the action is started.⁵³¹ The court finally ruled that seizure of the bank accounts by the English authorities, which were acting on request from the US government, in effect gave it constructive control over the funds.⁵³² Therefore, although the funds are not physically present in the US, their seizure by a foreign authority establishes US jurisdiction over the property. The *Meza* decision is significant for the authorities because it mitigates the practical disadvantages of international civil forfeiture actions.

Similarly in *United States v All Funds in Account Nos 747.034/278 (Banco Espanol de Credito)*⁵³³ the court confirmed that it did not need physical possession of the benefits of crime

⁵²⁷ Section 981(e) of the MLCA.

⁵²⁸ *Idem* section 981(i)(I).

⁵²⁹ Casella (2002) *J of Fin Crime* 271–272.

⁵³⁰ 63 F 3d 148 (2nd Cir 1995) [*Meza*]. The facts of this matter demonstrate the ease with which an international restraining order can be obtained. US federal authorities targeted funds in several bank accounts at different banks in London, England which they believed to represent the proceeds of an international drugs and money laundering organisation (149). After a request by the Justice Department, English authorities obtained a court order interdicting suspect bank accounts (150). The government then proceeded to file a civil forfeiture action seeking forfeiture of the funds. The court eventually ordered forfeiture of the funds pursuant to section 981(a)(1)(A) of the MLCA against which order the defendant appealed (152).

⁵³¹ *Meza* 152.

⁵³² *Idem* 154. The defendant subsequently brought an action in England claiming that the English court lacked jurisdiction to enforce international *in rem* confiscation orders (*Re S-L* [1996] QB 272 (CA)). The Court of Appeal dismissed the action reasoning that an *in rem* order was an order against the owners of the property and, therefore, it fell under the scope of the applicable law (276). See ch 6.C.4.4 as regards English civil forfeiture proceedings.

⁵³³ 141 F Suppl 2d 548 (2001).

to have jurisdiction to grant a civil forfeiture order and that constructive control was sufficient.⁵³⁴ A court may furthermore obtain actual or constructive control over property located abroad if the person who owns it voluntarily surrenders to the US his rights to the property. In *McNichols v Commissioner of Internal Revenue*⁵³⁵ the government persuaded a convicted drug dealer to surrender all rights to the proceeds, deriving from drug trafficking held in bank accounts abroad, to the US in return for a recommendation to the Internal Revenue Service by the US Attorney's Office not to seize and forfeit his home.⁵³⁶ The government subsequently obtained the money in the accounts without having to approach a court for an order to that effect. Moreover, it was ultimately able to seize the funds in the foreign accounts without foreign assistance, thereby saving itself from the practical realities of international cooperation.⁵³⁷

Although introducing a broad civil forfeiture process to the US AML regime, section 981 of the MLCA has been criticised⁵³⁸ as constituting a tool for the government to generate money and bolster statistics used to measure its performance as regards combating crime. Whether there is any truth in the allegations is a matter of opinion, but statistics⁵³⁹ have shown that the reform pursuant to the CAFRA has not had the desired effect of streamlining civil forfeiture.

4.2.3 Civil Asset Forfeiture Reform Act (2000)

The CAFRA was enacted to address some of the criticisms raised against the MLCA.⁵⁴⁰ To this end, it inserted section 983 in the MLCA which pertains to procedures governing civil forfeiture proceedings. Of note, CAFRA does not repeal the civil forfeiture provisions of the RICO and the

⁵³⁴ *Idem* 552–553. In this matter a cooperation agreement between the US and Spanish authorities as regards seizure of the defendant's funds coupled with an agreement by Spain to transfer the funds to the US as soon as the civil forfeiture order was given by the US court, were sufficient to give the US court constructive control over the funds (553).

⁵³⁵ 13 F 3d 432 (1st Cir 1993).

⁵³⁶ *Idem* 433–434.

⁵³⁷ Cf Zagaris (2004) *Berkeley J of Internat L* 148.

⁵³⁸ Hinterseer *Criminal Finance* 217; Baum *War on Drugs* 310; Boudreau & Pritchard (1993) *San Diego LR* 82–92.

⁵³⁹ In 2001, the total assets forfeited due to money laundering offences amounted to 241 362 783 US dollars (US Treasury 2002 *AML Strategy* 11).

⁵⁴⁰ For an overview of the legislative history of the CAFRA, see Casella (2001) *J of Legislation* 98–101.

MLCA. Instead it ‘superimposes’⁵⁴¹ section 983 over existing provisions. Two core provisions of CAFRA, which were inserted in the MLCA, are considered below.

First, a provision in the MLCA that a defendant in a civil forfeiture matter had the burden of proving that the property should not be forfeited was contentious. Therefore, section 983(c)(3) was inserted by CAFRA in the MLCA so that the burden of proof for civil forfeiture is moved back to the government to establish by a preponderance of the evidence that the property is subject to forfeiture.⁵⁴² The defendant may furthermore challenge the forfeiture on grounds that it is grossly disproportional to the seriousness of the offence.⁵⁴³ Secondly, CAFRA extends the provision of the MLCA which protects the rights of third parties whose property is subject to seizure.⁵⁴⁴ In this regard, two situations exist and a number of factors will be taken into consideration by the court to determine whether a third party may utilise the innocent owner’s defence to contest civil forfeiture of property. This defence is explored elsewhere⁵⁴⁵ in more detail.

Ultimately, CAFRA is a civil forfeiture statute which clarified existing civil forfeiture provisions to the benefit of the government and defendants alike. Initially, civil forfeiture functioned as a civil remedy which mostly favoured the government. At present, however, the harsh outcome of civil forfeiture namely, property deprivation is moderated by provisions that serve to benefit *bona fide* defendants of actions of this kind.

4.2.4 Patriot Act (2001)

The Patriot Act⁵⁴⁶ extended existing civil forfeiture legislation. It aims to simplify civil forfeiture proceedings and boost compliance with the UN’s Vienna Treaty.⁵⁴⁷ To this end, section 5317 of

⁵⁴¹ Casella (2001) *J of Legislation* 104.

⁵⁴² Section 983(c)(1) of the MLCA; Low et al *US AML* 368. In *316 Units*, which concerned a civil forfeiture action under section 981 of the MLCA (for the facts of the matter, see par C.3.2.2 above) the court concluded that the burden of proof in a civil forfeiture case is less than the burden of proof in a criminal proceeding (*316 Units* 176).

⁵⁴³ Section 983(g) of the MLCA. This provision codified the ruling of the court in *United States v Bajakajian* (524 US 321 (1998)) where the court found that civil forfeiture violates the Excessive Fines Clause of the Eighth Amendment to the US Constitution if it is disproportional to the seriousness of the offence (332–333).

⁵⁴⁴ Section 983(d) of the MLCA.

⁵⁴⁵ See par D.4.3 below.

⁵⁴⁶ See also par C.8. above.

⁵⁴⁷ See ch 5.C.1.2.

the BSA⁵⁴⁸ was amended by the Patriot Act to streamline civil forfeiture of money that was applied in violation of the BSA's currency-reporting provisions. The relevant forfeiture procedures are contained in section 981(a)(i) of the MLCA.⁵⁴⁹

Section 981 of the MLCA⁵⁵⁰ was amended by section 319 of the Patriot Act to allow for the confiscation of interbank⁵⁵¹ accounts held at foreign banks, situated in the US, where the money which is subject to the forfeiture action was deposited.⁵⁵² Pursuant to amended section 981 the government may commence civil forfeiture proceedings against the property of a defendant which derived from an offence committed in a foreign country.⁵⁵³ Significantly, benefits of crime subject to forfeiture must be located within the US.

It is evident that the Patriot Act broadens the enforcement capabilities of the authorities to achieve the ultimate goal of combating money laundering. It is submitted that this goal is likely only be achieved if potential unfair and arbitrary measures of the Patriot Act are allowed with circumspection by the judiciary.

4.3 Innocent Owner Defence

Under US civil forfeiture law a person whose property is subject to civil forfeiture may utilise the innocent owner⁵⁵⁴ defence to prevent forfeiture thereof. The defence was first recognised in 1921 when Justice McKenna acknowledged that forfeiture statutes could result in the seizure and forfeiture of property that belonged to an innocent owner.⁵⁵⁵

⁵⁴⁸ 31 U.S.C. See also par C.2 above.

⁵⁴⁹ 18 U.S.C. See also par C.4 above.

⁵⁵⁰ See also par D.4.2 above.

⁵⁵¹ An interbank account is an account which is maintained by one bank for another with the intent of facilitating consumer transactions (section 984(c)(2)(B) of the MLCA). If funds that are subject to forfeiture are held in a foreign bank which has an interbank account with a US based bank, this provision enables civil forfeiture of that particular funds (Gallant *Money Laundering* 107; Stern et al (2002) *Banking LJ* 8).

⁵⁵² Section 981(k)(1)(A) of the MLCA.

⁵⁵³ This type of civil forfeiture is available in three situations (cf section 320 of the Patriot Act; Whitehead & Aden (2002) *American ULR* 1081).

⁵⁵⁴ In relation to the innocent owner defence the concept 'owner' includes all types of innocent parties who may become embroiled in a civil forfeiture action, for example, lenders of money, business partners and mortgagees (cf Saltzburg (1992) *Boston ULR* 228–229).

⁵⁵⁵ *Goldsmith* 510. Although this matter concerned the civil forfeiture of a vehicle instead of a bank account, which is the main focus of this study, ambiguous observations by

Section 881 of RICO⁵⁵⁶ creates two statutory innocent owner defences which, due to their narrow application, are not readily used.⁵⁵⁷ Nevertheless, first, it is possible for a victim of fraud or theft of, for example, confiscated cash to reclaim his property.⁵⁵⁸ He must establish that the defendant acquired the confiscated cash from him through fraud or theft. Secondly, a bank as mortgagor of property such as a house that was used by the customer to, for example, manufacture illegal drugs may use the innocent owner defence to protect his interest against civil forfeiture by establishing that he was unaware that the house could be linked to a drug offence.

the court warrant mention in this context. Of note, the plaintiff as seller who retained an interest in the vehicle for the unpaid balance, was unaware of the purchaser's illegal use of the vehicle (509). The court accentuated the notion that property may be regarded as the offender (511). It explained that since the object of the forfeiture action (a vehicle) was used in the removal of illegal goods, it could be forfeited (513). Therefore, the vehicle could be forfeited to the government regardless of the innocence of the plaintiff (511). It is submitted that the latter finding was incorrect and negated the purpose of civil forfeiture which is punishing a criminal through the removal of property utilised in, or deriving from, crime. Where the facts of a matter dictate the existence of an innocent third party, the courts should consider at length whether it would be fair in the circumstances to expect the former to investigate the purpose for which the vehicle is utilised. At the time of the *Goldsmith* ruling no rules existed which placed an obligation on the seller to investigate the source of the buyer's income. Therefore, in light of the circumstances the ruling of the court in *Goldsmith* should be regarded as harsh and unjust even against the background of current forfeiture legislation. At present, despite extensive efforts to curb crime through civil forfeiture, it remains an open question whether it reasonably could be expected of banks, which extend loans to property buyers, to investigate the purpose for which the property is to be utilised. A customer with a legitimate source of income could borrow money from a bank to buy property which is then utilised in criminal activities. Disallowing the innocent owner defence in circumstances of this kind would negate the purpose of civil forfeiture.

⁵⁵⁶ Section 881(a)(6) of the RICO.

⁵⁵⁷ *Zeldin et al (1991) American CLR 847; Canavan (1990) Pace LR 494–495.*

Consider, for example, the problem that a bank, for example X Bank, may experience in reclaiming money it provided as an innocent commercial lender. X Bank provided a mortgage to a person using the benefits of crime as a down payment on the relevant property. If X Bank was unaware of the criminal acquisition of the money used as down payment, it will retain its rights under the mortgage as envisioned by section 881(e) of RICO. But, although awarding rights, section 881(e) does not assure the X Bank's rights by placing it first in line to receive the proceeds of a forfeiture sale. Before the bank is entitled to any proceeds from a sale, the government will be allowed to use the proceeds to pay expenses incurred during and after the forfeiture proceedings (section 881(e)(2) of RICO). Only then will the remainder of the proceeds be distributed to X Bank. Therefore, X Bank, although having rights as an innocent party, may nevertheless incur loss as a result of the proceedings. In contrast, see ch 8.D.4.5 where the position pursuant to POCA is spelt out.

⁵⁵⁸ Section 881(a)(4)(A)–(B) of RICO.

However, probably due to the strict application of the innocent owner defence in terms of RICO an innocent owner defence was also included in the MLCA. In terms of section 983(d) of the MLCA lien holders, for example banks, which have rights in customer accounts, may also utilise the innocent owner defence. The innocent owner defence under the MLCA comprises three elements that an applicant must establish.⁵⁵⁹ The applicant must establish that he has one, a valid *bona fide* interest in the seized property,⁵⁶⁰ two, a lack of knowledge⁵⁶¹ that the asset was used in crime and three, that he has taken all reasonable steps to prevent illegal use of the property. In *Banco Cafetero* the court asserted as regards the level of knowledge expected from a bank that was charged with violating section 1957 of the MLCA⁵⁶² and as a result countered with the innocent owner defence, that:⁵⁶³

[a] bank has no duty to investigate the source of its customers' deposits. It acts at its peril only when, as a passive receiver of knowledge, it learns that a deposit derived from drug profits and nevertheless accepts that deposit. The [forfeiture] statute imposes no investigatory costs on the banking system.'

The first part of the remark disregards the KYC standard duties of a bank. Pursuant to US AML laws banks must establish not only the identities of customers, but also ascertain the nature of their business to ensure that funds deposited into bank accounts are legitimately derived.⁵⁶⁴ It would be paradoxical if a bank that failed to verify the legitimacy of a customer's money is allowed to rely on the innocent owner defence where the government seeks to forfeit funds held in the customer's account. In a civil forfeiture application the government must give notice to all relevant parties who then have the option to object to the seizure and possible forfeiture of their property.⁵⁶⁵ Two

⁵⁵⁹ See section 981(a)(2) of MLCA; Carberry & Adams (1988) *Corporate CQ* 96.

⁵⁶⁰ See *United States v Two Hundred and Fifty Thousand Six Hundred and Twenty Five Dollars and Thirty Nine Cents* (551 F Supp 314 (1983)) where the court confirmed that a person who raises the innocent owner defence must have *lawful* possession of the property in issue, which in this case was money (317).

⁵⁶¹ Absence of actual knowledge as opposed to willful blindness is paramount for a successful utilisation of the defence. A lack of *actual* knowledge instead of constructive knowledge is required (*United States v \$4,255,000* 762 F 2d 895 (11 Cir 1985) 906).

⁵⁶² See par C.3.4 above.

⁵⁶³ *Banco Cafetero* 1162.

⁵⁶⁴ See paras C.2–9 above.

⁵⁶⁵ Section 983(a)(1)(A)(ii) of the MLCA as inserted by the CAFRA. See, for example, *Kadonsky v United States* (216 F 3d 499 (5th Cir 2000)) where the court ruled that administrative civil forfeiture is void if adequate notice was not given (505–506). In contrast, in *United States v Dusenbery* (201 F 3d 763 (6th Cir 2000)) the court found that if notice of the

situations must be distinguished where a defendant utilises the innocent owner defence to prevent forfeiture of his property.⁵⁶⁶ In the first situation the defendant was either unaware of the unlawful conduct which resulted in the forfeiture action⁵⁶⁷ or when he became aware of the conduct, he did everything in the circumstances to prevent or cease the continuation of the illegal conduct.⁵⁶⁸ In the second situation the defendant acquired only an interest⁵⁶⁹ in the property after the unlawful activity has occurred.⁵⁷⁰ In this context, CAFRA⁵⁷¹ introduces a new standard to determine whether a person may be regarded as an innocent owner. Therefore, an innocent owner is someone who is a *bona fide* purchaser or seller for value and did not know that the property was subject to forfeiture when he acquired an interest therein.⁵⁷² The defence is known as an ‘affirmative defence’⁵⁷³ on which the defendant bears the burden of proof.⁵⁷⁴ In general, the court will rule in favour of a defendant who did not give value for the property or where the property is not traceable to the benefits of crime or if it was acquired through any legal settlement.⁵⁷⁵

Banks that hope to rely on the innocent owner defence when confronted with an civil action to forfeit the bank account of a customer, however, may be foiled in their expectation. In *Miraflores* the court held that Republic National Bank, as the mortgagee, had not established its

administrative forfeiture was inadequate, a court should grant the claimant a judicial hearing on the merits to which he would have been entitled if he had received proper notice (768).

⁵⁶⁶ Section 983(d)(2)(B) of the MLCA.

⁵⁶⁷ The principle that willful blindness amounts to knowledge of an illegal activity is (see see par C.3.2.1 above) will likewise be applicable in this situation (Casella (2001) *J of Legislation* 111).

⁵⁶⁸ Section 983(d)(2)(B)(I) of the MLCA

⁵⁶⁹ In respect of a property interest, the court may, in the alternative order that the interest be transferred to the government or that the defendant may retain it but subject to a lien registered in favour of the government (section 983(d)(5)(A)–(C) of the MLCA). Cf above earlier remarks made in response to the ruling of the court in *Goldsmith*.

⁵⁷⁰ Section 983(d)(3)(A)(I) of the MLCA.

⁵⁷¹ See par D.4.2.2 above.

⁵⁷² Section 983(d)(3)(A)(ii) of the MLCA; Low et al *US AML* 370. In *Sokolow* the wife and daughter of the defendant, who was ultimately found guilty of violating section 1957 of the MLCA, contended that they were *bona fide* purchasers of value of property they received from the defendant (398). The court disagreed. It found that both defendants were not a *bona fide* purchaser because neither gave value for the property they received (407–408).

⁵⁷³ Casella (2001) *J of Legislation* 110.

⁵⁷⁴ Section 983(d)(1) of the MLCA.

⁵⁷⁵ *Idem* section 983(d)(3)(B). Note, however, the ruling of the court in *Sokolow* (see above).

status as innocent owner and therefore it forfeited the bank's 800,000 US dollars interest in a property. In the main, suspicious circumstances surrounding the mortgage loan transaction suggested 'actual knowledge, if not complicity' by the bank.⁵⁷⁶ Further, the court, in rejecting the innocent owner defence employed by the Republic National Bank, identified six factors which proved actual knowledge by the bank of its customer's illegal dealings. They are:⁵⁷⁷ one, both the shell corporation through which the loan was obtained and the trafficker were unknown to the bank, two, the borrower of the 800,000 US dollars (the shell corporation) had no known source or assets other than the house as collateral, three, the bank failed to enquire into the purpose of the loan, conduct a title search or assess the financial standing of the trafficker, four, the transaction was unusual because no repayment schedule was made and the amount borrowed was more than two thirds of the house's appraised value,⁵⁷⁸ five, the loan was quickly approved outside normal channels and six, most of the borrowed money was transferred to the borrower's Swiss bank account.

Two lessons are to be learned from *Miraflores*. First, banks that extend loans to customers must establish a due diligence process to demonstrate a *bona fide* belief in the legitimacy of its customer and the origin of its funds.⁵⁷⁹ Secondly, the lending process must be above suspicion and documented and bank employees must be trained to notice transactions which may involve the benefits of crime. These lessons are likewise reflected in the ruling of the court in *United States v BCCI Holdings, Luxembourg S.A.*⁵⁸⁰ The claimant, a bank, was unable to convince Green J that its right of set-off against the account of the defendant should be construed as a 'purchase.' Most notably, the court explained that the account holder is regarded as the funds' owner.⁵⁸¹ This is because, although title to the deposited funds passed to the bank when the deposit was made, the

⁵⁷⁶ *Miraflores* 1573.

⁵⁷⁷ *Idem* 1566–1572.

⁵⁷⁸ *Miraflores* 1572.

⁵⁷⁹ Cf Adams (1993) *Alabama LR* 696; Zeldin et al (1991) *American CLR* 853.

⁵⁸⁰ *United States v BCCI Holdings, Luxembourg S.A.* 961 F Supp 287 (1997) [*BCCI*].

This is one of many cases that followed after the much-publicised demise of the Bank of Credit and Commerce International, an offshore bank which was employed, *inter alia*, for money laundering purposes (see ch 1.A; ch 4.D.1). In the present matter the claimant argued that it, as owner of the funds in a bank account of the defendant, was an innocent purchaser of value and therefore the bank account of the defendant should not be forfeited to the government (*BCCI* 295–296).

⁵⁸¹ *BCCI* 287, 295.

account holder is the owner of the debt that the bank owed as a consequence of the deposit. Accordingly, it is that debt which is the state sought to forfeit.

Further, as justification for its ruling, Green J asserted that due to the extensive public record of the defendant bank, BCCI, 's misconduct the claimant should have known that its assets were subject to forfeiture.⁵⁸² The court confirmed that the standard to determine whether the innocent owner defence should be applied is that of 'objective reasonableness.'⁵⁸³ Therefore, once again attempts by a bank to establish its *bona fides* in relation to a transaction failed. Evidently, the courts expect more than mere *bona fide* conduct by a bank; it must, in addition, demonstrate that it has done everything *reasonably* required to ensure that a transaction is legitimate and that its customer's dealings are above board. Onerous obligations of this kind reflect those included in AML statutes.⁵⁸⁴ A final observation in this regard concerns the legitimacy of property. Suffice it to point out that a defendant is precluded from asserting a claim over illegal property, for example, counterfeited money.⁵⁸⁵

To conclude, the application of the innocent owner defence in civil forfeiture cases where the courts of two countries are involved should briefly be considered. The question is this: may a court that has granted a restraining order at the request of another country entertain a third-party claim or should the claim be referred back to the requesting country where the forfeiture action is pending? It has been proposed⁵⁸⁶ that as long as the party whose property was seized in one country have an opportunity to defend the claim in the country where the offence was committed and where forfeiture proceedings are pending, that party should be able to use the innocent owner defence in the country where the property is located. Therefore, the court that granted a restraining order against property located in its jurisdiction should leave it to the requesting country to hear matters regarding the merits of the forfeiture action.

4.4 Interim Recovery Orders

⁵⁸² *BCCI* 300.

⁵⁸³ *Idem* 301.

⁵⁸⁴ See paras C.2–9 above.

⁵⁸⁵ Section 983(d)(4) of the MLCA.

⁵⁸⁶ Casella (2002) *J of Fin Crime* 274.

It is inevitable that time will elapse from the moment that property becomes the subject of forfeiture proceedings and the moment when the forfeiture order is given. Therefore, interim measures is a necessity to ensure that a defendant does not interfere with the property in the meantime.

Section 1963(d) of the MLCA provides for various interim measures including restraining orders to ensure that property remains available for forfeiture purposes. The CAFRA has supplemented the MLCA as regards pre-trial restraining orders pertaining to property that is earmarked for forfeiture. Section 981(b) of the MLCA was amended to authorise so-called ‘out of district’⁵⁸⁷ seizure warrants. Accordingly, a warrant for the seizure of property issued in one district may be enforced in another district. Further, in terms of section 983(j) of the MLCA a court may issue a restraining order to preserve property for forfeiture pending the civil trial. The order may be employed to appoint a trustee to monitor the property. Like the CAFRA, the Patriot Act has amended existing civil forfeiture legislation to allow for the preservation of property that is subject to a foreign civil forfeiture order.⁵⁸⁸

When a bank becomes suspicious that money in an account may stem from a SUA it must inform the Justice Department which is empowered to obtain a freezing order. Significantly, it is unnecessary to establish that either the defendant or any person with an interest in the property received notice of the proceedings.⁵⁸⁹

E. INDIVIDUALISED ANTI-MONEY LAUNDERING MEASURES

1. Financial Crimes Enforcement Network

FinCEN, an agency that acts as coordinator for information as regards money laundering, was established in 1990 to assist with the collection of data regarding money laundering.⁵⁹⁰ It is

⁵⁸⁷ Section 981(d)(4) of the MLCA.

⁵⁸⁸ Section 323(1) of the Patriot Act; Cuéllar (2003) *J of Crim LC* 414n356.

⁵⁸⁹ Section 323(2)–(3) of the Patriot Act.

⁵⁹⁰ Godsen (1999) *T in Organised C 2*; FinCEN *Banks and Beyond 2*.

empowered to:⁵⁹¹ analyse suspicious activity reports,⁵⁹² coordinate AML efforts with other agencies and foreign governments,⁵⁹³ disclose information⁵⁹⁴ it received from banks through STRs to various law enforcement agencies,⁵⁹⁵ bring administrative enforcement actions through civil penalties for violations of the BSA, conduct research concerning the economic and technological aspects of money laundering and provide training to government and private sector personnel.

Furthermore, FinCEN publishes a semi-annual report which contains statistics on suspicious activity reports, money laundering trends and other issues relating to AML.⁵⁹⁶ The reports are of particular importance to banks because they advise of, *inter alia*, new methods to launder money and what to be on the lookout for as far as suspicious activities are concerned. However, in response to the Patriot Act⁵⁹⁷ FinCEN's function has been augmented to include the sourcing of advice.⁵⁹⁸ To this end, FinCEN is involved in three programmes designed to extend knowledge about issues relevant to devising strategies to combat money laundering. The first strategy, known as the Magnitude of Money Laundering, aims to develop money laundering measurement methodology in order to provide information regarding the amount of money being laundered within the economy.⁵⁹⁹

The second programme operated by FinCEN is the Gateway Programme which provides access to various US enforcement agencies and agencies in Puerto Rico of STRs made under the BSA. As the Gateway Programme has a feature that informs if two or more agencies have submitted similar inquiries, it acts as a mechanism to improve coordination among the various

⁵⁹¹ Springer (2001) *J of Fin Crime* 161; US Treasury 2000 AML 89; Van Cleef (2003) *J of Fin Crime* 97–98; Wyrsh (1992) *Denver J of Internat L& P* 525n75.

⁵⁹² Analysis is conducted through the employment of an advanced computer system designed to locate suspicious activity in the millions of CTRs submitted annually to FinCEN (Godsen (1999) *T in Organised C* 72).

⁵⁹³ In this respect FinCEN responds to requests from US and foreign law enforcement agencies for the exchange of information (Springer (2001) *J of Fin Crime* 161).

⁵⁹⁴ Section 314 of the Patriot Act specially provides for enhanced information sharing among either banks or enforcement agencies (cf par C.8.2 above).

⁵⁹⁵ See par C.1 above.

⁵⁹⁶ See, for example, US Treasury *SAR Review (2006)* 5–52 where the role of STRs in money services businesses are evaluated and related strategies discussed.

⁵⁹⁷ See par C.8.1 above.

⁵⁹⁸ In fact, inter-agency coordination is regarded as one of the principal objectives of the AML strategy (US Treasury *AML Strategy* 29).

⁵⁹⁹ US Treasury *FinCEN (2000)* 15, 26.

agencies in the US.⁶⁰⁰ The Gateway Programme saves investigative time and money because the different agencies are enabled to conduct their own research instead of relying on other resources to obtain information. The third programme that FinCEN operates is the Platform Access Programme which provides for the training of agency personnel in using databases and other technical matters.⁶⁰¹ The Platform Access Programme was initiated in 1994 by FinCEN to assist the various enforcement agencies.

Finally, FinCEN may not order banks to freeze funds of customers or to take any other action as regards bank accounts. Instead, it works in conjunction with enforcement agencies which will approach the court for permission to take action when deemed necessary.

2. Federal Banking Agencies

The Federal Deposit Insurance Corporation, Office of Thrift Supervision, Office of the Comptroller of the Currency⁶⁰² and the Federal Reserve Board are principal regulators of banks in the US.⁶⁰³ All of these agencies are also actively involved in assisting banks to meet AML requirements. The OCC, in particular, has taken part in two integral AML initiatives. First, in 1997 the OCC established the National Anti-Money Laundering Group⁶⁰⁴ which constitutes an internal task force.⁶⁰⁵

Through the NAMLG the OCC extended the scope of money laundering investigations. The OCC also cooperates with the other regulatory agencies and conducts specific examinations based on leads received from law enforcement officials.

3. Bank Secrecy Advisory Group

⁶⁰⁰ *Idem* 5.

⁶⁰¹ See *FinCEN (2000)* 4; US Treasury *Platform Programme* (2003).

⁶⁰² Or 'OCC'.

⁶⁰³ Broom & Markham *Bank Activities* 183, 197.

⁶⁰⁴ Or 'NAMLG'.

⁶⁰⁵ *OCC AML Comptroller's Handbook* 2–3. See also Low et al *US AML* 403n24.

Pursuant to the Annunzio Act⁶⁰⁶ the Treasury established the Bank Secrecy Act Advisory Group⁶⁰⁷ to enhance its efforts aimed at the prevention of money laundering in the banking industry. The BSA Group is chaired by the Treasury's Undersecretary of Enforcement and comprises 30 representatives from various enforcement agencies such as FinCEN.⁶⁰⁸

The BSA Group provides a forum for the exchange of views and is geared towards furthering cooperation between enforcement agencies and the financial industry. It therefore follows that the group's members represent all types of banks, the securities sector and informal money transmitting businesses.⁶⁰⁹ In addition, there is representation from state and federal enforcement and regulatory authorities.

Significantly, the BSA Group's simplification of reporting requirements and its refinement of record-keeping rules are likely to assist banks with AML duties.⁶¹⁰ Elsewhere it was proposed⁶¹¹ that AML legislation, in particular, the KYC standard, does little to protect banks from potential civil liability in the context of money laundering. Therefore, it is possible that industry specific action may alleviate the burden on banks created by AML legislation. A concerted approach involving all the role players in the banking industry may redress pertinent difficulties which banks are apparently experiencing in the execution of statutory AML obligations.

F. CHAPTER COMMENTARY AND SUMMARY

This chapter examined the content of the US AML regime. The evaluation imparted feelings of both exasperation and irritation. One would be hard pressed to imagine Congress ever conceiving such a muddled regime of money laundering control. There is no order to be found and seemingly no coordinated effort of money laundering control is forthcoming. Instead, existing legislation is merely augmented by additional provisions that add little value to those already on the books.

It is further evident that the US adopted a hybrid model of money laundering control comprising both elements of the Objective Model and the Subjective Models for Money

⁶⁰⁶ Section 1564(a)–(b) of the Annunzio Act (see par C.5 above).

⁶⁰⁷ Or 'BSA Group' which has been active since 1994.

⁶⁰⁸ FinCEN *Banks and Beyond* 24; Godsen (1999) *T in Organised C* 77.

⁶⁰⁹ Godsen *op cit* 77.

⁶¹⁰ FinCEN *Banks and Beyond* 26.

⁶¹¹ See par B.2, par D.1 above.

Laundering Control. However, even in combination the two models of money laundering control fail to redress the difficulties that banks are experiencing with money laundering control.

Further, it was argued that the outcome of KYC standard rules and the subsequent attack on the confidentiality duty of banks continue to raise privacy concerns. A complex struggle was found to exist between, on the one hand, the government which believes that the financial system must be protected from criminals and on the other hand, individuals who support financial privacy. It was therefore suggested that a balance must be found between the need for banks to have sufficient information about their customers and the need for customers to be assured that their privacy would be protected as far as possible, especially in relation to legitimate transactions.

Meanwhile, it is accepted that US banks may have divergent interests when compared to other financial services providers and, therefore, are likely to prefer legislation that affords them flexible implementation of AML measures instead of a one-size-fits-all implementation approach. However, the chapter established that the implicit message of currency and suspicious transaction reporting was that no legitimate reason exists to keep certain banking transactions secret. In the absence of clear parameters it is unclear to which extent a bank will be protected against civil liability on account of filing a STR. Therefore, regardless of legislation that sanctions disclosure of financial information, banks are left to fend for themselves when faced with decisions as regards the disclosure of confidential customer information. Presumably the finer avenue to follow in a situation of this kind is to approach the court for guidance. However, this path obviously has cost implications for the bank.

In contrast to its civil forfeiture laws which provide in detail for the civil forfeiture of the benefits of crime, the application of restitution principles in US cases where the benefits of fraud or theft were deposited with a bank is still at a neophyte stage.

As regards the possibility of civil action taken against banks by victims of fraud or theft, the chapter indicated that under US statutory law, the requirements for imposing constructive trust liability on a bank as recipient of the benefits of fraud or theft are in salient ways similar to English common-law. One may even go as far as to say that the codification of difficult English common-law principles may be the greatest contribution of the US legal system to systems elsewhere. Much could be learned from the sober, unambiguous restatements of the US law. The investigation, however, did identify one drawback of codification, namely, that it leaves no room for extended liability. Applied to banks it means that the courts will seldom impose constructive liability on a bank that paid the deposited benefits of fraud or theft to the fraudster or thief, which

means that the funds are no longer under the control of the bank at the time of *litis contestatio*. In such a case the court may still hold the bank liable to the victim of fraud or theft, but not on the basis of constructive trust.

The gist of the US civil forfeiture system seems to be that the judiciary decide individually on which side of the proverbial coin should fall. One thing however is evident: a bank that expects to use the innocent owner defence to protect its ownership of deposited benefits of crime must ensure that its *bona fides* is above suspicion. Evidently, US courts would rather err on the side of caution than find in favour of a defendant bank.

The analysis then proceeded to examine the content of various auxiliary government programmes which are aimed at supplementing the legislative component of money laundering control. It is evident that the US government is not taking the issue of using banks to warehouse or launder the benefits of crime lightly.

Where are we then? At the end of the chapter, it is necessary to pronounce whether the creators of the US AML regime can rightfully command the so-called ‘mighty’ to look at the regime they created and ‘despair.’⁶¹² Without a doubt the wisdom portrayed by Shelley in the poem ‘Ozymandias’⁶¹³ befits the US AML regime; the complex patched model of AML control belies the fact that it fails to address the challenges banks face in executing AML control obligations. This failure is likely to contribute to the eventual failure of money laundering control in the US.

In conclusion, this chapter commenced with a chess quotation that suggests that the White King must allocate different tasks to the White Bishops and the White Knights so that they can assist one another in toppling the Black King. To draw from the chess analogy, this chapter illustrated that the US Congress did the opposite; its enactment of a myriad of AML legislation has left the US AML regime badly fractured.

In Chapter 8 the AML regime of South Africa is set forth. In contrast to the comprehensive AML regimes of England and the US, it will be illustrated that South Africa, not unlike the EU, has thus far managed to implement elementary AML legislation only. Further, while South African courts have been afforded ample opportunity to consider the suitability of civil forfeiture applications in relation to the benefits of crime deposited into bank accounts, civil claims against

⁶¹² Shelley *Ozymandias* verse 11 (see par A.1 above).

⁶¹³ *Idem* verses 10–11.

banks that received and parted with deposited benefits of fraud or theft have yet to be entertained by the judiciary. Significantly, Chapter 8 will impart that at present there is no South African ownership remedy which can redress the loss suffered by victims of fraud or theft with the same measure of success as the remedies available at English common-law.

(Chapter 8 to follow)

PTO

CHAPTER 8**MONEY LAUNDERING CONTROL FRAMEWORK
OF SOUTH AFRICA**

We rivet our attention on the games of the experienced, the thinking, the strong players, preferably the strongest of them, the masters, and among them certain regularities show very plainly.

Lasker *Chess* 35

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A. INTRODUCTION

Thus far this study has demonstrated that AML measures carry unforeseen consequences for banks. One of these consequences include a conflict between the reporting duty of banks and their confidentiality duty. In addition, the comparative analysis revealed that English courts sometimes allow victims of fraud or theft to claim loss from a bank that received the benefits of the fraud or theft and parted with the money. Moreover, the benefits of crime can also be forfeited to the state

following a civil forfeiture order to the effect. In this chapter South Africa's AML regime falls under the spotlight.

In 1998 academics denounced Parliament's AML initiatives as being unrealistic.¹ In particular, a lack of resources and the political will to provide institutional and financial backup for money laundering control were singled out as key impediments to the country's money laundering control effort. More recently, a 2004 IMF report² indicated that despite the development of a comprehensive legal structure to combat money laundering, few money laundering cases are adequately investigated and prosecuted in South Africa.³ The situation remains unchanged in 2009⁴ despite the enactment of additional measures⁵ to assist with FICA's implementation.⁶

This chapter compares and evaluates the AML regime of South Africa with the AML regimes of the EU, England and the US and illustrates where the current position is either deficient or idiosyncratic. For this purpose I have divided the chapter into two parts. The overriding question posed in the first part of the chapter is whether FICA assists banks with the

¹ Camerer *Decriminalisation* 57; Swanepoel *Anti-Laundering* 30–34.

² IMF *South Africa Report 2004*, available at <<http://www.imf.org>> (2011.03.10). Significantly, the IMF employed the 40 recommendations of the FATF (see ch 6.B.4.3.2) as yardstick to measure the effectivity of the South African AML regime. It recommended that (IMF *South Africa Report 2004* par 25) South Africa improve its efficacy in prosecuting money laundering offences, that the AML Regulations (see par C.5 below) are amended and that the country develops additional guidelines to assist with the identification of suspicious account activities. I will return to the IMF's recommendations at the end of the chapter (see par F below).

³ IMF *South Africa Report 2004* par 12. Similar concern was raised in international academic circles about the future of contemporary global AML measures (cf Shams (2004) *Banking FL* 292; Naylor *Follow the Money* 276–280).

⁴ FATF *SA Report-2009* par 10. In a damning article published in the Cape Argus newspaper (*De Vries SA Mafia* 7) it was reported that organised crime syndicates have moved their financial operations to South Africa. The reason for this trend is explained as follows: '[m]oney laundering (is) easy here because of an unsophisticated anti-crime corruption unit and the ability to exploit officials' (ibid).

⁵ See paras C.5, E.1 below.

⁶ FICA was amended by the Financial Intelligence Centre Amendment Act 11 of 2008 ('Amendment Act') which, *inter alia*, widened its scope to include terrorist financing and related money laundering (see section 1 of the Amendment Act; par C.4.3 below). This amendment is in line with similar amendments to international AML legislation elsewhere (see ch 6.B.3.6; ch 7.C.8).

identification of the benefits of crime⁷ or whether the authorities⁸ are toiling with little to show⁹ for their efforts as suggested by the IMF?

The bulk of the chapter comprises two sections. The first section is devoted to an analysis of traditional common-law remedies to ascertain whether they can assist a victim of fraud or theft to claim loss from a bank which received the benefits of fraud or theft and parted with the money. In the second section civil forfeiture as codified common-law remedy used by the state to deprive criminals of the fruit of their unlawful activities is explored. The purpose here is to ascertain if these remedies can address the consequences of depositing the benefits of crime with a bank. At the end of the chapter some conclusions will be offered as regards the AML regime of South Africa.

This chapter commences with a brief exposition on the historical development of money laundering control in South Africa. Thereafter the South African AML regime is analysed within the following critical aspects: (I) AML legislation in as far as it concerns the KYC standard; (II) the extent to which South Africa's common-law allows for civil claims against a bank as recipient of the benefits of fraud or theft (III) the adequacy of the protection that POCA offers to a victim of fraud or theft where the benefits of theft or fraud have been earmarked for civil forfeiture; and (IV) individualised South African AML initiatives. The chapter concludes with a summary and some comments about the aforementioned aspects. This chapter, together with Chapter 3 which explores the bank-customer relationship under South African law, provides the backdrop for the evaluation of the current position as regards money laundering control in South Africa that will follow in Chapter 9.

⁷ Note, although South Africa's AML legislation employs the concept 'proceeds of unlawful activities' as synonym to the concept 'benefits of crime' (see section 1 of FICA read together with section 1(xv) of POCA), the concept 'benefits of crime' is used in this chapter for the sake of uniformity except where the civil forfeiture provisions of POCA are considered (see par D.4 below). See also par C.3.2 below, ch 1.A.2, ch 2.C.3.5.3 as regards the difference between the concepts 'proceeds' of crime *vis-à-vis* 'benefits' of crime.

⁸ Note that since the FIC is tasked with information assimilation (see par E.1 below) other agencies are involved in investigating and prosecuting money laundering offences. They include the National Prosecuting Authority ('NPA'), the South African Revenue Service ('SARS') and the South African Police Service ('SAPS'). The Asset Forfeiture Unit provides support to the SAPS in relation to civil forfeitures (see par D.4.2 below).

⁹ Cf ch 5.A where the myth of Sisyphus is explored for the purpose of evaluating the efficacy of money laundering control.

B. HISTORICAL DEVELOPMENT

1. General

South Africa is the regional financial centre of sub-Saharan Africa with a modern financial system and banking infrastructure. In 2008, 64 registered banks¹⁰ were operating in South Africa.¹¹ There are currently 33 authorised foreign currency dealers in South Africa, the majority of which are banks.¹² According to a recent survey AML control has been given top priority in South African banks at senior management level.¹³

Following South Africa's ratification of the UN's Convention Against the Illegal Traffic in Narcotic Drugs of 1988¹⁴ the country set in motion the drafting of legislation aimed at combating activities in relation to the proceeds of drug-related offences. As a result the Drugs and Drug Trafficking Act was enacted in 1992. In 1996 the Proceeds of Crime Act¹⁵ amended the limited scope of the 1992 Act.¹⁶ POCA repealed the 1996 Act with its enactment in 1998. South Africa's AML regime was completed in 2001 when FICA was signed into law.

Collectively, POCA and FICA form the backbone of the South African AML regime. While POCA sets out substantive money laundering provisions, FICA provides the administrative arrangements.¹⁷ The AML provisions of the two Acts must be read in conjunction with the AML

¹⁰ For the statutory definition of 'bank' in terms of the Banks Act 94 of 1990 ('Banks Act'), see ch 3.B.1. See par C.4.2.1 below for the definition of 'bank' under FICA.

¹¹ SA Fin Forum *Banks in SA 1–3*, available at <http://www.finforum.co.za/banks_South_Africa.htm> (2011.03.10).

¹² See SA Reserve Bank *Authorised Dealers 1*, available at <<http://www2.resbank.co.za/Internet/publication.nsf/WCEV/F6698D55841D101742256B4A0047939F/?opendocument>> (2011.03.10).

¹³ KPMG *Global Report-2007* 68. In contrast, with the exception of Nigeria, in other African countries money laundering control is a low priority issue. Key reasons for this include the costs involved in AML control and reduced access to information technology (idem 69).

¹⁴ Or 'Vienna Convention' - see ch 5.C.1.

¹⁵ 76 of 1996 ('1996 Act' - see par C.2 below). This is in stark contrast to the position in other countries. For example, the US enacted AML legislation already in 1970 (see ch 7.C.2). At regional level, the EU issued primary AML legislation in 1991 (see ch 6.B.3.4) whilst England put AML measures in place in 1986 (see ch 6.C.3.1).

¹⁶ See par C.1 below.

¹⁷ As regards the interaction between FICA and POCA, see De Koker *ABLU-2008* 282–287.

Regulations¹⁸ which were published pursuant to FICA. But, prior to analysing the provisions of the AML legislation mentioned above, it is important to consider briefly the provisions of their predecessors.

2. South African Law Commission Report

With the signing of the Vienna Convention¹⁹ in 1988 South Africa was ushered into the fast-paced²⁰ world of money laundering control. The 1992 Act was enacted pursuant to the Vienna Convention and dealt mainly with the confiscation of the proceeds of drug-related offences.²¹ However, the 1992 Act was a disappointment in as far as money laundering control was concerned.²²

In April 1996 the Minister of Justice appointed a Money Laundering Project Committee acting under the auspices of the South African Law Commission²³ to examine administrative measures to combat money laundering. The Law Commission released its report on money laundering control in August 1996.²⁴ The report proposed and included draft legislation aimed specifically at money laundering control.²⁵ The Money Laundering Control Draft Bill²⁶ comprised a proposal for the creation of a unit to facilitate information dissemination about potential money laundering schemes. It also established two categories of money laundering offences, namely

¹⁸ See par C.5 below.

¹⁹ See ch 5.C.1.

²⁰ See ch 1.A.1; ch 4.C–D where the point is made that criminals frequently devise new money laundering techniques in an effort to outsmart the authorities, hence the need for the police authorities to keep abreast of the newest money laundering trends.

²¹ Note, the 1992 Act replaced the penal provisions of the Abuse of Dependence-Producing Substances and Rehabilitation Centre Act 41 of 1971.

²² Smit *Money Laundering* 9–10; Itzikowitz *Money Laundering* 38–39. See also par C.1 below.

²³ ‘Law Commission’.

²⁴ See SA Law Commission *Money Laundering*.

²⁵ SA Law Commission *Money Laundering* 38–76. For a complete evaluation of the Money Laundering Draft Bill, see Swanepoel *Anti-Laundering Legislation* 24–34; Itzikowitz *Money Laundering* 43–54; Smit *Money Laundering* 8–23.

²⁶ B-1 of 2001 (‘Draft Bill’). It specifically sought to strengthen the administrative framework of money laundering control in South Africa and introduced measures to assist with the identification and prosecution of money laundering offences.

offences committed by designated institutions²⁷ and a second category relating to the abuse of information obtained from the proposed financial intelligence centre.²⁸

In summary, the Law Commission's report emphasised two crucial components of the proposed administrative AML framework, namely customer identification and suspicious transaction reporting. These two components are at the heart of the internationally recognised KYC standard²⁹ and arguably the best means to ferret out potential money laundering schemes. Evidently the Law Commission purported to introduce a working system of money laundering control for South Africa. But for a few insignificant differences the Draft Bill may be regarded as the blue print of FICA.

C. ANTI-MONEY LAUNDERING LEGISLATION

1. Drugs and Drug Trafficking Act (1992)

The international community regards the Vienna Convention as 'the foundation of the international legal anti-money laundering regime.'³⁰ However, it could be likewise regarded in relation to South Africa's AML regime. The first South African legislative instrument to deal explicitly with money laundering, namely the 1992 Act, emanated from recommendations by a task-group established to advise the government on the signing of the Vienna Convention.³¹

The 1992 Act criminalises the acquisition of property³² by a person who knew³³ it to be the proceeds of a so-called 'defined crime'³⁴ and the conversion of such property where the

²⁷ See SA Law Commission *Money Laundering* 43–51. The offences criminalised contravention of any of the four KYC standard obligations (see par C.4.2.3 below).

²⁸ *Idem* 50.

²⁹ See ch 5.B.3 ; ch 6.B.3.6, par C.3.4; and ch 7.C.2–8.

³⁰ Savona & De Feo *International Money Laundering Trends* 123. See ch 5.C.1 where the content of the Vienna Convention is discussed.

³¹ See Itzikowitz (1994) *SA Merc LJ* 302; De Koker (1997) *J for Juridical S* 17–18; par B.2 above.

³² Section 1 of the 1992 Act defines the concept 'property' widely as money or any other movable, immovable, corporeal or an incorporeal thing.

³³ See section 22 of the 1992 Act.

³⁴ The concept 'defined crime' comprised two parts, one part which pertained to the meaning of the concept 'drug offence' and the second part which described conduct as regards the offence (see section 1 of the 1992 Act which was repealed by POCA; De Koker (1997) *J for Juridical S* 22).

person knew or had reasonable ground to suspect³⁵ it to be proceeds of a 'defined crime'. Definitions used by the 1992 Act are complex. In addition, the Act limits the meaning of concepts³⁶ to specific chapters only with the result that the meaning of some concepts was left undefined in other chapters. Peculiarities of this nature compound the complexity of the Act's application.³⁷

More positively regarded, some of the provisions of the 1992 Act may be considered as forerunners of the KYC standard provisions as codified in FICA. For example, section 10(2) of the 1992 Act (which was repealed by POCA) placed a duty on the executive staff of financial institutions³⁸ to report suspicions as regards the source of money acquired in the course of business. Notably, no obligation to observe the confidentiality of customers or any other limitation on the disclosure of information is included in the 1992 Act. Moreover, information as regards the affairs of customers can be disclosed to the authorities if the information is regarded crucial for either the prevention of drug-related offences, or money laundering of the proceeds of drug-related offences.³⁹

At the time of the 1992 Act's enactment reservations were expressed about the potential difficulty that banks could experience in identifying both the proceeds of drug-related offences and suspicious transactions.⁴⁰ But the greatest weakness of the 1992 Act is presented by its limited scope; only money laundering activities in relation to the proceeds of drug-related offences are criminalised.⁴¹ This drawback resulted in the enactment of the 1996 Act.

2. Proceeds of Crime Act (1996)

The 1996 Act⁴² was introduced following the recommendations of the Law Commission which

³⁵ Section 7 read together with section 14(b) of the 1992 Act.

³⁶ See, for example, the concept 'drug trafficking' which is defined by section 28 of the 1992 Act as conduct that constitutes drug offences and economic offences.

³⁷ De Koker *ABLU-2001* 48; De Koker (1997) *J for Juridical S* 20.

³⁸ The 1992 Act employs the concept 'financial institution' which includes any public company registered as a bank pursuant to section 1 of the Banks Act.

³⁹ Section 9(1) of the 1992 Act.

⁴⁰ Itzikowitz (1994) *SA Merc LJ* 309–310.

⁴¹ See section 6 of the 1992 Act read together with section 14; Itzikowitz (1999) *THRHR* 90; Turkson (1998) *J of Fin Crime* 394; Bourne (2002) *SA Merc LJ* 487.

⁴² Note, the 1996 Act was subsequently repealed by POCA.

investigated international cooperation in criminal prosecutions.⁴³ In 1992 with the lifting of international financial sanctions against South Africa, the country re-entered the international free trade markets.⁴⁴ However, due to the globalisation of crime⁴⁵ South Africa became the target of international crime organisations whose activities included a wide range of unlawful conduct.⁴⁶ Consequently, the need for a money laundering control Act whose ambit extended beyond drug-related offences was recognised and addressed by Parliament.

The 1996 Act extended the scope of money laundering offences to include the proceeds of all types of criminal activity. Additional offences⁴⁷ were inserted into the Act and suspicious transactions⁴⁸ had to be reported to the Commercial Crime Unit of the SAPS. Even though banks were not yet required to ‘know their customers’,⁴⁹ they were required to formulate an opinion about the legitimacy of their customers’ money. In this sense the Act was an improvement of the 1992 Act. The 1996 Act further permitted so-called ‘defensive reporting’⁵⁰ which resulted in the filing of a dearth of reports about insignificant transactions.

Most significantly is, however, that the reporting duty pursuant to section 31(1) of the 1996 Act was so ill-defined that it was unclear whether banks had to file suspicious transaction reports at all.⁵¹ In addition, since STRs had to be filed with the SAPS, banks were not required to have an internal money laundering reporting officer⁵² to facilitate the reporting process. The consequence was haphazard report filing characterised by ineffective administrative procedures.⁵³

⁴³ See in general De Koker *ABLU-2001* 48; Itzikowitz (1999) *THRHR* 90; Schonteich (1999) *African Security R* 3.

⁴⁴ Grobler *Impact of POCA* par 2.

⁴⁵ See ch 4.B.2.1.

⁴⁶ De Koker *ABLU-2001* 46; De Koker (1997) *J for Juridical S* 20. Note, the argument runs that by combating money laundering the cycle used by organised crime to acquired benefits of crime will be disrupted (cf ch 2.C.5.2).

⁴⁷ For example, assisting some other to benefit from possessing the proceeds of crime and misusing customer transaction information (see sections 29 and 32 respectively of the 1996 Act).

⁴⁸ Section 31 of the Act.

⁴⁹ Itzikowitz *ABLU-1997* 30; Itzikowitz *Money Laundering* 42.

⁵⁰ *Ibid.*

⁵¹ See Itzikowitz ((1999) *THRHR* 90) and Cowling ((1992) *SA Merc LJ* 467–468) who explained that section 31(1) of the 1996 Act applied solely to a person who carried on a business. As a result, bank tellers and persons who transacted on behalf of customers were excluded.

⁵² As to which see paras C.4.2.3.3, C.4.2.3.5, C.4.3 below.

⁵³ (1998) *J of Fin Crime* 394–395; Itzikowitz *Money Laundering* 42.

Unintended consequences such as the aforementioned led to the proposal by the Law Commission of a Draft Bill aimed at strengthening the administrative framework of money laundering prevention. The Draft Bill would further introduce measures to assist with the identification and prosecution of money laundering offences.⁵⁴

3. Prevention of Organised Crime Act (1998)

3.1 Background

POCA is fundamentally based on the premise that organised crime in South Africa must be eradicated. In *National Director of Public Prosecutions v Seevnarayan*⁵⁵ the court remarked that the organised crime *leitmotif* forms ‘a recurrent theme throughout the Act.’ Yet, it curious that POCA fails to provide a definition for the concept ‘organised crime’.⁵⁶

The long title of POCA sets out the purpose of the Act. POCA strives to introduce measures aimed at combating organised crime and money laundering,⁵⁷ prohibit racketeering activities and money laundering, impose obligations on businesses as regards the reporting of information, criminalise gang activities, provide for matters connected to the recovery and subsequent civil forfeiture of the benefits of crime, establish a criminal assets recovery account and provide for matters connected therewith. POCA was amended on two occasions to rectify

⁵⁴ De Koker *ABLU-2001* 49. See also par B.2 above, par C.4.1 below.

⁵⁵ [2003] 1 All SA 240 (C) [*Seevnarayan*] par 60.

⁵⁶ See Howie J in *National Director of Public Prosecutions v Geyser* [2008] 1 All SA 15 (SCA) par 17. As regards the meaning of ‘organised crime’, see ch 2.C.5.2.1.

⁵⁷ In *Seevnarayan* the court found that due to the short title of POCA individual unlawful activity fell outside the ambit of the Act (par 59). This view was rejected by the Supreme Court of Appeal which asserted that POCA applied to individual criminal conduct as well as to organised crime (*National Director of Public Prosecutions v R O Cook Properties (Pty)Ltd*; *National Director of Public Prosecutions v 37 Gillespie Street Durban (Pty) Ltd*; *National Director of Public Prosecutions v Seevnarayan* [2004] 2 All SA 491 (SCA) [*Seevnarayan II*] par 65 - see par D.4.2.1.3 below). Likewise in two earlier judgments the courts failed to restrict the application of POCA to organised crime and unlawful gang activities (see *National Director of Public Prosecutions v Mcasa* 2000 (1) SACR 263 (Tk); *National Director of Public Prosecutions v Alexander* 2001 (2) SACR 1 (T)). More recently in *National Director of Public Prosecutions v Van Staden and others* ((2007 (1) SACR 338 (SCA) [*Van Staden*]) the Supreme Court of Appeal hopefully put the matter to rest when it affirmed that POCA applies to organised and individual wrongdoing alike (paras 1, 10). See also par D.4.5 below.

drafting faults, insert further money laundering provisions and to give some of its provisions retrospective application.⁵⁸

3.2 Money Laundering Provisions

Since POCA repealed the 1996 Act, all legislative provisions as regards the criminalisation of money laundering are now contained in one Act.⁵⁹ In *Mohunram and another v National Director of Public Prosecutions and another*⁶⁰ the court pointed out that POCA is not a model of clarity and coherence. However, it failed to elaborate on this statement. It is likely that the court realised that POCA's objective and the formulation of some of its provisions fail to correspond with each other.⁶¹ For this reason it is submitted that POCA is a challenging piece of legislation to use because of the disjointed fashion in which its provisions have been arranged.⁶²

POCA creates two categories of money laundering offences, namely offences that involve the 'proceeds of all forms of unlawful activities'⁶³ and offences that involve the 'proceeds of a

⁵⁸ See the Prevention of Organised Crime First Amendment Act 24 of 1999 and the Prevention of Organised Crime Second Amendment Act 38 of 1999.

⁵⁹ See sections 4–6 of POCA; par C.4.2.1 below.

⁶⁰ [2007] ZACC 4 [*Mohunram*] par 25. This case went as far as the Constitutional Court which found in favour of the applicant (see par D.4.2.1.3 below).

⁶¹ The premise is based on the following remark by the court in *Seevnarayan* (paras 59–60): 'The short title of the Act holds a clue to the mischief aimed at by the Legislature: it is directed at the prevention of "organised crime". Not by the widest stretch of imagination could the evasion of tax by [an] ... individual be categorised as 'organised crime'. The court therefore implied that some of the provisions of POCA were ambiguous. Cf De Koker *Money Laundering* 2-21.

⁶² For example, chapter 2 of POCA concerns racketeering whilst chapter 4 relates to gang related offences. Chapter 3 is between the two chapters and describes money laundering offences. Provisions pertaining to the benefits of crime are contained in chapter 5 which for the greatest part touches on confiscation orders whilst chapter 6 deals with civil forfeiture (see par D.4 below). A better arrangement may have been to organise all the offences in one chapter followed by the bulk of POCA's provisions, most which relate to civil forfeiture and the confiscation of the benefits of crime.

⁶³ Sections 4–6 of POCA. See also De Koker *ABLU-2001* 53–57; par C.4.2.1 below. Section 1(xv) of POCA defines the concept 'proceeds of unlawful activities' as 'any property or any service, advantage, benefit or reward which was derived, received or retained, directly or indirectly, in connection with or as a result of any unlawful activity carried on by any person'. The concept 'property' is denoted as '*money* or any other movable, immovable, corporeal or incorporeal thing and includes any rights, privileges, claims and securities and interest thereon and all proceeds thereof' whilst an 'unlawful activity' is *any* criminal conduct whether such conduct occurred in the Republic or elsewhere.

pattern of racketeering activity'.⁶⁴ In simple form, a person commits a money laundering offence where he benefits from a criminal activity.

The use of the concept 'proceeds' in POCA is significant. It is submitted that use of the concept 'proceeds' to denote property that was acquired through criminal means is incorrect. This is because grammatically regarded the concept 'proceeds' limits illegally acquired property to include only benefits which were generated by unlawful activities as opposed to benefits which were acquired through unlawful activities.⁶⁵ The unintended effect of this limitation is that POCA should apply only to money that was generated by crimes such as drug-trafficking and dealing in stolen property as opposed to money that was illegally acquired from victims of crimes such as fraud or theft.⁶⁶

⁶⁴ See section 2(1)–(4) of POCA. A 'pattern of racketeering activity' is any planned or ongoing participation or involvement in any of the offences listed in Schedule 1 of POCA (section 1(xii)). The following 34 offences are listed in Schedule 1: murder; rape; kidnapping; arson; public violence; robbery; assault with intent to do grievous bodily harm; indecent assault; rape; any offence under any legislation dealing with gambling, gaming or lotteries; sexual offences; corruption; extortion; childstealing; breaking or entering any premises with intent to commit an offence; malicious injury to property; theft; any offence under section 36 or 37 of the General Law Amendment Act of 1955; fraud; forgery; offences relating to the coinage; illegal drugs trafficking; dealing in or smuggling of ammunition, firearms; arms and ammunition offences; the dealing in or being in possession of endangered, scarce and protected game or plants or parts or remains thereof; exchange control offences; offences relating to the illicit dealing in or possession of precious metals or precious stones; intimidation; defeating or obstructing the course of justice, perjury; offences relating to the benefits of crime or to criminal gangs; any offence the punishment wherefor may be a period of imprisonment exceeding one year without the option of a fine; any conspiracy, incitement or attempt to commit any offence referred to in this Schedule. Two observations about the foregoing will suffice. First, a person commits a money laundering offence where the proceeds of a pattern of a racketeering activity are invested in an enterprise with a view to facilitate either of the outcomes mentioned below. Secondly, it is submitted that POCA's distinction between 'unlawful activities' and 'offences' listed in Schedule 1 of the Act serves no purpose. See par D.2.1.4 below where a recommendation in this regard is made.

⁶⁵ See Collins *Dictionary* ('proceeds' sv) which defines 'proceeds' as: '[t]he profit or return *derived* from a commercial transaction, investment, ... the result ... accruing from some undertaking'. In turn, the verb 'derive' means 'to produce or be produced from' (*op cit* 'derive' sv).

⁶⁶ Note, this limitation is not mentioned in POCA (see also ch 1.A.2; ch 2.C.5.3). However, in the absence of another explanation it is submitted that use of the concept 'proceeds' instead of 'benefits' in POCA (as well as in FICA - see par C.4.2.1 below) could be attributed to the fact that Parliament used the Vienna Convention (see ch 5.C.1) as template for FICA (see paras B.1, C.1 above, C.4.1 below) and US civil forfeiture legislation as template for POCA (see par D.4.1 below; ch 7.D.4.2.1 where the civil forfeiture provisions of the US RICO Act is discussed).

It is therefore recommended that POCA is amended as follows: first, the concept ‘proceeds’ should be replaced with the concept ‘benefits’. Secondly, a definition for ‘benefits’ should be inserted in section 1(xv) of POCA to read as follows:

‘benefits’ means any economic advantage acquired from unlawful activities.⁶⁷

The two recommended amendments will close the current loopholes that may be exploited by criminals who face prosecution or the civil forfeiture of their illegal gains pursuant to the Act.

In terms of POCA the unlawful activities from which the benefits must derive include all criminal conduct that is unlawful whether it occurred in South Africa or abroad. It follows that money that was acquired from unlawful conduct which occurred abroad constitutes the benefits of crime when it is repatriated to South Africa. Consider, for example, the scenario where a member of a German crime syndicate used money that was generated by the illegal selling of cocaine in Berlin to buy property in South Africa. Pursuant to POCA the property is the proceeds of a drug-related offence regardless of whether the illegal activities occurred outside of South Africa. As a result, it can be confiscated and subsequently forfeited to the state.⁶⁸ However, it is submitted that without the assistance of the German police authorities it is doubtful whether the National Director of Public Prosecutions⁶⁹ will be successful in establishing that the property is the proceeds of an unlawful activity.⁷⁰

So-called ‘own funds’⁷¹ money laundering and acts committed either intentionally where

⁶⁷ Which definition was taken from article 1 of the Strasbourg Convention’s definition of ‘benefit of criminal conduct’ (see ch 6.B.3.2, B.4.2.2).

⁶⁸ See par D.4.2.1.1 below.

⁶⁹ Or ‘NDPP’ which is tasked with handling civil forfeiture applications on behalf of the state (see sections 1, 48 of POCA).

⁷⁰ See par D.4.4 below as regards international assistance in criminal matters.

⁷¹ This concept refers to conduct by a person which is aimed at concealing the criminal origin of his own money as opposed to similar conducted by a third party, for example, a bank employee in respect of a customer’s money. Consider, for example, the scenario where X, a member of a crime syndicate uses the proceeds he made by selling stolen vehicles as a deposit on a new residence. This transaction amounts to own funds money laundering because X laundered his own money in an effort to conceal its criminal origin. In contrast, if X deposited the same proceeds into a bank account and Y, an investment advisor at the bank and also a member of the crime syndicate, transfers the funds to an offshore account whilst being aware that it is the proceeds of dealing in stolen vehicles, he would likewise commit a money laundering offence (see below). For an interesting analysis of how a *stokvel*, a community-based credit scheme, could be exploited by criminals for money laundering purposes, see Schulze (1997) *THRHR* 516 where the author questions whether AML legislation could counteract the abuse of this scheme for money laundering purposes.

the accused had actual knowledge of the criminal nexus of the funds, or acts committed negligently where the accused ought reasonably to have known are both criminalised by POCA.⁷² The Act initially compelled businesses to file STRs, but this duty has now been replaced by the broader reporting duty under FICA.⁷³

Chapter 3 of POCA is of special significance to banks because it criminalises three money laundering offences.⁷⁴ The offences can be committed in relation to the benefits of any unlawful activity.⁷⁵ The first money laundering offence is contained in section 4 of POCA which provides that a person that knows or ought *reasonably* to have known that property is the benefits of crime is guilty of a money laundering offence if it:

- enters into any agreement or engages in a transaction with some other in connection with that property, whether such agreement or transaction is legally enforceable or not;⁷⁶ or
- performs any other act in connection with such property which has the outcome of concealing the nature, source, location, disposition or movement of the property in issue.

Section 5 of POCA contains the second money laundering offence, namely that a person is guilty of an offence if he knows or ought *reasonably* to have known that some other has acquired the benefits of a crime and enters into a transaction aimed at making the funds available to him. Section 6 criminalises the acquisition, use or possession of property by a person who knows, or ought *reasonably* to have known, that it constitutes the benefits of crime. For the purpose of establishing liability in terms of POCA a person is deemed to have knowledge of a fact if he was actually aware of the fact, or if the court finds he knew there was a *reasonable* possibility that a fact existed yet failed to investigate the matter.⁷⁷ For example, a bank employee

⁷² See below.

⁷³ See par C.4.2.3.3 below.

⁷⁴ See sections 4–6 of POCA; par C.4.2.1 where the sections are quoted in full.

⁷⁵ As opposed to the 34 offences listed in Schedule 1 of POCA (see above). For example, a residence used to manufacture illegal drugs is the instrumentality of an offence listed in Schedule 1 of POCA (see also par D.4.2.1.3 below as regards the concept ‘instrumentality of an offence’).

⁷⁶ See ch 3.B.2.1 as regards when agreements will not be legally enforceable.

⁷⁷ Section 6 of POCA. In *Stannic v SAMIB Underwriting Managers (Pty) Ltd* ([2003] 3 All SA 257 (SCA)) Lewis JA had to distinguish between actual and constructive knowledge for the purpose of deciding whether SAMIB had any knowledge of the cession of an insurance policy. Stannic alleged that SAMIB knew that an insurance policy was ceded to some other yet it paid the proceeds of the policy to the cedent. The court *a quo* dismissed Stannic’s claim. On appeal the Lewis JA pointed out that actual knowledge could be established in different ways. It could be inferred from proved facts, or circumstances may be

who suspects that money used in a transaction may be the benefits of crime and then continues with the transaction without taking reasonable steps to obtain further information will be deemed to have knowledge of the fact that the money was acquired through criminal means.

As a result of the ‘ought to have known or suspected’ part of sections 4 to 6 of POCA it is possible to commit a money laundering offence negligently.⁷⁸ This is because a person who assists some other to conclude transactions which are aimed at laundering the benefits of crime is guilty of committing a money laundering offence. It follows that the accused will be unable to argue that he was unaware of the purpose of the transaction, namely to conceal the criminal nexus of the money. POCA further delineates in detail which factors may be considered to establish negligence by a person; a person acts negligently if he fails to recognise or suspect a fact that may reasonably be expected of a person with the general knowledge, skill, training and experience in his position and the knowledge, skill, training, and experience that he in actual fact has.⁷⁹ It follows that a bank employee who transfers funds to some other commits a money laundering offence if a reasonable bank employee would have suspected that the objective of the transaction was to launder (read: conceal the criminal nexus) of the money.

It is submitted that the importance of POCA as regards money laundering control is twofold. First, the Act defines key concepts in relation to money laundering which are cross-referenced by FICA.⁸⁰ Secondly, POCA extends the definition of ‘proceeds of crime’ from mere drug-related offences to include any type of criminal conduct. Of significance, POCA and FICA supplement each other’s money laundering provisions. POCA criminalises conduct which amounts to money laundering whilst FICA creates offences where designated institutions such as banks neglect its money laundering control obligations. It is to FICA’s money laundering control

such that a *reasonable* inference could be drawn that an individual had actual knowledge of a fact (par 17). A person who ignored ‘flashing lights’ would not have actual knowledge of a fact, but rather constructive knowledge. The consequences were, however, the same. In this case the court found that SAMIB had neither actual nor constructive knowledge that the insurance policy was ceded to some one than the cedent (par 19). As a result, it dismissed the appeal with cost.

⁷⁸ Whether a money laundering offence could be committed negligently pursuant to the 1996 Act was unclear (*Commissioner, South African Revenue Services and another v ABSA Bank Ltd and another* 2003 (2) SA 96 (W) [*Commissioner*] par 46). The matter has now been resolved by POCA and FICA.

⁷⁹ Section 1(3) of POCA. De Koker (*ABLU-2001 55*) doubts whether a person who negligently failed to recognise the benefits of crime committed a money laundering offence. It is submitted that the circumstances of the case may be a deciding factor for liability to lay.

⁸⁰ See par C.4.2.1 below.

provisions that the analysis now turns.

4. Financial Intelligence Centre Act (2001)

4.1 Background

Money laundering control was the topic of discussion in April 1996 when the Minister of Justice appointed a money laundering project committee to focus on administrative measures to combat the crime. The Law Commission subsequently formulated a report on money laundering and issue an AML Draft Bill.⁸¹ The end-result was FICA which constitutes South Africa's principal AML Act.⁸²

FICA creates a 'partnership'⁸³ between the business community and the government in combating national and international crime. This partnership is particularly poignant in view of the menace posed by organised crime and the money laundering techniques used by criminals to conceal the illegal nexus of their money. It was estimated in 2007 that the value of laundered money in South Africa may be as high as 80 billion rands annually.⁸⁴ The amount is so significant in the South African economy that it is likely that the majority of businesses in South Africa are affected by the benefits of crime and hence money laundering.⁸⁵

⁸¹ See par B.2 above.

⁸² For a comprehensive background of FICA, see De Koker *ABLU-2002* 7–8. The Act comprises five chapters and four schedules. Chapter 1 concerns the FIC (see par E.1 below), chapter 2 establishes the Counter-Money Laundering Advisory Council (see par E.2 below), chapter 3 comprises AML measures (see par C.4.2.3 below), chapter 4 describes money laundering offences and penalties whilst chapter 5 concerns miscellaneous provisions. Four schedules list accountable institutions (see par C.4.2.3.3 below), supervisory bodies, reportable institutions and amendments to relevant statutes respectively.

⁸³ De Koker (1997) *J for Juridical* S 21.

⁸⁴ Goredema *South Africa* 86. In comparison, between 2003 and 2008 only 61 money laundering cases were prosecuted and 19 convictions obtained (FATF SA Report-2009 par 10). For money laundering trends in South Africa, see Moodley *SA Strategic Review* 79.

⁸⁵ Recent examples where stolen pension and investment funds were laundered include the Fidentia Asset Management scandal which followed in the wake of financial scams such as LeisureNet and Masterbond. Arthur Brown, the chief executive officer of Fidentia Asset Management, allegedly abused pension funds for his personal benefit. More than 650 million rand of assets apparently have been used by Brown in private investment ventures. To date the Financial Services Board has been unable to follow the money to particular ventures which suggests that most of it was successfully laundered (for the differences between the concepts 'trace' and 'follow', see par C.4.2.3.2 below).

The AML regime of South Africa derives from internationally established guidelines that target banks as entry point for the benefits of crime.⁸⁶ FICA is a progressive statute that takes cognisance of these international measures⁸⁷ and the experience of other countries⁸⁸ in combating money laundering. It follows that the bulk of its content comprises the KYC standard.⁸⁹

_____ The objective of FICA is fourfold, namely to⁹⁰ establish two bodies to oversee efforts aimed at combating money laundering,⁹¹ impose KYC standard obligations on designated persons including banks,⁹² amend POCA⁹³ and the Promotion of Access to Information Act⁹⁴ and to provide for matters connected with the above mentioned.⁹⁵ FICA regulates the activities of the FIC⁹⁶ and further covers the KYC standard obligations, offences and penalties for failure to heed its provisions⁹⁷ and the release of AML Regulations⁹⁸ to clarify the KYC standard obligations. It complements POCA through the introduction of administrative measures to prevent money laundering and the financing of terrorist-related activities. At the outset it should be emphasised

⁸⁶ See ch 6.B.3, par C.3.4; ch 7.C.2–9. As regards FICA's provisions, see in general De Koker (1999) *Accountancy* 15; Itzikowitz (2000) *J of Fin Crime* 185; De Koker *Money Laundering* 2–8; Goredema & Montsi (2002) *African Security R* 8; Itzikowitz *ABLU-2005* 1; De Koker *South Africa* 97–110.

⁸⁷ For example, the guidelines of the Basel Committee on Banking Regulation and Supervision and the recommendations of the FATF (see ch 5.B.3.2–3.3).

⁸⁸ For example, the EU, England and the US (see ch 6.C.3.4, par B.3.6 and ch 7.C.2–9 respectively).

⁸⁹ As determined by KPMG: '[t]he basic premise of AML [control] is understanding who you are dealing with and the nature of their business' (KPMG *Global Report-2007* 26) - see par C.4.2.3 below.

⁹⁰ See the long title of FICA.

⁹¹ Namely the FIC and the Counter-Money Laundering Advisory Council (see sections 2–20 of the Act; paras E.1–2 below).

⁹² See sections 21–45 of FICA. Schedule 1 of the Act defines a bank as a person who carries on the 'business of a bank' as defined by the Banks Act (cf ch 3.B.1).

⁹³ See Schedule 4 of FICA. As a result, section 7A was inserted in POCA (see par C.4.2.3.3 below).

⁹⁴ 2 of 2000, as amended ('POAIA' - see also ch 3.B.2.3.3.1). Schedule 4 of FICA determines that section 36 of FICA is inserted in Schedule 1 of POAIA. As a result, the Reserve Bank and SARS must disclose knowledge or suspicion about the use of banks for money laundering purposes to the FIC.

⁹⁵ See par C.4.3 below.

⁹⁶ The obligation to file reports with the FIC came into effect on 3 February 2003 (see GG 24349 of 31 January 2003; paras C.4.2.3.3, E.1 below).

⁹⁷ Sections 46–69 of FICA. Some of the offences include failure to identify persons; keep records; report cash transactions, suspicious transactions and certain EFTs; implement internal rules; and to train employees.

⁹⁸ See par C.5 below.

that FICA imposes suspicious transaction reporting obligations on businesses in general⁹⁹ while additional AML obligations are imposed on accountable institutions¹⁰⁰ and so-called ‘reporting institutions’.¹⁰¹

FICA therefore comprises three key components which describe the functions of the FIC, the KYC standard requirements and offences in relation to the failure to implement KYC standard obligations.¹⁰²

4.2 Key Provisions

4.2.1 Definitions

At the outset, it is important to define the concept ‘money laundering.’ Money laundering includes conduct aimed at concealing the criminal nexus of illegally acquired money.¹⁰³ FICA delimits the concept ‘money laundering’ as:¹⁰⁴

[a]n activity which has or is likely to have the effect of concealing or disguising the nature, source, location, disposition or movement of the proceeds of unlawful activities or any interest which anyone has in such proceeds, and include any activity which

⁹⁹ Section 29 of FICA - see par C.4.2.3.3 below.

¹⁰⁰ See Schedule 1 of FICA which lists 19 accountable institutions which include banks.

¹⁰¹ See Schedule 3 of FICA which list two reporting institutions, namely motor vehicle dealers and persons dealing in Krugerrands. Note that accountable and reportable persons must register their particulars with the FIC (section 43B of the Act).

¹⁰² The arrangement of FICA’s provisions is sensible and forms a logical sequence. It is, however, submitted that the short title of FICA is a misnomer. The reason is threefold. First, like the AML legislation of the EU, England and the US (see ch 6.B.3.6, par C.3.4 and ch 7.C.2–8 respectively) the KYC standard obligations constitute the crux of FICA, a fact that is not reflected by the Act’s short title. Secondly, its short title is misleading seeing that it refers only to one of FICA’s four objectives, namely the creation of the FIC. Thirdly, only 19 sections of FICA cover the administrative arrangements of the FIC as opposed to its AML provisions which comprise 63 sections out of 82 sections. It is therefore recommended that FICA’s short title is changed to the Counter-Money Laundering and Reporting Act. The proposed title embodies all of FICA’s objectives and draws attention to its key AML obligation, namely the filing of reports about activities which may be indicative of a money laundering scheme.

¹⁰³ For the functional definitions of money laundering, see ch 4.B.1.

¹⁰⁴ See section 1 of FICA.

constitutes an offence of section 64¹⁰⁵ of this Act or section 4, 5 or 6¹⁰⁶ of the Prevention Act.¹⁰⁷

The definition above correlates with similar definitions included in the AML statutes of the other jurisdictions¹⁰⁸ under discussion in this study. Pursuant to sections 4 to 6 of POCA, FICA criminalises three categories of activities, namely:

1. *engaging* in an agreement or transaction for the purpose of concealing property whilst *knowing or ought to know* that it involves the benefits of crime;
2. *assisting* a person to benefit from the retention of property whilst *knowing or ought to know* that it involves the benefits of crime; or
3. *acquiring, using or possessing* property whilst *knowing or ought to know* that the property is the benefits of crime.

It follows that a bank employee commits a money laundering offence where he, for example, conducts a transaction for a customer whilst knowing or ought to have known that the funds used constitute the benefits of crime. From the definition and similar definitions included in the AML legislation of other jurisdictions referred to in this study,¹⁰⁹ it is further evident that the presence of the benefits of crime constitute the crux of the money laundering offences because they are the *raison d' être* for money laundering to be committed.¹¹⁰

Section 1 of FICA defines the concept 'proceeds of unlawful activities' with reference to the meaning attributed to it in POCA. In this regard three remarks will suffice. First, for reasons which were spelt out above¹¹¹ it is submitted that the concept 'proceeds of unlawful activities' should be replaced in FICA with the concept 'benefits of unlawful activities' defined as any economic advantage acquired from unlawful activities. Secondly, like the EU and England¹¹² South Africa has an 'all crimes' criterion of determining through which unlawful activities the

¹⁰⁵ Section 64 of FICA criminalises transactions conducted for the purpose of avoiding the Act's reporting obligations (cf par C.4.2.3.3 below).

¹⁰⁶ See also par C.3.2 above; ch 1.A.1 where sections 4–6 of POCA are quoted in full.

¹⁰⁷ Which reference is to POCA (see section 1 of FICA; par C.3 above).

¹⁰⁸ Namely the EU, England and the US (see ch 6.B.3.4–3.6, par C.3.4.1; and ch 7.C.2–9 respectively) which subscribe for the most part to the definition of money laundering adopted by the UN in the Vienna Convention (see ch 5.C.1).

¹⁰⁹ See ch 6.B.3.6, par C.3.4; ch 7.C.2–8.

¹¹⁰ As to which, see ch 4.B.2.

¹¹¹ See par C.3.2 above.

¹¹² See ch 6.B.3.2, par C.3.4.2.1 respectively.

‘proceeds’ must be acquired.¹¹³ This means that any conduct that is unlawful whether it occurred in South Africa or elsewhere can predicate the offence of money laundering.

Thirdly, whether the unlawful activity requirement of money laundering refers to conduct that is criminalised under South Africa law only, or includes conduct that is criminalised elsewhere is a contentious issue. Since the relevant part of the definition of ‘unlawful activity’ merely specifies ‘conduct that constitutes a crime or that contravenes *any* law’, it is an open question whether the words ‘any law’ have extraterritorial application. One may argue that FICA in reference to POCA implicitly contains extraterritorial reference¹¹⁴ and therefore, if the relevant conduct was conducted abroad there is no reason why the phrase ‘any law’ could not also include conduct which is criminalised internationally.

A useful analogy could be drawn from the US Patriot Act whose extraterritorial jurisdiction over a person outside the US who engages in any act which if it had been committed in the US would constitute an offence, has rendered it a controversial and unpopular statute internationally.¹¹⁵ In South Africa the position as regards the meaning of ‘unlawful activity’ is as follows: the unlawful activity in the definition of ‘proceeds of unlawful activities’ may be committed anywhere in the world, but if that same activity constitutes a criminal offence if committed in South Africa the conduct is likely to predicate an offence of money laundering regardless of whether it is deemed unlawful elsewhere.¹¹⁶

¹¹³ FATF *SA Report-2009* par 5. In contrast, in the US the benefits of crime must be acquired through any of a list of unlawful activities in order to predicate money laundering (see ch 7.C.3.1).

¹¹⁴ This premise is based on the fact that in the definition of ‘proceeds of unlawful activity’ FICA fails to exclude conduct which is criminal under international law. This possibility is also not listed in section 74 which list exceptions to the provisions of the Act.

¹¹⁵ See ch 7.C.8.3.

¹¹⁶ This broad definition of the concept ‘unlawful activity’ under POCA is likely to result in rather extraordinary outcomes. Consider, for example, the scenario where money which derived from the sell of Marijuana in a country where its sell and use are legal such as the Netherlands is repatriated to South Africa. Since the sell and use of the drug is criminalised in South Africa, money that derived from dealing therein constitutes the proceeds of drug trafficking pursuant to POCA. Section 6(c) of POCA criminalises mere possession of the benefits of a crime. If the proceeds of illegal drug dealing are deposited into a South African bank account via an EFT in an effort to conceal its criminal origin, the offence of money laundering is committed with all the consequences it carries for the account holder. In addition, if the bank fails to report the transaction to the FIC, it will commit an offence under section 56 of FICA which criminalises failure to report EFTs as required by section 31 of the Act. Note further that it is unlawful to bring cash or money via an EFT in excess of a prescribed amount to South Africa without filing a report with the Reserve Bank

4.2.2 Knowledge Requirement

The concept ‘knowledge’ is pivotal as regards the potential criminal of banks for a money laundering offence.¹¹⁷ In contrast to the AML legislation of other countries¹¹⁸ FICA specifies the circumstances under which a person is deemed to have or ought to have knowledge that a transaction is suspicious or unusual. A person namely has knowledge of a fact if:¹¹⁹

[2] (a) [the person] has *actual* knowledge of that fact; or
 (b) the court is satisfied that (I) the person believes that there is a reasonable possibility of the existence of that fact; and (ii) the person fails to obtain information to confirm or refute the existence of that fact.

[3] For the purposes of this Act a person ought *reasonably* to have known or suspected¹²⁰ a fact if the conclusions that he or she ought to have reached, are those which would have been reached by a reasonably diligent and vigilant person having both— (a) the general knowledge, skill, training and experience that may *reasonably* be expected of a person in his or her position; and (b) the general knowledge, skill, training and experience that he or she in fact has.

Five comments in this regard will suffice. First, knowledge as an element of liability is required for the three money laundering offences listed in FICA.¹²¹ Secondly, Parliament set down both an objective test¹²² and a subjective test¹²³ to determine the presence of knowledge. The tests are

first (see sections 30–31 of FICA; paras C.4.2.3.3, D.4.3 below).

¹¹⁷ See also par C.4.2.3.3 below as regards suspicious transaction reporting.

¹¹⁸ In this regard the EU’s AML legislation, English PCA and the US Bank Secrecy Act similarly provide that knowledge may be inferred from objective factual circumstances (see ch 6.B.3.2, paras B.3.4–3.6, par C.3.4.3.1 and ch 7.C.2.4 respectively).

¹¹⁹ See sections 2–3 of FICA as read together with section 1(xv) of POCA.

¹²⁰ What amounts to a reasonable suspicion remains uncertain. On occasion it was suggested that a suspicion must not be confused with speculation or a hunch, or gut feeling as it may sometimes take a while to formulate a suspicion (ICA *AML Manual* 118). A suspicion further falls short of proof based on evidence. It is evident that in the case of suspicion a factual basis must exist upon which it can be founded. Therefore, an objective and subjective test can be employed to confirm the existence of a suspicion. The objective test can be formulated as follows: where a person has *reasonable grounds* to suspect (ICA *op cit* 119). The subjective test of suspicion requires that the state proves that the accused *actually suspected* that a transaction involves the benefits of crime, but instead chose to ignore information which was likely to be relevant in a subsequent investigation of money laundering.

¹²¹ See sections 4–6 of POCA as cross-referenced by section 1 of FICA.

¹²² See section 1(3)(a)–(b) of FICA above (‘reasonably diligent and vigilant person having ... general knowledge’).

¹²³ See section 1(2)(b)(i) of FICA above (‘the person believes that there is a reasonable possibility’).

straightforward and adequate to determine whether liability should be imposed on an accused. Thirdly, whether a criminal or civil standard is likely to be used by the courts for the purpose of establishing knowledge on the side of a defendant bank is uncertain. It is submitted that since money laundering is a criminal offence, knowledge as an element of liability should be understood from a criminal point of view.

Fourthly, since the aforementioned definition of the knowledge element does not contribute to certainty as regards when to file a STR to the FIC, ultimately, the courts will have to determine whether an accused bank employee knew or should have known that a transaction is suspicious or unusual and, therefore, reportable. It follows, fifthly, that in the absence of clear-cut rules as regards suspicious or unusual transactions the court's interpretation of particular circumstances surrounding a transaction may be a deciding factor for a conviction.

It is submitted that since reasonableness is used in FICA as measure to determine liability for failure to file a STR,¹²⁴ the court should use a reasonable bank employee test to determine whether liability for a money laundering offence should be imposed on the accused.¹²⁵ It could further consider the bank's internal AML rules coupled with the AML training it provides to its employees as factors to determine liability.¹²⁶ Whether the KYC standard assists banks to protect their employees from prosecution for a money laundering offence is considered next.

4.2.3 KYC Standard Provisions

4.2.3.1 Introduction

The KYC standard provisions of FICA¹²⁷ are in some ways analogous to the AML recommendations of the FATF.¹²⁸ This is probably because FICA stems from a desire to enact legislation aimed at combating money laundering which would conform with similar international legislation.¹²⁹ FICA exemplifies a framework of AML control measures aimed at

¹²⁴ See sections 1(3)(a)–(b) ('reasonably diligent and vigilant person having ... general knowledge'), 2 of FICA above.

¹²⁵ See also par C.4.2.3.3 below.

¹²⁶ See paras C.4.2.3.3, 4.2.3.5, 4.3 below.

¹²⁷ See, for example, sections 21(a); 21(c); 22; and 42-43 of the Act.

¹²⁸ See ch 5.B.3.3.

¹²⁹ As demonstrated elsewhere in the study (see ch 5.B–C; ch 6.B.3.6, par C.3.4; ch 7.C.2–8), the international community has had much more exposure to issues related to

facilitating the detection and investigation of money laundering. Its AML measures are based on three basic principles, namely:

1. customer identification;
2. suspicious transaction reporting; and
3. preservation of the paper trail of transactions through the financial system.

Internationally,¹³⁰ the three measures above represent three of the four elements of the KYC standard.¹³¹

For the most part the KYC standard provisions of FICA are moulded on the same pattern as its international counterparts which comprise four key obligations.¹³² It should be emphasised that in international AML circles the current trend in money laundering control is to replace the identification obligation of the KYC standard with customer due diligence measures.¹³³ The EU's AML Directive has taken it further; it uses customer due diligence as an umbrella concept which encompasses all four of the KYC standard obligations.¹³⁴ In contrast to the KYC standard, the concept 'customer due diligence' encompasses a variety of additional measures which determine the *risks* involved in conducting business with a particular person. Risk determination and assessment are further regarded as vital for sound banking management practices.¹³⁵ Whether FICA requires a 'risk-based'¹³⁶ approach by bank as regards money laundering control is explored next.

4.2.3.2 Identification Obligation

money laundering control. It therefore would have been sensible for Parliament to have studied international AML legislation and to use similar provisions in its own AML laws.

¹³⁰ See ch 5.B.3.2–3.4, par C.1; ch 6.B.3.6, par C.3.4; and ch 7.C.2–3.

¹³¹ See ch 5.B.3.

¹³² Which include customer identification, suspicious transaction reporting, record-keeping and the training of employees (see ch 5.B.3.4.2–3.4.5).

¹³³ See ch 5.B.3.2.5, paras B.3.3.4, D.4.

¹³⁴ See article 8(a)–(d) of the 2005 Directive. Conversely, pursuant to the English 2007 Regulations customer due diligence measures denote only the identification obligation of the KYC standard.

¹³⁵ See section 60A–B of the Banks Act; regs 39–48 of the Regulations relating to Banks (GG 30629 - 1 January 2008); and the King II Code of Corporate Governance (King Committee *Code of Corporate Practices* paras 2.1.4(j), 3) which require banks to consider the risks that may affect the business at hand.

¹³⁶ See par C.4.2.3.2 below.

Section 21(1)(a) of FICA sets out the first obligation of a bank as an accountable institution, namely to establish and verify the identity of customers. Proper identification of a customer is vital because it constitutes the foundation upon which other obligations under the Act are built. A [rectify] bank that fails to obtain sufficient knowledge about the identity of a customer and the nature of his business would be unable to identify a particular transaction as unusual or suspicious.¹³⁷ The identification obligation further means that banks have to conduct customer profiling which includes familiarity with the background of the customer, his credentials and earning capacity.¹³⁸

In terms of section 21(1) of FICA a bank is precluded from establishing a ‘business relationship’¹³⁹ or conclude a ‘single transaction’¹⁴⁰ with a customer or prospective customer unless it has taken the required measures to establish and verify his identity and the source of his income. In addition, identification of the ‘principal’ and ‘agent’ coupled with proof of authority are required where the customer is acting on behalf of some other or someone is acting on his behalf.¹⁴¹

Three Identification Levels

FICA distinguishes among the following three levels of identification and dictates the identification obligations of a bank accordingly to:¹⁴²

1. where the bank is approached by a customer in person;
2. where the bank is approached by a customer acting on the behalf of another,¹⁴³ and

¹³⁷ See section 29 of the Act; par C.4.2.3.3 below.

¹³⁸ See regs 3–18, 21 of the AML Regulations which list which information banks must obtain and verify; De Koker *ABLU-2002* 11–12.

¹³⁹ The concept ‘business relationship’ is defined in section 1 of the Act as: ‘[a]n arrangement between a client and an accountable institution for the purpose of concluding transactions on a *regular basis*’. The prerequisite of ‘regular basis’ effectively distinguishes a ‘business relationship’ from a ‘single transaction’ (see below).

¹⁴⁰ The concept ‘single transaction’ is defined in section 1 of FICA as meaning: ‘[a] transaction other than a transaction concluded in the course of a business relationship’.

¹⁴¹ Section 21(2)(b)–(c) of FICA.

¹⁴² See *idem* section 21(1)(a)–(c) respectively.

¹⁴³ Under the AML Regulations a distinction is made between natural and legal persons such as companies and trusts (see regs 3–6 and regs 7–16 respectively of the AML Regulations). Procedures for identity and address verification differ depending on the type of customer involved. For example, the bank must verify the identity and addresses of each director in order to properly identify corporate customers (for an analysis of the misuse of

3. where the bank is approached by another person acting on behalf of the customer.

The AML Regulations provide in detail the manner in which identification and verification of various categories of customers should be conducted. In addition, the AML Regulations indicate the manner in which basic customer identification particulars should be verified.¹⁴⁴

In essence, FICA's identity obligation comprises two parts. First, a bank must have internal account-opening identification procedures to establish that the customer is as he presented himself to be.¹⁴⁵ Secondly, the bank must obtain sufficient ongoing understanding of the nature of the customer's business¹⁴⁶ for the purpose of identifying suspicious and unusual transactions that could be associated with a money laundering scheme.¹⁴⁷ FICA therefore states unequivocally that banks must police the account activities of their customer on a continuous basis. In effect this means that banks must question the *bona fides* of their customers even if there is no reason for it to be suspicious.

It is submitted that the impact of FICA's identification obligation on banks is twofold. First, a bank must ensure that each transaction that it conducts on behalf of a customer has a legitimate purpose and is conducted with legally earned money.¹⁴⁸ Secondly, in the event of fraud

legal entities for money laundering purposes, see ch 4.C.2).

¹⁴⁴ For example, a natural person's name and identity number should be verified by reference to an identity document (see regs 3–4 of the AML Regulations read together with guidelines of the FIC). In this regard the FIC (see *Customer Identification 3* notes 6–14) lists which documentation may be used for information verification. Other forms of identification verification are acceptable only if a person is, for a reason which a bank find satisfactory, unable to produce an identity document (see reg 4(a)(ii) of the AML Regulations read together with note 6 of FIC *Customer Identification 3* which provides that a driver's licence or passport may be used as alternative forms of identification). Additional identification particulars such as the residential address of a natural person may be verified by reference to any information which can reasonably be expected to serve as verification for the particulars in question (see reg 4(3) of the AML Regulations and note 11 of FIC *Customer Identification 3*).

¹⁴⁵ See reg 21(1)(a)–(b) of the AML Regulations in terms of which banks are required to identify the benefits of crime and money laundering activities.

¹⁴⁶ See *idem* reg 21(3)(a)–(b) in terms of which bank must ascertain the source of a customer's income and the money used in a transaction.

¹⁴⁷ FIC *Guidance Notes 1* 2–9; *Bredenkamp and others v Standard Bank of South Africa Ltd and another* (2009 (6) SA 277 (GSJ)) [*Bredenkamp*] par 51 (see ch 3.B.2.1.2.1). In its second set of guidelines the FIC lists activities which may be regarded by banks as a transaction (FIC *Meaning of Transaction 2* (a)–(f)). Suspicious and unusual transactions must be reported to the FIC which will investigate the matter further (cf par C.4.2.3.3 below).

¹⁴⁸ See *Nissan South Africa (Pty) Ltd v Marnitz NO and others ((Stand 186 Aeroport (Pty) Ltd Intervening)* 2005 (1) SA 441 (SCA) [*Nissan*] (par 28) as regards arguments made

the bank's failure to properly establish above mentioned information may have two undesirable consequences for it. First, the bank will be prosecuted for a money laundering offence whilst secondly, it may be sued by the customer who as a victim of fraud suffered loss due to the bank's negligence. In the latter instance the claim may be based on either delict or breach of contract depending on the conduct of the bank.¹⁴⁹

Reasonableness

When a bank knows or suspects that a customer conducts a transaction on behalf of some other, his identity and the identity of the other person must be established.¹⁵⁰ Banks are further required to obtain a certain amount of information about a potential customer and to verify its authenticity before accepting him as a customer.¹⁵¹ A reasonable, prudent bank must:¹⁵²

[n]ot only satisfy himself of the identity of a new customer but also to gather sufficient information in regard to such client to enable him to establish whether the person is the person or entity he ... purports to be.

In addition, there is an imposed duty on the bank not to accept any evidence of identity or address at face value. It follows that a bank is expected to take *reasonable* measures to verify the evidence presented.¹⁵³

The obligation of banks to verify and establish the identity of customers was considered

on behalf of the respondent bank. For the facts of the case, see ch 3.B.2.1.

¹⁴⁹ See ch 3.B.2.1–2.2, par B.2.3.4. For an instructive analysis of the potential liability of a bank, see Sonnekus (2001) *J for Juridical S* 106–113.

¹⁵⁰ See section 21(1)(b)–(c) of FICA; reg 17 of the AML Regulations; point 12 of FIC *Customer Identification* 3. A bank may not contract with the customer or conclude any transaction on his behalf unless it has established and verified the authority of the customer or person to act on behalf of another individual (section 21(1)(b)(ii); section 21(1)(c)(ii)).

¹⁵¹ See *Columbus Joint Venture v Absa Bank Ltd* 2002 (1) SA 90 (SCA) [*Columbus II*] paras 9–11 where Cameron JA distinguished between the bank's duty to verify the identity of an existing client and verify the identity of a new client (see also ch 3.B.2.2).

¹⁵² *KwaMashu Bakery Ltd v Standard Bank of South Africa Ltd* (1995 (1) SA 377 (D)) 395I–396B. See also *Energy Measurements (Pty) Ltd v First National Bank of SA Ltd* 2001 (3) SA 132 (W) 147B–C. Ultimately, the standard correlates with the standard described by the Supreme Court of Appeal in *Columbus II* (par 11): '[t]he bank is under a duty to take reasonable measures to ascertain and verify the new customer's identity and trustworthiness'.

¹⁵³ Measures of this kind include consulting independent sources and applying appropriate risk management measures in the process (SAB *Banking Code* paras 3.5–3.6).

by the Supreme Court of Appeal in *Columbus II*.¹⁵⁴ The court asserted that banks are required to consider all documents of new customers and to ‘apply their minds thereto’.¹⁵⁵ As regards the verification of an existing customer’s identity who applied for another account, the court found that the necessary inquiries should be made as dictated by the given circumstances.¹⁵⁶ For this reason FICA and the AML Regulations collectively require that banks accurately¹⁵⁷ identify all customers with whom they conduct business unless an exemption¹⁵⁸ is applicable in the given circumstances.

Fortunately, banks are not required to follow a ‘one-size-fits-all approach’ in the methods used to identify customers.¹⁵⁹ A bank may exercise its own judgment to decide on an appropriate balance between the level of verification and the most practical means of obtaining it.¹⁶⁰ Banks must further verify details against information that ‘can reasonably be expected to achieve such

¹⁵⁴ Paras 25–26. Although *Columbus II* concerned the potential negligence of a bank in relation to the collection of cheques, the court’s observations about the opening of new accounts are important to the discussion at hand. Columbus Joint Venture was appealing a ruling by Malan J that Absa Bank was not negligent when it opened an account for an existing customer without reestablishing his personal details first (for a detailed evaluation of the matter, see Pretorius (2002) *SA Merc LJ* 95–96).

¹⁵⁵ *Columbus II* par 6. Cameron JA asserted that a bank should be careful when opening new accounts for customers because this could prevent loss to the true owner of a stolen cheque (par 11). Its duty to act with reasonable care when opening a new account further extends to its existing customers (paras 9–10). The court found that Columbus Joint Venture failed to establish that Absa Bank was negligent by opening another account for the customer without conducting a detailed investigation first. It continued to describe the bank’s ‘anxiety about prospective or existing customers’ sensibilities’ as misplaced (par 23). The appeal was therefore dismissed (par 26).

¹⁵⁶ *Idem* par 25. In this matter there was nothing to suggest to Absa Bank that further inquiries were called for.

¹⁵⁷ The correct assessment of risk in relation to a specific business relationship and, or transaction is a twofold process (FIC *Guidance Note 1* note 3). First, it should enquire how a *reasonable* bank manager would rate the risks involved in a similar situation, and secondly, what the likelihood is of money laundering occurring with the customer type and transaction in question.

¹⁵⁸ See section 74 of FICA which provides that the Minister of Finance may exempt accountable institutions from complying with the Act’s provisions. To date three sets of exemptions have been published, namely Exemptions in terms of the Financial Intelligence Centre Act, 2001 (GN 596 of 20 December 2002); Exemptions in terms of the Financial Intelligence Centre Act, 2001 (GN 788 of 30 June 2004) and Second Reporting Exemption in terms of the Financial Intelligence Centre Act, 2001 (GNR 1354 of 19 November 2004). See also par C.4.2.3.2 below.

¹⁵⁹ See FIC *Guidance Notes 1* (see below).

¹⁶⁰ FIC *Guidance Notes 1* note 3.

verification’¹⁶¹ and that ‘is obtained by reasonably practical means’.¹⁶²

Risk-Based Approach

As mentioned above,¹⁶³ banks are advised to adopt a ‘risk-based approach’ when verifying customer information.¹⁶⁴ This entails that the greater the perceived risk of money laundering ‘the higher the level of verification, and the more secure the methods of verification used, should be.’¹⁶⁵ The risk-based approach also enables banks to assess the money laundering risks of certain combinations of customer profiles, product types,¹⁶⁶ and transactions.¹⁶⁷ The FIC advises as follows:

[t]he balance and the accuracy between the accuracy of the verification required on the one hand, and the level of effort invested in the means to obtain such verification on the

¹⁶¹ Reg 21 of the AML Regulations. This phrase has a two-fold implication for banks (FIC *Guidance Notes 1* note 3). First, a risk-based approach requires that the bank must both correctly assess the money laundering risk of a transaction and decide which methods and levels of verification are required. Secondly, the bank must always have specific grounds with which to justify its decision relating to the method and level of verification it employed to assess risk.

¹⁶² FIC *op cit* note 2. This means that banks are expected to take into account any guidance notes pertaining to the verification of identities. It follows that in specific instances a bank will have to assess which information may be necessary to verify the particulars in question and the means by which it can be obtained. The bank must exercise its judgement to ascertain the most practical means of obtaining the required verification.

¹⁶³ See par C.4.2.3.1 above.

¹⁶⁴ FIC *Guidance Notes 1* 2–7; FIC *Customer Identification 3* note 2. The risk-based approach parallels the approach that has been advocated in the EU, England and the Wolfsberg Group of Private Banks (see ch 6.B.3.6, par C.5.2 and ch 5.D.4 respectively).

¹⁶⁵ FIC *Guidance Notes 1* note 3; FIC *Customer Identification 3* note 4. Of significance, the latter document lists a number of factors that may be indicative that a transaction poses a high risk of money laundering.

¹⁶⁶ In this regard it is necessary to emphasise the difficulties posed by non-face to face banking services such as electronic banking, Internet banking, phone banking and postal banking. The value of anonymity in the money laundering process is evaluated elsewhere in this study (see ch 4.D.4.3). Internationally, great emphasis is placed on the use of enhanced measures in verifying the identity of non-face to face customers (see ch 5.B.3.2.5, par B.4.4.2). The point is this: the onus of verifying the identity of customers lays with the bank. Similar to their international counterparts (see ch 6.B.3.6, par C.3.4; and ch 7.C.2–3) South African banks are expected to take every measure necessary to ensure compliance with internationally accepted AML identity verification standards irrespective of the costs involved (FIC *Customer Identification 3* note 9).

¹⁶⁷ For the definition of the concept, see par C.4.2.3.3 below.

other, has to be commensurate with the nature of the risk involved in a given business relationship or transaction.

It follows that banks must afford sufficient attention to the practicalities of separating different risks. It is submitted that it is of little use to have extensive risk identification modules available when the costs and expertise required to successfully employ them means that they have to be ignored in favour of superficial practices.¹⁶⁸ For this reason it may be assumed that instead of prescribing set customer identification techniques, the FIC elected to release guidelines so that banks are able to weigh the unique money laundering risk posed by a certain customer and then decides individually on the level of identity verification required. For example, the risk posed by a potential customer with no fixed income who resides in an African country that has no AML control measures in place will be much higher than that of a South African citizen who has resided for more than a decade at the same address.

In summary, three points are of importance as regards FICA's identification obligation. First, it is submitted that some of FICA's identification exceptions¹⁶⁹ are likely to restrict its effectivity. This is because the mentioned exemptions fail to provide for error or fraud by an employee of the other bank involved in the transaction. Consequently, the bank cannot be sure that the customer is in fact who he presented himself to be or whether the transaction fits his profile. It is therefore recommended that the mentioned exceptions are removed from FICA and that banks are required to establish the identity of every customer they conduct a transaction for.

Secondly, it is submitted that guidelines are not always sufficient to cultivate a culture of efficient risk assessment in banks. It is therefore recommended that Parliament should amend section 21 of FICA in order to provide for simplified and enhanced customer due diligence akin to the EU's AML Directive.¹⁷⁰ The amended section should read as follows:

Identification of clients and other persons

¹⁶⁸ FIC *Customer Identification 3* note 2.

¹⁶⁹ For example, a bank is exempted from establishing a customer's identity where it either conducts a transaction for a customer of another bank provided that the latter has established the customer's identity, or where the customer is situated abroad in a country that has AML measures in place (see above).

¹⁷⁰ See ch 6.B.3.6. 'Simplified due diligence' is required where a reduced risk of money laundering exists and 'enhanced due diligence' where there is a high risk of money laundering. It is submitted that insertion of the two categories of due diligence would restructure the due diligence provisions of FICA, the AML Regulations (see regs 2–19) and the FIC's relevant guidelines which at present are too generally phrased.

21(1) An accountable institution may not establish a business relationship or conclude a single transaction with a client unless the accountable institution has **[used simplified or advanced customer due diligence]** (a) to establish [...] the identity of the client.

The AML Regulations should further be amended to clarify what is meant by simplified and enhanced customer due diligence.¹⁷¹

Thirdly, it is submitted that faultless verification by banks of customer information is an impossible task for two reasons. First, due to practical constraints a bank is in no position to verify the truth of the information that is presented by a customer.¹⁷² Secondly, similar to an auditor who expresses only an opinion or assurance that the statements of a company are free from misstatements, a bank can form only a *reasonable* belief that it knows the true identity of the customer.

It is therefore recommended that the concept ‘verify’ should be repealed from section 21 and that a definition for ‘establish’ should instead be inserted in FICA. The definition should read as follows:

‘to establish’ means to form a *reasonable* belief about the true identity of a customer.

In turn, the concept ‘reasonable belief’ should be defined in section 1 of FICA as follows:

‘reasonable belief’ means what a reasonably diligent and vigilant person might have believe having both the general knowledge, skill, training and experience that may reasonably be expected of a person in his or her position, and the general knowledge, skill, training and experience that he in fact has.¹⁷³

Ultimately, it should be kept in mind that assessing risk can never be an exact science because most of the transactions conducted for money laundering purposes appear normal. Currently, banks are required to have internal AML rules in place, the content of which is at the discretion of the bank.¹⁷⁴ It is therefore pivotal that banks are encouraged to devise individualised risk assessment protocols according to the products they offer and the risk profiles of their customers.

¹⁷¹ See paras C.5, F below.

¹⁷² Especially as regards international transactions where it is impossible for the bank to verify the underlying agreements between a customer and another party (*Bredenkamp* par 54).

¹⁷³ See section 1(3) of FICA on which the proposed definition is based.

¹⁷⁴ See par C.4.2.3.5 below.

When to Trace

Contemporary banking transactions leave paper as well as electronic¹⁷⁵ trails which in theory¹⁷⁶ should make it easy to establish who the originator and the beneficiary of the transaction is. For this reason section 21(2)(d) of FICA provides that a bank may not conclude a transaction unless it has traced all the accounts involved therein.¹⁷⁷ The idea is that a bank should be able to establish the legitimacy of a customer and the transaction by tracking the path of the money involved.

Elsewhere in the study¹⁷⁸ it was pointed out that the concept ‘tracing’ is sometimes confused in the literature with the concept ‘following’. To recap, ‘tracing’ is an English legal concept which refers to a process used by a claimant to establish what happened to misappropriated money. It supposes the identification of a *new* asset as a substitute for the original one and therefore involves asserting a ‘new title’ to money that has been substituted for the original funds.¹⁷⁹ Legally, tracing is the correct term to use in relation to deposited money because an account holder acquires a personal right to reclaim the value of a deposit from the bank as opposed to the actual notes and coins that were deposited.¹⁸⁰

In contrast, the concept ‘following’ implies a process of determining where a transaction originated from. It involves tracking money used in the transaction as the money is transferred from account to account and is aimed at verifying information obtained from the customer.

It is submitted that the tracing obligation of section 21(2)(d) was incorrectly formulated in FICA because legally tracing an account has a different purpose than following the money used

¹⁷⁵ See ch 2.B.2 as regards electronic banking.

¹⁷⁶ See, however, ch 4.C.4.3 as regards the use of encryption keys to launder money over the Internet.

¹⁷⁷ Of note, FICA is the only AML legislation discussed in this study which specifically requires that banks must trace the accounts involved in a transaction. It is likely that the legislator used the FATF’s Forty Recommendations as blueprint for FICA’s tracing obligation (see FATF *Forty Recommendations 1990* Recommendation 8; ch 5.B.3.3.2).

¹⁷⁸ See ch 1.B; ch 6.C.4.1 and ch 7.D.3.

¹⁷⁹ See ch 6.C.4.3, ch 7.D.3 where tracing as remedy is discussed.

¹⁸⁰ See ch 2.C.2, par C.4. Note that Sonnekus (*Ongegronde Verryking 2007* 146) argues that giving recognition to the English concept of ‘tracing’ in South African law is unnecessary because no need for it exists. However, it is submitted that there is no reason why our law should not import English tracing principles which have been used with success to recover the benefits of fraud or theft from a bank that receipted the funds (see ch 6.C.4.3).

in a transaction. For this reason it is recommended that section 21(2)(d) of FICA should be amended to read that banks must ‘follow all accounts’ as opposed to ‘trace all accounts’ involved in a transaction. For the purpose of section 21 the process of following money would be sufficient to establish information given by the customer to the bank. In short, when Parliament requires that banks assist with ‘tracing’ an account, it in actual fact requires that banks pinpoint the source of the money with a view of determining whether it was legitimately or illegally acquired.

To conclude, one can only imagine the time and effort spend by banks to observe the two identification-related obligations, especially in complex transactions that involve both national and international accounts. It is therefore submitted that satisfactory compliance to section 21’s obligations may never be obtained in transactions where foreign nationals and banks are involved.

4.2.3.3 Suspicious Transaction Reporting Obligation¹⁸¹

Following an evaluation of FICA’s content it is fair to describe the obligation to report suspicious and unusual transactions¹⁸² as being of paramount value to money laundering control. The reason for this premise is twofold.

First, all three types of institutions¹⁸³ to which FICA applies share the obligation to report certain transactions to the FIC. Secondly, the content of the reporting obligation determines whether a country is regarded by the international community as having adopted an Objective Model of Money Laundering Control or a Subjective Model of Money Laundering Control.¹⁸⁴ As a result of FICA’s reporting obligation, it is evident that South Africa akin to the US adopted a hybrid model of money laundering control that encompasses both elements of the Subjective

¹⁸¹ See section 29(1) of FICA; ch 3.B.2.3.3. The corresponding defence is given in section 7A(1) of POCA (see below). In the following evaluation I hope to illustrate that the greatest problem with filing a STR is that the meaning of ‘suspicious or unusual transaction’, ‘knowledge’ and ‘good faith’ are open to interpretation which is likely to sabotage the effectiveness of the provision.

¹⁸² The concept ‘transaction’ is defined in section 1 of FICA as a transaction concluded between a client and an accountable institution in accordance with the type of business carried on by that institution. See also *FIC Meaning of Transaction 2–5*.

¹⁸³ Namely businesses in general, reporting and accountable institutions (see par C.4.2.3.1 above; see also below).

¹⁸⁴ See par A above; ch 5.B.1–2.

Model of Money Laundering Control and the Objective Model of Money Laundering Control.

In line with international trends¹⁸⁵ the reporting obligation of FICA is a broad and onerous obligation requiring banks to file two types of transaction reports. This type of reporting is known as a ‘hybrid reporting system’ due to the combination of threshold and suspicion-based reporting that is created.¹⁸⁶ FICA establishes two types of reporting obligations. First, an obligation for all businesses¹⁸⁷ to report a transaction if it is *known* to involve, or *suspected* to involve the benefits of crime, or if it does not have an apparent lawful or business purpose.¹⁸⁸ Secondly, FICA creates additional reporting obligations for two designated groups of institutions, namely accountable institutions¹⁸⁹ such as banks and reporting institutions.¹⁹⁰ Section 76 of FICA empowers the Minister of Finance to insert additional reporting institutions to Schedule 3 of the Act if required to meet the objectives of money laundering control.

Accountable Institutions

Banks as accountable institutions¹⁹¹ have a broader reporting obligation as reporting institutions¹⁹² which are compelled to report only transactions involving cash¹⁹³ amounts in excess of a

¹⁸⁵ See ch 5.B.3.2–3.3, par B.3.4.3; ch 6.B.3.6, par C.3.4.2; ch 7.C.2.3–2.4, par C.3.2, par C.8.2.

¹⁸⁶ Itzikowitz (2001) *Annual Survey* 615.

¹⁸⁷ Therefore, any person who carries on, manages or is in charge of a business or employed by a business has a section 29-reporting duty.

¹⁸⁸ Section 29(1) of FICA; *FIC Transaction Reporting* 1.1. Transactions of this kind are designated in the Act as ‘suspicious and unusual transactions’. Reports to FIC must relate to the benefits of crime or to money laundering and not to unlawful conduct in general (cf *FIC Transaction Reporting* 2.7). For example, a bank employee who suspects that the purpose of a transaction is to evade payment to the creditors of a customer need not file a STR.

¹⁸⁹ The 19 institutions that are designated as ‘accountable institutions’ are listed in Schedule 1 of FICA (see par C.4.1 above).

¹⁹⁰ The two institutions that are designated as ‘reportable institutions’ are listed in Schedule 3 of FICA (see par C.4.1 above).

¹⁹¹ See Schedule 1 of FICA.

¹⁹² Note also section 30(1) of FICA which provides that a report must be filed by *any* person intending to carry cash in excess of the prescribed amount to or from South Africa (see also par D.4.3 below).

¹⁹³ Which concept is defined as (section 1) ‘(a) coin and paper money of the Republic or of another country that is designated as legal tender and that circulates as, and is customarily used and accepted as, a medium of exchange in the country of issue; (b) travellers’ cheques.’

prescribed amount.¹⁹⁴ In addition to the latter, banks must also report international money transfers in excess of a prescribed amount.¹⁹⁵ The two reporting obligations apply in addition to the bank's obligation to file STRs.

It follows that banks must report two types of transactions to the FIC, namely¹⁹⁶ cash transactions above the prescribed limit¹⁹⁷ and any suspicious and unusual transaction.¹⁹⁸ Instead of specifically referring to the standard of reasonableness¹⁹⁹ for determining when a transaction is suspicious, FICA identifies four kinds of transactions which must be reported. This is an original idea of Parliament and deserves special mention given that none of the AML legislation used in this study for comparative purposes has similar provisions.²⁰⁰ A reportable transaction include²⁰¹ a transaction which facilitate, or is likely to facilitate the benefits of crime; without a business or lawful purpose; which is construed to avoid reporting under the Act; and a transaction which may be relevant to an investigation as regards outstanding income tax payments. Six comments as regards tax payments and tax evasion are warranted.

First, tax evasion concerns the intentional avoidance of paying taxes to the government.

¹⁹⁴ This type of obligation is known as 'threshold reporting' or 'currency transaction reporting' (see ch 7.B.2, par C.2.3).

¹⁹⁵ See section 31 of FICA which refers to EFTs (see also par C.4.2.1 above).

¹⁹⁶ A section 29-report must be filed with the FIC as soon as possible, but not later than 15 business days after the bank became aware of facts as regards the basis of which a report must be filed (reg 24 of the AML Regulations). The report can be filed electronically via the Internet at the internet-based portal of the FIC (see <<http://www.fic.gov.za>> (2011.03.10)), sent via facsimile or delivered to the FIC in Pretoria (reg 23 of the AML Regulations; *FIC Transaction Reporting* 6.5).

¹⁹⁷ Section 28(a)–(b) of FICA.

¹⁹⁸ *Idem* section 29(1)–(2). The FIC lists a number of indicators to assist a bank to identify suspicious or unusual transactions (*FIC Transaction Reporting* 4.1). They make for interesting reading, probably for banks and criminals alike. For example, a transaction should be red flagged as suspicious or unusual. where the customer demonstrates knowledge about AML legislation and procedures, does not question the costs involves, does not have an identity document and is vague about the reason for the transaction.

¹⁹⁹ Note, however, that when section 29 is read together with section 52(2) of FICA it is evident that the standard of reasonableness will be used to determine the potential criminal liability of an employee who failed to file a STR (see below). Note further that in contrast to section 29, section 1(3) of POCA dictates use of the standard of reasonableness to determine when a person ought to have known or suspected a fact about a transaction.

²⁰⁰ See ch 6.B.3.6, par C.3.4; ch 7.C.2–8.

²⁰¹ Section 29(b)(i)–(iv) of FICA.

Secondly, income from both illegal and legal sources is taxable income.²⁰² Thirdly, there are several types of tax evasion offences, for example, making false statements or not reporting income on a tax return to the SARS.²⁰³ Fourthly, a criminal has to do something with his illegal income in order to hide it from the SARS. Criminals therefore launder illegally acquired money to make it appear as if it were acquired from a legitimate source which allows them to spend it in assets without having to worry about tax consequences.²⁰⁴ For this reason money laundering has a close relationship with tax evasion because it allows a criminal to profit from his criminal conduct. Fifthly, tax offences often predicate money laundering offences in AML legislation.²⁰⁵ For the aforementioned reasons transactions aimed at tax evasion are reportable.

But, sixthly, income that a customer lawfully receives cannot be laundered because it is not the benefits of a crime.²⁰⁶ Only that part of the income that is payable to the SARS is the object or benefit of theft and then only after the tax evasion was committed. For this reason FICA does not expect a bank employee to determine whether part of the money used in a transaction is payable to the SARS. Instead, he should report any transaction which appears unusual given the customer's profile. For example, consider the scenario where a bank employee knows that a customer is unemployed and does charity work on a part-time basis based on information that she gave the bank. The customer informs the bank that she is purchasing property and instructs it to handle the transport on her behalf. Since the customer's income and the transaction fail to correspond, the bank employee should file a STR report to the FIC.

Further, although the distinction in FICA between businesses in general and accountable institutions is sensible, it is submitted that the listing of 19 accountable institutions in Schedule 1 is superfluous. In this respect the EU's AML Directive is better arranged; it simply states that

²⁰² See gross 'income' as defined in section 1 of the Income Tax Act Income 58 of 1962, as amended ('Tax Act'); *MP Finance Group CC (in liquidation) v Commissioner for the South African Revenue Service* 2007(5) SA 521 (SCA) par 12 where Howie P found that illegally derived income is also taxable.

²⁰³ See section 75 of the Tax Act which lists 15 different offences.

²⁰⁴ See ch 4.B.2.1–2.2, paras C.1, E.2.

²⁰⁵ For example, pursuant to section 338 of the English PCA 2002 knowledge or suspicions about tax evasion must be reported to the NCIS (see ch 6.C.3.4.3.1) whilst tax evasion is listed as a specific unlawful activity in the US Money Laundering Control Act (see ch 7.C.3.2.1–C.3.2.2).

²⁰⁶ See the court's decision in *Seevnarayan* as regards money as the proceeds of a tax offence; par D.4.2.1.1 below.

the instrument applies to banks, financial institutions, non-financial institutions and businesses that carry out life insurance activities.²⁰⁷ It is therefore recommended that Schedule 1 should be repealed from FICA and that a definition for ‘accountable person’ should be inserted in section 1 of the Act which reads as follows:

‘**accountable institution**’ means banks as defined by the Banks Act 94 of 1990, financial institutions, non-financial institutions, businesses that carried out life insurance activities and persons who transact on behalf of customers.

The latter provision should be included to insure that any person that deals with money or currency on behalf of some other such as attorneys and money-lenders fall within the ambit of FICA as well.

Knowledge or Suspicion

FICA does not require the filing of STR only where a transaction is in actual fact carried out. Under section 29(2) a bank (employee) that *knows* or *suspects* that a transaction about which enquiries are made may have caused the consequences that would have rendered it suspicious or unusual must report that attempted transaction irrespective of the fact that the transaction was not concluded.²⁰⁸ Earlier, it was mentioned that FICA describes when a person is deemed to know a fact for the purposes of FICA.²⁰⁹ In this regard the required element of knowledge is deemed present in two situations.²¹⁰

First, where a bank employee actually *knows* that a transaction meets with the section 29-reporting requirements, or secondly, where it willfully turns a so-called ‘blind eye’²¹¹ to the fact.

²⁰⁷ See ch 6.C.3.4–3.6.

²⁰⁸ In terms of the FIC’s guidance notes a person must report his knowledge or suspicion about a transaction as soon as he becomes aware of something (FIC *Transaction Reporting* 2.1–2.2).

²⁰⁹ See par C.4.2.2 above.

²¹⁰ Section 1(2)(b) of FICA.

²¹¹ *Commissioner* par 46 (see below). Depending on the facts of a case a court may infer that a person had actual knowledge of the facts that were suspected. In addition, the court may impute knowledge of those facts to the accused. Significantly, in *Frankel Pollak Vindirine Inc v Stanton* ([1996] 2 All SA 582 (W)) the court ruled that a person who fails to inquire further when he has real suspicions about a situation may be deemed to have actual knowledge about the facts (596C–D). Therefore, real suspicions about the nature of a transaction demand that the person who is mandated to execute it, actively seeks to establish

In a ruling handed down more than 60 years ago the court succinctly remarked as follows in relation to the meaning of ‘knowledge’ as an element of the crime of receipt of stolen goods:²¹²

[k]nowledge is not confined to that mental state of awareness produced by personal participation in the theft or by information derived from the actual thieves, but includes also a conviction or belief engendered by the attendant circumstances ... On the other hand mere suspicion not amounting to conviction or belief is not knowledge.

The concepts ‘conviction’ and ‘believe’ therefore denote something more than a mere suspicion of a fact.²¹³ In turn, the concept ‘suspicion’ has been defined as follows:²¹⁴

[s]uspicion in its ordinary meaning is a state of conjecture or surmise where proof is lacking; ‘I suspect but I cannot prove’.

Since FICA requires a bank employee to report the grounds for the knowledge or suspicion as part of the report that has to be filed with the FIC,²¹⁵ it is fair to surmise that for a valid suspicion to exist some foundation or reasons will have to be present before an obligation to file a report will arise.²¹⁶ Unfortunately, there are no absolute rules to guide a bank as to when a suspicion

the actual facts prior to continuing with the execution thereof.

²¹² *R v Patz* 1946 AD 845 [*Patz*] 857.

²¹³ See also *FIC Transaction Reporting* 3-5-3.6. In *SVV Construction v Attorneys, Notaries & Conveyancers Fidelity Guarantee Fund* (1993 (2) SA 577 (C)) the court cleverly distinguished between the concepts ‘conviction’ and ‘suspicion’ as follows (585F-H): ‘[b]elieve or conviction connotes something less than certainty in the mind, but at least that which amounts to ‘mental acceptance of a proposition, statement or fact as true, on the ground of authority or evidence’ ... ‘conviction’ is ‘strong believe on the ground of satisfactory reasons or evidence’ ... just as this is more, considerably more, than mere suspicion (however well founded that suspicion may subsequently prove to be) so also is it stronger than an impression.’

²¹⁴ Per the Privy Council in the English case of *Shaaban Bin Hussein v Chong Fook Kam* [1969] 3 All ER 1627 (PC) 1630 which definition has been applied by our courts (see, for example, *Duncan v Minister of Law and Order* 1986 (2) SA 805 (A) 819I; *Minister of Law and Order v Kader* 1991 (1) SA 41 (A) 50H-J; *Isaacs v Minister van Wet en Orde* [1996] 1 All SA 343 (A) 348E-F).

²¹⁵ See section 29(2), section 32(2)-(3) of the Act; reg 23(6)(a) of the AML Regulations.

²¹⁶ In *Commissioner* the court agreed that suspicions as regards the benefits of crime are qualified by reasonableness (par 55 - cf Van der Westhuizen (May 2004) *De Rebus* 37; De Koker *Money Laundering* 3-11). The *Commissioner* case was decided pursuant to the reporting duty under the 1996 Act (see par C.2 above). The court made some crucial observations as regards the duty of banks to report suspicious account activity which are considered below. The salient facts of the case are the following: Absa Bank and Standard Bank were sued by SARS after both banks paid out VAT cash refunds to the amount of nearly 50 million rand within days of being deposited. SARS argued that Standard Bank

regarding the nature of a transaction is concrete enough to warrant a report.

In a ruling handed down before FICA came into effect the court held that it would be ‘repugnant to logic and law’ to expect a bank not to continue with a transaction after it has been satisfied that the transaction was not tainted by illegality.²¹⁷ In *Zamzar Trading* a customer claimed loss from Standard Bank which it suffered as a result of a fraudulent scheme in which it had participated. As submitted elsewhere in the study,²¹⁸ in a scenario similar to the latter, it is unlikely that the bank would be able to establish with certainty the fraudulent nature of the transaction even if it did investigate the source of the customer’s money and the nature of the transaction. This is because the perennial problem as regards the identification of the benefits of crime was not addressed by FICA or by any of the current money laundering control guidelines.²¹⁹

It is evident that banks find themselves in unfamiliar territory as regards the recognition of the benefits of crime and suspicious or unusual transactions. Clearly, when to file a section 29-report to the FIC is one of those ‘you will know it when you see it’ situations. It is submitted that banking experience and extensive customer profiling may assist a bank employee to recognise when a transaction is suspicious or unusual.²²⁰ The complexity of a particular transaction coupled

failed to identify the customer when the account was first opened whilst the account activity should have been alerted the bank. Absa Bank was sued because SARS alleged that it provided the documentation that was used to defraud it. The court agreed that the account activity and the large withdrawals should have made Standard Bank suspicious. In particular, the court reasoned that society’s idea of justice necessitated that a bank not turn a blind eye to the possibility that an account may be employed for criminal purposes (par 46). It is submitted that had the case being adjudicated pursuant to sections 21 and 29 of FICA, both defendant banks would have been more careful in allowing the account to be opened and in paying the money away. However, it is an open question whether the AML Regulations and the guidelines of the FIC would have prevailed so that the banks would have realised that the account was opened and used by criminals (see paras C.5, E.1 respectively below).

²¹⁷ *Zamzar Trading (Pty) Ltd (in Liquidation) v Standard Bank of SA Ltd* 2001 (2) SA 508 (W) [*Zamzar Trading*] 515B–D. See ch 3.B.2.2 for the facts of the case.

²¹⁸ See ch 3.B.2.2.

²¹⁹ Similar difficulties exist internationally as well (see ch 6.B.3.6, par C.3.4.3; ch 7.C.2–8).

²²⁰ In fact, the FIC recommends that bank employees consider various factors to ascertain whether a transaction is suspicious or unusual (*FIC Transaction Reporting* 3.6–3.8). These include, for example, the business, history, background and behaviour of a customer. It is submitted that the time and the effort which the FIC suggests a bank spend on this endeavour is unrealistic giving bank practice and the amount of transactions that are conducted on a daily basis. Indeed, it is likely that many transactions conducted for money laundering purposes and with the benefits of crime are completed on a daily basis despite the

with its purpose may further alert banks to potential money laundering scheme.

Section 52(2) of FICA criminalises the failure to file a STR. Section 52(2) provides that a bank employee who ‘*reasonably*’ ought to have known or suspected facts which necessitate a section 29-reporting obligation and ‘*negligently*’ fails to file a report, contravenes the provisions of FICA, and thereby commits a money laundering offence. This means that section 52(2) when read together with section 29 of FICA implies that a bank employee must file a STR in either one of two scenarios:

1. where he subjectively *believes* or *suspects* that a transaction must be reported and some grounds exist for that belief of suspicion; or
2. where he has grounds upon which another bank employee with his expertise would reasonably form such a *belief* or suspicion.

However, in contrast to section 52(2) of FICA, section 29(1) and section 29(2) fail to specify that reasonableness will be used as standard to determine the potential liability of a person who failed to file a STR.²²¹ This is an omission that should be rectified in order to clarify which standard will be used to determine liability for the contravention of sections 29(1) and 29(2) of FICA.

It is therefore recommended that section 29(1) and section 29(2) should be amended with the insertion of ‘reasonably’ before the phrase ‘knows of suspects’. The relevant part of the amended sections should read as follows:

Suspicious and unusual transactions

Section 29. (1) A person ... who [**reasonably**] knows or suspects ...

(2) A person ...who [**reasonably**] knows or suspects that a transaction.

Further in this regard, section 33 of FICA provides that a bank may continue with a transaction after it has filed a STR. This means that a bank that filed a STR and continues with the transaction may in actual fact be assisting the customer with laundering the benefits of crime. Since FICA does not recognise the aforementioned irony, it is recommended that section 33 of FICA should be amended so that it affords a bank respite from continuing with a suspicious transaction until the matter has been resolved by either the authorities or the judiciary. The amended section 33 should read as follows:

best intentions of the bank to control money laundering.

²²¹ Note that whilst section 330 of the English PCA specifies the use of a standard of reasonableness to determine liability, no standard is indicated in the EU’s AML Directive and the US AML statutes (see ch 6.C.3.4.3.1, par C.3.6 and ch 7.C.2.4, par C.3.2 respectively).

Continuation of transactions

33. An accountable institution ... may [not] continue with and carry out the transaction in respect of which the report is required to be made unless the Centre directs the accountable institution .. to proceed with the transaction.

The amendment will ensure that a bank does not find itself in two minds as regards whether to assist with money laundering control albeit indirectly, or whether to heed the customer's instruction.

In conclusion, the FIC may request a bank that filed a section 29-report to furnish it with additional information about the report in as far as the information can *reasonably*²²² assist the FIC to execute its duties.²²³ Importantly, the FIC may after deciding that *reasonable* grounds exist that a reported transaction involves the benefits of crime, direct the bank in *writing* to suspend the transaction until it has made further inquiries in the regard or obtained advice from the NPA or the SAPS.²²⁴ A bank that ignores its instruction contravenes FICA.²²⁵

How the bank should explain the situation to a customer without committing a tipping-off offence²²⁶ should be questioned. The bank could probably use internal banking procedures as the reason for its delay to execute the transaction provided that the delay is not unreasonable. However ultimately, the bank should not be blamed when the customer becomes wise to the fact

²²² The requirement of 'reasonableness' in this setting is likely to frustrate banks. Obviously, the FIC may decide on the amount of information it requires for investigative purposes which left a bank with little choice but to comply. Similar to banks operating in the EU, England and the US (see ch 6.B.2.2, par C.2.2; and ch 7.B.2.2 respectively), South African banks have a common-law duty to observe the confidentiality of customers (see ch 3.B.2.3). The statutory protection afforded by FICA to banks against, *inter alia*, civil liability pertains only to claims based on the filing of a STR. A bank that disclosed *additional* information about the affairs of a customer may still be sued by the customer who may contend that the information was not *reasonably* required by the FIC. So, a bank may decide to err on the side of caution and face the wrath of the FIC for its failure to provide the requested information instead of facing the possibility of civil action by the customer. In *First National Bank of Southern Africa Ltd v Perry No and others* (2001 (3) SA 960 (SCA) [Perry] par 18) the court advised banks to adopt an 'attitude of neutrality' whilst awaiting the outcome of legal proceedings (for the facts of the case, see par D.2.1.2 below). Likewise in *Nissan* - see paras D.2.1.2, D.2.3 below) the court advised banks to 'adopt the stance of a stakeholder' (par 28). It is submitted that this is a sensible attitude to assume in all money laundering related matters.

²²³ Section 32(2) of FICA.

²²⁴ *Idem* section 34(1); FIC *Transaction Reporting* 5.1–5.2.

²²⁵ Sections 57–58 of FICA.

²²⁶ See below.

that he is under investigation for potential money laundering.

Tipping-Off Offence

Suspicious or unusual transaction reports are confidential and may be disclosed only to designated institutions such as the SAPS or SARS.²²⁷ In addition, confidential information gleaned from these reports may be used only in certain circumstances and for certain purposes.²²⁸ A bank employee may not inform the customer that a STR was filed and that he is under investigation.²²⁹ This provision against so-called ‘tipping-off’ a customer is also included in the AML legislation of countries used in this study for comparison purposes.²³⁰

The rationale for the provision is self-evident; the obligation to report suspicious transactions is of not much use if the suspected money launderer is informed of the fact that he is under investigation. Therefore, the tipping-off offence usually occurs when a suspect receives information which could prejudice an investigation. For this reason banks must be cautious when providing information to the effect that a report about some suspicious transaction or account activity has been made.

Defences

FICA provides five defences to a charge of failure to file STRs under FICA.²³¹ The first four defences are available to a bank’s employees, directors or trustees when charged with failure to file a STR whilst the fifth defence may be used by any person who is required to file STRs such as the owner of a pawn shop.²³² The accused must establish first that he complied with the bank’s internal rules as regards the filing of STRs or secondly, that he reported the transaction

²²⁷ Section 40(1) of FICA.

²²⁸ Information held by the FIC may only be disclosed in the following circumstances: in terms of legislation, to promote the purposes of FICA, with the permission of the FIC, for the purpose of legal proceedings or pursuant to a court order (section 41(a)–(e) of FICA).

²²⁹ Section 60(2) (a)–(b) of FICA; *FIC Transaction Reporting* 5.8–5.10.

²³⁰ See ch 6.B.3.2, par C.3.4.3.3; ch 7.C.8.2.

²³¹ See section 52 and 69(a)–(c) of FICA and section 7A(2)(a)–(c) of POCA for a corresponding provision; *FIC Transaction Reporting* 5.11–5.13.

²³² See section 29(1) of FICA; above.

to the bank's money laundering reporting officer²³³ or thirdly, that he reported the transaction to his superior because the bank either does not have a money laundering reporting officer, or its internal AML rules were not made available to him and therefore he was ignorant as to the nature of the transaction and the procedure to follow.

The latter defence may impose a twofold criminal liability on the bank. First, for failing to make its internal AML rules available to employees, trustees, and directors and secondly, for failing to provide the necessary training as required by section 43 of FICA.²³⁴

As a fourth defence to a charge of failure to file a STR a bank employee may contend that he did not *know* or *suspect* that the customer was engaging in money laundering. He therefore failed to report the transaction which turned out to involve the benefits of crime or to facilitate money laundering. But, as was pointed out above, the bank's employee will be liable if he is found to have *reasonable* grounds for knowing or suspecting that the customer engaged in money laundering and neglected to file a report.

The fifth defence provided in FICA to a charge of failure to file a STR is captured by section 33 of the Act. Section 33 of FICA provides that a bank may continue with a transaction after filing a STR unless otherwise directed by the FIC. In this sense section 33 of FICA provides an incentive to banks to ensure STRs are filed. For example, a bank employee who filed a STR may already have committed a money laundering offence under POCA if he concluded the suspicious or unusual transaction.²³⁵ However, if the employee is subsequently charged with a money laundering offence he may raise as defence that he reported the transaction to the FIC pursuant to section 29 of FICA.

As pointed out elsewhere in the study,²³⁶ FICA also aims to provide protection to bank employees against liability emanating from filing a report pursuant to the Act. Section 38(1) of FICA contains the so-called 'safe-harbour'²³⁷ provision and states that no criminal or civil action may be filed against a bank that complies in *good faith* with the Act's reporting provisions. However, it is submitted that FICA's safe-harbour protection provides meagre protection to banks against civil suits filed by disgruntled customers. The reason concerns the good faith requirement

²³³ See paras C.4.2.3.3, C.4.2.3.5, C.4.3 below.

²³⁴ As read together with section 62 of FICA (see par C.4.2.3.5 below).

²³⁵ See sections 4(b), 5(b) of POCA; paras C.3.2, C.4.2.1 above.

²³⁶ See ch 3.B.2.3.4 as regards bank confidentiality and section 29 of FICA.

²³⁷ As it is known internationally (see ch 5.B.3.3.2, par B.3.4.3; ch 6.B.2.2, paras B.3.2, B.3.4, B.3.6, B.4.1.3, C.2.2, C.3.4.3.1; ch 7.B.2, par C.5).

of section 38(1) which may promote rather than prevent potential civil claims against the bank because a disgruntled customer can argue that a bank filed a STR with malicious intent.²³⁸ This potential quagmire of liability could have been avoided if Parliament omitted the *good faith* requirement in the provision, in which case the reporting bank would be fully protected against any potential liability emanating from filing a STR.

It is therefore recommended that section 38(1) of FICA should be amended in order to provide complete protection to banks that file STRs. The amended section 38(1) should correspond to the safe-harbour provision of the EU's 2005 AML Directive²³⁹ and should read as follows:

Protection of persons making reports

38. (1) No action, whether criminal or civil, lies against an accountable institution ... or any other person complying [...] with a provision of this Part ...

Internal Rules

The obligation of banks to file a section 29-report is closely connected with the fourth requirement of the KYC standard,²⁴⁰ namely that banks must provide sufficient training to employees in all aspects concerning money laundering control.²⁴¹ Not only can this obligation protect a bank from criminal liability pursuant to FICA,²⁴² but well-trained employees are an asset to a bank for reasons which are self-evident. It is therefore in a bank's best interest to have well-trained employees and easily accessible internal AML rules which inform its employees in writing about its internal AML measures and the procedures to follow.²⁴³

Regulation 27 of the AML Regulations requires that the internal rules of a bank should address specific aspects relating to the filing of STRs.²⁴⁴ The rules should further reflect the

²³⁸ This is also why the safe-harbour provision of the EU's 1991 AML Directive was amended by the 2005 AML Directive (see ch 6.B.3.6).

²³⁹ See ch 6.B.3.6 as regards the EU's 2005 AML Directive's safe-harbour provision.

²⁴⁰ As to which, see ch 5.B.3.4.5.

²⁴¹ See section 43 read together with section 62 of FICA; par C.4.2.3.5 below.

²⁴² See above; section 69(c)(ii) of FICA.

²⁴³ See section 42(3); Bester (2002) *De Rebus* 23–24.

²⁴⁴ For example, procedures geared towards filing a STR, training to enable employees to recognise suspicious transactions, management's responsibility in relation to compliance with FICA, internal AML rules and other AML industry measures, allocation of responsibility to ensure compliance with FICA and disciplinary measures to be taken against employees for non-compliance with the Act and the bank's internal AML rules.

guidance notes of the FIC.²⁴⁵ For this reason it is vital that a bank employs a money laundering reporting officer²⁴⁶ who not only ensures that the content of the bank's internal AML rules conform with national and international standards, but also monitors internal compliance to these rules.

4.2.3.4 Record-Keeping Obligation

The third KYC standard requirement concerns record-keeping. The preservation of records in relation customers and transactions is an important part of money laundering control for two reasons. First, records kept in terms of statutory provisions are admissible to court as an exception to the hearsay rule, thus limiting problems relating to the admissibility of evidence in the event of a criminal trial.²⁴⁷ Secondly, the authenticity of such records is unlikely to be challenged because they stemmed from ordinary banking business.

Pursuant to FICA banks are required to keep records which identify who the customer is in every transaction, how his identity was established, the nature of the business relationship and the number of accounts held by the customer.²⁴⁸ Records must be kept in electronic format five years. In addition, records originating at different branches of the same bank group must be centralised to enable access.

4.2.3.5 Training Obligation

Section 43 of FICA requires that banks educate their employees to comply with the Act and the internal AML rules of the bank. Failure to observe FICA's training obligation is not only an offence, but may also be raised as a defence by an employee charged with a money laundering offence.²⁴⁹ An employee of a bank when charged with a reporting offence may defend himself by countering that the bank failed to adequately train him to comply with the provisions of FICA

²⁴⁵ To date FIC has not yet issued guidance notes pertaining to the training of employees. This is probably due to the fact that sufficient training opportunities exist within the banking sector (see par C.4.2.3.5 below).

²⁴⁶ See paras C.4.2.3.5, C.4.3 below.

²⁴⁷ Section 25 of FICA.

²⁴⁸ See sections 22(1)(a)–(i), 22(2), 23, 26 of FICA.

²⁴⁹ Section 43(a) read together with section 62 of FICA.

or the bank's internal AML rules.²⁵⁰ It follows that it is in a bank's best interest to train its employees as required by FICA.²⁵¹

International AML legislation compels banks to appoint a person to ensure internal compliance to their AML measures.²⁵² This so-called 'money laundering reporting officer'²⁵³ must be a senior officer within the bank whose duty includes receiving STRs from fellow employees and keeping abreast with the newest money laundering schemes.

FICA provides in general terms for the appointment of a person whose main responsibility is to ensure compliance of AML measures by both fellow employees and his employer, the bank.²⁵⁴ This person is tasked with evaluating, preparing and where good cause exists, report suspicions transaction reports to FIC. Due to the descriptive nature of the concept 'money laundering reporting officer', it is suggested that the concept should likewise be assumed by FICA. It is therefore recommended that the concept 'person' used in section 43(b)(i) of FICA should be replaced with the concept 'money laundering reporting officer'. The reason for the suggested amendment is twofold. First, to update this provision of FICA according to international trends and secondly, to ensure that there are no doubts as regards the obligations of the appointed person.

It is imperative that South African banks annually review the effectiveness of the training offered to employees. Indicators, for example, the quality of KYC standard compliance, level of understanding by staff and the interaction taking place during training systems should be judged

²⁵⁰ See section 43(a) of FICA; par C.4.2.3.3 above.

²⁵¹ A recent AML report suggests that face-to-face training of staff is the most effective way to ensure that get the message across to employees that money laundering is an existing and prevalent issue (KPMG *Global Report-2007* 41). Training should be continuous and follow-up courses should be offered. At present, there are four institutions that offer money laundering compliance training in South Africa. They include the Compliance Institute of South Africa which is an association for compliance professionals (see <<http://www.compliance-sa.org>> (2011.03.10)), and the Money Laundering Forum which was founded in 1995 for the purpose of fostering understanding about money laundering and AML control. The Reserve Bank and the Institute for Security Studies also provide AML training.

²⁵² See ch 5.B.3.2.4 ; ch 6.B.3.6, par C.3.4.3.1; ch 7.C.8.3.2.

²⁵³ Which is the concept used by the English AML Regulations and the AML rules of the Financial Services Authority (see ch 6.C.3.4.3.1).

²⁵⁴ Section 43(b)(i)–(ii) of the Act. Note that reg 49(2) of the Regulations Relating to Banks of 2008 (GG 30629 of 1 January 2008) likewise compels banks to have an internal compliance officer in place to guard against money laundering. As regards the duties of a money laundering reporting officer, see idem reg 49(4); Bester (2002) *De Rebus* 24.

by the bank to establish the strength of its training programmes.²⁵⁵ Banks could use these indicators to enhance their internal AML training programmes and to widen the ambit of their internal AML control systems.

4.3 Auxiliary Provisions

FICA empowers various supervisory bodies to oversee compliance with its provisions by accountable institutions under their control.²⁵⁶ Although banks are supervised by the Reserve Bank, failure to comply with FICA's provisions may result in administrative sanction by either the FIC or the Reserve Bank.²⁵⁷ In determining an appropriate administrative sanction the FIC (or the Reserve Bank) are required to consider the nature of the bank's offence; whether it has a history of non-compliance; any steps it has taken to prevent recurrence of the offence; and any mitigating factors that may exist. Ultimately, the bank may be cautioned, reprimanded or ordered to take remedial action. Its activities may further be suspended or it may be fined or prosecuted for the violation of FICA's provisions.

Two remarks as regards FICA's administrative sanctions will suffice. First, section 45A to section 45F were newly inserted in FICA in 2008 by the Amendment Act. In this regard FICA simulates the US AML statutes²⁵⁸ which provide both administrative and criminal sanctions²⁵⁹ for non-compliance with AML obligations. Clearly, the US experience in AML matters taught that the value of administrative sanction in addition to criminal prosecution should not be underestimated.

Secondly, it is submitted that administrative sanction has corrective value in the sense that a bank is afforded an opportunity to rectify its conduct before prosecution is pursued. It may be assumed that prosecution for a money laundering offence would be pursued by the authorities only after administrative sanctions have failed. It is therefore further submitted that administrative sanction should be hailed by banks because it both presents an alternative to being prosecuted for

²⁵⁵ KPMG *Global Report-2007* 42.

²⁵⁶ See Schedule 2 of FICA. Some of these bodies include the Financial Services Board and the Law Society of South Africa.

²⁵⁷ Section 45C(1)–(2) of FICA.

²⁵⁸ See ch 7.C.3, par C.8. In contrast, sections 324 of the English PCA imposes only criminal sanctions for money laundering offences (see ch 6.C.3.4.2).

²⁵⁹ The penalties for money laundering are a fine not exceeding 100 million rand or imprisonment for a period no exceeding 15 years (section 68(1)–(2) of FICA).

a money laundering offence and provides banks with an opportunity to redress the conduct concerned.

What may be deducted from this rather lengthy analysis of FICA's provisions? Simply that banks must know with whom they are conducting business with. As it is impossible to know with certainty where a customer's money is originating from, banks should consider implementing as part of their internal AML measures customer due diligence measures which focus more on the background of a customer rather than on *pro forma* procedures. The best example in this regard presents in the form of the EU's 2005 AML Directive.²⁶⁰ For this reason the implementation of simplified and enhanced customer due diligence measures in FICA is recommended.

These customer due diligence measures should further serve a two-fold purpose. First, banks will be in a position to test the waters so to speak in an effort to determine which measures are conducive to procure customer information with the least cost implications for the bank. Secondly, by experimenting with customer due diligence measures banks will not only be directly involved in empirical research in this area of money laundering control, but will also contribute directly to South Africa's AML effort. Ultimately, Parliament must be convinced that inserting into FICA a provision that requires simplified and enhanced customer due diligence measures will greatly improve money laundering control in South Africa.

It is further evident that the FIC's AML guidelines do little to protect the interests of banks. This is probably because they are intended to elaborate on FICA's provisions and not to clarify the AML duties of banks. It is submitted that this outcome is unintentional because banks are only one of the 19 accountable institutions to which FICA apply. It is therefore understandable that any guidance coming from the FIC would be phrased in general terms only. For this reason it is recommended that banks should assume leadership and generate their own AML rules which not only promote compliance to FICA, but also serve their specific interests and the interests of their customers.²⁶¹

In summary, it is submitted that FICA should serve a threefold purpose in relation to money laundering control and banks. First, it should protect the banking system against criminals

²⁶⁰ Cf ch 6.B.3.6.

²⁶¹ An example in point is the submissions made by the Law Society of South Africa to the Portfolio Committee on Finance which specifically delineated the AML challenges face by attorneys (see SA Law Society *FICA-2008*).

and the benefits of their criminal conduct.²⁶² Secondly, the Act should guard banks against potential criminal liability by requiring adoption of stringent yet reliable and practical AML measures. Thirdly, FICA should provide sufficient guidance to banks in identifying the benefits of fraud or theft in order to escape subsequent civil liability to a victim of fraud or theft.²⁶³ Whether FICA has achieved or is likely to achieve these lofty goals is considered at the end of the chapter.

5. Money Laundering and Terrorist Financing Control Regulations²⁶⁴

The AML Regulations were enacted in terms of section 77(1)(b) of FICA and came into operation on 1 July 2003. Their gist is encapsulated in FICA's section 21; accountable institutions²⁶⁵ are prohibited from conducting business with *unidentified* clients.²⁶⁶

It follows that the AML Regulations comprise guidelines which inform banks, *inter alia*, how to accurately identify specific categories of customers.²⁶⁷ Regulation 18 requires that a bank takes reasonable steps to verify the identity of a natural person when establishing a non-face to face business relationship with him.²⁶⁸ The AML Regulations also set forth the manner in which section 29-reports must be filed and the type of information that should be disclosed.²⁶⁹

Content-wise it is evident that the AML Regulations are suppose to represent the more practical component of FICA. While this can be appreciated, it is rather disappointing that the

²⁶² As to which, see ch 4.E.4.

²⁶³ As to which, see paras D.2–3 below.

²⁶⁴ Elsewhere in this study (see ch 6.C.3.5; ch 7.C.9), the point was made that no purpose is served by analysing the AML Regulations in detail because key provisions should be appraised against relevant statutory provisions. The same method was followed in the foregoing paragraphs (see paras C.4.2.3.2–4.2.3.5 above). For this reason this section sets forth only a few additional remarks about the AML Regulations.

²⁶⁵ See par C.4.1 above.

²⁶⁶ See par C.4.2.3.2 above.

²⁶⁷ See, for example regs 3–19 which list different particulars that must be established for different types of customers.

²⁶⁸ For example, where a business relationship is established solely via the Internet (for the money laundering schemes over the Internet, see ch 4.D.4.3).

²⁶⁹ See regs 22–23 of the AML Regulations respectively. In short, some of the information included in a report must describe the reporting institution, the suspicious transaction and the account concerned, the person mandating the transaction and general data such as the availability of documentary proof and reasons for the suspicion.

AML Regulations appear merely to copycat other similar AML Regulations²⁷⁰ instead of addressing some of the practical dilemmas that banks experience in the face of the KYC standard obligations.²⁷¹ It is unfortunate that Parliament let the opportunity pass to make an original contribution to the AML effort.

It is not that the AML Regulations are unimportant. The AML Regulations are important because they elaborate on FICA's KYC standard obligations. However, their conventional content should be rethought, especially in light of the potential civil liability that may be imposed on a bank as a result of its failure to identify both a potential money launderer and the benefits of crime.

For this reason it is recommended that the content of regulations 2 to 19 (customer identification) of the AML Regulations be rearranged according to instances where simplified or enhanced customer due diligence are required akin to the EU's AML Directive.²⁷² An amendment of this kind should not only protect a bank against prosecution for a money laundering offence, but may further prevent civil a victim of fraud or theft from filing a civil claim against a bank as the recipient of the benefits of the fraud or theft. It is to this issue that the analysis now turns.

D. CIVIL REMEDIES

1. Introduction

The research objectives in this section remains the same as the ones explored elsewhere in this study. This section is therefore divided into two sections.²⁷³ The position that is considered first is that of a person who fell prey to fraud or theft²⁷⁴ and seeks to claim loss from the bank that

²⁷⁰ See ch 6.C.3.5; ch 7.C.9.

²⁷¹ For example, the extent to which a person's identity should be established, the amount of information to include in the report, the differences between filing a report in good faith and filing it maliciously and when to approach the court for guidance (see also par C.4.2.3.3 above).

²⁷² See ch 6.B.3.6. where the 2005 Directive's customer due diligence provisions are considered.

²⁷³ See ch 6.B.4.1, par C.4.1; ch 7.D.1.

²⁷⁴ Note that since the FATF recognised theft and fraud as major profit-generating crimes in South Africa (FATF *SA Report-2009* 3), the scope of this investigation has been limited accordingly.

received the benefits of the fraud or theft. Consider the scenario where Y misappropriated money from his employer, an attorney, who held the funds in trust for various clients. Y deposited the stolen money with a bank. The clients as victims of theft followed the money to the bank only to learn that Y's account has been closed and that his whereabouts are unknown.²⁷⁵ As a result, the victims seek to hold the bank liable as former recipient of the stolen money.

Whether they will be successful in this endeavour is explored first in this section. In this regard the court made the following prediction:²⁷⁶

[w]hilst society may morally condemn a bank's failure to report its suspicions (about the transaction), I do not believe that society's legal convictions demand that (the bank's) failure to do so ... would be branded as wrongful and that retribution would be exacted from the bank by holding it liable for loss suffered by the plaintiffs.

Legal precedents of other jurisdictions used in this study for comparative purposes proved this statement incorrect.²⁷⁷ In particular, it is evident that at English common-law a victim of fraud or theft may under certain circumstances claim loss suffered from the bank which received the benefits of theft and paid it to the fraudster or thief.²⁷⁸ The claim against the bank will be based on equitable principles.²⁷⁹ In addition, the fact that the English bank filed a STR about the transaction will be used by the victim-claimant to establish the required knowledge on the side of the bank. In this sense English AML legislation exposes the bank to civil liability.

FICA, to paraphrase the court in *Commissioner*,²⁸⁰ was not designed for the purpose of assisting a victim of fraud or theft to recover loss from a bank which received the benefits of fraud

²⁷⁵ It stands to reason that if the stolen money was still in the account the clients first should have approached the court for an injunction to prevent the dissipation thereof (see par D.4.5 below) and thereafter proceeded with a civil action against Y (see below for the grounds of the claim). Under these circumstances the bank should adopt the position of a stakeholder whilst the court decide the ownership of the deposited funds (*Perry* par 18; *Nissan* par 28).

²⁷⁶ *Commissioner* par 59. See also par C.4.2.3.3 above.

²⁷⁷ See ch 6.C.4.2.

²⁷⁸ See ch 6.C.4.1–4.2.

²⁷⁹ See in this regard Smith [2000] *LQR* 426 n58; Millett (1991) *LQR* 71; *AG for Hong Kong v Reid* [1994] 1 AC 324 where the court reasoned that it is seldom possible to hold a fraudster or thief liable because the latter usually has disappeared to 'some Shangri La' leaving the bank to account for the benefits of fraud or theft (339). See also Sonnekus ((2001) *J for Juridical S* 113–114) who explains why English courts allow victims of fraud or theft to claim loss from a bank which received the benefits of fraud or theft in instances where unjust enrichment principles usually are not applicable.

²⁸⁰ Par 59. Note that the court made a similar remark in reference to the purpose of the now repealed 1996 Act (see par C.2 above).

or theft and parted with the money. It is therefore necessary to turn to the common-law to ascertain whether it can avail a victim of fraud or theft to recover loss suffered from the bank which received the benefits of fraud or theft from the account holder who is a fraudster or thief.

The second part of this section considers civil forfeiture as a statutory common-law remedy used by the state to redress criminal conduct. It is an apposite remedy to use where deposited funds constitute the benefits of crimes such as corruption and drug trafficking which render the identification of obvious victims who suffered loss due to the criminal activity factually impossible. As a result, the state will commence civil forfeiture proceedings against the criminal account holder.

In contrast, a victim of fraud or theft who follows the benefits of the fraud or theft to the fraudster or thief's bank account only to discover that the money is the subject of civil forfeiture proceedings will need to establish his interest in the funds *vis-à-vis* the interest of the state. The section questions whether POCA offers adequate protection to a victim where fraudulently acquired or stolen funds which the victim followed to a bank account are the subject of civil forfeiture proceedings.²⁸¹

Since the notion of ownership is threaded throughout the section²⁸² it may be convenient to restate²⁸³ two fundamental principles in this regard. First, ownership confers to a person comprehensive rights to use and enjoy his property. Secondly, ownership does not pass in the absence of a clear *intention* between the parties.²⁸⁴ It follows that there can never be a meeting of minds so to speak between a fraudster or a thief and the victim of the fraud or theft to transfer the fraudulently acquired or stolen money to the former. In contrast, the bank acquires ownership of the money as soon as it is deposited into a bank account.²⁸⁵

A bank as recipient of deposited benefits of fraud or theft may become embroiled in civil litigation instigated by the victim of fraud or theft in two scenarios. First, the victim followed the benefits of fraud or theft to the fraudster or thief's bank account and obtained an interdict against the bank to prevent it from dealing with the money until the issue of ownership has been

²⁸¹ See par D.4 .3 below.

²⁸² Note, a person may only vindicate property if ownership thereof did not pass to some other person (see par D.2.1.1 below).

²⁸³ See also ch 3.C.2.

²⁸⁴ See *Van der Merwe and another v Taylor NO and others* 2007(11) BCLR 1167 (CC) [*Van der Merwe*] paras 42–43 (see par D.2.1.2 below); *Nissan* par 24; *Chong Sun Wood Products Pty Ltd v K and T Trading Ltd and another* 2001 (2) SA 651 (D) 656I–J.

²⁸⁵ See ch 3.C.3.1–3.2 as regards a bank's ownership of deposited money.

adjudicated.²⁸⁶ Secondly, if the fraudster or thief absconded with the benefits of fraud or theft before the victim can obtain an interdict, the victim may turn to the bank in an attempt to recover his loss. This section investigates whether the common-law remedies for the protection of ownership are likely to avail a victim of fraud or theft against the bank under the aforementioned circumstances.

Traditional common-law remedies for the protection of ownership can be divided into three categories, namely:²⁸⁷

1. remedies which concern the law of property such as the *rei vindicatio*, *quasi-vindictory action*, *actio Pauliana* and interdicts;²⁸⁸
2. delictual remedies such as the *actio legis Aquilliae*, *actio ad exhibendum* and the *actio furtiva*;²⁸⁹ and
3. restitution remedies based on unjust enrichment which may be instituted against a person who has been unjustly enriched.²⁹⁰

Since there is no contractual relationship between a victim of fraud or theft and the bank which received the benefits of the fraud or theft and further no basis for a delictual claim against the bank, only the first category and the third category of remedies above are relevant to this investigation. The crux of this section is whether South Africa's common-law together with POCA can redress the consequences where criminals use banks to launder money in a similar fashion as its English and US counterparts.²⁹¹

2.1 *Rei Vindicatio*

2.1.1 General Principles

²⁸⁶ See par D.2.3 below.

²⁸⁷ Henning & De Koker *South Africa* 2/1–2/2.

²⁸⁸ Of significance, these remedies are used solely to recover property as opposed to loss suffered as a result of property deprivation.

²⁸⁹ These remedies become relevant when the owner of property suffered loss because his property has been stolen, damaged or destroyed by the defendant (see in general Sonnekus (2001) *J for Juridical S* 108–109).

²⁹⁰ See paras D.3.1–3.4 below.

²⁹¹ See ch 6.C.4.2–4.3 and ch 7.D.2–3 respectively.

As a result of the common-law dictum *ubi rem meam invenio ibi vindico*²⁹² persons deprived of their property may seek to recover it with the *rei vindicatio*. The *rei vindicatio* is fundamentally an ownership remedy aimed at the recovery of loss of possession. It is further a legal action by which the plaintiff demands that the defendant returns property belonging to him.

The *nemo plus iuris* rule, which means that no one can transfer more rights to property to someone else than what he himself has, also comes into play.²⁹³ The *rei vindicatio* may be used only where a plaintiff owns the property in issue and the defendant has impeded his possession. In *Dreyer and another NNO v AXZS Industries (Pty) Limited*²⁹⁴ the court explained as follows:

[a] party who institutes the *rei vindicatio* is required to allege and prove ownership of the thing. Since one of the incidents of ownership is the right to possession of the thing, a plaintiff who establishes ownership is not required to prove that the defendants' possession is unlawful. In that event, the onus to establish any right to retain possession will rest on the defendant, as long as the plaintiff does not go beyond alleging ownership.

The cause of action is twofold, namely the plaintiff's ownership of the property coupled with the defendant's *possession* of thereof.²⁹⁵ There are three general prerequisites that a plaintiff must satisfy before he can succeed with an action based on the *rei vindicatio*.²⁹⁶ First, he must have ownership or co-ownership of the said property. Secondly, the property must still exist and it must be clearly identifiable.²⁹⁷ Significantly, money may be vindicated only if it is '[i]dentifiable with or earmarked as a particular fund to which the (plaintiff) is entitled'.²⁹⁸ Thirdly, the

²⁹² Which means 'wherever I am finding my property I assert my claim to it' (see in general Hahlo & Kahn *Union of SA* 580–582; Pretorius (2004) *SA Merc LJ* 2469–472; Du Toit *Dematerialisasie van Geld* 12–15; Badenhorst *Law of Property* 225–239; Malan & Pretorius *Malan on Bills* 43–44; Sonnekus (2001) *J for Juridical S* 108,113,116–119).

²⁹³ See ch 2.C.1.3, par C.4.2 where ownership rules in relation to money is considered. The *nemo plus iuris* rule is based on the fact that a *bona fide* acquirer of money such as a bank obtains ownership in the physical notes and coins.

²⁹⁴ 2006 (5) SA 548 (SCA) [*Dreyer*] par 4.

²⁹⁵ *Goudini Chrome Pty (Ltd) v MCC Contracts (Pty) Ltd* 1993 (1) SA (A) [*Goudini Chrome*] 81–82; *Jeena v Minister of Lands* 1955 (2) SA 380 (A) 382F–H; *Krugersdorp Town Council v Fortuin* 1965 (2) SA 335 (T) [*Fortuin*] 336B–E.

²⁹⁶ *Van der Merwe* par 114.

²⁹⁷ *Sorvaag v Petterson and others* 1954 (3) SA 636 (C) 639G, 641B; *SA Hyde (Pty) Ltd v Neumann NO and another* 1970 (4) SA 55 (O) [*SA Hyde*].

²⁹⁸ *SA Hyde* 61; *Unimark Distributors (Pty) Ltd v Erf 94 Silvertondale (Pty) Ltd* 1999 (2) SA 986 (T) [*Unimark*] 996C–D, 1011A–B.

defendant must have possession of the property at the time of *litis contestatio* or when the action is instituted.²⁹⁹

In *Mehlape v Minister of Safety and Security*³⁰⁰ the court held that legal claims based on the *rei vindicatio* must always relate to physical control being exercised by the defendant over the object concerned when proceedings are instituted. Where property was unlawfully acquired and cannot be recovered, the owner may bring a personal action to recover its value from a person who received it with *knowledge* of the tainted title.³⁰¹

Onus of proof is important in a claim based on the *rei vindicatio*. The plaintiff is required to establish both ownership of the property³⁰² and that the defendant has it in his possession.³⁰³ Establishing ownership of property requires that the physical and mental elements of ownership must be established.³⁰⁴ Both the facts of the case and relevant legal principles are crucial to the inquiry. Once the plaintiff's ownership of the property has been established the defendant in turn must prove his right of retention of the property against the plaintiff as owner thereof otherwise the defendant will be unable to retain it.³⁰⁵ The success of a claim based on the *rei vindicatio* is further determined by facts that existed at the time the action was instituted.³⁰⁶ In *Mehlape* the court explained as follows:³⁰⁷

[t]he *rei vindicatio* is not instituted in respect of an act that has been performed; it is instituted in respect of a factual situation pertaining at the time of the institution of the legal proceedings.

²⁹⁹ *Chetty v Naidoo* 1974 (3) SA 13 (A) [*Chetty*] 20C; *Vulcan Rubber Works (Pty) Ltd v South African Railways and Harbours* 1958 (3) SA 285 (A) [*Vulcan Rubber Works*] 297E; *Unimark* 995I–996D.

³⁰⁰ 1996 (4) SA 133 (W) [*Mehlape*] 136G.

³⁰¹ *Hahlo & Kahn Union of SA* 582. See further below as regards conversion.

³⁰² *Motloun v Rokhoeane* 1991 (1) SA 708 (W) 716G–H; *Van der Merwe* par 114.

³⁰³ In *Chetty* the court found that where a plaintiff went beyond alleging his ownership and the defendant's possession of the property in issue, other considerations came into play (*idem* 20A). This ruling was confirmed in *Bekker and another v Jika* 2003 (1) SA 113 (SCA) par 46.

³⁰⁴ *Dreyer* par 17.

³⁰⁵ *Fortuin* 336A–337B; *Unimark* 996C–D.

³⁰⁶ *Vulcan Rubber Works* 289; *Mehlape* 136B–E; *Unimark* 1011A–B. Similarly, any defence to a *rei vindicatio* action must be established at the time the action is launched otherwise it will be invalid (*Van der Merwe* paras 98–99).

³⁰⁷ *Mehlape* 136B–C.

After the plaintiff has established ownership in the property, the defendant who has it in his possession, must return it unless he can demonstrate why it should not be returned to the plaintiff.³⁰⁸ If the defendant is unable to return the actual property to the plaintiff who has successfully vindicated it the equivalent value must be returned.³⁰⁹

From the aforementioned principles, it may appear that using the *rei vindicatio* to vindicate benefits of fraud or theft that were deposited with a bank by the fraudster or thief is a straightforward exercise provided that the victim of fraud or theft can establish its requirements as spelt out above. In *Perry* the court explained as follows:³¹⁰

[i]t might seem a simple thing to recover stolen money from one found in possession of it. But the matter is complicated by the rule in our law, an inevitable rule it seems to me, flowing from physical reality, that once money is mixed with other money without the owner's consent, ownership in it passes by operation of law.

Money is therefore an exception to the well-established *nemo plus iuris* rule.³¹¹ Consider the scenario where a creditor clerk employed at an attorney's office embezzled cash from her employer over a period of two months. She used some of the stolen cash to settle her credit card debt at X Bank. The attorney followed the stolen money to the employee's bank account and discovered that although the whereabouts of the employee are unknown, part of the stolen amount of money was left in the account. As a result, the attorney obtains an interim interdict to prevent further dissipation of the funds³¹² and thereafter instigates action based on the *rei vindicatio* against X Bank as recipient of the stolen funds for payment thereof.

It is submitted that the attorney's claim against X Bank based on the *rei vindicatio* will be unsuccessful, mainly because X Bank became owner of the stolen money as soon as it was deposited in the clerk's account with X Bank. Secondly, since the stolen money commingled with other money in the clerk's account, it is unidentifiable *in specie*. Whether a quasi-vindictory action will avail the attorney to recover the balance of the stolen money is considered next.

³⁰⁸ *Unimark* 1000B-1001I. In this matter, the court found that the defendant's liability had to be determined and judged within the context of all the relevant facts.

³⁰⁹ *Unimark* 996E. See also *Mlombo v Fourie* 1964 (3) SA 350 (T) 358B-D; *Standard Bank of SA Ltd v Stama (Pty) Ltd* 1975 (1) SA 730 (A) 741C-F.

³¹⁰ *Perry* par 16. The court found that the *rei vindicatio* as ownership remedy did not lie against Nedbank. See also the *Nissan* case as regards stolen money (see ch 3.B.2.1.2.2).

³¹¹ See ch 2.C.1.3, par C.4.2 where ownership rules in relation to money is considered.

³¹² See par D.2.3 below for the requirements of an interim interdict.

2.1.2 Quasi-Vindictory Action

As illustrated in the foregoing evaluation, a victim of fraud or theft is likely to experience two main difficulties with using the *rei vindicatio* to recover the benefits of fraud or theft which the fraudster or thief deposited with a bank. They are:

1. ownership; and
2. the identifiability of the money concerned.³¹³

Since a bank acquires ownership of all money, even the benefits of fraud or theft, that is deposited with it, a victim of fraud or theft will be unable to establish ownership of the deposited benefits.³¹⁴ The second difficulty is presented by the fact that as soon as the fraudster or thief deposited the benefits of fraud or theft with the bank, the money commingles with other moneys of the bank which renders its identification *in specie* impossible.³¹⁵

For this reason the courts have recognised a so-called quasi-vindictory action which is a useful remedy where money claimed is not the same notes and coins which were stolen or fraudulently acquired from the victim.³¹⁶ The action is quasi-vindictory because money that was deposited into a bank account belongs to the bank and, therefore, the victim does not owe it.³¹⁷ However, the vindictory-part of the claim exists in that the money was fraudulently acquired or stolen from the victim of fraud or theft.³¹⁸ In contrast to the *rei vindicatio* where the victim must establish ownership to the benefits in issue, he can use a quasi-vindictory action to claim money

³¹³ See par D.2.1.1 above.

³¹⁴ See ch 2.C.1.3, par C.4.1–4.2; ch 3.C.3.1–3.2.

³¹⁵ *Ibid.*

³¹⁶ See in general *Kerbyn 78 (Pty) Ltd Van Den Heerden and others NNO* 2000 (4) SA 804 (W) [*Kerbyn*]; *Fedsure Life Assurance Co Ltd v Worldwide African Investment Holdings (Pty) Limited & Others* 2003 (3) SA 268 (W) [*Fedsure Life*] 278B–D, 279H; *Pipe Makers (Pty) Limited v Sash Consultants CC and others* Unreported case no 14185/2008 [*Pipe Makers*]; *Van Woudenberg* 114.

³¹⁷ *Piper Makers* par 33. The matter concerned 21 stolen cheques which a fraudster deposited in Sash Consultants' ('Sash') account with Standard Bank. Pipe Makers, whose cheques were stolen, acquired an interim interdict against Standard Bank and Sash to prevent them from dealing with the money which the bank collected (paras 1–2). In the present case Sishi J had to decide whether to grant a final interdict to preserve funds in Sash's account pending an action by Pipe Makers to recover the fraudulently acquired 700 000 rand. Sishi J granted the order and found that Pipe Makers has established a *prima facie* right to 700 000 rand in Sash's account (paras 36–37).

³¹⁸ *Piper Makers* par 33.

that he has right to possess.³¹⁹ It follows that where a fraudster or thief deposited the benefits of fraud or theft with a bank, the latter's ownership of the money will not present an impediment to the victim of the fraud or theft's claim.

In *Van Woudenberg* the court explained that a plaintiff is entitled to a remedy not only where the property concerned has been established, but also where its proceeds are in the defendant's possession.³²⁰ It observed that any other finding would be '(an) unjustifiable nicety and refinement'.³²¹ However, there must be a clear connection between the converted property and its proceeds which is the subject of the claim. In *Kerbyn*, a case which concerned an application for an interdict to prevent alienation of a business's assets, Nugent J explained as follows:³²²

[w]hat is important to bear in mind is that the remedy ...is quasi-vindictory in that the very same property which has been acquired, or its *value* or *proceeds* is required to be surrendered ...

It follows that a victim of theft such as the attorney used in an earlier example³²³ whose employee stole money from him and deposited it with a bank, may use a quasi-vindictory action to recover part of the money. However, he must establish a clear right to the money in the thieving employee's bank account.³²⁴ The fact that the stolen money commingled in the thief's bank account with other moneys in the account³²⁵ and that the bank acquired ownership of the money are irrelevant.

2.1.3 Evaluation

A claim based on the *rei vindicatio* or a quasi-vindictory action instigated by a victim of fraud or theft against the bank that received the benefits of the fraud or theft.

2.1.3.1 Bank Exercises Control over Benefits of Fraud or Theft

³¹⁹ See *UDC Bank Ltd v Seacat Leasing and Finance Co (Pty) Ltd and another* 1979 (4) SA 682 (T) 688G–H; *Fedsure Life* 278C–D.

³²⁰ 114.

³²¹ *Ibid.*

³²² *Kerbyn* 817C–D.

³²³ See par D.2.1.1 above.

³²⁴ See above.

³²⁵ See also par D.2.3 below as regards interim interdicts.

At the outset it is evident that the *rei vindicatio* raises a number of difficulties as regards claiming the benefits of fraud or theft as money *in specie* from the bank where the fraudster or thief deposited it. However, the evaluation importantly imparted that a quasi-vindictory action is likely to address some of the difficulties. Consequently, a victim of fraud or theft should be able to recover deposited benefits of fraud or theft provided that he can establish a right to the funds.

Consider requirements (1) and (2) above for the *rei vindicatio*. Not only is a victim of fraud or theft no longer owner of the deposited benefits of fraud or theft because the bank acquired ownership of the funds,³²⁶ but any attempt at identifying specific currency in a bank account is a futile exercise.³²⁷ This is due to two factors, namely the normal rules of *commixtio* and the lack of correlation between the valueless paper and the value it represents.³²⁸ This point was recognised by the court in *Amalgamated Society of Woodworkers of South Africa and another v 1963 Ambagsaalvereniging*³²⁹ which agreed in reference to the deposit of an unauthorised donation into a bank account that:³³⁰

I do not think that the fact that the *causa* of the transfer was void renders the transfer of ownership invalid. ... once the money was paid over it became unidentifiable, and rights of ownership if any, were lost. The money can, therefore, not be vindicated.

It follows that a victim of fraud or theft will be unable to vindicate the deposited benefits of fraud or theft unless the money is identifiable as the fraudulently or stolen money *in specie*.³³¹

³²⁶ See ch 2.C.4.2; ch 3.C.3.1.

³²⁷ See *Khan* 88E where the court reasoned that money that commingles with other funds belongs to the person who received it. However, money in an account can be held on behalf of some other despite the fact that following it *in specie* is impossible as a result of commingling which occurred in the account (*Barnard Jacobs Mellet Securities (Pty) Ltd v Matuson* 2005 CLR 1 (W) [*Barnard Jacobs*] par 25).

³²⁸ Badenhorst *Law of Property* 239–240; Van der Merwe *Things* 342. An interesting situation is presented where a criminal rents a safety deposit box from the bank in which he hides foreign currency that was fraudulently acquired. In the scenario the bank does not become owner of the currency, because it was contractually determined that it should be kept separately from the bank's funds (see ch 3.C.2–3). It follows that the victim of fraud should be able to recover the currency with the *rei vindicatio* for two reasons: first, the currency is easily identifiable as the money stolen from the victim and secondly, the latter is owner thereof.

³²⁹ 1967 (1) SA 586 (T) [*Amalgamated Society*].

³³⁰ *Amalgamated Society* 596B–C. Cf *Alley Cat Clothing v De Lisle Weare Racing* [2002] 1 All SA 123 132B (for an analysis of the case, see ch 2.C.5.3.3).

³³¹ Malan & Pretorius (1994) *TSAR* 388. See also the *Van der Merwe* case below.

However, consider a scenario where X, who is far sighted, gave ten hundred rand in bank notes to Y whom he thought was his gardener. X subsequently learns that Y is a fraudster who misled him and therefore attempts to recover the money he paid to Y. If X can find Y and Y kept the money in a drawer at home, X can claim it from him with the *rei vindicatio* because the money is identifiable as the money which Y fraudulently acquired from him.

Stolen foreign currency that is kept separately from the bank's funds and stolen cheques which were deposited into a bank account but not paid yet may, however, be vindicated by a victim of the theft.³³² In all other cases the benefits of fraud or theft that are deposited with a bank are rendered unidentifiable from other money held by the bank which renders the *rei vindicatio* unsuitable to avail the victim of the fraud or theft.³³³ This is because deposited benefits of fraud or theft commingle with other money of the bank and, therefore, belong to the person that received it, namely, the bank where the fraudster or thief keeps his account.³³⁴ These principles were recognised by the courts in the *Perry* and *Van der Merwe* cases.

Perry was an appeal against an order upholding exceptions against FNB's particulars of claim. In short, it concerns a money laundering scheme that went wrong leaving FNB to attempt to recover the proceeds of the stolen cheque.³³⁵ The court held that the money deposited into the account with Nedbank was stolen money. But, in reference to the rule that once money is mixed with other money without the owner's consent, ownership in it passes by operation of law, the court confirmed that when payment was made of the two cheques payable to Dambha and the

³³² See below; Malan & Pretorius *Malan on Bills* 393.

³³³ See ch 2.C.4; ch 3.C.1.

³³⁴ See *Khan* 88E; *Commissioner of Customs and Excise v Bank of Lisbon International Ltd and another* 1994 (1) SA 205 (N) [*Bank of Lisbon*] where Thirion J ruled that since the bank became owner of a *res fungibiles* such as money when *commixtio* occurred, vindicatory remedies did not apply (208I–H); Malan & Pretorius (1994) *TSAR* 388; *Joint Stock Varvarinskoye v Absa Bank Ltd* 2008 (4) SA 287 (SCA) paras 33–35 (for an analysis of the case, see ch 3.C.3.2.2).

³³⁵ *Perry* paras 1–4. FNB paid out on a forged cheque. It argued that the cheque was laundered through the bank account of a stockbroker who subsequently issued three cheques as instructed by one of the defendants. The three cheques were paid to Nedbank, Standard Bank and the NRB which credited the accounts of some of the defendants. Since Nedbank used the money it received to reduced its customer's overdraft, FNB alleged that Nedbank was enriched. For a detailed evaluation of the case, see Sonnekus (2001) *J for Juridical S* 99–124.

trust, ownership of the money's value as embodied in the cheques passed to Nedbank.³³⁶ As a result the *rei vindicatio* was not available to avail FNB. Schutz JA asserted as follows:³³⁷

[w]hat an applicant must do in such a case is to trace the money back to the stolen money, to identify it as a 'fund' of stolen money in the defendant's hands.

Therefore, the fact that money becomes unidentifiable once deposited into a bank account is a key impediment to using the *rei vindicatio* to vindicate the benefits of fraud or theft that were deposited with a bank.

In contrast, a victim of fraud or theft should experience no problem with using the *rei vindicatio* to recover fraudulently acquired or stolen foreign currency as long as it remains identifiable in the hands of the defendant. This point was demonstrated in the *Van der Merwe* case. Although the case does not concern currency that was deposited with a bank, the comments of the Constitutional Court nonetheless makes for interesting reading.

In *Van der Merwe* foreign currency was confiscated at the Cape Town International airport.³³⁸ In the High Court Van der Merwe attempted to vindicate part of the currency on the basis that he was the owner thereof. The court dismissed the application stating that although SARS had no legal entitlement to the currency, it was still rightly forfeited to the National Revenue Fund.³³⁹ On appeal Van der Merwe once again failed to establish ownership of the currency concerned and consequently failed with a vindicatory action. Both aforementioned verdicts are unsatisfactory in the light of general ownership principles and the *rei vindicatio*.³⁴⁰ Inexplicably, while the court *a quo* and the Supreme Court of Appeal alike were in agreement

³³⁶ Par 16. See also paras D.2.2.2, D.3.1 below.

³³⁷ *Perry* par 18.

³³⁸ Van der Merwe, the applicant, was stopped at Cape Town International Airport on his way to join family for a vacation in Europe and searched by customs officials. The search turned up one point two million rand in foreign currency. He was allowed to proceed to the airplane. However, after contacting the SAPS customs officials arrested Van der Merwe. He explained that the money was the total allowance permissible for six people to be used for holiday purposes. This explanation was rejected and customs officials confiscated the currency in his possession (paras 3–5). In the end Van der Merwe's explanation for the amount of foreign currency found in his possession was accepted which left the return of the currency the only matter for the courts to adjudicate. The currency was turned over to the SARS and returned to the Reserve Bank after a court found that SARS had no legal claim to it.

³³⁹ *Van der Merwe* paras 11–12, par 26.

³⁴⁰ See ch 3.C.2; par D.1, par D.2.2.1 above respectively.

that Van der Merwe was not owner of the currency, both courts failed to indicate where ownership laid.

The Constitutional Court took a different stance. It found that the Court of Appeal erred by ruling that Van der Merwe was not owner of the currency in issue.³⁴¹ As regards the *rei vindicatio*, the court declared that once a person claims ownership of property that was in the possession of some other, the property should be returned immediately unless the defendant is able to show cause why the property should not be returned. Therefore, if Van der Merwe could prove that he remained owner of the currency it should be returned to him.³⁴² The court proceeded to weigh the requirements for ownership.³⁴³ It asserted that although Van der Merwe bought the currency for family members he never lost ownership of the money. Van der Merwe thus remained owner of the currency.³⁴⁴ Most notably, the court agreed that the *rei vindicatio*:³⁴⁵

[c]an raise difficulties when dealing with the return of money, unless it concerns individual and identifiable currency with some form of intrinsic value.

For example, money that is kept in a bag or is placed in a safety deposit box at a bank is identifiable currency with an intrinsic value. Similarly, stolen notes and bills of exchange that are hidden away by a thief in a safety deposit box that he rented from a bank can be vindicated by the victim of the theft in the event that the thief has absconded. Since the *Van der Merwe* case concerned identifiable currency, the onus was on the respondents to show why the currency should not be returned to Van der Merwe.³⁴⁶ The respondents failed to establish any justification for not returning the currency. Since they were not entitled to hold the currency, the court ordered it be returned to Van der Merwe.

In summary, it is submitted that the *rei vindicatio* is unsuitable for the purpose of recovering fraudulently acquired or stolen money *in specie* from a bank which once received the money. In addition, where the fraudster or thief absconded with the money in issue the bank is no longer in possession of the funds. But even if the funds remained in the fraudster or thief's

³⁴¹ *Van der Merwe* paras 31–32.

³⁴² *Idem* par 38.

³⁴³ *Van der Merwe* paras 40–43. See also ch 3.C.2.2 as regards ownership of money.

³⁴⁴ *Van der Merwe* paras 46, 59. The reason is that Van der Merwe had no intention to transfer ownership of the money to family members and in turn, they had no intention to accept ownership of the funds (see par D.1 above).

³⁴⁵ *Van der Merwe* par 116. See also Sonnekus *Ongegronde Verryking 2007* 366–367.

³⁴⁶ *Van der Merwe* par 116.

bank account it became unidentifiable *in specie* due to commingling that occurs in the account. Moreover, the bank obtained ownership thereof, a key impediment to any claim based on the *rei vindicatio*. It follows that the benefits of fraud or theft can be vindicated by the victim of fraud or theft only if the funds remain identifiable in the hands of the defendant bank.

However, in a claim based on a quasi-vindictory action the victim of fraud or theft should not be frustrated by the bank's ownership of the deposited benefits of fraud or theft or the fact that the money commingled with funds of the bank. As long as he is able to establish a clear right to money deposited in the bank account of the fraudster, he should be able to successfully claim payment thereof from the bank.

2.1.3.2 Bank Paid Benefits of Fraud or Theft to Fraudster or Thief

The greatest problem with using the *rei vindicatio* in a scenario where the bank parted with the deposited benefits of fraud or theft as instructed by the fraudster or thief concerns requirement (3) of the remedy above³⁴⁷ in terms of which the defendant bank must be in possession of the funds claimed at the time of *litis contestatio*. It follows that where the fraudster or thief withdrew the benefits of fraud or theft and absconded with the money, the bank as cannot be held liable to the victim of fraud or theft based on the *rei vindicatio*.

For the same reason the victim of fraud or theft will be unable to use a quasi-vindictory action against the bank.³⁴⁸ It follows that a victim of fraud or theft will be out of luck where the fraudster or thief absconded with the benefits of fraud or theft. Whether the *actio Pauliana* can assist a victim to recover the benefits of fraud or theft from a bank where the fraudster or thief deposited the money is considered next.

2.2 Actio Pauliana

2.2.1 General Principles

³⁴⁷ See par D.2.1.1 above.

³⁴⁸ See par D.2.1.2 above.

The *actio Pauliana* is a remedy rooted in Roman Dutch law and therefore remains recognised in South African law.³⁴⁹ It is used by creditors in insolvency matters to set aside fraudulent dispositions.³⁵⁰ The creditor can use the *actio Pauliana* to challenge the validity of a transaction made by the debtor in prejudice to his rights. As such, the *actio Pauliana* aims to return the debtor to the position he was prior to the fraudulent³⁵¹ activities conducted to the prejudice of the creditor. As a common-law remedy used for the setting aside fraudulent dispositions,³⁵² it enables the creditor to interfere in an agreement between the debtor and some other which is to his detriment.³⁵³

The requirements for the *actio Pauliana* are set out in *Hockey v Rixom No and Smith*.³⁵⁴ The creditor must establish the following requirements before the property concerned will be returned to the debtor's estate:

1. the existence of a valid claim against a debtor;

³⁴⁹ *De Villiers v Estate Hunt* 1939 AD 532 532; *Van der Merwe Onregmatige Daad* 259.

³⁵⁰ Which are transactions where there are collusive dealings between two parties to the agreement (*Coetzer v Coetzer* 1975 (3) SA 931(E) [Coetzer] 936F; *Fenhals v Ebrahim* 1956 (4) SA 723 (D) [Fenhalls] 727D–G; *Bank of Lisbon* 209D–J. See in general Thomas & Boraine (1994) *THRHR* 678 as regards fraudulent dispositions.

³⁵¹ Note that the fraud referred to in insolvency cases differs from its criminal meaning (Boraine (2007) *TSAR* 529fn105). In insolvency cases the plaintiff must establish that the debtor knew that he was insolvent at the time the disposition was made and intended to defraud his creditors with the disposition (*Hockey* 122; *Scharff v Trustee Scharff* 1915 TPD 463 [Scharff] 476).

³⁵² See section 2 of the Insolvency Act 24 of 1936, as amended ('Insolvency Act'), which defines 'disposition' as follows: '[d]isposition 'means any transfer or abandonment of rights to property and includes a sale, lease, mortgage, pledge, delivery, payment, release, compromise, donation or any contract therefor, but does not include a disposition in compliance with an order of the court; and 'dispose' has a corresponding meaning.'

³⁵³ See, for example, *Fourie NO v Edeling NO* 2005 (4) All SA 393 (SCA) par 9; *Fenhalls* 727; *Kommissaris van Binnelandse Inkomste v Willers* 1999 (3) SA 19 (SCA) [Willers II] par 17. *Willers II* was an appeal to the full bench of the court which concerned erroneous payments made by the liquidator of a company to some of its shareholders. Since the payments were due to the Commissioner of Inland Revenue as income tax, the shareholders were sued by the Commissioner on the basis that they were, *inter alia*, unjustly enriched at it's expense. The Court of Appeal in part confirmed and in part reversed the ruling of the court *a quo* (*Kommissaris van Binnelandse Inkomste v Willers* 1994 (3) SA 283 (A) [Willers I]). The case ended in the Supreme Court of Appeal where Hefer AR concurred with the verdict of the Court of Appeal.

³⁵⁴ 1939 SR 107 [*Hockey*] 118–122. See also *Van Den Heever and others NNO* 2000 (4) SA 804 (W) 817H–818A; *Fenhalls* 727; *Willers I* 306; Malan & Pretorius (2007) *THRHR* 20.

2. the debtor has taken steps to dispose of property to the benefit of a third-party recipient;
3. there is prejudice to the creditor as a result of the disposal;
4. the debtor's action is fraudulent in nature which is prejudicial to the creditor;
5. the recipient for whose benefit the disposition was made was aware of the fraud³⁵⁵ and that it is to the prejudice of the creditor; and
6. there is no other legal remedy available to assist the creditor against the prejudice of the disposal.

From the aforementioned requirements three points must be highlighted. First, the action taken by the debtor must be deliberate. Secondly, the recipient must have known that the purpose of the debtor's disposition is to defraud the creditor. Thirdly, a distinction should be drawn between receiving property on a lucrative title and receiving it on an onerous title.³⁵⁶ Property received on an onerous title, for example, through barter or purchase cannot be recovered from the recipient except if he was *aware* of the fraudulent nature of the transaction. It follows that similar to the *rei vindicatio* guilty knowledge by the recipient of the property is a crucial requirement that the plaintiff must establish before liability based on the *actio* Pauliana will vest.

In contrast, property received on lucrative title, for example, through donation, gift or legacy can be reclaimed without establishing guilty knowledge by the recipient as long as there was fraudulent intent on the side of the debtor.³⁵⁷ This construction is sensible because if the recipient received property without valuable consideration there is no reason why the property may not be recovered, especially if the disposition was made to the detriment of the creditor and the recipient benefited as a result. In contrast, where the recipient gave value³⁵⁸ for the property the disposition may be set aside only if he had *knowledge* of the fraudulent nature of the

³⁵⁵ For the elements of fraud, see *Willers I* 304–305; *Courtney-Clarke v Bassing-Thwaighe* 1991 (1) SA 684 (N) 698.

³⁵⁶ Which is also referred to as *ex titulo lucrativo* and *ex titulo oneroso* respectively (*Hockey* 118–119; *Bank of Lisbon* 209I–J; *Willers II* par 21). A person receives property *ex titulo lucrativo* where he receives property that neither belonged to him nor was owned to him (*Willers II* par 19; *Boraine* (2007) *TSAR* 529; see also below).

³⁵⁷ In *Coetzer* the court asserted that it was unnecessary to establish fraud on the side of the recipient where property was obtained *ex titulo lucrativo* (936F). This is because the *actio* Pauliana finds application only where there was a *collusive* agreement between the two parties to the transaction.

³⁵⁸ That is, he received the property *ex titulo oneroso* (see par D.2.2.2 below) and not as a donation or as a gift.

disposition. This crucial requirement of knowledge may potentially sabotage a victim of fraud or theft's case against the bank that once received the benefits of fraud or theft.

2.2.2 Evaluation

A claim based on the *actio Pauliana* instigated by a victim of fraud or theft against the bank that received the benefits of fraud or theft.

It is submitted that the *actio Pauliana* is unsuitable to assist a victim of fraud or theft to claim loss from the bank that once received the benefits of the fraud or theft. The reason is that it is fundamentally an insolvency remedy which aims to avail a creditor to set aside a fraudulent transaction between a debtor and the recipient of the property concerned so that it can be returned to the debtor's estate. It follows that the debtor must have been insolvent at the time when the fraudulent disposition was made.³⁵⁹ This requirement fails to fit the scenario where a victim of fraud or theft seeks to recover loss from a bank which received the benefits of fraud or theft.

Consider, for example, the scenario where Y, who is employed as an accountant at Liberty Fund, fraudulently channelled 25 electronic fund transfers to his own account at X Bank over a period of two years. The transfers which involved 100,000 rand were in fact intended for Liberty Fund's creditors. Y used the money to fund his cocaine habit. Liberty Fund followed the money to Y's account held at X Bank. Since Y is the proverbial man of straw, Liberty Funds seeks to reclaim its loss from X Bank with the *actio Pauliana*. It contends that X Bank knew that the money it received was fraudulently obtained or stolen by its customer, Y, because the transfers was made from Liberty Fund's bank account to Y's account over an extended period of time. It is submitted that in the scenario above the *actio Pauliana* will be unsuitable to avail Liberty Fund against X Bank simply because Liberty Fund is neither a creditor of Y nor did Y pay the funds to X Bank to the prejudice of a creditor.

But what if the scope of the *actio Pauliana* could be broadened to allow its application in matters other than insolvency related, for example, to recover loss from the bank that once

³⁵⁹ Malan & Pretorius *Malan on Bills* 352–353; Malan & Pretorius (1994) *TSAR* 389; Sonnekus (2001) *J for Juridical S* 118. Note that in *Bank of Lisbon* the court disregarded this key requirement (see Thomas & Boraine (1994) *THRHR* 678; *Nedcor Bank Ltd v ABSA Bank and another* 1995 (4) SA 727 (W) [*Nedcor Bank*] 729 where the ruling is criticised).

received the benefits of fraud or theft? This is exactly what the court allowed in *Bank of Lisbon*.³⁶⁰ It asserted that due to development the *actio* Pauliana had become a personal action with general application in cases where the claimant suffered loss as a result of fraud. The court further reasoned that the *actio* Pauliana could be applicable where the benefits of fraud were deposited into a bank account with a twofold result.³⁶¹ First, the money became the property of the bank³⁶² and secondly, the fraudster reduced his assets which could have been used to repay the Commissioner as former owner of the money.³⁶³ The court therefore supported broadening the scope of the *actio* Pauliana so that it may find application in cases where traditionally it would have been unsuitable.³⁶⁴ It allowed the Commissioner to use the *actio* Pauliana to recover the benefits of fraud from the Bank of Lisbon.³⁶⁵ It is submitted that the ruling is open to criticism because the court evidently neglected to consider all the requirements for the action.³⁶⁶

Consider requirement (2) above which stipulates that a *disposition* must be made for the *benefit* of the third party recipient of the property concerned. In the scenario where loss is claimed from the bank that once received the benefits of fraud or theft there are two key problems with the concepts ‘disposal’ and ‘benefit’. First, although a disposition is made because the bank

³⁶⁰ 213. For the facts of the case, see ch 3.B.2.1, par C.3.2.1.

³⁶¹ *Bank of Lisbon* 213H.

³⁶² 208I.

³⁶³ The court in *Commissioner* disagreed with this finding (129E–131G). It reasoned that the duty of the bank to pay stolen deposited cheques was unaffected by the fraud. By depositing the stolen cheques into his account the thief obtained a personal claim against the bank for payment thereof.

³⁶⁴ This approach is criticised by Malan and Pretorius ((2007) *THRHR* 20–21) who assert that given the lack of authority for extension of the *actio* Pauliana, the court erred in allowing the remedy in cases where ‘neither insolvency nor a fraud on creditors’ is involved.

³⁶⁵ 213H–215A. In contrast, see *Nissan* (par 17) where the court declined to comment on the decision in *Bank of Lisbon* as regards the suitability of the *actio* Pauliana to recover from a defendant bank the benefits of fraud or theft.

³⁶⁶ For additional criticism against the ruling, see Malan & Pretorius *Malan on Bills* 352–353. In short, Malan and Pretorius argue that no agreement existed between the parties as to the purpose for which the cheques were given. Therefore, no contract was concluded between them (*idem* 339). The authors suggest that the plaintiff in *Bank of Lisbon* could have recovered the unpaid cheques, *inter alia*, with the *rei vindicatio*. This argument is sound, because there is no reason why unpaid cheques cannot be vindicated (see par D.2.1.2 above). However, to allow a claim against a bank for the repayment of a credit entry is likely to compel the bank to pay the cheque twice, that is, once to the customer and once to the claimant (Malan & Pretorius *Malan on Bills* 350fn152). The authors therefore conclude that no claim could be entertained against the bank.

becomes owner of the benefits of fraud and theft as soon as the funds commingled with other funds of the bank, the disposition fails to reduce the assets of the fraudulent or thieving account holder.³⁶⁷ This is because the fraudster or thief retains a personal claim against the bank for repayment of the deposited amount. Secondly, as recipient of the benefits of fraud or theft the bank fails to benefit from the deposit because it does not receive the money *ex titulo lucrativo* but on an onerous title.³⁶⁸

As pointed out above, a disposition *ex titulo onerosa* may be set aside only if the bank had *knowledge* that the funds it received did not belong to the customer.³⁶⁹ In contrast, a disposition *ex titulo lucrativo* may be set aside if the disposal was made to the benefit of the bank and if the fraudster or thief as customer had the intention to defraud its victim.³⁷⁰ It follows that a victim of fraud or theft who seeks to use the *actio* Pauliana against a bank must establish that a disposition was made by the fraudster or thief from which the bank benefited. It is submitted that an endeavour of this kind is an exercise in futility. The reality is simply that there can never be a disposition *ex titulo lucrativo* in relation to money deposited into a bank account.³⁷¹ In the scenario above X Bank received the stolen money *ex titulo onerosa* and, therefore, it did not benefit from Y's deposit. Moreover, X Bank merely acted pursuant to the agreement with its customer, Y, when it allowed him to withdraw the funds from the account.

Notably, Boraïne³⁷² argues that codification of the *actio* Pauliana may alter its limited application. This is a feasible suggestion provided that two requirements are met. First, the common-law requirements for the action as set out above will have to be negated otherwise codification is unlikely to extend its use to matters other than insolvency related. Secondly, the

³⁶⁷ See ch 3.B.2.1; *Willers I* 306B–D.

³⁶⁸ *Willers II* par 21. In *Bank of Lisbon* the court incorrectly remarked as follows as regards money deposited into a bank account (213H): '[b]y paying the moneys to the Bank, [the customer] diminished its assets which were available to pay its debt to the Commissioner.' Money deposited into a current bank account fails to increase the assets of the bank (Malan & Pretorius *Malan on Bills* 353; Malan & Pretorius (1994) *TSAR* 387; Malan & Pretorius (2007) *THRHR* 20–21. See ch 3.B.2, par C.3.1–3.3.

³⁶⁹ *Hockey* 118; Boraïne (1996) *SA Merc LJ* 222.

³⁷⁰ *Willers II* par 19; *Scharff* 476; Boraïne (1996) *SA Merc LJ* 222 - see also the authorities there referred to.

³⁷¹ It has been suggested that a collecting bank that receives the proceeds of a stolen or fraudulently acquired cheque has no obligation to repay the money to the customer (Malan & Pretorius ((2007) *THRHR* 21). For a contrasting opinion, see Sonnekus *Ongegronde Verryking* 374–375. See also ch 3.B.2.1.

³⁷² (1996) *SA Merc LJ* 213, 221–222.

actio Pauliana will need to be codified in legislation that deals in general terms with the protection of ownership or else its use will be limited anyway which renders codification superfluous. Regardless, the issue of whether or not to codify the *actio Pauliana* fails to alter the current legal position. In summary, ultimately the fact that the *actio Pauliana* is an insolvency-related remedy renders it unsuitable to recover the benefits of fraud or theft from a bank that received the funds as deposit from the fraudster or thief.

2.3 Interdict

In general the courts are willing to grant interim relief such as an interdict in relation to money held in a bank account pending its recovery with an ownership protection remedy. However, this statement should be qualified. Legal precedents illustrate that in most instances the relief granted depends upon whether the court elects to settle the dispute there and then,³⁷³ or whether to grant interim relief only.³⁷⁴ In the later instance the application for an interim interdict will be separately adjudicated from the main proceedings.³⁷⁵

Two observations are important in this regard. First, an interdict can avail a victim of fraud or theft only where the benefits of fraud or theft remain in the bank account, are identifiable and the victim endeavours to prevent their dissipation by the fraudulent or thieving account holder.³⁷⁶ Secondly, as soon as the court has granted the interim interdict against the bank the

³⁷³ See *Commissioner, South African Revenue Services, Gauteng West v Levue Investments (Pty) Ltd* [2007] 3 All SA 109 (SCA) [*Levue*] par 59; *Barnard Jacobs* where Malan J found that the applicant's case was not (par 34): '[f]or interim relief pending recovery of the money by way of a *condictio* or other remedy but for a declarator that it 'owns' the ... funds.' The case concerned an application by B, a cessionary of some monetary claims, for a declarative order that certain funds held in an account as well as money that was refunded to an insolvent estate belonged to it. For an analysis of the matter, see ch 3.C.3.2.1.

³⁷⁴ See *Levue* paras 22–24; *Nissan* (par 10) where the applicants first obtained an interdict to prevent disposal of the funds in issue which was followed by an application for an declaratory order that the money belonged to them; *Perry* par 18 (as to which, see paras D.2.1.2 above, D.3.4 below).

³⁷⁵ See *Knox D'Arcy Ltd & Others v Jamieson & Others* 1996 (4) SA 348 (AD) [*Knox D'Arcy*] 359H read with 357C.

³⁷⁶ See *Setlogelo v Setlogelo* 1914 AD 221 [*Setlogelo*] 227; *Nissan* par 18; *Fedsure Life* 277F–I. See also Malan & Pretorius (2007) *THRHR* 13–15; below.

victim of fraud or theft must instigate action against the fraudster or thief for payment of the amount in issue.³⁷⁷

Compare the scenario where a victim of fraud follows the benefits of the fraud to a bank account only to discover that the account has been emptied by the fraudster with the scenario where the benefits of fraud are held on fix deposit for 30 days by the bank. In the latter scenario the victim of fraud must approach the court for an interdict to prevent the bank from paying the deposited amount to the fraudster when the 30 days expire. Thereafter, he should instigate action against the fraudulent account holder for repayment of the amount in issue.

The Mareva injunction is an interim restraining order which prevents the removal of property pending the outcome of the matter.³⁷⁸ It may be ordered against a person such as a bank that holds money which is the subject of court proceedings. In *Knox D'Arcy* the court, after remarking that the Mareva injunction is rooted in English law, explained its operation as follows:³⁷⁹

[a]lthough associated with a main action, the application for an interim interdict seeks to secure relief which is separate from that claimed in the action.

In *Fedsure Life Assurance* the court used the concept 'quasi vindicatory interdict' in an application for an interdict because, as the court explained it, following deposited money was different from following currency that could be vindicated.³⁸⁰ An interim or temporary interdict may be the finest way for a victim of fraud or theft to prevent a bank from paying the benefits of the fraud or theft away until the issue of their ownership is determined.³⁸¹ As a temporary measure

³⁷⁷ For possible causes of the claim, see par D.1 above.

³⁷⁸ *Knox D'Arcy* 358B. For a full evaluation of the Mareva injunction, see Faul (1990) *SA Merc LJ* 305–327; Hillestad (1994) *JBL* 123–124; *Bekker NO v Total South Africa (Pty) Ltd* 1990 (3) SA 159 (T) 164D–G.

³⁷⁹ 357D.

³⁸⁰ As regards the problem of vindicating the benefits of fraud or theft that commingled with other funds in a bank account, see paras D.2.1.1–2.1.3 above. Notably, the court's remark supports the synthesis offered earlier as regards the unsuitability of using the *rei vindicatio* to reclaim the benefits of fraud or theft which commingled in the bank account with other funds in the account.

³⁸¹ *Perry* par 18; *Lockie Bros Ltd v Pezaro* 1918 WLD 60 [*Lockie Bros*] 62; *Henegan and another v Joachim and others* 1988 (4) SA 361 (D) 365B–C; *Fedsure Life* 278fn.

an interdict does not guarantee success to the victim of fraud or theft in his claim against the fraudster or thief.³⁸²

The following general requirements must be met before the court will grant a temporary interdict to prevent the dissipation of property, namely, a right to the property in issue,³⁸³ evidence of irreparable injury and the absence of any other remedy.³⁸⁴ The court will grant an interim interdict to a victim of fraud or theft in relation to deposited benefits of fraud or theft only if he can establish that:

1. the benefits of fraud or theft are identifiable or ‘earmarked’ as part of a specific fund to which he is entitled,³⁸⁵
2. the bank must be in possession of the benefits;³⁸⁶ and
3. he can follow³⁸⁷ the fraudulently acquired or stolen money to a specific fund (i.e. the thief or fraudster’s money held with the bank).

In *Barnard Jacobs* the court emphasised requirement (3) above. Malan J (as he then was) reasoned that following the benefits of fraud or theft to the bank account of the defendant was a key requirement before an interdict to prevent their dissipation may be granted.³⁸⁸ Consequently, the applicant must establish that the fraudster or thief’s account into which the funds were deposited increased as a result of the deposit.³⁸⁹ In *Barnard Jacobs* the funds available in the account had a nexus to the money that was refunded by Nedcor.³⁹⁰ However, the court pointed out that even if the balance of the account increased due to the deposit, it does not necessarily follow that the funds belong to the applicant. The court therefore found that the

³⁸² This is because an interdict does not grant the applicant an *in rem claim* to the deposited money (see *Barnard Jacobs* par 31; *Knox D’Arcy* 359H read with 357C).

³⁸³ Note that in relation to money that commingled in a bank account, the applicant will only have a quasi-vindictory as opposed to a vindictory claim (see paras D.2.1.2, D.2.1.3 above; *Van Woudenberg* 114).

³⁸⁴ See *Setlogelo* 227; *Fedsure Life* 227G–H; *Knox D’Arcy* 360–362.

³⁸⁵ *Fedsure Life* 278H–J, 279H; *Barnard Jacobs* paras 30–31.

³⁸⁶ *Van Woudenberg* 114; *Barnard Jacobs* par 38.

³⁸⁷ See par C.4.2.3.2 above as regards the difference between ‘following’ money and ‘tracing’ it.

³⁸⁸ Par 31. More specifically, the court agreed that although money *in specie* could not be followed due to commingling (see ch 2.C.4.2), the account could be held on behalf of some other (*Barnard Jacob* par 25). See also Malan & Pretorius *Malan on Bills* 346–348; *Perry* 16.

³⁸⁹ *Lockie Bros* 62.

³⁹⁰ *Barnard Jacobs* paras 34–35.

applicant should not have used an interim remedy such as an interdict as first avenue to a subsequent claim based on an unjust enrichment *condictio*.³⁹¹ Instead, he should have applied for a declaratory order³⁹² that the money in issue belongs to him. In *Stern and Ruskin NO v Appleson*³⁹³ the court summarised the issue as follows:

[i]t is quite true that money, like any other species of property, may be interdicted; but then it must be shown that the money to be interdicted is identifiable with or earmarked as a particular funds to which the Plaintiff claims to be entitled.

However, it would seem that the courts will assist a victim of fraud or theft and grant an interim interdict where he can establish only a *prima facie* right to the deposited amount as opposed to the other elements mentioned above such as irreparable loss and the unavailability of any other remedy.³⁹⁴

Malan and Pretorius³⁹⁵ advocate use of interdicts to safeguard the benefits of fraud or theft after the funds were deposited with a bank. Schutz JA in *Nissan* agreed with the bulk of Malan and Pretorius's sentiment and made some valuable comments as regards the use of interdicts in relation to deposited money.³⁹⁶ The court concurred with Thirion J in *Bank of Lisbon*³⁹⁷ that the law would be deficient if it failed to provide a remedy to recover the benefits of fraud or theft from the bank as recipient. It considered the applicability of an interim interdict pending an action to determine the rights in question.

With reference to the *Lockie Bros* and *Perry* cases Schutz JA reasserted that courts frequently grant interim interdicts against banks. In that case the a bank will be well advised to adopt 'the stance of a stakeholder' whilst the court determines where the money's ownership lays.³⁹⁸ The *Nissan* court further disagreed with Malan and Pretorius's suggestion that Mareva-

³⁹¹ As to which, see par D.3.3 below.

³⁹² See below. Ultimately, Malan J found in favour of the applicant with the result that the money in the account as well as the refunded amount had to be repaid by the insolvent estate.

³⁹³ 1951 (3) SA 800.

³⁹⁴ See *Pipe Makers* par 34; *Fedsure Life* 278.

³⁹⁵ *Malan on Bills* 346–350; (2007) *THRHR* 14–15.

³⁹⁶ *Nissan* paras 16–18.

³⁹⁷ 209.

³⁹⁸ *Perry* par 18. Note, in *Perry* Nedcor did exactly the opposite and opposed First National Bank's claim. The court remarked that in such a case one must enquire as a matter of substantive law which cause of action may lay against the bank (par 19). See also par D.2.1.2 above.

type interdicts are adequate remedies to prevent dissipation of money.³⁹⁹ However, since the court apparently only objected to the use of interim interdicts in insolvency cases it is submitted that there is no reason why an interdict may not be used to prevent dissipation of deposited benefits of fraud or theft pending adjudication of the issue of their ownership. In fact, it should not be difficult for a victim of fraud or theft to establish a *prima facie* right to the funds deposited into the fraudster or thief's bank account in order to obtain an interim interdict.

Interdicts in relation to deposited benefits of fraud or theft may further alleviate the burden of the bank that is caught between conflicting obligations: whether to heed the account holder's instruction as opposed to prevent suspected benefits of fraud or theft from being paid away. Since the bank is usually contractually bound to heed the instructions of an account holder,⁴⁰⁰ it may have little choice but to continue with a suspicious transaction. This would be the position even after the bank filed a STR.⁴⁰¹ An interim court order can provide the bank with a suitable excuse for not heeding the account holder's instructions and paying the money away. Consequently, an interdict will prevent dealings with suspected benefits of fraud or theft until the dispute can be adjudicated.⁴⁰²

A final issue as regards court orders concerns the use of a declarative order by a victim of fraud or theft who followed the funds to the fraudster or thief's bank account. Malan and Pretorius⁴⁰³ propose that a declarative order will be more suitable to overcome the obstacles of using traditional ownership remedies to recover fraudulently acquired or stolen funds from the bank that received the funds.

Consider the scenario where Y deposited the proceeds of a pyramid investment scheme into his own bank account. After finding out that the scheme in which he invested is a pyramid scheme one of the investors in the scheme, M, laid fraud charges against Y and lodged a complaint with the Financial Services Board. M then followed the money he invested in the scheme to Y's account at X Bank. He applied and was granted an temporary interdict against X Bank to prevent the bank from dealing with the money in the account. M also prepared to file claim against Y for repayment of the amount of money he paid as an investment only to discover

³⁹⁹ Par 19.

⁴⁰⁰ Unless it has concrete evidence of an ownership claim to the deposited money, or that it is the benefits of crime - see ch 3.B.2.1.2.2 where the issue is considered in detail.

⁴⁰¹ See par C.4.2.3.3 above.

⁴⁰² *Knox D'Arcy* 357D. See also par D.4.5 below as regards interim recovery orders.

⁴⁰³ Malan & Pretorius *Malan on Bills* 350.

that Y has fled the country for parts unknown, a situation which renders it impossible to serve Y with the court papers.

It is submitted that the best avenue for M to follow under these circumstances may be to approach the court for a declaratory order that he has a valid claim to some of the funds in Y's account.⁴⁰⁴ However, M is likely to face two key obstacles when he approaches the court. First, consider the nature of a declaratory order. A declarative order is a discretionary remedy because the courts are vested with a discretion whether or not to pronounce on the question in issue.⁴⁰⁵ Consequently, a court may not always be willing to decide the matter there and then which still leaves M without a remedy. Secondly, an applicant such as M may experience difficulty in establishing *locus standi* before the court.⁴⁰⁶ *Locus standi* may present a problem in instances such as the scenario above where there are other investors as well who fell prey to the pyramid scheme and who seek to recover their share of the proceeds from the fraudster's commingled fund.

For this reason it is submitted that it may be a finer option for a victim of fraud such as M in the example above, to apply for an interdict to prevent dissipation of the benefits of fraud deposited in the fraudster's account pending the outcome of the main claim based on a suitable remedy. However, before an interdict will be granted M must follow the money to M's account and establish that its balance increased as a result of the deposited amount.⁴⁰⁷

Following the syntheses above that the *rei vindicatio*, quasi-vindictory action and the *actio* Pauliana alike are far from perfect in as far as recovering the benefits of fraud or theft from the bank where the money was deposited,⁴⁰⁸ the basis on which a victim may file his main claim against the remains uncertain. Whether a claim based on unjust enrichment is likely to raise to the occasion so to speak to assist a victim of fraud or theft against a bank that received the benefits of fraud or theft is henceforth investigated.

⁴⁰⁴ M may also file a claim as a creditor of Y (see, for example, *Visser v Rousseau & andere NNO* 1990 (1) 139 (A) 153C–154D).

⁴⁰⁵ See section 19(1)(a)(iii) of the Supreme Court Act 59 of 1959, as amended; *South African Mutual Life Assurance Society v Anglo-Transvaal Collieries Ltd* 1977 (3) SA 642 (A) 658H.

⁴⁰⁶ *Locus standi* means the 'sufficiency and directness of interest in litigation' (*Gross and others v Pentz* 1996 (4) SA 617 (A) 632 B–C) or 'substantial interest in the relief sought' (*Firstrand Bank Ltd v Chaucer Publications Pty (Ltd)* 2008 (2) SA 592 (C) par 15).

⁴⁰⁷ *Perry* par 18; *Fedsure Life* 279H; *Barnard Jacobs* paras 30–31.

⁴⁰⁸ See paras D.2.1–2.2 above.

3. Aspects of Unjust Enrichment Liability

3.1 Background

Nearly a decade ago Sir James Rose Innes summarised the *raison d' être* of unjust enrichment law as follows:⁴⁰⁹

[t]urning now to our own law, we find the doctrine well established that no man may enriched himself at the expense or to the detriment of another. Its general operation lies outside the realm of contract

Similar to other jurisdictions⁴¹⁰ at common-law unjust enrichment concerns a claim against a person who received a benefit that has resulted either in his assets or liabilities increasing or not decreasing.⁴¹¹ Both outcomes are considered as unjust enrichment. Unjust enrichment as remedy further lies where a person unfairly obtained a benefit by chance, mistake or due to some other's misfortune for which the one enriched has not paid and legally should not keep.

Eiselen and Pienaar⁴¹² define unjust enrichment as an obligation that arises where a person's estate increased at the expense⁴¹³ of another person's estate and no *causa* or legal ground⁴¹⁴ for retaining the increase exists. Sonnekus⁴¹⁵ delineates unjust enrichment in a more complex fashion. The author explains that unjust enrichment liability constitutes restoring an unjustified balance of value which resulted in an increase of one person's wealth. The increase occurred *sine causa* to the detriment of some other. It follows that the law of unjust enrichment aims either to reverse a value transfer that was without legal ground or restore the plaintiff to the position he was before the value transfer occurred which resulted in the reduction of his estate.

⁴⁰⁹ *Hauman v Nortje* 1914 AD 293 301. For a recount of the development of unjust enrichment law, see Visser *Enrichment* 524 ev; Van Zyl *General Enrichment Action* 115–128.

⁴¹⁰ See ch 6.C.4.2–4.3 (England), ch 7.D.2–3 (US).

⁴¹¹ Beatson & Schrage *Enrichment* 155. See in general Malan & Pretorius *Malan on Bills* 329–333.

⁴¹² *Enrichment* 3.

⁴¹³ The 'at the expense of' requirement of a claim based on unjust enrichment has been considered widely in academic circles (see par D.3.2 below).

⁴¹⁴ Notably, at English common-law there is no general requirement that the unjust enrichment must have occurred *sine causa* (see ch 6.D.4.1).

⁴¹⁵ Sonnekus *Ongegronde Verryking* 2007 1,12.

Although the law of equity is not recognised by our common-law ultimately, unjust enrichment may be regarded as an equitable remedy.⁴¹⁶ This is because the person who was unjustly enriched at the expense of some other must legally return the benefit. Since the unjust enrichment remedy is applied in the absence of a contract the same remedy is given as would be given if the obligation arose *ex contractu*.⁴¹⁷

3.2 Establishing Liability

Comparative research illustrates that at English common-law and US codified law banks may be held liable as recipients of the benefits of fraud or theft in claims based on principles of an unjust enrichment action, namely constructive trust.⁴¹⁸ This type of liability is the result of multi-party enrichment⁴¹⁹ which raises intricate problems as far as establishing enrichment of an intermediary as owner of the property concerned at the expense of the plaintiff.

At South African common-law there are certain generic elements that are common to all types of unjust enrichment actions. It follows that a victim of fraud or theft must first establish

⁴¹⁶ *Kudu Granite Operations (Pty) Ltd v Caterna Ltd* 2003 (5) SA 193 (SCA) [*Kudu Granite*] par 15. For analysis of the case, see Eiselen (2004) *J of Contemp Roman Dutch L* 524-527; Visser *Annual Survey 2003* 289-292. See ch 6.C.2.1, par C.4.3.3 and ch 7.D.2-3 where English and US equitable principles are discussed.

⁴¹⁷ See, for example, *BK Tooling Bpk v Scope Precision Engineering* 1979 (1) SA 391 [*BK Tooling*] 436B-F where the court considered the use of the *condictio sine causa* to resolve a dispute concerning breach of contract; Visser *Rethinking Enrichment* 204, 218-222.

⁴¹⁸ See ch 6.C.4.2, ch 7.D.2 respectively. Note, however, at US common-law a victim of fraud or theft can only use constructive trust as remedy against a bank which exercised control over the benefits of fraud or theft at the time of *litis contestatio* (see ch 7.D.2.4).

⁴¹⁹ Which is where more than two parties are involved in the enrichment event by virtue of legal facts or legal acts (Maxwell *Multi-Party Enrichment* 3). See in general Maxwell *op cit* 4-7, 110 ev; Sonnekus *Ongegronde Verryking 2007* 58-64, 72-76; Visser *Setting the Limits* 358-61; Malan & Pretorius (1996) *SA Merc LJ* 399-400. Whether or not an enrichment action will lie in cases of multi-party enrichment is a debate which falls outside the scope of this investigation. But, there are plenty of precedents which support such recognition (see, for example, *McCarthy Retail Ltd v Shortdistance Carriers CC* 2001 (3) SA 482 (SCA) [*McCarthy Retail*] paras 20-23; *Absa Bank Ltd t/a Bankfin v Standard t/a Caw Paneelkloppers* 1998 (1) SA 939 (CPD) 948-950 and the authorities referred there).

the following four requirements⁴²⁰ before unjust enrichment liability may lay against a bank as recipient of the benefits of fraud or theft:

1. the defendant bank must be enriched with the deposit;
2. the victim of fraud or theft must be impoverished;⁴²¹
3. the defendant bank's enrichment must be at the expense⁴²² of the victim of fraud or theft;
4. the enrichment must be unjustified or *sine causa*.

In addition to the four requirements above other requirements that are inherent to each of the different categories of unjust enrichment *condictiones*⁴²³ must then be established before a victim will have a remedy. This is because our courts have yet to recognise general unjust enrichment liability.⁴²⁴ It follows that there is no common rule that determines whether an enrichment is justified. Sometimes the judiciary may extend a traditional unjust enrichment *condictio* for the purpose of imposing liability in instances⁴²⁵ where previously liability would not have lain. This is likely to occur only where two requirements have been met, namely, modern circumstances allow it and a traditional enrichment action concedes to development.⁴²⁶

Requirement (3) above, the 'at the expense of' requirement of an unjust enrichment claim, dictates that the victim of fraud or theft's impoverishment must be causally linked to the defendant bank's enrichment before the courts will consider the claim.⁴²⁷ Evidently it is sufficient

⁴²⁰ See in general *Mndi v Malgas* 2006 (2) SA 182 (OK) par 21; *St Helena Primary School v MEC, Department of Education, Free State Province* 2007 (4) SA 16 (O) [St Helena Primary School] 24D–G; *Kudu Granite* paras 17–23; *Rapp and Maister Holdings Ltd v Reflex Holdings (Pty) Ltd* 1972 (3) SA 835 (T) 837F–838; *Goudini Chrome* 85J–86A; *First National Bank v Tshidiso Isaac Leeuw* unreported case no A251/05 (O) [Leeuw] 6; *McCarthy Retail* paras 15–16, *Laco Parts (Pty) Ltd t/a Aca Clutch v Turners Shipping (Pty) Ltd* 2008 (1) SA 279 (W) par 22.

⁴²¹ For an evaluation of the requirement of impoverishment, see Sonnekus & Schlemmer (2007) *TSAR* 805 where the *St Helena Primary School* case is considered.

⁴²² See Malan & Pretorius *Malan on Bills* 336–338; *Malan Price v Neal* 132–135 where the 'at the expense of' requirement for unjust enrichment is discussed.

⁴²³ To date, only one type of enrichment action has been codified, namely an action in terms of section 28(1) of the Alienation of Land Act 68 of 1981.

⁴²⁴ See par D.3.4 below.

⁴²⁵ See *Perry* par 28; *Willers I* 331B–333E; *Bowman, De Wet and Du Plessis NNO and others v Fidelity Bank Ltd* 1997 (2) SA 35 (A) [Bowman] 40A–B.

⁴²⁶ That is under Roman or Roman Dutch law (see Van Zyl *General Enrichment Action* 115–116, 120–128; Visser *Return of Enrichment* 176).

⁴²⁷ See De Vos *Verrykingsaanspreeklikheid* 339–340; Sonnekus (1991) *TSAR I* 474; Sonnekus (1996) *TSAR* 1; Sonnekus (1996) *SALJ* 22; Sonnekus (1996) *TSAR II* 583.

for a plaintiff in an unjust enrichment claim to establish a ‘logical and legal link’⁴²⁸ between the transfer of value and the receipt of the same value by the defendant. Visser⁴²⁹ agrees with this approach but posits that if the one party with whom two parties had contracted disappeared ‘a personal right is of no value and one is tempted to hold C to be enriched at the expense of A, in spite of the latter’s personal right against B.’⁴³⁰ The author therefore correctly suggests that:⁴³¹

[t]he most satisfying solution to this problem is to allow each situation to be judged according to the relevant policy considerations so that, over time, a body of precedent will cover the typical instances of indirect enrichment.

Pursuant to requirement (4) for unjust enrichment the victim of fraud or theft must establish that the enrichment of the defendant bank was *sine causa* or without a legally recognised ground.⁴³² After the victim of fraud or theft has established a cause of action⁴³³ he may claim relief in the form of a remedy. Notably, a presumption of enrichment arises where money was paid.⁴³⁴ This means that a defendant bank as recipient of the benefits of fraud or theft bears the onus of disapproving the claim of the victim of the fraud or theft.⁴³⁵

Since the unjust enrichment *condictiones* each have their own requirements that must be satisfied before a claim will be allowed, the question is whether a victim of fraud or theft can use

⁴²⁸ Eiselen & Pienaar *Enrichment* 70.

⁴²⁹ Visser *Setting the Limits* 358–361.

⁴³⁰ Visser *Setting the Limits* 358. In the present study the construction implies that where both the defendant bank (C) and the victim of fraud (A) contracted with the fraudster (B) who had disappeared, the bank (C) must be enriched to the detriment of the victim (A).

⁴³¹ *Ibid.*

⁴³² *Mndi* par 23; *McCarthy Retail* par 4. See also par D.3.3.2 below.

⁴³³ See, for example, *Klokow v Sullivan* 2006 (1) SA 259 (SCA) [*Klokow*] where the court considered whether Klokow had established a cause of action for repayment of 250,000 rand that he was claiming from Sullivan (for the facts of the case, see ch 3.B.2.1). The court found that Sullovan had to show ‘a clear case’ that Klokow failed to disclose a cause of action (par 28).

⁴³⁴ *Kudu Granite* par 21; *African Diamond Exporters (Pty) Ltd v Barclays Bank International Ltd* 1978 (3) SA 699 (A) [*African Diamond*] 713G–H. Note, however, as argued already (see paras D.2.2.1–2.2.2 above), it is incorrect to regard money that has been deposited into a bank account as being ‘paid’ to the bank. Instead, the bank as recipient receives the money on an onerous title subject to the instructions of the customer (see also ch 3.B.2.1, par C.3).

⁴³⁵ *Govender v Standard Bank of Southern Africa Ltd* 1984 (4) SA 392 (C) [*Govender*] 404B; *Standard Bank of SA v Absa Bank Ltd and another* 1995 (2) SA 740 (T) [*Standard Bank*] 744F–I; *African Diamond* 706H–708E; *Absa Bank Ltd v Standard Bank of SA Ltd* 1998 (1) SA 242 (SCA) [*Absa Bank*] 252F–G; *Perry* par 31; *Kudu Granite* par 21; *Klokow* par 26.

one of the unjust enrichment *condictiones* to claim loss from the bank that received the benefits of fraud or theft. This question is answered next.

3.3 The *Conditiones*

3.3.1 General

The South African law of unjust enrichment is contained in a number of *condictiones* through which unjust enrichment may be redressed. The *condictiones* aim to:⁴³⁶

[recover] property in which ownership has been transferred pursuant to a juristic act which was *ab initio* unenforceable or has subsequently become inoperative.

Four *condictiones* exist at common-law that are similar to the ones that existed under Roman law and Roman-Dutch law.⁴³⁷ They include the:

1. *condictio sine causa* which is divided into the *generalis* action and the *specialis* action;
2. *condictio indebiti* which is used to reclaim property which was transferred or paid *indebiti* by mistake;
3. *condictio ob turpem vel iniustam causam* which is used to reclaim property which was transferred pursuant to an illegal contract; and
4. *condictio causa data causa non secuta* which is used to recover property transferred under specific circumstances.

Each of the unjust enrichment *condictiones* above specifies the circumstances that justify a conclusion that some form of enrichment was unjust or *sine causa*.⁴³⁸ However, before a *condictio* can be used to recover loss from the bank which received the benefits of fraud or theft, the victim of the fraud or theft must first establish the five ground principles of unjust enrichment which were spelt out above.⁴³⁹

⁴³⁶ *Pucjowski v Johnston's Executors* 1946 WLD 1 6; Visser *Annual Survey* 2003 293–294.

⁴³⁷ *Hahlo & Kahn Union of SA* 565–566; Visser *Enrichment* 549–555; *McCarthy Retail* paras 8–9.

⁴³⁸ See paras D.3.3.2–3.3.4 below.

⁴³⁹ See par D.3.2 above.

Significantly, a *condictio* may be used to recover the *value* of property where the latter cannot be recovered.⁴⁴⁰ It follows that where the benefits of fraud or theft commingled with other moneys held in a bank account, the victim of the fraud or theft may recover the deposited amount in the place of the actual money were deposited. As pointed out already,³⁸¹ as point of departure it is accepted that a bank may be enriched when a customer, who is a fraudster or thief, deposited the benefits of fraud or theft with the bank which neither belongs legally to it nor to the customer.³⁸²

The following analyses focuses on the inherent requirements for each of the *condictiones* below to determine whether any of them may be suitable to avail a victim of fraud or theft against the bank as recipient of the benefits of the fraud or theft.³⁸² However, it is important to underline that the bank must have the benefits of fraud or theft under its control in order for the victim of fraud or theft to claim loss from it.³⁸³

3.3.2 *Condictio sine Causa*

The *condictio sine causa* lies in cases where no legal *causa* exists for the defendant bank to receive money such as the benefits of fraud or theft.³⁸⁴ At common-law two types of *condictiones sine causa* are recognised, namely the *condictio sine causa generalis* and the *condictio sine causa specialis*.³⁸⁵ The *condictio sine causa generalis* applies to cases where any of the other *condictiones* are available as well.³⁸⁶ In contrast, the *condictio sine causa specialis* action may be resorted to in circumstances where no other *condictio* applies as long as unjust enrichment can

⁴⁴⁰ See par D.2.1.2 above as regards the commingling of money in a bank account.

³⁸¹ See par D.3.2 above.

³⁸² See also ch 3.B.2.1.2.2.

³⁸² See *Perry* where the court identified a key problem (par 19): '[C]ondiction ... appears to provide the remedy, but which *condictio*'.

³⁸³ In contrast, see ch 6.C.4.2 as regards the constructive trust remedy.

³⁸⁴ *Perry* par 22; Sonnekus *Ongegronde Verryking* 2007 308.

³⁸⁵ See in general Malan & Pretorius *Malan on Bills* 334–335; Visser *Enrichment* 338 ev; De Vos *Verrykingsaanspreeklikheid* 211–213; *Parkin v Smuts* 1978 (3) SA 55 (T) [*Parkin*] 55H; *B & H Engineering v First National Bank of SA Ltd* 1995 (2) SA 279 (A) [*B & H Engineering*].

³⁸⁶ It is therefore simply another name for any of the other *condictiones*, but with limited procedural benefit (Sonnekus *Ongegronde Verryking* 2007 308).

be established.³⁸⁷ Notably, the *condictio sine causa specialis* does not lie in cases where one of the other *condictiones* is available.³⁸⁸

Despite the aforementioned two types of *condictio sine causa* actions, the basic requirement for the *condictio* to lie is that the defendant must be in possession of the property in issue without a just cause.³⁸⁹ Use of the *condictio sine causa* was neatly illustrated in *B & H Engineering*³⁹⁰ and *Govender*.³⁹¹

In *Govender* the court found that the *condictio sine causa* could not lie because the contract between the parties constituted a valid cause for the transaction in issue.³⁹² In *B & H Engineering* the court considered, *inter alia*, the applicability of the *condictio sine causa specialis* to recover the proceeds of a cheque paid by mistake.³⁹³ The court laid down the basic principles for use of the *condictio sine causa*. It observed that any enrichment action may be used where some one was enriched *sine causa*.³⁹⁴ To determine whether the appellant was enriched it is necessary to consider its total financial position directly after the enrichment.³⁹⁵ If there was no enrichment it is not useful to consider whether the enrichment was *sine causa* because none of the *condictiones* not even the *condictio sine causa specialis* would be applicable.

³⁸⁷ Hahlo & Kahn *Union of SA* 569; Visser *Annual Survey 2003* 292–293; *B & H Engineering* 285A; *Kudu Granite* par 15; *Rulten NO v Herald Industries (Pty) Ltd* 1982 (3) SA 600 (D) 610F.

³⁸⁸ See *Firststrand Bank Ltd (formerly First National Bank of SA Ltd) v Absa Bank Ltd* 2001 (1) SA 803 (W) [*Firststrand Bank*]; *Govender* where the court found that the *condictio sine causa specialis* can not be used where the *condictio indebiti* applies (396H–397G) (cf par D.3.3.3 below; Sonnekus (1992) *THRHR* 301–309).

³⁸⁹ See *Parkin* where the court pointed out that (58B): ‘[T]here is no magic in the classification of the *condictio sine causa* into the two groups of general and special.’

³⁹⁰ In the matter the appellant was the payee of a countermanded cheque which was negligently and by mistake paid by the bank. It appealed against the ruling of the court *a quo* that the respondent bank was entitled to recover the amount paid to it by mistake.

³⁹¹ In short, the drawee bank sought to recover an amount paid by mistake for a countermanded cheque. The main issue before the court was whether the *condictio sine causa* or the *condictio indebiti* laid against the payee of the cheque. See also par D.3.3.3 below; Visser *Enrichment* 538–539 where the case is considered in detail.

³⁹² 404B: ‘[h]is enrichment is contractual and justified and no obligation arises from justifiable enrichment’, 406H–407E. Ultimately, the court reasoned that the bank’s impoverishment was due to its own mistake.

³⁹³ See par D.3.3.3 below where the *condictio indebiti* is analysed.

³⁹⁴ *B & H Engineering* 285D.

³⁹⁵ *Ibid.*

In the present case the court considered two questions to determine whether the *condictio sine causa specialis* would lie.³⁹⁶ First, was *B & H Engineering* enriched when it received payment of the cheque, and secondly, if so, was the enrichment *sine causa*? The court found that *B & H Engineering* was not enriched with the amount of the cheque, because:³⁹⁷

[a]s I explained ... its receipt of the amount of the cheque was balanced by its loss of a claim against Sapco. Its net financial situation was unchanged.

Since *B & H Engineering* was not enriched the court found it unnecessary to consider whether the enrichment was unjustified.³⁹⁸ This ruling is much more satisfactory than the decision in *Standard Bank*³⁹⁹ where the court found that the *condictio sine causa* laid to recover the proceeds of a forged cheque paid to a collecting bank which used the funds to discharge the indebtedness of its customer. The court reasoned that Absa Bank was enriched with the proceeds of the cheque because due to the forgery the cheque had become inoperative.⁴⁰⁰

It is submitted that this finding is incorrect for two reasons.⁴⁰¹ First, Absa Bank was not enriched with the proceeds of the cheque because its assets did not increase when it collected the cheque and used the funds to discharge the customer's indebtedness. Essentially the bank's financial position remained unchanged.⁴⁰² Secondly, Absa Bank merely executed its obligation to the customer by collecting the proceeds of the cheque. Whether or not the proceeds were legally due to the customer is not a requirement for the *condictio sine causa* to lie.⁴⁰³ It follows that the court erred in finding that Absa Bank was enriched and that the *condictio sine causa* laid to recover the amount of the cheque. In this case the court also incorrectly applied the *ex turpi causa non oritur actio* rule⁴⁰⁴ which prohibits enforcement of illegal contracts. The reason is that there

³⁹⁶ *B & H Engineering* 284G.

³⁹⁷ *B & H Engineering* 294I.

³⁹⁸ *B & H Engineering* 294I; *Nedcor Bank* 730C–D.

³⁹⁹ Which ruling was confirmed by the Supreme Court of Appeal in *Absa Bank* (see also ch 3.C.3.2.1, par C.3.3 where the *Standard Bank* ruling is considered). In short, here Absa Bank collected the proceeds of a forged cheque as mandated by the customer and applied the amount to discharge the latter's indebtedness. As payee bank Standard Bank contended that Absa Bank was enriched with the amount of the cheque.

⁴⁰⁰ *Standard Bank* 745C–D.

⁴⁰¹ See also Malan & Pretorius (1996) *SA Merc LJ* 399–401.

⁴⁰² See below, par D.2.2.2 above where receiving money on onerous or lucrative title is discussed.

⁴⁰³ However, the *condictio ob turpem vel iniustam causam* could have laid provided that the claimant can establish the requirements for the action (see par D.3.3.4 below).

⁴⁰⁴ See par D.3.3.4 below; ch 3.B.2.1.

was nothing illegal about either the contract between the bank and the customer, or the obligation of the bank to collect the proceeds of cheques for the customer. The collecting bank merely performed as it was obligated to do.

Malan⁴⁰⁵ has a novel suggestion as regards the use of the *condictio sine causa specialis* in three-party enrichment matters. He suggests that where the property in issue is payment made to a bank both the *causa* of payment and the *causa* of acquisition of the funds should be considered to determine whether the *condictio* will lie. It is submitted that this suggestion may assist to adjudicate cases where both *causas* are easily ascertainable, for example, where money was transferred to the account of a bank's customer as part of a business deal. In this example both the *causa* of payment and the *causa* of acquisition could be ascertained with a measure of certainty.

The situation is, however, different where the bank is dealing with the benefits of fraud or theft. Where the benefits of fraud or theft were transferred to some other as instructed by the fraudster or thief the *causa* of the payment is his instruction to the bank to deal with the money in a certain manner. The instruction derives from the contract concluded between the bank and the fraudster or thief who may, or may not be a money launderer.⁴⁰⁶ For the bank determining the *causa* of the money's acquisition is likely to be an endeavour riddled with difficulty. It is likely that upon inquiry the fraudster or thief will have a ready explanation on hand and refuting it may be a frustrating and, ultimately, futile exercise.

It is further unlikely that upon inquiry the defendant bank would admit to the court that it suspected that the funds in issue derived from criminal activity. Notably, FICA also does not expect a bank to investigate suspicions it may have as regards the nature of a transaction, but merely to file a STR in terms of section 29 of the Act.⁴⁰⁷

It is more likely that the defendant bank will counter upon inquiry that it followed its obligations in terms of section 21 of FICA and accepted the explanation given by the customer about the source of the funds.⁴⁰⁸ Ultimately, the court will need to pronounce on the reasonableness of the explanation given to the defendant bank. In absence of evidence to the

⁴⁰⁵ Malan (1978) *CILSA* 276; Malan *Price v Neal* 142–144. Note, although Malan's proposition was made in reference to cheques with falsified endorsements, the proposition remains relevant where the benefits of fraud or theft are deposited into a bank account.

⁴⁰⁶ See ch 3.B.2.1 as regards the bank-customer relationship.

⁴⁰⁷ See par C.4.2.3.3 above.

⁴⁰⁸ See paras C.4.2.3.2, C.5 above.

contrary the court must find in favour of the defendant bank. It is, therefore, submitted that where the *causa* of payment - the instruction of the fraudster or thief - has been established, it is unnecessary to delve further into the *causa* of the funds' acquisition because a *causa* for the purpose of unjust enrichment already exists. The existence of a *causa* for the bank's payment is sufficient to warrant a finding that the *condictio sine causa* will not lie against the defendant bank.

Of significance, although obiter, it was nevertheless suggested that the *condictio sine causa* is unlikely to lie where a bank receives money on an onerous title.⁴⁰⁹ If, however, the money was received on lucrative title the bank may be ordered to make restitution to the plaintiff. It is submitted that the issue of whether a bank received money on onerous or on lucrative title is pivotal as regards the question of whether it was in fact enriched. A bank is likely to be enriched only in two instances. First, where it receives money on lucrative title, which seldom occurs due to the nature of banking and the bank-customer relationship.⁴¹⁰ Secondly, where the bank accepted a deposit of the benefits of fraud or theft and subsequently realised that neither it nor the customer has any rights to the funds.⁴¹¹ Even then, the victim of fraud or theft would be well advised to use a quasi-vindictory action to recover the benefits of fraud or theft from the bank instead of the *condictio sine causa* simply because of the requirements that he would have to establish.⁴¹²

3.3.3 *Condictio Indebiti*

Since Roman times the *condictio indebiti* has been regarded as a remedy *ex aequo et bono* to prevent one person from being unjustified enriched at the expense of some other.⁴¹³ The *condictio* usually lies to recover transfers made under mistake. Proof that transfer of property was made in error is a pivotal requirement for the *condictio indebiti* to lie.

⁴⁰⁹ *Govender* 405. See also paras D.2.2.1–2.2.2 above for the difference between money received on onerous title and money received on lucrative title.

⁴¹⁰ See ch 3. B.2.1.

⁴¹¹ See ch 3.B.2.1.2.2 as regards the bank's right to refuse payment of deposited funds.

⁴¹² See also par D.3.4 below.

⁴¹³ See in general De Vos *Verrykingsaanspreekliheid* 25–29; Malan & Pretorius *Malan on Bills* 333–335; *Willis Faber Enthoven Pty (Ltd) v Receiver of Revenue* 1992 (4) SA 202 (A) 220, 224.

The *condictio indebiti* is further a widely used unjust enrichment remedy for which detailed rules exist.⁴¹⁴ It generally applies only to cases where the defendant such as a bank has been enriched by money it received that was not owed to it.⁴¹⁵ However, in *Bowman* the court pointed out that the rules for the *condictio* were not identical and could be varied depending on the circumstances of a case.⁴¹⁶ Notably, sometimes a claimant may rely on an ‘analogous’⁴¹⁷ application or extended operation of the *condictio indebiti* to ‘cope with modern *condictiones*’.⁴¹⁸

In *Frame v Palmer*⁴¹⁹ the court identified the following three principal requirements for the *condictio indebiti* to lie against a defendant:⁴²⁰

1. the property reclaimed was transferred to the defendant by the plaintiff;⁴²¹
2. transfer was made under a mistake; and
3. transfer was made under a mistake that it was due.

Simply by reading the aforementioned requirements, it should be obvious that the *condictio indebiti* is an unsuitable remedy in a case where a victim of the fraud or theft endeavours to file suit against the bank where a fraudster or thief deposited the benefits of the fraud or theft.

Although similar to the *condictio sine causa* in the sense that the bank’s enrichment must be unjustified,⁴²² there is an important difference between the two *condictiones*. For the *condictio indebiti* to lie the victim of fraud or theft must establish that he as plaintiff transferred the benefits

⁴¹⁴ See in general Hahlo & Kahn *Union of SA* 566–568; *Union Government v National Bank of South Africa Ltd* 1921 AD 121 [*Union Government*].

⁴¹⁵ Or payment *indebiti* which means payment of something that is not owed to the payee (*Bowman* 40G–H).

⁴¹⁶ 40A–C. In short, the case concerned Bowman’s attempt to recover an overpayment of 340 000 rand from the respondent bank. The court allowed the appeal due to the fact that Bowman was acting in a representative capacity as joint liquidators coupled with the fact that the overpayment was a *bona fide* mistake (44C–D, 44H, 45F).

⁴¹⁷ *Bowman* 40 A–B.

⁴¹⁸ *Perry* par 28.

⁴¹⁹ 1950(3) SA 340 (C) 346A–337.

⁴²⁰ Although, the rules for the *condictio indebiti* may be varied depending on the type of case before the court (*Bowman* 39E, 40A–C; *Willers I* 333G–H). For a detailed analysis of the *condictio indebiti*, see Sonnekus *Ongegronde Verryking* 2007 229–328.

⁴²¹ *Kudu Granite* par 20. In *Bowman* the court asserted that depending on the circumstances (43D): ‘[a] may reclaim from B what C has overpaid, especially if C was acting in a representative ... capacity’.

⁴²² Sonnekus *Ongegronde Verryking* 2007 230.

of fraud or theft to the bank under the mistaken belief that it was due.⁴²³ The *condictio indebiti* will not lie in the absence of a mistake as regards the transfer of property.⁴²⁴

In terms of requirement (3) for the *condictio indebiti* transfer of property must be made under mistake that it was due to the defendant bank. Requirements (1) above further stipulates that the debt or obligation must be that of the victim of fraud or theft before the *condictio* may lie. The conclusion that may be drawn is simply that for the *condictio indebiti* to lie the victim of fraud or theft must have paid the benefits of fraud or theft to the bank to discharge his own debt. Since the latter facts are inconceivable not to mention absurd, the *condictio indebiti* is clearly unsuited to assist a victim of fraud or theft to recover loss from a bank where the fraudster or thief deposited the benefits of fraud or theft.

3.3.4 *Condictio ob Turpem vel Iniustam Causam*

The *condictio ob turpem vel iniustam causam*⁴²⁵ is an unjust enrichment action that is used to recover property that was transferred for a dishonourable cause.⁴²⁶ Since the purpose of the transaction is legally prohibited, the law is unable to preserve it. The *condictio ob turpem causam* finds expression in the *in pari delicto potior est condictio defendentis* rule⁴²⁷ which means that where both parties to an agreement are equally guilty,⁴²⁸ the plaintiff is unlikely to succeed with

⁴²³ See *Leeuw 7*; *Union Government 140*; *Recsey v Riche 1927 AD 554 557*; *Firstrand Bank 815B–E* where the court rejected a claim based on the *actio indebiti* because the mistake requirement was not established. In *Firstrand Bank* the bank tried to recover an amount paid as a result of fraud to Absa Bank (see below). Although notified about the possibility of fraud by some other, Firstrand Bank failed to confirm its indebtedness before paying the amount in issue.

⁴²⁴ See *Financial Services Board v De Wet NO 2002 (3) SA 525 (C) [De Wet]* par 290; *Perry* where the court found that the *conditio indebiti* could not lie against Nedbank in the absence of a mistake as regards an obligation to make payment of the cheques (par 22 - see par D.2.1.2 above for the facts of the case). See also Malan (1978) *CILSA* 180.

⁴²⁵ Or ‘*condictio ob turpem causam*’.

⁴²⁶ See in general Visser *Unjustified Enrichment 2008 425 ev*; Sonnekus *Ongegronde Verryking 2007 139 ev*.

⁴²⁷ Or ‘*par delictum* rule’ (see also ch 3.B.2.1.2.1). Translated the dictum reads ‘in equal guilt the possession of the defendant is stronger’ (*Afrisure CC v Watson NO (522/2007) [2008] ZASCA 89 (11 September 2008) [Afrisure]* par 51).

⁴²⁸ Which in this context is construed as turpitude or impropriety.

the claim. The *par delictum* rule may further be raised as defence to aver a claim based on the *condictio ob turpem causam*.⁴²⁹

There are three requirements for the *condictio ob turpem causam* to lie, namely:

1. the property claimed was transferred to the bank pursuant to an illegal agreement;
2. the victim of fraud or theft did not act dishonourably or with turpitude; and
3. the bank had knowledge of the illegal nature of the agreement and the fact that it is tainted by turpitude.

Requirement (1) above encapsulates the primary reason for the *condictio ob turpem causam* to lie as it emphasises that illegal agreements are unenforceable.⁴³⁰ This is because illegal agreements are both prohibited by law and contrary to public policy and good morals.⁴³¹ However, it is important to distinguish between an event where there is no valid *causa* for the agreement and one where there is a *causa* albeit illegal.⁴³² In contrast to the *condictio sine causa* and the *condictio indebiti* which lie in the absence of a *causa*, the *condictio ob turpem causam* applies to events where there is a valid *causa* for the property's transfer but it is illegal.

Whether an agreement is indeed illegal is not as clear cut as it may appear. Therefore, it has been the subject of litigation in a number of cases. For example, in *Legator* the court was called upon to decide whether the *condictio ob turpem* would lie where an agreement was invalidly concluded. The court confirmed that:⁴³³

⁴²⁹ As to which, see ch 3.B.2.1.2.1.

⁴³⁰ *Minister van Justisie v Van Heerden* 1961 (3) SA 25 (O) par 28; *Legator McKenna Inc v Shea* Unreported case no 143/2008 (SCA) [*Legator*] par 30; *Afrisure* paras 5, 34; *Perry* par 22; *Barclays National Bank v Brownlee* 1981 (3) SA 579 (D) [*Brownlee*]. However, not all illegal contracts contain an element of turpitude. Evidence may indicate that the defendant genuinely believed that it could act (*Visser Unjustified Enrichment I* 636).

⁴³¹ *Henry v Branfield* 1996 (1) SA 244 (D) [*Henry*] 253B; *De Wet* par 290; *Afrisure* par 5; *Perry* par 22.

⁴³² *Perry* par 22; *Afrisure* paras 5, 51.

⁴³³ *Legator* par 30. In this matter, a firm of attorneys, Legator McKenna ('LM') was appointed as curators for the respondent, Shea, and sold her residence while she was incapacitated. Upon recovery Shea instigated action against LM based on the *condictio ob turpem causam*. She contended that the sale agreement was invalid because it was concluded before LM had been issued letters of curatorship by the Master. The court *a quo* agreed and declared the sale agreement illegal and void (par 10). On appeal LM argued that the Administration of Estates Act (66 of 1965) was not contravened, because the agreement was conditional upon the Master's approval of the transaction. Only after the Master approved the transaction did it become final. Since the Master approved the transaction, there was no illegality attached to it.

[i]llegality of the underlying transaction is an essential element of the *condictio ob turpem vel in iustam causam*. That much is trite.

It also agreed that LM indicated in writing that the agreement was subject to the approval of the Master and therefore, the agreement was subject to a suspensive *condictio*. It follows that the agreement was invalid because the buyers of Shea's home offered an unconditional agreement whilst LM agreed to a conditional one.⁴³⁴ After considering various theories for the passing of ownership, none which is relevant to the discussion at hand, the court arrived at the conclusion that LM's mistake as regards the validity of the sale agreement had no effect on the effectiveness of the agreement.⁴³⁵

The court then proceeded to evaluate the *condictio ob turpem causam*. It found that LM did not enter into an illegal agreement, but rather into an agreement that was invalid for lack of compliance with the prescribed formalities for the sale of immovable property.⁴³⁶ However, since the house was transferred to a buyer who performed in terms of the agreement, the agreement was *ab initio* valid which justified a finding in favour of LM. It follows that the *condictio ob turpem causam* lies only where an agreement was concluded for an illegal purpose as opposed to one which was invalidly concluded.

In *Henry*⁴³⁷ the court took the position that agreements tainted by turpitude should not be enforced regardless of whether the illegality was perpetrated in a foreign country.⁴³⁸ The court asserted that since the agreement in issue was tainted with illegality it had to be regarded as a nullity and was therefore unenforceable.⁴³⁹ In an alternative plea the plaintiff accepted both the illegality of the agreement and the possibility that the *par delictum* defence could be applicable, but contended that the *par delictum* rule should be relaxed to prevent unjust enrichment.⁴⁴⁰ The

⁴³⁴ *Legator* par 17.

⁴³⁵ *Idem* par 24.

⁴³⁶ *Legator* paras 30–31.

⁴³⁷ In this matter, the plaintiff claimed money paid to the defendant's agent in an effort to subvert Zimbabwe's exchange regulations. When the defendant failed to repay the money's value in Zimbabwean dollars the plaintiff turned to the courts to enforce the contract. The defendant countered that the agreement was tainted by illegality since the obligations of the parties contravened both the Zimbabwean and South African exchange regulations.

⁴³⁸ This is on account of public policy and comity of nations (*Henry* 251B–D).

⁴³⁹ See also *Brownlee* 582–584.

⁴⁴⁰ *Henry* 252B. See ch 3.B.2.1.2.1 as regards the *par delictum* rule.

court disagreed and dismissed the claim mainly because the plaintiff failed to establish that the defendant was unjustly enriched.⁴⁴¹

In *Mndi*⁴⁴² the appellant denied concluding an illegal loan agreement as well as being repaid the amount in issue. In addition, she contended that since the agreement was concluded with a club for which she acted as an agent, the amount claimed accrued not to her personally but to the club. The court rejected the appellant's arguments.⁴⁴³ It reasoned that there was no evidence to indicate that the appellant entered into the money-lending transaction on behalf of the club. Based on the requirements for unjust enrichment the court agreed that the appellant was unjustly enriched. The agreement in issue was unenforceable, because the interest agreed upon contravened the Usury Act. The court essentially found that no legally recognised ground existed to justify the excessive payments made by the respondent to the appellant.

In terms of requirement (2) above the victim of fraud or theft must establish that he did not act dishonourably or with turpitude. This is because the bank may raise the *par delictum* defence in the event that the victim also acted dishonourably. Whether an agreement which sought to evade the law was illegal presented one of two principle issues before the court in *Afrisure*.⁴⁴⁴ The second issue before the court was whether the *condictio ob turpem causam* may lie only if the plaintiff's conduct was without turpitude.

First, the court affirmed that the *condictio ob turpem causam* would lie if the amount claimed was transferred pursuant to an illegal agreement.⁴⁴⁵ It concurred with the court *a quo*

⁴⁴¹ *Henry* 253D–H. The court emphasised the unlikelihood that the defendant intentionally defrauded the plaintiff who was refunded part of the money he paid.

⁴⁴² Paras 14–17. The case concerned a loan of money between two friends. After the loan was repaid, the respondent realised that interest was calculated at nearly 30% per month. She therefore approached the court to recover the money she paid in excess based on unjust enrichment. The court *a quo* ruled in her favour, which decision was appealed.

⁴⁴³ *Mndi* paras 18–24. The court ultimately found that even though the appellant was unjustly enriched, the court *a quo* incorrectly calculated the amount of the respondent's impoverishment (paras 27–29).

⁴⁴⁴ *Afrisure CC*, the first appellant, conducted business as an insurance broker. Over time Publiserve Healthcare Scheme ('Publiserve') conducted business as a medical scheme under the Medical Schemes Act 131 of 1998 ('1998 Act'). In May 2001 Publiserve was provisionally wound up. At this time Publiserve made five payments to Afrisure CC to the total amount R5 454 636.50. The liquidator of Publiserve instigated action against Afrisure CC for, *inter alia*, repayment of the said amount. The claim was based on the *condictio ob turpem causam*. The court *a quo* found in favour of the liquidator of Publiserve which ruling Afrisure CC appealed.

⁴⁴⁵ *Afrisure* paras 4–6.

albeit for a different reason that the agreement between Afrisure CC and Publiserve was illegal, and hence unenforceable. Payments made to Afrisure CC was illegal, because it aimed to evade the 1998 Act.⁴⁴⁶ The court found that the payments made by Publiserve were not for services rendered as Afrisure CC alleged, but rather for the purpose of retaining prospective members of Afrisure CC. It followed that the agreement was *fraudem legis*.⁴⁴⁷ The court referred⁴⁴⁸ to an English case where Lord Diplock remarked:⁴⁴⁹

[f]raud unravels all. The courts will not allow their process to be used by a dishonest person to carry out a fraud.

The court therefore found that Afrisure CC acted with turpitude and dismissed its appeal.

In contrast to requirement (2) for the *condictio ob turpem causam* which concerns the conduct of the victim of fraud or theft, requirement (3) above concerns the conduct of the defendant bank. The victim in order to succeed with the *condictio ob turpem causam* must finally establish that the bank knew about the illegal nature of the transaction.⁴⁵⁰ A fine example of how a defendant's turpitude may present is found in *De Wet*, a complex case which concerned, *inter alia*, a claim for repayment of pension fund assets which were illegally transferred to other benefit funds.⁴⁵¹ In considering the claim the court first questioned why the Fund was not co-sued because

⁴⁴⁶ *Idem* paras 31–34. The agreement between the parties was illegal because excess broker's commission was paid. Should Publiserve fail to continue with paying broker's commission in excess of three percent, Afrisure would have moved its clients to a different medical scheme.

⁴⁴⁷ Or 'to evade the law' (*Afrisure* par 34).

⁴⁴⁸ *Idem* par 38.

⁴⁴⁹ *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1982] 2 All ER 720 (HL) 725H.

⁴⁵⁰ *Perry* par 22.

⁴⁵¹ In short, the Pension Funds Act 42 of 1956 ('the Act') prohibits transfer of a business from a registered pension fund to some other person unless certain requirements have been met. The trustees of the Pepkor Pension Fund ('the Fund') devised a scheme which involved splitting the Fund into four benefit pension funds. Applications to the effect were made to the Registrar of Pensions ('the Registrar') which were granted. Some years later when the Fund applied for liquidation the plaintiffs, which included the Financial Services Board and the Registrar, sought to have earlier approvals reviewed. In addition, they claimed repayment of the Fund's assets which were transferred to the Pepkor Retirement Fund. Two contentions by the plaintiffs are relevant to the discussion at hand. First, they alleged that the scheme was in conflict with the Act as well as against the interest of the Fund's members and public policy. Secondly, the plaintiffs alleged that the Registrar was misled into granting approval for the initial transfers. In turn, the defendants countered that the plaintiffs lacked *locus standi* to pursue the case in court.

it was clearly party to the unlawful transfer of the Fund's assets.⁴⁵² The court further agreed with the plaintiffs's contention that if not for the defendants' misrepresentations the Registrar would not have approved the transfer of the assets in the first place.⁴⁵³ Consequently, it declared the Registrar's approval void.⁴⁵⁴

As regards the nature of the plaintiff's claim, the court observed that 'precise classification' of the claim among the *condictiones* 'was perhaps open to debate'.⁴⁵⁵ Thus, the claim could be accommodated under either the *condictio sine causa*, *condictio indebiti* or the *condictio ob turpem causam*.⁴⁵⁶ If the transfer was *ultra viris*, either the *condictio indebiti* or the *condictio sine causa*⁴⁵⁷ could lie to recover the assets in issue. However, since there was no mistake as regards the transfer of assets the *condictio indebiti* was unlikely to lie.⁴⁵⁸ The asset transfer was clearly unlawful and, therefore, the court asserted that the *condictio ob turpem causam* appeared most suitable to recover the Fund's assets. The court confirmed that for the *condictio ob turpem causam* to lie the plaintiffs had to establish turpitude on the side of the defendants.

It was evident that the defendants knew that approval in terms of the Act was not obtained for the transfer and therefore, they acted with turpitude. Regardless of the latter, the court in reference to *McCarthy Retail*⁴⁵⁹ concurred with Schutz JA that too much time was spend on identifying the correct *condictio*. The court therefore declined to specify which *condictio* would be the most suitable for the purpose of recovering the assets of the Fund. As regards the question of *locus standi*, the court asserted that *locus standi* was a procedural issue where no fix rules existed and where public policy should be considered.⁴⁶⁰ Without further elucidating the issue the court found that the plaintiffs had *locus standi* to approach the court for redress.

In *De Wet* the defendants' knowledge of wrongdoing presented a key factor in the court's decision to allow the claim. It is, therefore, conspicuous that the court failed to pronounce the

⁴⁵² *De Wet* 290. In the court's opinion the Fund did not have 'clean hands' as regards the transfer of the assets in issue.

⁴⁵³ Par 255.

⁴⁵⁴ *De Wet* paras 263, 268, 274—275.

⁴⁵⁵ Par 290.

⁴⁵⁶ *De Wet* paras 290—291.

⁴⁵⁷ See par D.3.2 above.

⁴⁵⁸ See par D.3.3.3 above.

⁴⁵⁹ See par D.3.4 below.

⁴⁶⁰ *De Wet* paras 296—301. See also par D.2.3 above as regards *locus standi*.

condictio ob turpem causam the most suitable *condictio* with which to recover the Fund's assets, especially in light of the fact that the plaintiffs established all the requirements for the *condictio* to lie. It is submitted that the *condictio sine causa* would have been unsuitable in this case, because the agreement to transfer the assets in issue constituted a *causa* albeit illegal.⁴⁶¹

A different situation presented in *Zamzar Trading*.⁴⁶² In this case it was found that the plaintiff failed to establish knowledge of wrongdoing on the side of the defendant bank. The court reasoned that by holding the money in issue in the account the defendant bank unknowingly assisted in wrongdoing.⁴⁶³ It follows that where a victim of fraud or theft fails to prove knowledge by a defendant bank that it was dealing with the benefits of fraud or theft or that the purpose of the transaction in issue was illegal, for example, to launder the benefits, the defendant bank will not be held liable based on the *condictio ob turpem causam*.

3.4 Evaluation

A claim based on one of the unjust enrichment *condictiones* instigated by a victim of fraud or theft against the bank that received the benefits of fraud or theft.

The discussion above imparts that whether a victim of fraud or theft can use any of the enrichment *condictiones* against the bank which received the benefits of fraud or theft from a fraudster or thief will depend on three requirements.

First, whether the bank exercised control over the benefits of fraud or theft at the time of *litis contestatio*. Secondly, whether the victim can establish that the deposited money is the benefits of fraud or theft with the result that the bank does not need to pay or 'account' to the account holder who is a fraudster or a thief.⁴⁶⁴ Thirdly, whether he can establish the requirements for one of the *condictiones* to lie against the bank. It is submitted that the third element is most likely to frustrate any unjust enrichment claim against a bank as recipient of the benefits of fraud or theft.

The question as to whether the *condictio sine causa* may lie to recover loss from the bank as recipient of the benefits of fraud or theft must be answered in reference to the two questions

⁴⁶¹ See par D.3.3.2. above.

⁴⁶² See ch 3.B.2.2 for the facts of the case.

⁴⁶³ *Zamzar Trading* 514–515.

⁴⁶⁴ See *Nissan* (ch 3.B.2.1.2.2); *Perry* (par D.3.3.4 above).

designed by the court in *B & H Engineering*,⁴⁶⁵ namely, was the bank enriched and if so, was the enrichment *sine causa*.

A bank is enriched when it receives benefits of fraud or theft which belongs legally does not belong to it or to the customer because he is a fraudster or thief.⁴⁶⁶ This is the position unless the bank used the benefits to discharge the indebtedness of the fraudster or thief in which case the bank will not be enriched.⁴⁶⁷ It follows that the main difficulty with using the *condictio sine causa* to recover the benefits of fraud or theft from a bank lies with the *sine causa*-requirement. The reason is that the bank prior to conducting a transaction needs an instruction from the customer.⁴⁶⁸ It is submitted that the customer's instruction constitutes a valid *causa* for the purpose of the *condictio sine causa*,⁴⁶⁹ because it derives from the contractual relationship that exists between the bank and the customer.⁴⁷⁰

Sonnekus⁴⁷¹ suggests that in terms of the bank-customer relationship the bank has a duty to recount to the customer. Therefore, even if the benefits of fraud or theft were used in a transaction the bank can never be enriched *sine causa*, because the customer's instruction constitutes a legal ground or *causa* for the transaction in issue. Another consequence of the contractual relationship is that the bank is generally obligated to heed the customer's instructions.⁴⁷² However, a bank that has concrete evidence that the money is the benefits of a fraud or theft or that is interdicted by the court, is precluded from paying the money to the customer.⁴⁷³ It follows that any instruction by the customer in relation to deposited the benefits of

⁴⁶⁵ See par D.3.3.2. above.

⁴⁶⁶ See par D.3.2 above.

⁴⁶⁷ See par D.3.3.2 above; ch 3.C.3.3. However, it is submitted that the bank's customer will be enriched because his indebtedness was discharged with money which did not belong to him.

⁴⁶⁸ See ch 3.B.2.1.

⁴⁶⁹ Unless the bank found out or has been informed by the victim of fraud or theft that the customer is a fraudster or thief (see ch 3.B.2.1.2.1–2.1.2.2).

⁴⁷⁰ See in this regard ch 3.B.2.1.2.

⁴⁷¹ Sonnekus *Ongegronde Verryking 2007* 368. The argument runs that a bank may not deny a customer's instruction by countering that money involved are the benefits of fraud or theft.

⁴⁷² See ch 3.B.2.1.2.

⁴⁷³ See ch 3.B.2.1.2.2. This is not to say that a bank that has suspicions about the origin of the money, or the purpose of a transaction must surrender the funds immediately to the state. Here is where the dilemma lies; either the bank pays away the money as instructed by the fraudster or thief despite its suspicions that it most likely constitutes the benefits of fraud or theft, or it acts in defiance of the customer and freezes the account whilst waiting for

fraud or theft amounts to a legal *causa* for the purpose of vesting liability based on unjust enrichment.

Sonnekus⁴⁷⁴ is further in agreement with Malan⁴⁷⁵ that one should not confuse the *causa* between a bank and the customer, which is the payment instruction, with how funds paid into the account was obtained. The validly concluded contract that exists between the bank and the customer is the foundation for any instruction that the bank may receive from him in relation to the deposited the benefits of fraud or theft.⁴⁷⁶ Accordingly, the instruction constitutes a valid legal *causa*.⁴⁷⁷ This outcome cannot be altered by a finding of the court that the funds involved in the transaction are the benefits of fraud or theft.⁴⁷⁸ Ultimately, the terms of the bank-customer relationship are contractually determined as opposed to by unjust enrichment rules.⁴⁷⁹

It is, therefore, submitted that regardless of how one dissects the matter the *condictio sine causa* may lie only where a bank was enriched without a legal ground. The analysis above emphasises one key dilemma with using the *condictio sine causa* to recover loss from the bank as recipient of the benefits of fraud or theft. That is, namely, that even if one accepts that the bank was enriched when it accepted a deposit of the benefits of fraud or theft, it does not alter the fact that a valid contract exists between the bank and the customer. The contract is the foundation for the instruction given by the customer to the bank as regards the funds.⁴⁸⁰ This is the position even where the bank suspected that the benefits of fraud or theft are used in a transaction designed to launder the funds. In short, the *condictio sine causa* lies only in the absence of a legal *causa*.⁴⁸¹

the court to adjudicate the matter or for instructions from the FIC (*Absa Bank* 252F–G). It is, therefore, futile to argue that a transaction conducted with the benefits of fraud or theft has no consequence for the bank. Either way the bank is caught in the middle between the AML authorities on the one side and the customer on the other side.

⁴⁷⁴ *Ongegronde Verryking* 2007 376.

⁴⁷⁵ Malan (1978) *CILSA* 276 (see also par D.3.3.2 above).

⁴⁷⁶ The exception is where a bank employee and a customer colluded to used the account for money laundering purposes. Consequently, the contract between the parties is *ab initia* invalid (see ch 3.B.2.1.2.1 where the *ex turpi causa non oritur actio* rule is considered).

⁴⁷⁷ See *BK Tooling* where the court decided that enrichment could not be regarded as *sine causa* in the face of breach of contract (424D–H).

⁴⁷⁸ In *Perry* the court explained as follows (par 22): ‘[h]owever tainted the instruction or the money was, there was nonetheless an instruction’ (see par D.3.4 above).

⁴⁷⁹ De Vos *Verrykingsaanspreeklikheid* 356.

⁴⁸⁰ See ch 3.B.2.1.

⁴⁸¹ See par D.3.3.2 above.

Consequently, it cannot lie against a bank as recipient of the benefits of fraud or theft. As summarised by Malan & Pretorius⁴⁸² in respect of the ruling in *Bank of Lisbon*:⁴⁸³

[t]here is, surely, no room for an action by the Commissioner against the respondent bank, whether this be the action Pauliana⁴⁸⁴ or the *condictio sine causa*.

In turn, the *condictio indebiti* may lie against a bank to recover benefits of fraud or theft paid to it by mistake for the purpose of discharging a debt that was not due.⁴⁸⁵ It follows that in the present context a victim of fraud or theft will have to establish that he paid the benefits of fraud or theft to the defendant bank under the mistaken belief that payment was due and the mistake was excusable in the circumstances.

From this construction it is evident that there are glaring problems with using the *condictio indebiti* to recover loss from the bank. This despite the decision in *Bowman*⁴⁸⁶ which allows for a deviation of key principles in deserving circumstances. In fact, each of the three requirements for the *condictio indebiti* sabotages use of the *condictio* in cases where the benefits of fraud or theft were paid to the bank as part of a money laundering scheme.⁴⁸⁷

Consider, for example, requirement (2) in aggregate with requirement (3) for the *condictio indebiti* to lie, namely that the payment must have been made by mistake to discharge a debt of the victim of fraud or theft.⁴⁸⁸ It is submitted that the two latter requirements present the greatest impediment to using the *condictio indebiti* to claim from a bank. At the outset it may be useful to emphasise that in *Leeuw*⁴⁸⁹ the court asserted that the evidence required to establish the *condictio sine causa* likewise would establish the *condictio indebiti* with the exception of the mistake requirement. As emphasised in *Afrisure*⁴⁹⁰ in essence the *condictio indebiti* lies in the absence of a *causa*. It follows that if there was an underlying obligation to make payment the *condictio indebiti* would not lie because the obligation would amount to a *causa*.⁴⁹¹

⁴⁸² *Malan on Bills* 350fn152.

⁴⁸³ See par D.2.2.2 above.

⁴⁸⁴ See par D.2.2 above.

⁴⁸⁵ See par D.3.3.3 above.

⁴⁸⁶ 40A–C.

⁴⁸⁷ See par D.3.3.3 above.

⁴⁸⁸ See par D.3.3.3 above.

⁴⁸⁹ Par 4 - see par D.3.3.3 above.

⁴⁹⁰ Par 51. The court found that a *causa* existed although it was illegal (see par D.3.3.4 above).

⁴⁹¹ See par D.3.3.2 above.

As explained already, for the *condictio indebiti* to lie the victim of fraud or theft needs to establish that he deposited the benefits of fraud or theft with the defendant bank under the mistaken belief that the amount was due.⁴⁹² In short, the *condictio indebiti* is certainly the most unsuitable *condictio* of all the *condictiones* under evaluation in as far as claiming loss from a bank as recipient of the benefits of fraud or theft. It follows that the *condictio indebiti* may be excluded as suitable remedy to claim loss from a bank as recipient of the benefits of fraud or theft.

At first blush the *conditio ob turpem causam* seems perfectly suited to recover loss from a bank as recipient of the benefits of fraud or theft. This is due to requirement (1) for the *condictio* that requires an illegal purpose in relation to the transaction.⁴⁹³ In the present context where the benefits of fraud or theft were deposited into a bank account, the illegality is twofold. First, the benefits of fraud or theft are used in the transaction and secondly, the transaction purports to launder the benefits of fraud or theft. Even though the contract between the bank and the customer has been validly concluded,⁴⁹⁴ the transaction in issue is illegal because its purpose contravenes FICA and POCA alike.⁴⁹⁵

The seminal case in this regard is *Perry* where Schutz JA considered the operation of the *condictio* in the context of claiming from a bank as recipient of the benefits of fraud or theft.⁴⁹⁶ The court recognised that the *condictio ob turpem causam* may be an appropriate action to recover loss from the defendant bank because there was an illegal *causa* in the sense that no valid title to the money could be transferred by the thief to the bank.⁴⁹⁷

The statement of the court should, however, be read in context. It is importance to distinguish between an agreement that is *ab initio* invalid due to the fact that it was invalidly concluded and a valid agreement that is tainted by illegality that arises later on.⁴⁹⁸ The contract between the parties usually is perfectly legal unless the bank colluded with the customer to launder

⁴⁹² See above.

⁴⁹³ See par D.3.3.4 above.

⁴⁹⁴ See ch 3.B.2.1. This is the position despite the criminal intention of the bank's customer to use the account for money laundering purposes (see *African Realty Trust Ltd v Holmes* 1922 AD 389 403 where the court asserted as follows: '[b]ut, as a Court, we are after all not concerned with the *motives* which actuated the parties in entering into the contract, except insofar as they were expressly made part and parcel of the contract or are part of the contract by clear implication').

⁴⁹⁵ See paras C.3.4, C.3.2 respectively above.

⁴⁹⁶ See paras D.3.3.2, D.3.3.4 above. For the facts of the case, see par D.2.1.2 above.

⁴⁹⁷ *Perry* par 22.

⁴⁹⁸ See ch 3.B.2.1.2.1.

the deposited benefits of fraud or theft. Even subsequent suspicions by the bank as regards the purpose of the transaction do not affect the validity of the contract. However, this does not mean that the transaction remains unaffected by the turpitude once established. As recognised by the court in *Afrisure*,⁴⁹⁹ any payment based on an illegal *causa* is invalid and unenforceable. A transaction that is conducted for the purpose of laundering the benefits of fraud or theft not only contravenes AML legislation, but is also contrary to public policy and is therefore unenforceable.⁵⁰⁰

A victim of fraud or theft should further have no problem to establish requirement (2) for the *condictio ob turpem causam* to lie, namely that his own conduct was not immoral or tainted with turpitude.⁵⁰¹ Where money was fraudulently obtained or stolen and subsequently deposited with a bank, it stands to reason that the conduct of the victim is usually above board. It is at this point of the inquiry that the good news ends for a victim of fraud or theft hoping to use the *condictio ob turpem causam* to claim from a bank as recipient of the benefits of fraud or theft. Requirement (3) for the *condictio ob turpem causam* is likely to subvert a claim based on the *condictio*. The reason is that to satisfy requirement (3) the victim of fraud or theft needs to establish that the bank knew of the turpitude, for example, that it was dealing with the benefits of fraud or theft or that the purpose of the transaction is to launder the benefits of fraud or theft.

In *Perry* the court reasoned that the modern formulation of the cause of action was that proceeds of theft were transferred under an illegal agreement.⁵⁰² The implication is that the defendant bank must have had knowledge that it was dealing with the proceeds of theft at the time of transfer. However, the court asserted that if this description is universally applicable the *condictio* would fail, because Nedbank as defendant bank received the money innocently from the customer. It follows that one must determine whether a defendant bank had knowledge of the illegal nature of the transaction at the time the benefits of fraud or theft were deposited, or whether subsequent acquired knowledge would suffice to vest liability on its side.

⁴⁹⁹ Paras 37–38.

⁵⁰⁰ Note, in *Sasfin (Pty) Ltd v Beukes* 1989 (1) SA 1 (A) the court in relation to an alleged illegal contract warned that (9B): '[o]ne must be careful not to conclude that a contract is contrary to public policy merely because its terms ... offend one's individual sense of propriety and fairness'. However, transactions that are conducted with the benefits of crime or that are aimed at money laundering are contrary to public policy.

⁵⁰¹ See in general Sonnekus *Ongegronde Verryking* 2007 129–147; Visser *Enrichment* 542–543.

⁵⁰² *Perry* paras 22–25.

The court came to the conclusion that acquired knowledge would suffice because both the person who received the benefits of fraud or theft with knowledge of illegality as well as the one who learned of it while it was still in possession of the funds could be regarded as *male fide*. The operative word here is, however, knowledge; a bank's suspicions about the nature of the transaction or the origin of the money involved cannot be equated to knowledge for the purpose of using the *condictio ob turpem causam* to claim loss from it.⁵⁰³

In *Zamzar Trading*⁵⁰⁴ the court considered the nature of the *condictio ob turpem causam* in cases where the defendant bank was unaware that funds used to discharge the indebtedness of the plaintiff were the benefits of fraud. In this case there was no evidence that the bank breached the contract it had with the plaintiff or that it entered into an unenforceable contract with it.⁵⁰⁵ The bank merely held money for the plaintiff and unknowingly assisted in wrongdoing.

The court correctly reasoned that a bank that was unaware of the existence of a contractual relationship, which had been tainted by turpitude, between its customer and a third party and which had no knowledge of such turpitude, could not be held liable to repay money which it at some stage held legally for the customer.⁵⁰⁶ To hold someone liable irrespective of whether he had knowledge of wrongdoing affronted the principle that a party had to act wrongfully before he could be held liable for his conduct. Significantly, the court asserted as follows:⁵⁰⁷

⁵⁰³ See paras C.4.2.2, C.4.2.3.3 above as regards the concept 'knowledge'.

⁵⁰⁴ Note, the court made some salient remarks as regards the duty of a bank to report suspicious transactions (see par C.4.2.3.3 above). For the facts of the case, see ch 3.B.2.2. To recap, *Zamzar Trading* as a victim of fraud sought to recover from the defendant bank money used to discharge a supposed indebtedness of it (511–513). *Zamzar Trading* contended that it was unaware of the indebtedness and based its claim against the defendant bank on the *condictio ob turpem causam*. *Zamzar Trading* further argued that while the law accepted the *condictio* as an unjust enrichment action, this was incorrect as the real nature of the action had not been properly examined. Therefore, the court should consider public policy to determine whether something given could be recovered despite a lack of enrichment. In response the bank contended that *Zamzar Trading* particulars of claim were 'bad in law' because it lacked the elements required for the cause of action.

⁵⁰⁵ On the evidence before the court it was obvious that the only *turpis causa* alleged was the one between *Zamzar Trading* and a third party to whom funds were transferred by the bank as instructed by the customer (514B–C–515).

⁵⁰⁶ *Zamzar Trading* 514F–G, 515.

⁵⁰⁷ 514I–J. Note, *Zamzar Trading* was adjudicated before FICA was enacted so the comments of the court should be seen in absence of section 29(1) of the act (see par C.4.2.3.3 above).

[N]ot only does public policy not require a bank to be liable in [these] circumstances ... but requires that a bank should not be so liable in that such a liability would be destructive of banking practice as we know it in the modern world.

Ultimately, the court found that there was no evidence to suggest that the defendant bank had entered into an unenforceable contract with the plaintiff. It follows that a bank may not be held liable if wrongdoing in the execution of its mandate was not established. But wrongdoing is not an element of the *condictio ob turpem causam*.⁵⁰⁸ Knowledge of wrongdoing is where the greatest problem lies with using the *condictio ob turpem causam* against a bank as recipient of the benefits of fraud or theft. It is submitted that in most cases the victim of fraud or theft will be hard-pressed to establish knowledge of turpitude on the side of the bank. Even if the bank had filed a STR to the FIC pursuant to FICA suspicions do not amount to knowledge.⁵⁰⁹

In summary, this section illustrates that neither traditional ownership remedies nor any of the unjust enrichment *condictiones* are suitable to assist a victim of fraud or theft to claim loss from a bank that received the benefits of fraud or theft from the fraudster or thief. For various reasons each of the potential remedies were found lacking in the present context. However, a victim of fraud or theft may be able to use the quasi-vindictory action to recover the benefits of fraud or theft from the bank where the fraudster or thief deposited the money provided that the bank has not parted with the money at the time of *litis contestatio*. In all other scenarios he would be out of luck. The following diagram may best illustrate the position in our law as it currently stands:

Figure 8.1:

Remedy	Potential outcome of claim against B Bank	Reason for outcome
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⁵⁰⁸ See par D.3.3.4 above.

⁵⁰⁹ See par C.4.2.2 above.

<i>Rei Vindicatio</i>	*No success if benefits of fraud, theft commingled in bank account. *Potential success if benefits are kept separately, eg., in a safety deposit box with the bank.	*Benefits are unidentifiable from other moneys in account bank & bank is owner of deposited money. *Benefits are identifiable & bank did not acquire ownership thereof.
Quasi-vindictory Action	*Potential success.	*Legal right to benefits of fraud.
<i>Actio Pauliana</i>	*No success.	*Insolvency action.
<i>Condictio Sine Causa</i>	*No success.	*Bank-customer contract provides valid legal <i>causa</i> .
<i>Condictio Indebiti</i>	*No success.	*Fraudster or thief made no mistake when payment was made to the bank.
<i>Condictio ob Turpem Causam</i>	*No success.	*Impossible to establish bank's knowledge of turpitude, or that money is benefits of fraud, theft.

This outcome leaves a disturbing lacuna in the law as it currently stands. Recommendations on how this outcome should be rectified follow at the end of the chapter. Recommendations on how this outcome should be rectified follow at the end of the chapter.⁵¹⁰

4. Civil Forfeiture

4.1 Action in Rem

The foregoing section considered the potential civil remedies that a victim of fraud or theft may have against a bank which received a deposit comprising the benefits of fraud or theft. This section explores the mechanics of civil⁵¹¹ forfeiture as a remedy to combat criminal activities. More specifically, it questions whether POCA offers a remedy to a victim of fraud or theft who

⁵¹⁰ See par E below.

⁵¹¹ As opposed to criminal forfeiture which requires a criminal conviction before the NDPP can bring a forfeiture application against the property of the accused (see below).

followed his loss to a bank account only to discover that the benefits of the fraud or theft are the subject of civil forfeiture proceedings.

Civil forfeiture was introduced in South Africa for the purpose of combating crime. POCA endeavours to punish criminals by confiscating and forfeiting to the state benefits acquired through unlawful activities or property used to commit an offence.⁵¹² South Africa adopted POCA mainly because of pressure exerted by the US.⁵¹³ The country further had an obligation as co-signatory of the Vienna Convention to establish an asset forfeiture regime.⁵¹⁴ Significantly, section 37(1) of POCA designates the nature of the forfeiture proceedings as follows:

[f]or the purposes of this Chapter⁵¹⁵ all proceedings under this Chapter are *civil* proceedings, and are not criminal proceedings.

Civil forfeiture enables removal of the benefits of unlawful activities without the need to establish the criminal liability of the defendant.⁵¹⁶ It is an action of choice because the NDPP needs merely to establish a nexus between an unlawful conduct of the defendant and property that he owes.⁵¹⁷ As a legal action against an ‘inanimate object’⁵¹⁸, civil forfeiture constitutes a legal fiction.⁵¹⁹ Civil forfeiture thus purports to destroy the financial resources of criminals independent of criminal proceedings.⁵²⁰

⁵¹² See Preamble of POCA recitals 3–4, 6,7; ch 1.A.3. In 2003 it was estimated that the Asset Forfeiture Unit (‘AFU’) confiscated assets worth over 400 million rand (IMF *South Africa Report 2004* par 9).

⁵¹³ Shaw *Organised Crime* 9.

⁵¹⁴ See ch 5.C.1 as regard the Vienna Convention.

⁵¹⁵ That is chapter 6 of POCA which comprises the Act’s civil asset forfeiture provisions.

⁵¹⁶ Section 50(4) of POCA; *National Director of Public Prosecutions v Mohamed NO and others* 2002 (4) SA 843 (CC) [*Mohamed*] paras 16C–D.

⁵¹⁷ Section 50(1)(a)–(b) of POCA. Conversely, see *Shaik* (par C.4.2.1 above).

⁵¹⁸ Hofmeyr (1998) *Responsa Meridiana* 42; Redpath (2000) *African Security R* 16. The concept ‘inanimate object’ refers to property that is the subject of a civil forfeiture action.

⁵¹⁹ A ‘legal fiction’ is a supposition which is known to be untrue but which is not allowed to be denied (Curzon *Legal History* 87–88). In relation to civil forfeiture the concept ‘legal fiction’ emphasises the paradoxical nature of the action; it holds a lifeless thing liable as opposed to a thinking individual who can defend his conduct and accept responsibility for it.

⁵²⁰ *National Director of Public Prosecutions v Prophet* 2003 (8) BCLR 906 (C) [*Prophet I*] paras 6, 30; *Fraser v ABSA Bank Ltd (National Director of Public Prosecutions as Amicus Curiae)* 2007 (3) SA 484 (CC) [*Fraser*] par 11.

South Africa's civil forfeiture regime is based on the US model⁵²¹ which derives from English law.⁵²² In *Prophet I* the court explained as follows:⁵²³

[c]ivil forfeiture in South Africa is largely based on statutory provisions in the USA ... The US in particular has had extensive experience with civil forfeiture. American case law may therefore be usefully studied comparatively.

Likewise in *National Director of Public Prosecutions v Cole* Willis J remarked:⁵²⁴

I shall dwell briefly upon the [US] cases ... because they provide some contextual colour to the issues with which the South African Courts are having to grapple in dealing with the interpretation and the application of the Act.

Justification for civil forfeiture as tool to reduce crime is rooted in ancient English forfeiture laws which originated in and derived from Roman law.⁵²⁵ Early English civil forfeiture laws paved the way for modern forfeiture measures. Civil forfeiture as remedy was the primary weapon in fighting crime. Blackstone justified the need of civil forfeiture as follows:⁵²⁶

[t]he natural justice of forfeiture ... is founded on this consideration: that he who hath thus violated the fundamental principles of government, ... hath abandoned his connections with society, and hath no longer any right to those advantages which before belonged to him as a member of the community; among which social advantages the right of transferring ... property to others is one of chief.

This reasoning likewise has been applied to explain the contemporary purpose of civil forfeiture.⁵²⁷

⁵²¹ See in general Redpath (2000) *African Security R* 16; Cowling (1998) *SAJCJ* 351 as regards the historical background of POCA. POCA is based on the US Racketeer Influenced Corrupt Organisations Act of 1970 (18 U.S.C. chapter 96 - see ch 7.D.4.1).

⁵²² See ch 7.D.4.1.

⁵²³ *Prophet I* par 23.

⁵²⁴ [2004] 3 All SA 745 (W) par 9. See also Rautenbach (2002) *TSAR* 820–821.

⁵²⁵ Van Zyl *Romeins-Hollandse Reg* 279. In short, Britain was invaded by Julius Caesar in 43 AD and became a province of the Roman Empire. The Conquest was maintained for five centuries when the withdrawal of Roman officials resulted in the end of Britain's connections with Rome. In Roman times confiscation was part of the punishment for capital crimes. Note that some resources trace the roots of civil forfeiture back to Biblical times (see, for example, Finkelstein ((1973) *Temple L Quarterly* 180–183) and Blackstone (Kerr *Blackstone Commentaries Vol I* 301) who referred to Moses commenting that an ox goring a man must be stoned to death (Exodus 21:28–30)).

⁵²⁶ Morrison *Commentaries Vol IV* par 382.

⁵²⁷ See, for example, *First National Bank of SA Ltd t/a Wesbank v Commissioner, South African Revenue Service and another; First National Bank of SA Ltd t/a Wesbank v Minister of Finance* (2002 (4) SA 768 (CC)) par 98. In *Mohunram* the court asserted as follows (par 118): '[s]tatutory civil forfeiture of assets is ... aimed at curbing serious crime. And yet, there is no gainsaying that, in effect, it is draconian.'

4.2 Prevention of Organised Crime Act (1998)

4.2.1 Key Provisions

4.2.1.1 Property Subject to Civil Forfeiture

Civil asset forfeiture orders are ‘inherently intrusive’⁵²⁸ because they carry dire consequences for the owner of property that is the subject of a civil forfeiture order. In *National Director of Public Prosecutions v Mohunram and others*⁵²⁹ the Supreme Court of Appeal summarised the prerequisites of a civil forfeiture application as follows:

[t]here are usually three main issues in a case ... to decide and they are (a) whether the property concerned was an instrumentality; (b) whether any interests should be excluded from the forfeiture order; and (c) whether the forfeiture sought would be disproportionate.

POCA favours a broad definition of the concept ‘property’ and extends the definition of the concept provided in the 1996 Act.⁵³⁰ The Act’s definition of property correlates with the definitions provided in the civil forfeiture legislation of the jurisdictions used in this study for comparative purposes.⁵³¹ POCA further distinguishes among three categories of property that may be forfeited, namely⁵³² the proceeds of unlawful activities, real or personal property used in a

⁵²⁸ See *Prophet v National Director of Public Prosecutions* 2006 (2) SACR 525 (CC) [*Prophet II*] par 46. Nkabinde CJ reasoned that the courts should interpret POCA in a manner which ‘promote[s] the spirit, purport and objects of the Bill of Rights’ to ensure that the Act’s provisions are constitutionally justifiable.’ In *Fraser* the Constitutional Court recognised that POCA can have ‘potentially far-reaching and abuse effects’ (par 46).

⁵²⁹ 2006 (1) SACR 554 (SCA) [*Mohunram II*] par 2. The facts of the case are straightforward. Mohunram operated a legitimate glass and aluminum business and housed an unlicensed gaming machine in a building that was the subject of the civil forfeiture application. The court *a quo* dismissed NDPP’s civil forfeiture application which ruling was appealed. Since the appeal was upheld, Mohunram took the matter to the Constitutional Court (see par D.4.2.1.3 below).

⁵³⁰ Section 1(xvi) of POCA. Section 1(viii) of POCA defines the concept ‘interest’ as any right that a person may have.

⁵³¹ See ch 6.B.4.2, par C.4.4.2.1; ch 7.D.4.2.2.

⁵³² Section 1(xv)–(xvi) of POCA.

crime and property that is otherwise *concerned in* the commission of a crime.⁵³³ Realisable property is property that is the subject of a civil forfeiture application and includes any property held by a defendant⁵³⁴ or by a person to whom the defendant had made an ‘affected gift’.⁵³⁵

In *Seevnarayan*⁵³⁶ the court considered the concept ‘property’ in relation to money which the defendant argues he legitimately earned. The court found that Seevnarayan did not acquire the money in the form of interest by means of an unlawful activity.⁵³⁷ More specifically, the money was not ‘property derived (or) received’⁵³⁸ from an unlawful activity because it was acquired before the unlawful activity, here income tax evasion,⁵³⁹ occurred. The court thus rejected the NDPP’s forfeiture application on the basis that it failed to prove that the interest earned on money on which the defendant should have paid income tax constituted the proceeds of an unlawful activity and found that the interest was legitimately earned by Seevnarayan.

From the foregoing it is evident that the courts in deciding whether property should be forfeited to the state must consider the property’s connection to an unlawful activity which, if so proved, designates it as the proceeds of unlawful activities. On its own property can never be judged forfeitable without the existence of a direct link to an unlawful activity.⁵⁴⁰

4.2.1.2 Unlawful Activities

⁵³³ Which is known as the ‘instrumentality of an offence’ (section 1(vii) of POCA; *National Director of Public Prosecutions v Engels* 2004 (4) All SA 250 (C) 259G–H; *Mohunram II* par 17). See par D.4.2.1.4 below.

⁵³⁴ Section 14(1)–(2) of POCA.

⁵³⁵ See *idem* section 12(a)–(b) which defines an ‘affected gift’ as any gift made by the defendant not more than seven years before an action was instituted against him, or any gift by the defendant which is the proceeds of unlawful activities or property that exemplifies the latter.

⁵³⁶ In this matter the NDPP sought a civil forfeiture order in respect of money that was invested with Sanlam under fictitious names. It alleged that one of the defendants, Seevnarayan, invested the money with the purpose of avoiding income tax (244H–247H). Between 1994 and 1999 Seevnarayan allegedly colluded with his broker to invest more than four million rand for the purpose of avoiding payment of income tax. The NDPP therefore asserted that the money concerned was either an instrumentality of an offence or the benefits of an unlawful activity, namely, income tax evasion.

⁵³⁷ *Seevnarayan* 252D.

⁵³⁸ Section 1(xv)(b) of POCA.

⁵³⁹ See also par C.4.2.3.3 above as regards income tax evasion.

⁵⁴⁰ See *National Director of Public Prosecutions v Starplex 47 cc* unreported case no 12099/2007 (C) [*Starplex*] par 45. For the facts of the case, see par D.4.5 below.

The concept ‘unlawful activities’ referred to POCA’s definition of ‘proceeds of unlawful activities’⁵⁴¹ refers to any kind of conduct that is criminalised in South Africa.⁵⁴² The acquisition of money through criminal activities is usually financially motivated.⁵⁴³

The NDPP must establish that the property in issue derived from the defendant’s criminal conduct and hence constitutes the proceeds of an unlawful activity before the court will forfeit it to the state. However, as is illustrated next the nexus between the property that is earmarked for civil forfeiture and the unlawful conduct of the defendant should not be too far removed for a civil forfeiture application to be successful.

4.2.1.3 Proceeds of Unlawful Activities

In international legislation different concepts are used as synonyms for property that was acquired through criminal means, for example, ‘proceeds of crime’,⁵⁴⁴ ‘property obtained from unlawful conduct’⁵⁴⁵ and ‘property involved in a violation.’⁵⁴⁶

POCA uses the concept ‘proceeds of unlawful activities’ in reference to property that was acquired ‘in connection with or as a result of’ an unlawful activity.⁵⁴⁷ Suffice it to reemphasise the recommendation made earlier in this Chapter⁵⁴⁸ that Parliament should replace the concept ‘proceeds’ in POCA with the concept ‘benefits’ in order to ensure that any property that was acquired through criminal means or derived from criminal conduct falls within the ambit of the Act.

⁵⁴¹ See also paras C.3.2, C.4.2.1 above; par D.4.2.1.3 below.

⁵⁴² See section 1(xv)(a)–(b) of POCA which defines the concept ‘unlawful activity’ as: ‘[c]onduct which constitutes a crime or which contravenes any law ... whether such conduct occurred in the Republic or elsewhere.’

⁵⁴³ IMF *Financial System Abuse* par 5. It is submitted that one would be hard-pressed to find defendants who, for example, manufacture illegal drugs or perpetrated public tender fraud in order to feed their children or themselves. The motive for most financial crimes are usually self-enrichment (see ch 2.C.2 where money’s value to society is contemplated).

⁵⁴⁴ See article 5 of the Vienna Convention (see par C.2 above; ch 5.C.1); section 1 of the Strasburg Convention (see ch 6.B.4.2.2).

⁵⁴⁵ See section 242 of the English Proceeds of Crime Act 2002 - ch 6.D.4.4.2.

⁵⁴⁶ See sections 981(a)(1)(A) and 982(a)(1) of the Money Laundering Crimes Act of 1986; ch 7.D.4.2.2.

⁵⁴⁷ See par C.3.2 above.

⁵⁴⁸ See par C.3.2 above; ch 1.A.2.

'In Connection With' Requirement

International and national legislation alike criminalises all forms of ownership of property acquired through criminal means. The civil forfeiture legislation of the EU, England and the US⁵⁴⁹ therefore provides that any benefit or advantage that has a nexus to an unlawful activity may be confiscated and subsequently forfeited to the relevant authorities.

POCA determines that the court may forfeit property to the state only if it finds on a balance of probabilities⁵⁵⁰ that the property is the proceeds of an unlawful activity or the instrumentality of an offence.⁵⁵¹ Consider the scenario where a person is caught carrying a large amount of cash and is unable to give a reasonable explanation for possessing it. Reasonable grounds exist to confiscate the money on the assumption that it is the proceeds of an unlawful activity.⁵⁵² However, the NDPP will have to establish on a balance of probabilities a connection between the money and an unlawful activity before the court will forfeit the money to the state.

In *National Director of Public Prosecutions v Carolus*⁵⁵³ the court considered the nexus-requirement for civil forfeiture applications. It reasoned that the NDPP must establish a nexus between the unlawful activity and the property that is the subject of the application before a court will issue a civil forfeiture order.⁵⁵⁴

The court further explained that the requirement of a finding based on a balance of probabilities corresponds with POCA's definition of the proceeds of unlawful activity.⁵⁵⁵ The definition requires evidence that property derived or was received *in connection with*, or as a result

⁵⁴⁹ See ch 6.B.4.2, par C.4.2.2.1; ch 7.D.4.2.3 respectively.

⁵⁵⁰ Of note, section 37(1) of POCA provides that forfeiture proceedings are civil and not criminal in nature. For this reason section 50(1) of POCA (making a forfeiture order) provides for findings on 'a balance of probabilities' before the court may issue a civil forfeiture order. It is therefore curious that the requirement of 'reasonable grounds' is used in section 51(1) (notice to a person having an interest in or control over the property in issue) because it infers the standard of proof in a criminal action, namely beyond reasonable doubt.

⁵⁵¹ See section 50(1)(a)–(b) of POCA; *Mohunram* paras 112–114.

⁵⁵² See *National Director of Public Prosecutions v Van Heerden* [2003] 4 All SA 259 (C) [*Van Heerden*] 268G–I. In this case a person carrying a large amount of cash on behalf of Van Heerden was stopped at the Cape Town International Airport. Van Heerden's subsequent inability to give a satisfactory answer for having so much money in cash led to a suspicion that it was used to commit a money laundering offence. See also par D.2.2.2 above as regards the *Van der Merwe* case which has similar facts to *Van Heerden*.

⁵⁵³ 1999 (2) SACR 27 (C) [*Carolus*].

⁵⁵⁴ *Idem* 39C.

⁵⁵⁵ See section 1(xv) of POCA; par C.3.2 above.

of an unlawful activity. The phrase ‘in connection with’ is intended to broaden the scope of the concept ‘proceeds’ of unlawful activities’.⁵⁵⁶ Since Carolus had legitimate as well as illegal ways of earning an income, the court found it impossible to determine which of the said property, which included various businesses as well as a number of bank accounts, were acquired through criminal means.⁵⁵⁷ Blignaut J found that Carolus’s businesses and bank accounts were not the proceeds of unlawful activities and dismissed the NDPP’s application.

The reasoning above was accepted by the Supreme Court of Appeal in *Seevnarayan II*.⁵⁵⁸ It explained that although returns accruing from an unlawful activity are also forfeitable, the definition of ‘proceeds of unlawful activities’ requires a nexus between the return and the unlawful activity. The property in issue must therefore have a nexus to an unlawful activity before a court will issue a civil forfeiture order. It is evident that the judiciary favours a conservative interpretation of when money should be regarded as the proceeds of unlawful activities. This approach is correct as well as fair. Whether money deposited into a bank account is indeed the proceeds of unlawful activities depends on two prerequisites. First, the source of the money and secondly, whether the NDPP can establish on a balance of probabilities a reasonably direct link between the money and the commission of a crime.

Consider the scenario where X, a fraudster, acquired one million rand as a result of an investment scheme which in fact never existed. X deposited the benefits of the fraud into his current account where the funds commingled with other legitimately earned funds in the account. He subsequently transferred one million rand to his investment account. It is submitted that the one million rand should be judged as being the benefits of fraud on account of X’ fraudulent conduct.⁵⁵⁹ This means that the NDPP’s burden of proving that money *in specie* was acquired through fraud is lightened because it needs only to establish on a balance of probability that X acquired one million rand of the funds in the investment account through fraudulent conduct.

⁵⁵⁶ *Carolus* 39D–E.

⁵⁵⁷ *Ibid.*

⁵⁵⁸ Paras 32, 67. Ultimately, the court agreed that there was no connection between interest earned on capital and the offence (namely, income tax evasion) that Seevnarayan committed. Therefore, although Seevnarayan committed an income tax offence (see par C.4.2.3.3 above), he did not retain the interest earned on the money in connection with or as a result thereof (*Seevnarayan II* par 73).

⁵⁵⁹ The reason is that money itself is a neutral medium (see ch 2.C.5.3.2, par C.5.3.3). However, the intention of the fraudster to commit fraud designates it, here the one million rand, as the benefits of fraud.

4.2.1.4 Instrumentality of an Offence

The foregoing illustrates that property can be forfeited to the state pursuant to POCA only where it falls into one of two categories. It must either be acquired in connection with an unlawful activity or it must be the so-called ‘instrumentality of an offence’.⁵⁶⁰ Section 1(vii) of POCA defines the concept ‘instrumentality of an offence’ as property which is *concerned in* the commission of an offence listed in Schedule 1 of the Act.⁵⁶¹ Two remarks about the concept ‘instrumentality of an offence’ are necessary.

First, why it was necessary for Parliament to distinguish in POCA between unlawful activities and the offences listed in Schedule 1 of POCA is unclear.⁵⁶² It is submitted that the distinction above is superfluous and serves no purpose.⁵⁶³ For this reason Parliament should repeal Schedule 1 of POCA as well as any reference in the Act to it. The concept ‘instrumentality of an offence’ should further be amended to ‘instrumentality of an unlawful activity’ and defined as follows:

‘instrumentality of an [unlawful activity]’ means any property which is concerned in the commission or suspected commission of an **[unlawful activity]** at any time before or after the commencement of this Act, whether committed within the Republic or elsewhere.

Amending POCA in this fashion should streamline its provisions which in turn, may increase the NDPP’s success rate in obtaining civil forfeiture orders.

Secondly, to establish a nexus between property earmarked for civil forfeiture and one of the offences listed in Schedule 1 of POCA is not as straightforward as it may appear. The NDPP must establish two requirements to secure a civil forfeiture order in relation to property used to

⁵⁶⁰ See section 50(1)(a)–(b) of POCA.

⁵⁶¹ See par C.3.2 above.

⁵⁶² The reason for the distinction probably concerns the fact that the US MLCA (see ch 7.D.4.2.2) defines ‘proceeds’ with reference to a list of ‘specified unlawful activities’ which is reminiscent of the offences in Schedule 1. However, the use of complex US legislative provisions in South African AML legislation is unwarranted and should be guarded against (see also ch 7.F).

⁵⁶³ See, for example, the EU’s Strassburg Convention using ‘proceeds of crime’ and the English PCA, using ‘property obtained from unlawful conduct’, in relation to the civil forfeiture of property acquired through criminal means (see ch 6.B.4.2.2, par C.4.4.2.1 respectively).

commit an offence. First, that a clear nexus between the said property and an offence exists and secondly, that the property was used in the commission of an offence. In *Mohunram* the Constitutional Court emphasised the importance of determining whether property that is the subject of a civil forfeiture application was indeed used to commit or promote an offence listed in Schedule 1 of POCA. It asserted as follows:⁵⁶⁴

[t]he initial and central enquiry in asset forfeiture is whether the property is an instrumentality of an offence. If it is, the property is liable to be declared forfeit to the state.

'Which is Concerned in' Requirement

Sometimes it is the meaning of the phrase 'which is concerned in' which presents evidential problems in a civil forfeiture application.⁵⁶⁵ In *National Director of Public Prosecutions v RO Cook Properties (Pty) Ltd*⁵⁶⁶ the court held that the phrase 'which is concerned in' means that the NDPP must establish a direct link between an offence and the said property.⁵⁶⁷ The latter must be functional to the commission of the offence before it could be judged the instrumentality of an offence.⁵⁶⁸

The court's view in *RO Cook* was affirmed in *Seevnarayan II*⁵⁶⁹ where the Supreme Court of Appeal reasoned that the commission of a crime at a certain location does not necessarily constitute the location an instrumentality of the offence. The court eventually found that interest earned on money invested by Seevnarayan was not the instrumentality of a tax evasion offence. The reason was that the NDPP failed to establish a direct link between the interest that

⁵⁶⁴ *Mohunram* par 118 (see par D.4.2.1.1 above for the facts of the case).

⁵⁶⁵ *Carolus* 39F–H. The court found that the businesses and bank account were not instrumentalities of an offence because the NDPP failed to establish that they were used to commit an offence listed in Schedule 1 of POCA (see also par D.4.2.1.1 above).

⁵⁶⁶ [2002] 4 All SA 692 (W) [*RO Cook*]. In this case the court found that a house where kidnapped persons were held hostage was not an instrumentality of the kidnapping. It is submitted that this ruling should be questioned because the house was clearly functional to the execution of the kidnapping.

⁵⁶⁷ *RO Cook* 726E.

⁵⁶⁸ 726E–G. See also *Carolus* 39E.

⁵⁶⁹ *Seevnarayan II* 33–34.

Seevnarayan earned on an investment and the income tax evasion offence.⁵⁷⁰ Mpati DP and Cameron JA explained as follows:⁵⁷¹

[t]he words ‘concerned in the commission of an offence’, must in our view be interpreted so that the link between the crime committed and the property is *reasonably* direct, and that the employment of the property must be functional to the commission of the crime. By this we mean that the property must play a *reasonably* direct role in the commission of the offence.

It is submitted that the facts placed before the court in *Seevnarayan II* indicated that the interest earned on invested money did not played a direct role or assisted Seevnarayan to commit tax evasion. It was a mere byproduct of his unlawful conduct. For this reason the court was correct in asserting that the interest was not an instrumentality of an offence.⁵⁷²

Two years later in *Mohunram* the Constitutional Court had the opportunity to consider in detail the meaning of the concept ‘instrumentality of an offence’ as referred to in POCA.⁵⁷³ The court agreed only in part with the ruling in *Seevnanarayan II*. In *Mohunram* the applicant argued that property used for legitimate business purposes should not be forfeited simply because an illegal gaming machine was also operated on the premises.⁵⁷⁴ The court considered the contention and reviewed the interpretation of the Supreme Court of Appeal in three other forfeiture cases.⁵⁷⁵

In the first case, *Seevnarayan II*, the Supreme Court of Appeal found that the widest possible meaning should be given to the concept ‘instrumentality of an offence’ so that the nexus between a listed offence and the property is reasonably close.⁵⁷⁶ It therefore dismissed the NDPP’s appeal and allowed Seevnarayan to keep interest earned on money on which he should have paid income tax.⁵⁷⁷ In the second case, *Prophet v National Director of Public Prosecutions*,⁵⁷⁸ Mpati

⁵⁷⁰ *Idem* par 73. See also par C.4.2.3.3 above as regards the offence of tax evasion.

⁵⁷¹ *Seevnarayan II* paras 31–32, 59.

⁵⁷² Whether this outcome is fair is another question. Consider, for example, where a thief uses a stolen vehicle as a taxi. The money he earns is neither the benefits of theft nor the instrumentality of theft yet it seems unjust that it could not be declared forfeited to the state.

⁵⁷³ Although the subject of the civil forfeiture proceedings was not money but property used partly to house a legitimate business and an illegal gambling machine, the court’s observations merit mentioning in this context.

⁵⁷⁴ See par D.4.2.1.1 above for the fact of the case.

⁵⁷⁵ *Mohunram* paras 44–57.

⁵⁷⁶ *Idem* paras 31–32.

⁵⁷⁷ For the facts of the case, see par D.4.2.1.1 above.

⁵⁷⁸ 2006 (1) SA 38 (SCA) [*Prophet III*]. The court *a qua* granted the NDPP’s application and forfeited Prophet’s house to the state (*Prophet I* paras 27–31). Prophet’s appeal against this ruling was dismissed by Supreme Court of Appeal. He therefore turned to

DP found that the house which was the subject of the NDPP's civil forfeiture application, was an instrumentality of a drug offence because it was furnished and adapted to facilitate the appellant's illegal drug activities.⁵⁷⁹

In the third case, *National Director of Public Prosecutions v Parker*,⁵⁸⁰ the court decided that the use of a residence for the manufacture of illegal drugs rendered it the instrumentality of an offence pursuant to POCA even if it had not been adapted specifically for such activities.

After reviewing the three cases above, the Supreme Court of Appeal accentuated the importance of proportionality and pointed out that the NDPP had to put facts before it to enable a proportionality assessment.⁵⁸¹ The court further asserted that the proper approach in reviewing a civil forfeiture order comprised two inquiries.⁵⁸² First, whether forfeiture of the said property would serve the purpose of removing incentives for crime, and secondly, whether it would serve as an adequate deterrence to the offender and society alike.

Mostly as a result of the latter consideration the court upheld Mohunram's appeal against the civil forfeiture order. It found that the property was not the instrumentality of an offence as meant by section 50 of POCA. The court explained that it was unable to come to any decision other than that the civil forfeiture of the property was disproportionate to the offence, namely the illegal possession of a gaming machine.⁵⁸³ Ultimately, the court gave considerable weight to the fact that the whole property was not used to advance criminal offences and, therefore, its forfeiture would have been disproportionate in relation to the illegal gaming activities.⁵⁸⁴

The importance of the *Mohunram* ruling lies in the fact that the Constitutional Court added proportionality as yardstick to determine whether property should be forfeited to the state. It follows that the NDPP must establish three instead of two⁵⁸⁵ requirements before the court will

the Constitutional Court where Nkabinde CJ also dismissed his appeal (see *Prophet II* paras 71, 75).

⁵⁷⁹ *Prophet III* paras 28–29. Mpati DJ explained (paras 35–36) that the NDPP showed on a balance of probabilities that Prophet knew that his house was used as an instrumentality to manufacture methamphetamine which is an offence in terms of the 1992 Act (see par C.1 above).

⁵⁸⁰ 2006 (3) SA 198 (SCA) [*Parker*] par 46. For an analysis of the matter, see De Koker *ABLU-2008* 265–266.

⁵⁸¹ *Mohunram* par 132. See also De Koker *ABLU-2008* 265–268.

⁵⁸² *Mohunram* par 134.

⁵⁸³ *Idem* par 137. For the fact of the case, see par D.4.2.1.1 above.

⁵⁸⁴ *Mohunram* par 136.

⁵⁸⁵ See above.

declare property used to commit an offence forfeited to the state. They are one, a reasonably direct link between the property and an offence; two, that the property's use was functional to the commission of the offence; and three, that forfeiture of the property is proportional in relation to the offence.

If one were to replace the property that was the subject of the civil forfeiture application in *Mohunram* with a bank account comprising partly legitimately earned money and partly the proceeds of unlawful activities the outcome most likely will be the same. However, the NDPP will be required to establish on a balance of probabilities which part of the commingled fund was acquired through criminal means or used to commit an offence. Common sense dictates that the matter can be resolved by book entries and bank statements.

The discussion above further illustrates that money qualifies as an instrumentality of an offence only if it played a reasonably direct role in the commission of an offence.⁵⁸⁶ It is evident that our courts are rather cautious to designate money either as the benefits of unlawful activities or as the instrumentality of an offence. For this reason it is impossible to formulate definite rules in relation to the civil forfeiture of money. Instead, the facts of a case are likely to dictate whether the NDPP will be able to establish that the money concerned constitutes the benefits of unlawful activities or was used to commit an offence.

Compare, for example, the scenario where cash is found hidden on the property of a known drug trafficker with the scenario where cash is found on the property of a person who is charged with bribery and theft. The facts of the first scenario suggest on a balance of probabilities that the hidden cash is the proceeds of a drug offence and, therefore, it should be forfeited to the state.

In contrast, whether the cash in the second scenario above is money which the thief stole from his employer, money which the defendant earned legitimately and would have used to continue bribing a colleague to assist him with stealing from their employer, or money that was paid to him as a salary is likely to depend on the available evidence.

Similarly, if the NDPP seeks to secure a civil forfeiture order against moneys deposited into the bank account of a person who stands accused of, for example, corruption it will have to establish which part of the money in the account was acquired as a result of the corruption and which part was legitimately earned by the defendant. Either way, the NDPP must convince the court on a balance of probabilities that the money in issue was either acquired as payment for

⁵⁸⁶ *Carolus* 39F–G.

corruption or would have been used to induce some other to commit corruption before the court will forfeit it to the state.

4.3 Innocent Owner Defence

As seen above, a primary principle that governs civil forfeiture is that only the benefits of unlawful activities or property used to commit an offence may be forfeited to the state.⁵⁸⁷ But POCA also affords a remedy to two types of owners of property that is earmarked for civil forfeiture.⁵⁸⁸ First, a person who has an interest in the benefits of unlawful activities can use section 52(2) of the Act to prevent their forfeiture whilst a person with an interest in property that was used to commit an offence can use section 52(2A) of the Act⁵⁸⁹ to safeguard his interest against civil forfeiture.

The difference between the protection afforded by the sections above may best be illustrated by two examples. Consider the scenario where Y's salary is paid into a bank account which she shares with her husband. The NDPP⁵⁹⁰ informs Y that the account is the subject of civil forfeiture proceedings because her husband deposited money which he allegedly acquired through insider trading into the account. Y as an innocent owner of part of the money in the account must use section 52(2) of POCA to prevent forfeiture to the state of her part of the money in the account.

In contrast, section 52(2A) of POCA can be used by a person to prevent forfeiture of its interest in property that was used to commit an offence. Consider in this regard the scenario where the NDPP informs X Bank that property in which it holds an interest as mortgagee is the subject of civil forfeiture proceedings because its customer used the garden to grow marijuana plants and

⁵⁸⁷ See section 50(1) of POCA; par D.4.2.1.3 above.

⁵⁸⁸ See ch 6.C.4.4.3 and ch 7.D.4.3 for the English and the US position respectively.

⁵⁸⁹ As amended by section 9 of Act 38 of 1999 (see par C.3.1 above). Section 52(2A) concerns only an instrumentality of an offence such as a residence that was used as a brothel or money paid as a bribe to a government official and provides that: '[t]he High Court may make an order under subsection (1), in relation to the forfeiture of an *instrumentality of an offence* ... if it finds on a balance of probabilities that the applicant for the order had acquired the interest concerned legally, and (a) neither knew nor had reasonable grounds to suspect that the property in which the interest is held is an *instrumentality of an offence* ...; or (b) where the offence concerned had occurred before the commencement of this Act, the applicant has since the commencement of this Act taken all reasonable steps to prevent the use of the property concerned as an instrumentality of an offence.'

⁵⁹⁰ See section 48(2) of POCA which requires the NDPP to give 14 days notice of its intend to apply for a civil forfeiture order to all persons with an interest in the said property.

the outbuilding to store the dried produce. X Bank must therefore use section 52(2A) to bring an application as an innocent owner of an interest in property used to commit drug offences pursuant to the 1992 Act⁵⁹¹ to prevent forfeiture thereof.

In *National Director of Public Prosecutions v Levy*⁵⁹² the court considered POCA's innocent owner remedy. It confirmed that an innocent owner of confiscated property will have the property returned to it or its interest excluded if it can establish that the property was legally acquired and that it had no reason to suspect that the property was used to commit an offence.⁵⁹³ The onus to establish the latter two facts on a balance of probabilities is placed on the applicant claiming the defence.

POCA defines the concept 'interest' narrowly to include any right in property earmarked for civil forfeiture.⁵⁹⁴ Consider the scenario where a person was awarded compensation by the court only to find that the defendant has only one asset in the form of money in a bank account which is the subject of a civil forfeiture application. The court may, after the applicant has established his interest in part of the deposited money, order that compensation is paid to the applicant first before the balance is forfeited to the state.⁵⁹⁵

As mentioned above, 52(2A)(a) of POCA pertains specifically to a scenario where a person needs to use the innocent owner defence in relation to property that was used to commit an offence, the so-called instrumentality of an offence. Section 52(2A)(a) can therefore be used by a bank which holds a mortgage over a residence that is the subject of civil forfeiture proceedings because it was used, for example, as a brothel⁵⁹⁶ or an illegal drug manufacturing laboratory. The bank in order to protect its interest from being forfeited to the state must establish on a balance of probabilities that it:

- acquired the interest in the property legally; and

⁵⁹¹ See par C.1 above.

⁵⁹² [2004] All SA 103 (W) [*Levy*]. See also *Mohamed* paras 17–18; *Parker* paras 12, 23; *Seevnarayan II* par 11.

⁵⁹³ *Levy* 111H–I.

⁵⁹⁴ See par D.4.2.1.1 above.

⁵⁹⁵ *Levy* 110H–111E. An innocent owner is entitled to intervene in a civil forfeiture application by either opposing the civil forfeiture application or by requesting exclusion of its interest in the property from the civil forfeiture order (sections 52(2), 52(2A), 54 of POCA).

⁵⁹⁶ Note that operating a brothel is an offence in terms of section 2 of the Sexual Offences Act 23 of 1957.

- neither knew nor had *reasonable* grounds to suspect that the property was used to commit an offence.

In the scenario above the bank's onus to establish the requirements above is preceded by the first stage of the inquiry in which the onus rests on the NDPP to show on a balance of probabilities that the house in issue constitutes an instrumentality of an offence listed in Schedule 1 of POCA.⁵⁹⁷ Once this element has been established the onus shifts to the bank to establish the innocent owner defence. If the bank is successful with the defence the court will resolve how to deal with the house in order to compensate the bank as innocent owner first with the balance passed on to the state.⁵⁹⁸

A relevant issue in this regard is whether the applicant's suspicions about the potential criminal use of property would prejudice it in a subsequent section 52(2A)-application. Consider the scenario where a bank receives information that a small holding in which it has an interest as a mortgagee is being used as a chop shop of stolen vehicles. The bank reports its suspicions to the SAPS with the result that the small holding is confiscated and a civil forfeiture application is brought by the NDPP.

The question that should be considered next is whether the bank that reported its suspicions to the SAPS could still rely on section 52(2A)'s protection. Notably, section 52(2A)(a) of POCA requires that the bank above must establish not only that it acquired the interest in the small holding legally, but also that it had no knowledge or *reasonable grounds* to suspect that the property was used as a chop shop. POCA is silent about whether an applicant which reported suspicions to the SAPS will be able to safeguard its interest against civil forfeiture.

It is therefore submitted that the court on account of the common-law maxim that provides that the law does not demand the impossible, is likely to allow the innocent owner defence if the bank can establish that it did all that reasonably could be expected to prevent further criminal use of the property.⁵⁹⁹

⁵⁹⁷ See par D.4.2.1.4 above.

⁵⁹⁸ See section 58–62 of POCA as regards the preservation and realisation of forfeited property.

⁵⁹⁹ See also *Seevnarayan II* paras 24–26. It is submitted that the bank can also use the fact that it established the defendant's identity pursuant to section 21 of FICA (see par C.4.2.3.2 above) before it granted him a mortgage to prove to the court that there was no reasonable grounds to anticipate the defendant's subsequent criminal conduct.

Whether a victim of fraud or theft who followed his loss to the fraudster or thief's bank account and found that the account is the subject of a civil forfeiture application may likewise approach the court as an innocent owner is uncertain. Since the money in issue is the benefits of fraud or theft as opposed to the instrumentality of an offence, the victim of the fraud or theft will have to use section 52(2) instead of section 52(2A) of POCA to safeguard his interest. The problem with using section 52(2) is that it only applies to a person who *acquired* an interest in the said property as opposed to a person who was unlawfully deprived of his property as a result of fraud or theft. This distinction may be best illustrated with an example.

Consider the scenario where M followed money that was stolen from him by his investment advisor to the latter's bank account only to learn that the account is the subject of civil forfeiture proceedings. Even though the investment advisor as thief never obtained a legal title to the stolen money, it is doubtful whether M would be able to protect his rights in the money against civil forfeiture. The reason concerns section 52(2) of POCA's formulation.

It is submitted that M will be unable to use section 52(2) of POCA to protect his interest in the bank account from civil forfeiture because he did not *acquire* the money in issue but was illegally deprived thereof. The formulation of section 52(2) clearly restricts its application to specific scenarios only.⁶⁰⁰ It is therefore recommended that Parliament should amend section 52(2) of POCA as follows:

Exclusion of interest in property

(2) The High Court may make an order under subsection (1), in relation to the forfeiture of the **[benefits]**⁶⁰¹ of unlawful activities, if it finds on a balance of probabilities that the applicant for the order—

(a) had acquired the interest concerned legally and for a consideration, the value of which is not significantly less than the value of that interest; and (b) where the applicant had acquired the interest concerned after the commencement of this Act, that he or she neither knew nor had reasonable grounds to suspect that the property in which the interest is held is the **[benefits]** of unlawful activities crime; **[or**
[(c) has a legal interest in the property and that such interest was vested in him rather than in the defendant.]

⁶⁰⁰ Which position corresponds with the limited innocent owner defence provided by the English PCA (see ch 6.C.4.4.3).

⁶⁰¹ See par C.3.2 above where it is recommended for reasons which were spelt out in detail that the concept 'proceeds' in POCA should be replaced with the concept 'benefits'.

The insertion of subsection (c) in section 52(2) of POCA should widen its ambit and ensure that a victim of fraud or theft receives the same protection as other innocent owners of property that is the subject of a civil forfeiture application.

An ancillary issue in this regard concerns section 70(6) of FICA which provides a remedy to innocent owners that hold an interest in forfeited cash. To understand the remedy it is necessary to explain the provisions of section 30(1) of FICA. Section 30(1) of FICA provides that any person intending to carry cash in, or out of South Africa must file a report.⁶⁰² Cash found in the possession of a person in contravention of section 30(1) of FICA may be seized by the authorities.⁶⁰³ This is the type of situation where section 70(6) comes into play.

In terms of section 70(6) of FICA an applicant whose cash was confiscated may approach the court for the return of the cash if he can establish two factors. First, that he acquired the interest in the said cash in good faith and secondly, that he was unaware that the cash was either transported in contravention of section 30(1) of FICA, or that it was earmarked to structure transactions as intended by section 64 of FICA.⁶⁰⁴ If the court finds in the applicant's favour either the cash or an equal amount must be returned to him.

It is submitted, as pointed out by the Constitutional Court in *Fraser*,⁶⁰⁵ that the individual circumstances of a case coupled with the discretion of the court will be determining factors in the outcome of the case in the event that the innocent owner defence is claimed.⁶⁰⁶

4.4 International Cooperation in Criminal Matters Act (1996)

In 1996 following a proposal by the Law Commission of a Money Laundering Control Bill⁶⁰⁷ the government recognised the need to reinforce international cooperation in relation to organised

⁶⁰² A report must be filed either with the Minister of Finance in respect of an individual, or to the FIC in respect of a designated person (see par C.4.2.3.3 above). Note that section 54 of FICA criminalises willful contravention of section 30(1).

⁶⁰³ Section 70(2) of FICA.

⁶⁰⁴ Section 64 of FICA criminalises conduct aimed at structuring transactions for the purpose of avoiding the threshold reporting duty of the Act (see par C.4.2.3.3 above). See also ch 4.B.4 where the money laundering technique of 'structuring' is analysed.

⁶⁰⁵ Paras 58, 71. See par D.4.5 below for the facts of the case.

⁶⁰⁶ See also ch 7.D.4.3 where the point is made that a bank claiming the innocent owner defence must establish that it acted without failure in good faith.

⁶⁰⁷ See par B.2, par C.1 above.

crime and money laundering. The International Cooperation in Criminal Matters Act⁶⁰⁸ was thus enacted to facilitate international cooperation in these and related matters.

The Cooperation Act affords the AML authorities⁶⁰⁹ extended powers to provide mutual legal assistance⁶¹⁰ in relation to money laundering investigations. It provides a basis to facilitate the provision of evidence, execution of sentences in criminal matters and the confiscation and transfer of benefits of crime between national authorities and the authorities of other jurisdictions.⁶¹¹ The Cooperation Act further sanctions information exchanges among international counterparts whilst assistance may be given in the confiscation of assets situated abroad. Moreover, section 27 of the Cooperation Act empowers the President to:

[e]nter into any agreement with any foreign State for the provision of mutual assistance in criminal matters.

Other legislation that facilitates international cooperation includes, for example, the Extradition Act⁶¹² which enables the extradition of both South African nationals as well as non-citizens to requesting countries. South Africa has also entered into key treaties and other agreements to facilitate mutual legal assistance as well as for other law enforcement reasons.⁶¹³

4.5 Interim Recovery Orders⁶¹⁴

The primary purpose of this section relates to civil forfeiture. This is because motions that seek interim relief in relation to civil forfeiture form a key part of the High Court's jurisdiction. In general, the ability of a court to grant interim relief is governed by various statutory provisions and

⁶⁰⁸ 75 of 1996 ('Cooperation Act'). See in general FATF *SA Report-2009* paras 34–36.

⁶⁰⁹ See par A above.

⁶¹⁰ For the provisions of other international legislation pertaining to mutual legal assistance, see ch 5.C.2.

⁶¹¹ See the long title of the Cooperation Act.

⁶¹² 67 of 1962.

⁶¹³ For example, the 1988 Vienna Convention (see ch 5.C.1) and the UN Convention Against Organised Crime of 2000 (see ch 5.C.3.3).

⁶¹⁴ See also par D.2.3 above. The idea here is not to analyse in full the jurisprudence of interim recovery orders because such an endeavour falls beyond the ambit of this study. Instead, a few salient principles of interim recovery orders as regards the benefits of crime deposited with a bank are considered.

must be authorised by legislation. In line with the other jurisdictions considered in this study for comparative purposes⁶¹⁵

POCA allows the courts to issue interim orders for the preservation, inspection or custody of property that is the subject of a civil forfeiture application.⁶¹⁶ Where grounds exist that suggest, for example, that money deposited with a bank was unlawfully acquired by the account holder the court is empowered to grant an interim order to prevent the funds' removal.

An applicant such as a victim of fraud or theft may approach the High Court for a preservation order to prevent the fraudster or thief from withdrawing the deposited benefits of fraud or theft from the bank where he deposited it before the outcome of a civil action against him.⁶¹⁷ Since POCA provides for interim relief pending the outcome of a civil forfeiture application, the NDPP must use the Act's provisions to apply for interim relief in the form of a restraint or preservation order.⁶¹⁸ More specifically, in terms of section 38(1) of POCA the NDPP may bring an *ex parte* application to prevent any dealings in property seized pursuant to POCA. A final preservation order may be granted only after it was established that reasonable grounds exist to believe that the property in issue is either the benefits of an unlawful activity, or the instrumentality of an offence.⁶¹⁹

In the recent case of *Starplex* the court had to consider whether to grant a final order for the preservation of cash that were seized at a railway storage facility.⁶²⁰ It confirmed that the NDPP must establish on a balance of probabilities that the cash is either benefits of unlawful activities

⁶¹⁵ See ch 6.B.4.2.2, par C.4.4.4; ch 7.D.4.4.

⁶¹⁶ See Chapter 5 parts 2 and 3 of POCA.

⁶¹⁷ For example, a Mareva injunction which is an interim restraining order to prevent removal of property pending the outcome of the principal matter (see also par D.2.3 above).

⁶¹⁸ *Fraser* par 58. Likewise in *Van Staden* the court explained that interim preservation orders are aimed at preserving property pending an application for a civil forfeiture order (par 3). Nugent JA further commented that a court could grant such an order only if it was satisfied on a balance of probabilities that the property in issue constituted benefits of unlawful activities or the instrumentality of an offence.

⁶¹⁹ See par D.4.2.1 above.

⁶²⁰ In this matter, the immigration authorities and the SAPS found large amounts of cash at a Cape Town railway station. The cash comprised South African currency as well as international currency. When asked for an explanation, the respondents had various justifications for having the currency including that it was the benefits of a money exchange business and of a food selling business. The cash as well as documents were seized by the austerities and a rule *nisi* was granted for the preservation of the money pursuant to section 38(1) of POCA. The present case concerned an application by the NDPP for a final preservation order.

or the instrumentality of an offence.⁶²¹ Ultimately, the respondents in *Starplex* denied statements to the authorities that the said currency was the proceeds of an illegal money exchange business and contended that it derived from legitimate businesses they managed which included the selling of apparel.⁶²²

The court found the explanations of the respondents unconvincing.⁶²³ Mainly as a result of their inability to explain the amount of cash on the premises, the court agreed with the NDPP's contention that the cash was benefits of an illegal exchange business and asserted that the NDPP should be able to obtain a civil forfeiture order in due course. It granted a final preservation order in terms of section 38(1) of POCA mostly because of the NDPP's success in establishing on a balance of probabilities that the currency was the benefits of an illegal money exchange business.

In general, a restraint order may be varied or rescinded for two reasons only. First, if the High Court that made the order is satisfied that the operation of the order is likely to deprive the defendant of the means to provide for reasonable living expenses. Secondly, if the court is convinced that the hardship the defendant will suffer outweighs the risk that the property may be transferred or lost.⁶²⁴

But what if the rights of the defendant conflict with the rights of some other such as a bank which as creditor holds an interest in the property concerned? This was the primary issue before the Constitutional Court in *Fraser*. The *Fraser* case concerned a restraint order that the NDPP obtained on the applicant's property. Fraser approached the High Court for an order directing the curator to sell the property so that the proceeds could be applied towards his legal expenses. Absa Bank, a concurrent creditor of Fraser, obtained a default judgment against him for payment of a debt to the total amount of 1028 214.25 rand. Since the debt was unsecured, Absa Bank enjoyed no preference under the Insolvency Act for its claim against Fraser. Absa Bank subsequently opposed Fraser's application for legal expenses arguing that if Fraser was permitted to use the proceeds of the restrained property to pay for legal expenses, it might be unable to recover the money that Fraser owed it.⁶²⁵

⁶²¹ *Starplex* paras 13–14.

⁶²² *Idem* paras 21–27.

⁶²³ *Starplex* paras 38–42, 44–45.

⁶²⁴ See section 26(10)(a) of POCA; *Phillips v National Director of Public Prosecutions* (2003) 6 SA 447 (SCA) par 22. As regards the requirements for determining the appealability of interim preservation orders, see *Zweni v Minister of Law and Order* (1993) 1 SA 523 (A).

⁶²⁵ *Fraser* paras 3–9.

The High Court ruled against Absa Bank. It reasoned that Absa Bank's claims must be left out of the restraint order because they were an obligation of Fraser which conflicted with the restraint order. Absa Bank appealed the ruling to the Supreme Court of Appeal which found in the bank's favour. As a result, Fraser approached the Constitutional Court claiming, *inter alia*, that his right to appoint legal counsel of choice will be infringed on account of financial constraints should Absa Bank's claim be allowed.

The Constitutional Court partly upheld and partly overturned the judgment of the Supreme Court of Appeal. It pointed out that POCA could not have meant that concurrent creditors must be allowed to intervene and be treated as if they were preferential creditors.⁶²⁶ However, there are circumstances in which a creditor may participate in the distribution of a defendant's estate which was the subject of a restraint order. The purpose of a restraint order is to preserve the defendant's assets pending the NDPP's application for their confiscation. The court can decline to order confiscation or it can order confiscation of an amount less than the value of the defendant's assets that are subject to restraint. The effect is that all or some of the defendant's assets are returned to him and again become available to creditors for the execution of their claims.

Where the value of the defendant's property is more than the amount required to satisfy the confiscation order, the excess must be returned to the defendant and must become available to creditors for execution of their claims. The court can also order that a creditor's claims be paid before the proceeds are used to satisfy the confiscation order. The court further explained that in terms of section 33(1)(a) of POCA a court has to exercise its powers 'with a view to making available the current value of ... property for satisfying any confiscation order.'⁶²⁷ Any obligation of the defendant which conflicts with a confiscation order must be considered. It is in the creditors' best interest that as much of the restrained estate as possible be preserved because part of it can still become available to them for the satisfaction of their claims. Accordingly, in civil forfeiture cases the High Court has a discretion to allow a creditor to intervene.⁶²⁸ Financial constraints also play a role and the court has to balance competing interests. It follows that a concurrent creditor can intervene which intervention does not infringe upon the defendant's right to legal representation. However, the High Court's discretion is pivotal. The court has to ensure that a defendant neither benefits from a restraint order nor is prejudiced as far as reasonable legal

⁶²⁶ *Idem* paras 57–58.

⁶²⁷ *Fraser* par 59.

⁶²⁸ *Idem* paras 62–71.

expenses are concerned. Some of the circumstances which a court can consider include the seriousness of the charges against the defendant, the value of his assets, the number of creditor claims and the history of the specific claim of the creditor who sought intervention.

Notably, the court asserted that there is no duty on the NDPP to give notice to creditors of a civil forfeiture application.⁶²⁹ Any creditor can approach the court as soon as it becomes aware of the proceedings. In this case, Fraser's own role in a delay which result from Absa Bank's intervention had to be taken into account. For the reasons spelt out above, the Constitutional Court agreed with the Supreme Court of Appeal's decision and dismissed Fraser's appeal.

It reasoned that Fraser sought to evade his legal obligations to Absa Bank by concealing his assets in a close corporation and only taking possession of them again once the restraint order was in operation.⁶³⁰ For this reason the court referred the case back to the High Court so that it can use its discretion to determine the terms of an order which will allow consideration of Absa Bank's interests as creditor of Fraser.

The *Fraser* case demonstrates the potential difficulties that banks may experience in safeguarding their interests in property earmarked for forfeiture. From a legal viewpoint POCA ignores a bank's ownership as recipient of the benefits of unlawful activities.⁶³¹ Although the bank is in actual fact owner of the alleged benefits of unlawful activities after the funds have been deposited into a bank account, it may nevertheless be required to turn the funds over to the state following a court order in this respect irrespective of its interest in the money.

The outcome is likely to cause hardship for a bank which, for example, hoped to apply deposited funds towards payment of the customer's debts or which invested the funds. Ultimately, it is the bank that is left with the uncertainty of how the courts will resolve the situation as well as legal expenses as aptly illustrated in *Fraser*, a case which commenced in the High Court and ended in the Constitutional Court.

E. INDIVIDUALISED ANTI-MONEY LAUNDERING MEASURES

1. Financial Intelligence Centre

⁶²⁹ *Idem* paras 74–76.

⁶³⁰ *Fraser* paras 78–80.

⁶³¹ See ch 3.C.3 as regards a bank's ownership of deposited money.

FICA established the FIC with a two-fold mandate: to assist with the identification of the benefits of crime and to combat money laundering.⁶³² In addition, the FIC aims to disseminate information with national and international AML authorities alike.⁶³³ The FIC became operational in February 2003 and was created as a juristic person⁶³⁴ ‘outside the public service but within the public administration’⁶³⁵ in accordance with the values set out in section 195 of the Constitution of the Republic of South Africa.⁶³⁶

The FIC has four distinct functions, namely to:⁶³⁷

1. process and analyse information contained in reports filed with it;
2. advise and cooperate with law enforcement;
3. monitor banks;⁶³⁸ and
4. to keep record of procured information for at least five years.

It is further empowered to issue guidance notes and directives⁶³⁹ to banks regarding the application of FICA. To date the FIC has released four sets of guidance notes⁶⁴⁰ to assist banks in the detection

⁶³² Section 3(1) of FICA.

⁶³³ *Idem* section 3(2).

⁶³⁴ Section 2(2) of FICA.

⁶³⁵ *Idem* section 2(1).

⁶³⁶ 108 of 1996 (‘the Constitution’).

⁶³⁷ Section 4(a)–(d) of FICA. Between 2005 and 2006 more than 19,793 reports were filed with the FIC (Goredema *South Africa* 79). Between 2007 and 2008 this number increased to 24 585 (FATF *SA Report-2009* par 17). The FIC directs STRs for further investigation to various authorities including the SAPS, AFU, SARS, intelligence agencies and the exchange control department of the Reserve Bank.

⁶³⁸ While the Reserve Bank is the main supervisory body of banks (see section 11 of the South African Reserve Bank Act 90 of 1989, as amended), the ability of supervisors to enforce money laundering control measures is unclear. At present, they may only inspect banks for compliance with legislation. Like accountants which are listed in Schedule 1 of FICA (see par C.4.2.3.3 above) and which must comply with the Act’s AML provisions, supervisors of the Reserve Bank should be given specific functions for combating money laundering. This would entail amending existing legislation to authorise supervisors to inspect compliance with FICA and to authorise cooperation with foreign central banks for the purpose of information dissemination.

⁶³⁹ Section 43A(1)–(6) of FICA detailing the nature of the directives.

⁶⁴⁰ See FIC *Guidance Notes 1* which comprises elementary guidelines on customer identity verification; FIC *Meaning of Transaction 2* which defines a transaction pursuant to the use of the word in section 21 of FICA (see par C.4.2.3.2 above); and FIC *Customer Identification 3* which lists, *inter alia*, various risk indicators for banks to be used to differentiate among customers as regards customer acceptance policies. In March 2008 the FIC released a fourth set of guidance notes pertaining to section 29 (see FIC *Transaction Reporting*). The latter is the first of its kind locally and elsewhere and therefore presents an

and control of money laundering. The 2005 special guidance notes which comprise guidelines on how to prudently verify the identity of different type of customers⁶⁴¹ are the most detailed of the four sets of guidance notes.

Significantly, a 1998 report by the IMF attributed the lack of proper money laundering control in South Africa to the ineffective enforcement of AML legislation.⁶⁴² This criticism is directly squarely at the FIC because one of its key functions is to supervise⁶⁴³ compliance to FICA's provisions. However, apparently the FIC has been unsuccessful in fulfilling its supervisory obligation. Eleven years on and the existence of a financial intelligence centre does not seem to be the answer to South Africa's money laundering woes.⁶⁴⁴

The FIC is further permitted to cooperate with any domestic and foreign organisations for the purpose of promoting its objectives.

2. Counter-Money Laundering Advisory Council

innovative step in AML control. But its novelty may also explain its dull content. Ultimately, the guidance notes merely recap the provisions of section 29 of FICA. In addition, 22 pages out of a 48-page document are dedicated to procedures for the submission of reports to the FIC. More practical advice as regards the pitfalls of section 29's obligation would likely peek more interest in the document. Arguably the most enlightening part of the notes concerns the few indicators of suspicious and unusual transactions (see par C.4.2.2.2 above). Despite the fact that many of these are self-evident, one nonetheless calls into question the wisdom of including them in a document which is available for public consumption. It is further disappointing that the FIC failed to make use of this opportunity to illustrate its understanding of the difficulty banks are likely to experience in heeding the reporting obligations of section 29 of FICA.

⁶⁴¹ See FIC *Customer Identification* which distinguishes among various types of customers. Notably, similar to international arrangements in this regard (see ch 6.C.5.1; ch 7.E.1), the guidance notes of the FIC have no legal power and are mere suggestions on how to comply with FICA's AML obligations.

⁶⁴² Henning; Du Toit & Nel *Decriminalisation of Money Laundering* 92.

⁶⁴³ Section 4(c) of FICA.

⁶⁴⁴ For example, out of the 4,523 suspicious activity reports filed up to 2003 only 41 generated criminal investigations that resulted in five convictions for offences other than money laundering (IMF *South Africa Report 2004* par 11). In addition, a 2007-report by the Institute for Security Studies sketches a dark picture of money laundering control in South Africa. It contributes the country's failure to prosecute money laundering offences to the ineptness of the FIC to enforce compliance to FICA (Goredema *South Africa* 82). However, in all fairness it may be an oversimplification to place the blame for the lack of effective money laundering control squarely before one proverbial door. It is submitted for reasons which are spelt out at the end of the chapter (see par F below) that a combination of factors should shoulder the blame for the ineffectiveness of South Africa's AML regime.

FICA established a Money Laundering Advisory Council⁶⁴⁵ for the purpose of advising the Minister of Finance on combating money laundering. In 2008 the name of the Money Laundering Advisory Council was changed to the Counter-Money Laundering Advisory Council because the latter designation apparently denotes the purpose of the Council in a finer fashion.

In particular, the Council may be approached for guidance relating to AML policies, measures to control money laundering and the operation and management of the FIC. Moreover, the Council acts as a forum in which the FIC, representatives of financial organisations, organs of state and supervisory bodies can confer with one another.⁶⁴⁶

Council members include various representatives involved with AML efforts, for example, law enforcement, the National Prosecution Service, Reserve Bank, bank industry and officials from the Ministry of Finance.⁶⁴⁷

It is submitted that the Council has the potential to act as the lifeboat of money laundering control in South Africa providing that bureaucracy within its structures is curbed. The various representatives could make significant contributions to an AML regime that generally compares favourably with its international counterparts,⁶⁴⁸ but which at present demonstrates no insight as regards the practicalities of money laundering control and the reasons for South Africa's failure to control money laundering.

This could be the reason why salient challenges within the regime have not been addressed yet with the fervour they deserve. It is expected that if these issues do not receive urgent attention by the Council it is destined to become yet another meaningless creature of statute that falls short of contributing anything useful to the money laundering control effort.

3. Eastern and Southern African Anti-Money Laundering Group

⁶⁴⁵ Or 'Council' (section 18(a) of FICA). The Council is paramount to the sustainability of the FIC for two reasons. First, it must advise the FIC on its performance (section 18(b) of FICA) and secondly, it must provide financial and administrative support to the centre (*idem* section 18(2)).

⁶⁴⁶ Section 18(c) of FICA. See also De Koker *South Africa* 120. For the activities of the council's international counterparts, see ch 5.D.5; ch 6.C.5.2–5.3; ch 7.E.3.

⁶⁴⁷ Section 19 of FICA. FICA dictates the composition of the Council. The latter must include, *inter alia*, representatives from 11 stakeholders including the National Treasury, Commissioner of the SAPS and the Department of Justice (section 19(1)(a)–(k)).

⁶⁴⁸ See par F below.

Sub-Saharan Africa is riddled with constant wars, droughts, poverty and unsound economic policies. It has been argued⁶⁴⁹ that challenges such as the aforementioned present a barrier to sub-Saharan African countries in their efforts to combat money laundering. Elsewhere in the study,⁶⁵⁰ the point was made that money laundering has an international dimension which is advanced by the availability of electronic banking and EFTs.⁶⁵¹ It therefore follows that effective strategies to control money laundering call for transnational cooperation. This point likewise runs true in relation to sub-Saharan African countries which include South Africa.

In 1999 governments from eastern and southern Africa met in Arusha, Tanzania, to discuss the problem of money laundering.⁶⁵² In line with efforts by the FATF⁶⁵³ it was decided to establish a regional FATF-style organisation in Africa. This effort saw the establishment of the Eastern and Southern Africa Anti-Money Laundering Group.⁶⁵⁴

The ESAAMLG, which comprises 14 countries from the eastern and southern African region,⁶⁵⁵ has three objectives. They are to adopt and implement all⁶⁵⁶ the recommendations of the

⁶⁴⁹ Goredema *South Africa* 77; Goredema & Montsi (2002) *African Security* R 8. In fact, cash in the form of investments are so desperately needed by member countries of the Southern African Development Community ('SADC') that they are likely to accept money regardless of the source, giving credence to an attitude that has been described as 'deal first, ask questions later' (South (1995) *IASOC Crim Org*, available at <http://www.tni.org/detail_page.phtml?page=drugs-docs_south> (2011.03.10)). Similarly, informal AML agreements may well be agreed to by struggling SADC countries for the sake of keeping up appearances while in actual fact no genuine efforts are made to combat the crime. This danger has been recognised by the international AML expert, Barry Rider, who warns that (Rider (1999) *European J of L Reform* 507): '[t]here are countries which have become so isolated from conventional sources of development finance that their leaders, even assuming them to be men of honour, have but little alternative to seeking funds from those who require discretion. The laundering of money, in various states of cleanliness, through national treasuries and government-sponsored projects is nothing new.'

⁶⁵⁰ As to which, see ch 4.B.1; ch 5.A–D.

⁶⁵¹ For an evaluation of the role of e-banking in money laundering, see ch 4.D.4.

⁶⁵² Fakudze *Response to AML* 30.

⁶⁵³ See ch 5.B.3.3.

⁶⁵⁴ Or 'ESAAMLG'. The action was necessitated by the recognition that money laundering is occurring in the region on a significant scale (Goredema *Overview of the Threat* 1, 16).

⁶⁵⁵ Member countries of the group which all signed the ESAAMLG Memorandum of Understanding in June 2001 are Botswana, Kenya, Lesotho, Malawi Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe (Unknown (2002) *J African L* 105, 110). The Commonwealth Secretariat, UN Global Programme Against Money Laundering, FATF Secretariat, World Bank, IMF, Interpol,

FATF, to apply AML measures to serious crimes and to implement other measures contained in multilateral agreements relating to profits from serious crime. Member countries further agreed to consider the content of the Convention against Transnational Organised Crime⁶⁵⁷ despite the fact that only one member country, namely Namibië, had ratified it at the time.⁶⁵⁸

The ESAAMLG is headed by a ministerial council and a task force of senior officials with expertise in law, finance and law enforcement. The task force meets twice a year and the council at least annually. The Tanzanian based secretariat⁶⁵⁹ may implement a work programme that must be approved by the council of ministers. Soon after it was established the ESAAMLG identified three principals tasks that it had to execute.

First, the organisation had to compose a national contact register of persons responsible for coordinating AML efforts in member countries. Secondly, it was necessary to obtain information about the level of money laundering control in its member countries. Finally, each member country of the ESAAMLG had to complete self-assessment questionnaires which covered the FATF's recommendations.

The ESAAMLG has been working since 2003 on establishing an acceptable standard on legal, law enforcement and financial issues within the region. National targets on AML programmes have been set with time frames. In the near future, member countries of the ESAAMLG will be conducting mutual evaluations⁶⁶⁰ for the purpose of identifying and addressing

World Customs Organisation, the African Development Bank, SADC Secretariat, the COMESA Secretariat, the EAC Secretariat, East African Development Bank, Eastern and Southern Africa Development Bank, United Kingdom and the World Bank are jointly acting as observers of the ESAAMLG for the purpose of supporting its objectives.

⁶⁵⁶ Which include the task force's principal 40 recommendations as well as its additional eight recommendations which relate to terrorist financing (see ch 5.B.3.3).

⁶⁵⁷ Or 'Palermo Convention' as the convention is known internationally (see ch 5.C.3). The ESAAMLG probably decided on using the Palermo Convention as template for its AML efforts because in comparison to the Vienna Convention which serves as a template for FICA (see par C.4.1 above), the Palermo Convention pertains not only to money laundering but also to other offences such as corruption.

⁶⁵⁸ Goredema & Montsi (2002) *African Security R 5*.

⁶⁵⁹ The budget of the secretariat is funded by contributions from member countries, cooperating and supporting countries and international observers (*Kessy Regional Collaboration 38*).

⁶⁶⁰ By assuming the responsibility to conduct mutual evaluation exercises on the progress made by its member countries' with money laundering control, the ESAAMLG emulates one of the key functions of the FATF (see ch 5.B.3.3.1). However, whether the ESAAMLG is likely to earn the same respect internationally as its idol, the FATF, is a matter of wait and see.

potential problems with AML measures. South Africa as a result of its position in the region coupled with its modern financial system is likely to play a significant part in the successes or failures of the ESAAMLG.⁶⁶¹ The ESAAMLG acknowledged that various regional issues has foiled its attempt to combat money laundering.⁶⁶²

In 2005 in an effort to address these problems the ESAAMLG drafted a three year action plan for money laundering control in the region.⁶⁶³ The document accentuates the mission of the ESAAMLG and lists seven objectives aimed at achieving the group's goal.⁶⁶⁴ In the three-year strategic plan⁶⁶⁵ the ESAAMLG further contended that effective AML measures will increase the stability of its members' financial systems which, in turn, will improve their participation in global financial systems. Efficient money laundering control is therefore regarded as a contributing factor to the financial stability of the eastern and southern African region.

Despite the best efforts of the ESAAMLG to engender unified policies on money laundering prevention, the lack of modern payment systems coupled with the absence of financial intelligence centres such as the FIC in South Africa are likely to impede efforts to combat money laundering in the region.⁶⁶⁶ A key impediment to money laundering control is probably the costs involved in implementing administrative AML infrastructures in countries which scarcely have sufficient funds to provide basic services to their citizens. Any concerted effort to address money laundering in sub-Saharan should take this and other realities into account before international AML measures are transplanted to the region.

F. CHAPTER COMMENTARY AND SUMMARY

This chapter commenced with a chess quotation which suggests that the South African legislature would be well advised to look at the AML control efforts of jurisdictions such as the EU and the

⁶⁶¹ Cf Goredema *South Africa* 73–74.

⁶⁶² Cf Mcdowell *Key Issues* 3–4; Goredema & Montsi (2002) *African Security R* 10–11; Goredema *Overview of the Threat* 14–15. They include, for example, the involvement of attorneys and accountants in money laundering operations, regional instability, socioeconomic and political environments conducive to money laundering and the growth of informal remittance systems such as hawala (see ch 4.D.4.3.2).

⁶⁶³ ESAAMLG *Strategic Plan 2005–2008*, available at <http://www.esaamlg.org/strategic_plan/index.php> (2011.03.11).

⁶⁶⁴ *Idem* paras 5–10.

⁶⁶⁵ ESAAMLG *Strategic Plan 2005–2008* par 4.

⁶⁶⁶ Mcdowell *Key Issues* 5.

US which have extended experience in this regard. The issue of whether the South African AML regime is comparable with established AML models elsewhere therefore lies at the heart of the chapter.

The first part of the chapter was devoted to the provisions of South Africa's AML legislation. First, an overview of the statutory AML regime prior to the enactment of FICA was provided. It was illustrated that despite previous attempts to address money laundering, various shortcomings existed which preempted the enactment of FICA in 2001. Similar to the US AML regime, and unlike the AML regimes of the EU and England, South Africa has adopted a mixed model of money laundering control comprising both elements of the Objective Model and the Subjective Models for Money Laundering Control. It follows that banks must not only file reports on threshold transactions, but must also weigh transactions to ascertain whether they are suspicious and hence reportable.

By imposing both currency transaction and suspicious transaction reporting obligations on banks FICA utilises the widest possible spectrum of measures to combat money laundering. However, unlike the fragmented AML regime of the US,⁶⁶⁷ South Africa enacted one principal statute for the purpose of money laundering control akin to the EU and England.⁶⁶⁸

It was further evident that except for the absence of customer due diligent measures FICA's provisions are remarkable similar to the provisions of the EU's 2005 Directive. Parliament apparently also studied the English blueprint of money laundering control; basic KYC standard obligations have been included in FICA whilst the risk-approach to customer identification are explained in the AML Regulations. FICA further encompasses the four core requirements for the KYC standard. It was seen that section 29 which requires that banks file STRs constitutes the core of FICA. FICA makes it clear that the reporting duty of banks overrides their confidentiality duty to customers. Conceptual problems in defining concepts such as 'proceeds of unlawful activities' and 'reasonable grounds' where a bank is expected to form an opinion that money laundering is about to take place, or has taken place, were subsequently highlighted.

The discussion further accentuated that FICA's reporting duty demands more than the mere filing of STRs. Prior to filing a STR a bank must make a value judgment as regards the nature of the transaction. The nature of a transaction may be infer from various factors, key of which is the source of the transaction (read: money) involved. This means that something about the transaction

⁶⁶⁷ See ch 7.C.2–9.

⁶⁶⁸ See ch 6.B.3.6, par C.3.4 respectively.

must alert the bank to a suspicion that money involved in the transaction was probably acquired by criminal means. Therefore, in actual fact the bank must be able to designate certain transactions as legitimate or as potentially unlawful, the latter which renders the money involved the ‘proceeds’ of an unlawful activity. It was submitted that accurate judgments of this kind present banks with numerous difficulties despite the FIC’s guidelines which for the most part lack pragmatic advice. Evidently these guidelines were formulated to encourage compliance with FICA and not to protect the interests of banks.

Further still, possible ways in which the legal framework for combating money laundering in South Africa could be strengthened were explored. It was submitted that Parliament should reconsider some of the provisions of POCA and FICA in order to streamline money laundering control in the country.

For example, section 21 of FICA should be amended in order to require simplified and enhanced customer due diligence in the identification of customers. The fact that customer due diligence is an advanced form of money laundering control convinced the Basel Committee and the FATF to replace the identification obligation of the KYC standard with customer due diligence measures.⁶⁶⁹ This approach was likewise followed by the EU and the English legislature, and to some extent by the US Congress.⁶⁷⁰

By comparison, FICA subscribes to the KYC standard whilst updates of the standard’s identification obligation are accomplished through guidance notes issued by the FIC.⁶⁷¹ Updates through guidance notes are not a novel development in money laundering control because a similar approach has been followed in England and the US.⁶⁷² However, the FIC’s guidelines do not nearly carry the same weight as statutorily included due diligence measures. For this reason it was submitted that serious consideration should be afforded to amending FICA’s content so that it clearly reflect customer due diligence. In particular, it is recommended that section 21(1) of FICA should be amended to read as follows:

Identification of clients and other persons

Section 21(1) – An accountable institution may not establish a business relationship or conclude a single transaction with a client unless the accountable institution has **[used simplified or advanced customer due diligence]** (a) to establish [...] the identity of the client.

⁶⁶⁹ See ch 5.B.3.2.5, par B.4.3.4 respectively.

⁶⁷⁰ See ch 6.B.3.5, par C.3.5; ch 7.C.8.3.2 respectively.

⁶⁷¹ As to which, see par E.1 above.

⁶⁷² See ch 6.C.5.1–5.2; ch 7.C.9, par E.1 respectively.

The concepts 'simplified' and 'advanced' due diligence should subsequently be inserted in the AML Regulations as well to clarify the risk-based approach to customer identification which the regulations are advocating. Other recommendations aimed at streamlining and clarifying FICA's content as well as that of POCA were also made, the likes of which are spelt out in the chapter.⁶⁷³

Further, at the beginning of the chapter the derogative report by the IMF as regards the success of South Africa's AML effort was highlighted.⁶⁷⁴ It is now necessary to pronounce whether the three key recommendations of the IMF as regards money laundering control in South Africa indeed received attention by Parliament. For this purpose one needs to inquire and resolve the following three questions:

- Did South Africa improve its prosecution rate of money laundering offences?

The question must be answered in the negative. The blame for this could be attributed in aggregate to the failure of banks to recognise suspicious transactions, the ingenuity of criminals, inadequate criminal investigations and divergent political agendas which undermine the effectiveness of the NPA.

- Were the AML Regulations amended to provide for the identification of beneficial owners of bank accounts?

This has not been done yet although the risks of conducting business with third-parties acting on behalf of someone else have been recognised by and attended to by the AML Regulations and guidelines of the FIC alike.⁶⁷⁵

- Were additional AML guidelines released to assist banks, *inter alia*, with the recognition of suspicious transactions?

It was seen that although the FIC released guidelines pertaining specifically to the filing of STRs, their content is conspicuously lacking in practical advice.

Overall it was evident that the main problem with the FIC's AML guidelines is that they accentuate the lack of understanding in the practical difficulties that bank experience in identifying suspicious transactions. It was submitted that this outcome has little to do with the FIC and everything with the ingenuity of criminals and the failure of current AML measures to recognise this fact.

⁶⁷³ See also ch 9.B.4.4.1.

⁶⁷⁴ IMF *South Africa Report 2004* par 25. See also par A above.

⁶⁷⁵ See par C.4.2.3.2 above.

The latter two factors pose in my view the greatest challenge to efficient money laundering control in South Africa. The reality is, to draw from the chess analogy, that it is very difficult for the AML authorities to get the overhand if they are unable to predict their opponents' (read: criminals) moves. At present, neither international AML models nor the South African AML model can predict with any measure of certainty the moves which criminals make in a bid to deposit the benefits of their unlawful activities undetected into a bank account for the purpose of concealing the criminal origin of the funds. Careful and innovative thinking is needed to address this conundrum.

The bulk of the chapter was then devoted to an analysis of three potential remedies which can address the consequences of using bank accounts to warehouse or launder the benefits of crimes such as fraud or theft. First, the exposition illustrated that South Africa has embraced the idea of limiting ownership when deemed in the interest of society, a definitive move away from the absoluteness of ownership as favoured by Roman law.⁶⁷⁶ Early on two solutions were suggested in the event that traditional common remedies for the protection of ownership were found unsuitable to redress loss suffered by victims of fraud and theft. To recap, they are namely:

1. introduction of an English restitution remedy to our law; or
2. codification of a generic civil remedy akin to the US restatements of the common-law.

It soon became evident that the prerequisites of the various traditional remedies sabotage their application in cases where the benefits of fraud or theft were deposited with a bank by the fraudster or thief who subsequently absconded with the money. A few observations are merited.

First, it is clear that the *rei vindicatio* action is unsuitable in scenarios where a victim of fraud or theft attempts to recover loss from the bank that once accepted a deposit that comprised the benefits of the fraud or theft. A key reason concerns one of the requirements of the action which demands that the plaintiff must be owner of the property concerned. However, a bank acquires ownership of all deposited money, even if it is benefits of fraud or theft. This fact alone will frustrate any claim based on the *rei vindicatio* against the bank that received the benefits of fraud or theft.

In addition, the property must be identifiable in the hands of the bank before it can be vindicated. Money such as the benefits of fraud or theft that is deposited with a bank generally becomes unidentifiable from other funds in the bank account as a result of commingling that

⁶⁷⁶ See ch 3.C.

occurs in the account. This reality will prevent vindication in most instances where the benefits of fraud or theft were deposited with a bank.

However, where property such as travellers' cheques remains identifiable in the hands of its possessor as was the case in *Van der Merwe* it quite possibly may be vindicated. It is, however, submitted that the latter scenario is the exception to the rule so to speak. For this and other reasons it was clear that the *rei vindicatio* is an unsuitable remedy in as far as reclaiming the benefits of fraud or theft from the bank that received the funds.

The chapter continued and demonstrated that the courts on occasion allowed use of a quasi-vindictory action to assist a victim of fraud or theft. It soon became obvious that a quasi-vindictory action may assist a victim of fraud or theft to recover fraudulently or stolen money where he can establish a clear right to the money. However, the victim in order to use the quasi-vindictory action with any measure of success must establish that the benefits of fraud or theft remained under the control of the bank at the time of *litis contestatio*. It follows that the action will be useless in instances where the fraudster or thief absconded with the benefits before the victim could file suit against the bank.

The investigation then considered the applicability of the *actio Pauliana* in relation to recovering the benefits of fraud or theft from a bank as former recipient thereof. In short, since the *actio Pauliana* is fundamentally an insolvency remedy, it was found unsuitable in a scenario where a victim of fraud or theft attempts to recover loss from the bank that parted with the benefits of fraud or theft. This reality coupled with the fact that there can never be a disposition *ex titulo lucrativo* in relation to money deposited into a bank account renders it fair to surmise that a few significant shortcomings exist insofar as using the *actio Pauliana* to recover loss from a bank as former recipient of the benefits of fraud or theft.

An argument that codification is likely to alter the *actio Pauliana*'s limited application was considered. There was agreement that codification of the action is likely to alter its limited application provided two requirements, which were listed in the discussion, were satisfied. Ultimately, the analysis demonstrated that in absence of codification the *actio Pauliana* is not a suitable remedy where a victim of fraud or theft endeavours to recover loss from the bank that parted with the funds.

The analysis proceeded then to consider unjust enrichment as potential remedy in relation to deposited benefits of fraud or theft. It was shown elsewhere in the study⁶⁷⁷ that English courts sometimes allow victims of fraud or theft to use extended unjust enrichment principles to recover the loss they suffered at the hands of fraudsters and thieves from the bank which received the benefits of fraud or theft and parted with the money. This necessitated an investigation into the suitability of the South African unjust enrichment *condictiones* to ascertain whether they likewise would present a suitable remedy to a victim of fraud or theft.

The results of the analysis was disappointing. For various reasons which were spelt out in the chapter, none of the unjust enrichment *condictiones* are suitable to assist a victim of fraud or theft to claim loss from a bank that parted with the benefits of fraud or theft. Even if the benefits of fraud or theft remained in the bank account of the fraudster or thief, it is unlikely that the victim of fraud or theft could use any of the *condictiones* with a measure of success. Consequently, unjust enrichment similar to the vindictory actions and the *actio* Pauliana is an unsuitable remedy in as far as recovering loss from a bank that received the benefits of fraud or theft. It follows that a victim of fraud or theft may only be able to recover the benefits of fraud or theft with a quasi-vindictory remedy if the funds remained under the control of the bank at the time of *litis contestatio*.

One thing that stood out was regardless of the fact that some other suffered loss at the hand of a fraudster or thief, attempts to recover that loss from a bank that parted with the benefits of fraud or theft are likely to be futile endeavours under the law as it currently stands. It is therefore submitted that there are two options to rectify this outcome and to fill the current lacuna in our law. They are namely:

1. introduction of English constructive trust remedy to our law; and/or
2. codification in FICA of a generic remedy similar to the US restatements of the common-law.

Our courts could draw from the jurisprudential experience that has developed around unjust enrichment to broaden our common-law. More specifically, the English common-law constructive trust remedy of knowing receipt has been applied with success in money laundering related matters.⁶⁷⁸ Although the remedy is not by a far stretch perfect, our courts should nevertheless consider augmenting the common-law by giving credence to the aforementioned English remedy.

⁶⁷⁷ See ch 6.C.4.2–4.3 and ch 7.D.2–3 respectively.

⁶⁷⁸ See ch 6.C.4.2.3.

Similar credence has already been given by the legislature to the EU and English AML models which is reflected in FICA.

In the alternative, codification of a general remedy similar to the US Restatements⁶⁷⁹ should seriously be considered by Parliament. It could amend FICA by inserting a civil remedy in the Act to assist victims of fraud or theft to recover loss suffered from the bank which parted with the benefits of fraud or theft whilst suspecting that the money was acquired through criminal means.

Although the application of the suggested remedy will be restricted to cases involving the benefits of crimes which left an identifiable victim, it is submitted that in the event that the judiciary is unwilling to import and apply English law in cases pertaining to money that was acquired through illegal means, this option would present a suitable alternative to cement optimum results for victims of these crimes.

Despite the fact that FICA was not designed to avail civil litigants, there is no reason why a common-law remedy for the protection of ownership should not be inserted in the Act similar to the civil forfeiture remedy which already has been codified in POCA.

The US followed this path with success; its restatements of unjust enrichment constitutes a blueprint for our legislature to emulate. It is therefore recommended that Parliament should insert a provision with wording similar to the following in FICA's Chapter 3 (Money Laundering Control Measures), Part 4 (Measures to promote compliance by accountable institutions) to succeed after section 43 (Training and monitoring of compliance):

Section 43A (Consequences of receipt of the benefits of unlawful activities)

- (1) A bank which receives into a bank account a deposit of the benefits of unlawful activities and parted with the money whilst suspecting that its ownership vested in some other must compensate that person to the extent to which it suffered loss.
- (2) The amount of compensation is measured by the extent to which the plaintiff suffered loss as a result of the bank paying the benefits of unlawful activities away.
- (3) The extent of the loss suffered by the plaintiff is determined at the time the action is brought.
- (4) The bank may raise as defence that it is a *bona fide* purchaser for value, or that its position reasonably changed since it received the benefits of unlawful activities.

⁶⁷⁹ See ch 7.D.2.2.

The wording of the provision has been intentionally simplified to avoid the limited application of the traditional remedies for the protection of ownership. Significantly, the investigation revealed that civil forfeiture as a codified common-law remedy is used often and with a great measure of success. A similar result can therefore be predicted in relation to claiming loss from a bank which parted with the benefits of crime whilst knowing that the money may belong to someone other than the account holder.

The chapter then proceeded to dissect civil forfeiture as a codified remedy against crime. A few observations must be mentioned here. The aim of civil forfeiture, namely to deprive offenders of the benefits of their crimes, was accentuated early on in the analysis. It was seen that centuries ago civil forfeiture was recognised as a natural consequence of contract breach among an offender, society and the state. At the time loss of property was regarded as a fitting penal measure. This view linked-up with the contemporary realisation that different penal measures are needed in the place of incarceration which currently is of little deterrence value.

Whether civil forfeiture is more likely than incarceration to have a deterrence value is a matter of opinion. I think one must be realistic. Whilst organised crime syndicates and the corrupted may often consider the monetary rewards of their conduct, it is doubtful that common fraudsters give it any thought. Nevertheless, there is something quite satisfactory in the thought that at the very least, monetary rewards can no longer be the determining factor in the decision to commit crime - civil forfeiture ensures that.

An overview was further given of the use of civil forfeiture as punishment for involvement in criminal activities. It was seen that POCA provides in detail for civil forfeiture. The Act's extensive provisions permit civil forfeiture of three types of property, namely the proceeds of unlawful activities crime, assets of corresponding value and the instrumentalities of an offence.

Further still, the nexus between the property earmarked for civil forfeiture and unlawful conduct must be well established. This serves as evidence of the courts' desire to eliminate, but within reason, all the benefits acquired through criminal means. Since POCA's ambit has been unintentionally limited to extend only to the 'proceeds' of unlawful activities instead of all benefits acquired through criminal means, it was recommended that the concept 'proceeds' should be replaced in POCA with the concept 'benefits'. It is expected that the amendment above would widen the Act's ambit considerably. It was further seen that POCA provides protection only to some innocent owners of property that was earmarked for civil forfeiture. In particular, due to the wording of section 52(2) of POCA the protection is available only to innocent owners who

acquired an interest in as opposed to having a vested legal right to the said property. This is especially important in relation to victims of fraud or theft whose money was deposited into an account that subsequently became the subject of a civil forfeiture application brought by the NDPP. It was therefore recommended that Parliament should amend section 52(2) of POCA in order to extend its protection to all innocent owners of property that is the subject of a civil forfeiture application. An example of the amended section of POCA was provided in the chapter.

Further, individualised AML measures undertaken by the government and Parliament and in a bid to control the incidence of the crime both in South Africa and in particular, in the sub-Saharan African and the SADC region were considered. It was seen that despite explicit provision for cooperation in money laundering control, efforts aimed at controlling the incidence of money laundering in the SADC region have been hampered by the realities of the region. Whether anything is likely to change within the near future is a matter of wait and see. However, given the disappointing outcome of South Africa's AML effort one cannot help but feel pessimistic about the future of money laundering control in sub-Saharan Africa and the SADC region. Nevertheless, it was established that like the countries used in the study for comparative purposes, individualised measures aimed at money laundering control are a part of South Africa's AML regime.

Where are we currently at in South Africa? I cannot shake the feeling that those who are embroiled in the battle against money laundering are harping on the same string akin to Sisyphus whose unfortunate position is legendary. However, their tool of choice is the KYC standard and their mallets are banks but all the while they may be missing the bigger picture.

What then is the bigger picture as regards money laundering control in South Africa? More than a decade ago it was suggested⁶⁸⁰ that the blame for lax money laundering prevention in the country should be attributed to the lack of a competent authority to enforce effective regulation. At present, the FIC's does not seem to alleviate the banking industry's money laundering woes. To my mind the FIC is not solely to blame for the apparent lack of success of the South African AML effort. Neither should the blame be placed at the door of POCA and FICA. In fact, for the most part FICA compares favourably with the EU's 2005 AML Directive. This is arguably its greatest attribute but also its greatest failure. It is one thing to emulate an international statute, but something quite different to adopt a pragmatic and individualised approach to money laundering control. In this regard FICA failed to raise to the occasion so to speak.

⁶⁸⁰ Henning; Du Toit & Nel *Decriminalisation of Money Laundering* 92.

Nevertheless, the analysis imparted that Parliament managed to circumvent the pitfalls of the US AML model. FICA's unambiguous content and precise provisions renders it to my mind an adequate AML statute even if it comprises ordinary run-of-the-mill provisions. Of course I would have liked to proclaim that FICA is able to solve all the difficulties as regards prudent identification of the benefits of unlawful activities and the recognition of suspicious transactions. However, hopefully these are mere growing pains of our AML regime so that experience would impart to Parliament and the AML authorities the best way forward in controlling money laundering in banks. It is therefore submitted that the blame for South Africa's lack in prosecuting alleged criminals who used bank to launder the benefits of their unlawful activities should be attributed to the following two key factors:

1. a lack of experience and understanding by banks of the guile of criminals and the sophistication of money laundering schemes; and
2. uncertainties which beleaguer the various law enforcement agencies.

In all likelihood a lack of expertise coupled with vested political interests are further sabotaging efforts aimed at bringing money launderers to book. Collectively regarded, these factors undermine money laundering control in South Africa. Most notably, the comparative analysis illustrated that there is no perfect template to follow in relation to money laundering control. Indeed, the lacunas identified in the AML regime of South Africa to some extent match similar difficulties identified in other AML regimes.

In conclusion, to draw from the chess analogy this chapter illustrated that the statutory component of the South African AML regime emulates the more established AML regimes of the EU, England and the US as regards the civil forfeiture of the benefits of unlawful activities. However, it is evident that the time has arrived to rearrange the components of South Africa's AML regime in order to address all the consequences of money laundering, including the potential civil liability of banks which received and parted with the benefits of crimes such as fraud and theft.

In Chapter 9 key considerations and findings of this study are highlighted. The overriding purpose of the study, namely to investigate the consequences which money laundering control holds for banks, is reconsidered against the background of the bank-customer relationship. Ultimately, the question of whether the conflict between money laundering control and the business of banking can be resolved will be answered.

[Chapter 9 to follow]

CHAPTER 9

CONCLUSIONS AND RECOMMENDATIONS

Of several [Checkmate] combinations simultaneously existent you have to choose ... the one yielding the greatest advantage ... [as well as] ... the simplest one because that [Checkmate] is least open to error, because unfortunately *humanum est errare*.

LASKER *Chess* 137

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A. INTRODUCTION

In this study the analogy of a chess match between the AML authorities, as represented by the White pieces on the chessboard, and the money launderers, as represented by the Black pieces, has been used in an effort to illustrate that strategy and experience are essential if checkmate, or effective money laundering control, is to be achieved by White.¹ As suggested by the quotation above, it is now necessary to establish which combination of money laundering control strategies is likely to bring about optimum results for South Africa's AML authorities in their quest to identify, confiscate

¹ See ch 1.A.1.

and ultimately, forfeit the benefits of crime deposited into a bank as part of a money laundering scheme.

There appear to be a twofold consensus: first, there is something amiss with contemporary money laundering control strategies. Secondly, banks will continue to face civil litigation as a result of money laundering and money laundering control and better be prepared for the fallout. This study illustrates that although banks support Parliament's AML measures, FICA's AML obligations hold some unexpected consequences for the relationship that exist between them and their customers. This outcome was inevitable because contemporary money laundering control measures have failed to recognise or address the practical challenges that banks are experiencing with the identification of the benefits of crime before the money can be deposited into a bank account.

While research in the area of money laundering control is spread across various areas of interest, the interest of banking lawyers in the issue remains current. For this reason this study concentrated on the position of banks in relation to money laundering and money laundering control. It is evident from the literature reviewed that legal academic discourse on how to go about controlling money laundering in banks has one thing in common: criminals and the benefits of their illegal activities must be identified *before* they can gain access to the banking system. This is seen in the imposition of the KYC standard obligations which at one point formed the crux of contemporary AML legislation and AML strategies.²

This study endeavoured to distil some general principles out of various money laundering control issues in as far as they impacted on banks. In particular, the study set out to establish that whilst compliance with current AML measures may assist a bank to avoid prosecution for a money laundering offence, it may also expose the bank to civil liability despite the fact that its conduct was above reproach.

In this chapter the nine research objectives³ that were established in this study will be revisited in the order they were dealt with in the study. Ultimately, the question that must be answered is whether the conflict that exists between contemporary money laundering control measures and the business of banking can be resolved.

B. RESEARCH OBJECTIVES AND SYNTHESSES REVISITED

² See ch 5.B.3; ch 6.B.3.4–3.5, paras C.3.4, C.3.5; ch 7.C.2–3; ch 8.C.4.2–4.3, par C.5.

³ See ch 1.B.

The research objectives were presented in Chapter 1 of this study,⁴ and will now be discussed individually.

1 Concepts of Money

1.1 Functions of Money

The research shows that in order for an object to constitute money it must function as a chattel, a medium of exchange and legal tender, the latter which is determined according to the characteristics of the particular object.⁵

Money as legal tender presents the following four characteristics: it is a medium of exchange; constitutes final payment; is transferred by delivery; and needs no clearing or settlement.⁶ These characteristics determine whether a new commodity constitutes money.

1.2 Historical Development

Money has since the beginning of time reflected the ambiguity of its social function, namely, an instrument of cohesion and a source of violence.⁷ The evolution of bartering to money occurred due to the need to simplify payment.⁸ Money's evolution also influenced the development of the payment system.

1.3 Electronic Banking

1.3.1 General Principles

⁴ See ch 1.B.

⁵ See ch 2.A.1–3.

⁶ See ch 2.A.3.

⁷ See ch 2.B.1.

⁸ See ch 2.B.1.

E-commerce revolutionised international banking and created vast opportunities for generating money.⁹ The development of e-banking influenced key areas of banking business, for example, the bank-customer relationship, the transactions it conducts and its compliance functions.¹⁰ Data protection, communication safety and bank confidentiality are some of the problems presented by e-banking within the sphere of e-commerce.

1.3.2 Electronic Transfers

Current payment systems as a result of societal needs facilitate a move away from physical money towards electronic money.¹¹ The existence of intangible money is found in the physical documents that register claims to it.¹² In this regard money is nothing more than claims set out on paper.¹³

Electronic money transfers can be conducted over the Internet which is a global network of computers that speak the same language.¹⁴ Three principal systems facilitate payment over the Internet, namely, e-money, EFT systems and online-chequing.¹⁵ Banks generally accept any one of the following four alternatives as time of payment: one, the time at which a message is released by the sending bank, two, the time at which the receiving bank receives the message, three, the time at which the receiving bank enters the credit to the payee's account or four, the time at which the payee receives notice of the credit.¹⁶ It follows that the concept of time of payment remains open to interpretation.

1.3.3 Electronic Money

E-money is a monetary value that is represented by the holder's claim against the issuer.¹⁷ The claim is stored on an electronic device, issued on the receipt of funds which are not less in value than that

⁹ See ch 2.B.2.2.

¹⁰ See ch 2.B.2.2.

¹¹ See ch 2.B.2.3.1.

¹² See ch 2.B.2.3.2–2.3.3.

¹³ See ch 2.B.2.3.1.

¹⁴ See ch 2.B.2.3.4.

¹⁵ See ch 2.B.2.3.4.

¹⁶ See ch 2.B.2.3.5.

¹⁷ See ch 2.B.2.4.

issued and accepted as a means of payment.¹⁸ Whether e-money constitutes legal tender depends on the relevant legislation of a country.¹⁹ E

Even if e-money is permitted as legal tender a payee may nevertheless refuse to accept it as payment. E-money is therefore not legal tender because it is not a universally accepted medium of exchange.²⁰

1.4 Modern Conceptualisation of Money

1.4.1 Theoretical Approach

Two theories of money, the state theory and the societal theory, aim to explain the origin and function of money.²¹ The state theory of money holds that only movables which are issued by, or with the permission of, the state is accepted as legal tender.²² In contrast, the societal theory of money postulates that society's core values are channeled to money.²³ Its core is captured by proverbs such as 'money makes the world goes round' and 'the love of money is the root of all evil'. There is no gainsaying that money has a deep, unbreakable relationship with society.

Money is further a projection of society because it embodies its history and values.²⁴ For this reason a compounded theory, which allows for both the role of the state in issuing money as legal tender and the role of society in affirming the choice, should be used to delimit money.²⁵

1.4.2 Value of Money

There are two kinds of monetary values, namely, an objective value and a subjective value.²⁶ The value that society attributes to money should be given preference because this is what feeds the

¹⁸ See ch 2.B.2.4.

¹⁹ See ch 2.B.2.4

²⁰ See ch 2.A.2 as regards money as a medium of exchange.

²¹ See ch 2.C.1.1–1.2.

²² See ch 2.C.1.1.

²³ See ch 2.C.1.2.

²⁴ See ch 2.C.1.2.

²⁵ See ch 2.C.1.2.

²⁶ See ch 2.C.2.4

desire for money. Unfortunately, society which places great value on money attracts negative elements such as crime that are associated with the generation of money.²⁷

1.4.3 Corporeal Money versus Fungible Money

A *res corporalis* is whatever could be assessed in terms of money and has a cash value placed upon it.²⁸ Bank notes and coins are therefore regarded as corporeal things. But, money is also a *res fungibilis* or a fungible thing which implies that its value cannot be individually determined, but must be determined in terms of numbers or dimensions.²⁹

1.4.4 Recommended Definition of Money

A concise definition of money is difficult to formulate, probably because money has no fixed meaning assigned to it.³⁰ This fact has been recognised by the judiciary and legislation alike.³¹ None of the theories on the nature of money attribute much to explain the concept.³² Available definitions further fail to assist with delineating the concept of money.³³

This leads to the conclusion that money is in itself a neutral medium whose designation is affected by societal values.³⁴ Any modern conceptualisation of money must concede to society's influences and choices in the commodity that constitutes money. It follows that any definition of money should include a reference to society's viewpoint thereof and the manner in which it was acquired.

1.4.5 Commingled Money

²⁷ See ch 2.C.2.4.

²⁸ See ch 2.C.1.3.

²⁹ See ch 2.C.1.3.

³⁰ See ch 2.C.3.

³¹ See ch 2.C.3.

³² See ch 2.C.1.1–1.2, par C.2.

³³ See ch 2.C.3.

³⁴ See ch 2.C.1.2, par C.3.

Ownership in money is acquired by delivery and mixing.³⁵ Mixing or *commixtio* is an original method of acquiring ownership.³⁶ Money that is deposited into a bank account commingles with other money in the bank account and becomes an undistinguishable part thereof.³⁷ Money *in specie* paid into a bank account is thus rendered unidentifiable from other moneys in the account by virtue of the mixing that has transpired. At the same time the bank becomes owner of the commingled amount.³⁸

Money in the form of notes and coins cannot be recovered following its deposit into a bank account where it mixes with other moneys in the bank account.³⁹ However, the account holder acquires a personal right to claim from a bank the same amount of money that he deposited into his bank account⁴⁰ unless evidence exists which suggests that the money may be the benefits of crime. In that case the bank is precluded from paying it to the account holder on demand.⁴¹

1.5 Concept of Benefits of Crime

1.5.1 Impact of Organised Crime

Money's link with organised crime is undeniable.⁴² It is the main goal of organised crime syndicates, because they use it in the planning and execution of their criminal activities and to convince professionals to assist in laundering money.⁴³ In turn, money laundering is needed to conceal money's connection to criminal activities. It follows that crime is the *raison d'être* for money laundering whilst money laundering is a necessary activity of organised crime syndicates.⁴⁴

1.5.2 Tainted Theory

³⁵ See ch 2.C.1.3, par C.2, ch 3.C.3.1.

³⁶ See ch 2.C.4.1, ch 3.C.3.1.

³⁷ See ch 2.C.4.2, ch 3.C.3.1–3.2.

³⁸ See ch 2.C.4.2, ch 3.C.3.2.2.

³⁹ See ch 2.C.4.2, ch 3.C.3.1–3.2.

⁴⁰ See ch 3.B.2.1.1.

⁴¹ See ch 3.B.2.1.2.2.

⁴² See ch 2.C.5.2.1–5.2.2.

⁴³ See ch 2.C.5.2.1; ch 4.C.3.

⁴⁴ See ch 2.C.5.2.2, par C.5.3.1. See also Figures 1.2 and 1.3 in Chapter 1.A.2 that distinguish among different types of criminal activities.

The tainted theory sanctions the attachment of an owner's criminal conduct to a neutral commodity such as money.⁴⁵ It further promotes that the longevity of the criminal taint is dependant on two factors. First, whether the benefits of crime remain the property of the offender and secondly, whether the underlying crime is subject to statutes of limitations.

In combination, the two aforementioned factors carry a two-fold consequence as regards the nature of the benefits of crime.⁴⁶ First, as soon as the benefits of crime are transferred to a *bona fide* person the funds become legitimate again. Secondly, the benefits of crime that derive from crimes that are subject to statutes of limitation likewise become legitimate.

If the taint theory is accepted without reservation the foundations for money laundering control require rethinking.⁴⁷ The reason is that the state would be unable to prosecute an offender for a money laundering offence because the criminal taint which remains with the money, would be removed once it is deposited with a bank that acquires ownership thereof.⁴⁸

The practical effect is that the benefits of crime are laundered as soon as the funds are deposited with a bank and used for a legitimate purpose such as an investment. Whilst the tainted theory may justify civil forfeiture of property,⁴⁹ it should not be accepted in its entirety without reservation.⁵⁰

1.5.3 Suggested Construction

South Africa's judiciary does not use the US tainted theory to justify civil forfeiture applications.⁵¹ Instead, our courts accept that the benefits of crime when deposited into a bank account lose the taint of the crime as soon as commingling occurs in the account.⁵² If the account holder subsequently withdraws the money from the account, the criminal taint will fail to attach to the money with the result that it remains legitimate.

⁴⁵ See ch 2.C.5.3.2.

⁴⁶ See ch 2.C.5.3.2.

⁴⁷ See ch 2.C.5.3.2.

⁴⁸ See ch 2.C.5.3.2.

⁴⁹ See ch 6.B.4.2, par C.4.4; ch 7.D.4; ch 8.D.4.

⁵⁰ See ch 2.C.5.3.2.

⁵¹ See ch 8.D.4.2.1.3–4.2.1.4.

⁵² See ch 2.C.5.3.3.

For example, fraudulently acquired money that is deposited into the bank account of the fraudster becomes legitimately earned money as soon as the bank acquires ownership thereof.⁵³ As a result, the bank acquires ownership of money to which no criminal taint is attached. If the fraudster subsequently withdraws the benefits of fraud from the account, the criminal taint will fail to attach to funds with the result that the money remains legitimate.

The conclusion above has two consequences for the said fraudster.⁵⁴ First, he commits a money laundering offence as soon as he deposits the benefits of fraud with the bank.⁵⁵ Secondly, since the criminal taint does not attach permanently to the benefits of fraud, the state is likely to experience difficulty to establish the required connection between the deposited money and the fraudster's criminal conduct.⁵⁶ This is because money that was acquired through criminal means such as fraud can hardly be forfeited to the state if its criminal taint is removed once it is deposited with a bank.⁵⁷

A finer construction to explain what transpires when the benefits of a crime such as theft are deposited with a bank is found with reference to the thief's personal claim against the bank for payment of the deposited amount.⁵⁸ When the stolen money commingles with other funds in the bank account, the money cannot be identified *in specie*.⁵⁹ For this reason, and also because the bank becomes owner of it,⁶⁰ the criminal taint of the stolen money attaches to the thief's *claim* against the bank for payment of a corresponding amount.

This construction is also supported by the mechanics of EFTs and e-money, both which provide for the transfer of monetary *values* instead of physical notes and coins to a bank account.⁶¹ The criminal taint remains with the personal claim of an account holder against the bank for the deposited value irrespective of whether commingling occurred. If one accepts that the criminal taint refers to the criminal conduct or intention of the account holder instead of to the money itself like

⁵³ See ch 2.C.5.3.3.

⁵⁴ See ch 2.C.5.3.3.

⁵⁵ See ch 1.A.1; ch 8.C.3.2, par C.4.2.1.

⁵⁶ See ch 8.D.4.2.1.

⁵⁷ See ch 8.D.4.2.1.3–4.2.1.4.

⁵⁸ See ch 2.C.5.3.3.

⁵⁹ See ch 2.C.4.

⁶⁰ See ch 2.C.4.2; ch 3.C.3.1–3.2.

⁶¹ See ch 2. B.2.3.2.

the tainted theory maintains, it would make sense that money, which is a neutral medium,⁶² loses its criminal taint as soon as it is deposited with a bank.

Also consider the scenario where fifty thousand rand in the form of notes and coins is found in the possession of a known drug trafficker.⁶³ She is arrested, the money is confiscated and will be declared forfeited to the state if it can establish a connection between the money and the drug trafficker's criminal conduct. If established, the connection would render the money the proceeds of a drug offence.

However, if the same drug trafficker deposits the money with a bank, either by walking into the bank and handing stacks of bank notes and coins to the cashier, or by using an automated teller machine, the money would lose its criminal taint and the bank would acquire ownership thereof. But, the criminal taint would remain with the drug trafficker's claim against the bank for payment of the deposited amount, signifying the criminal manner of its acquisition and representing her claim against the bank for payment of the deposited amount.

For this reason, even though the deposited proceeds of a drug offence became legitimate as soon as the drug trafficker deposited it with the bank, the state may proceed against her for the purpose of obtaining a civil forfeiture order from the court.

1.6 Synthesis

Based on the conclusions above the following research objective can be considered:

1. money is a neutral concept whose designation depends on society's view of the manner in which it was acquired. The criminal conduct or intention of its owner or possessor renders it the benefits of crime.

The nature of money is determined by two forces: one, the state which designates a particular thing as legal tender; and two, society which attaches different meanings to money.⁶⁴ Since society determines the value that is attached to money, it is possible to link the criminal intention of its owner or possessor to it. The money is consequently regarded by law as the benefits of crime.⁶⁵

⁶² See ch 2.C.5.3.1.

⁶³ See ch 2.C.5.3.3.

⁶⁴ See ch 2.A.3, par C.1.

⁶⁵ See ch 2.C.5.3.

Money acquired through criminal means that mixes with legitimate money already in a bank account cannot be identified as the benefits of crime.⁶⁶ For this reason and also because the bank becomes owner of the deposited money, the criminal taint of the newly deposited money attaches to the account holder's *claim* against the bank for payment of a corresponding amount of money.⁶⁷

The criminal taint refers to the criminal conduct or intention of the account holder instead of to the money itself like the tainted theory maintains. This construction solves both the problem of the nature of the benefits of crime and its ownership after it was deposited with a bank.⁶⁸

2. Bank-Customer Relationship and Money Laundering

2.1 Nature of Relationship

2.1.1 European Union

Contract forms the core of all bank and customer relationships in the EU.⁶⁹ Within the framework of the bank-customer relationship the relationship between a bank and a customer is one of debtor and creditor respectively. Banks operating in the EU must observe EU law when contracting with customers.⁷⁰

However, depending on the national laws of the country where the bank operates, EU law is relegated to apply only to situations that were left uncovered by national law except if the latter leaves a party worse off than in terms of EU law.⁷¹

2.1.2 England

At English common-law the relationship between the bank and the customer is contractual in nature.⁷² The customer loans deposited money to the bank which loan must be repaid to the

⁶⁶ See ch 2.C.4, par C.5.3.3.

⁶⁷ See ch 2.C.5.3.3.

⁶⁸ See ch 2.C.5.3.3.

⁶⁹ See ch 6.B.2.1.

⁷⁰ See ch 6.B.2.1.

⁷¹ See ch 6.B.2.1.

⁷² See ch 6.C.2.1.

customer on demand. Equitable doctrines such as constructive trust adversely effect this relationship and the business of banking alike.⁷³

Ultimately, the relationship dictates that the bank must exercise its duty towards the customer with reasonable skill and diligence.⁷⁴ Nothing in the relationship between the parties renders it fair or reasonable that a bank should owe a duty of care in circumstances that do not relate to the customer.

2.1.3 United States

At common-law the relationship between a bank and a customer is that of debtor and creditor.⁷⁵ The bank-customer relationship is further based on a contract.⁷⁶ The duties of a bank to act in good faith and to take care as regards customers' banking affairs are implied contractual terms of the agreement between them. Moreover, a bank is compelled to act with the 'utmost fidelity and care'⁷⁷ in respect of deposits made with it.

2.1.4 South Africa

2.1.4.1 General Principles

At common-law the concept 'bank-customer relationship' refers to a relationship that is created with the opening and operation of a bank account.⁷⁸ It is a complex and confidential relationship which implies that banks are obliged to maintain a duty of confidentiality in relation to the affairs of customers. Following a deposit into a bank account a relationship of debtor and creditor is established between the bank and the customer.⁷⁹

⁷³ See ch 6.C.2.1.

⁷⁴ See ch 6.C.2.1.

⁷⁵ See ch 7.B.1.

⁷⁶ See ch 7.B.1.

⁷⁷ See ch 7.B.1.

⁷⁸ See ch 3.B.1.

⁷⁹ See ch 3.B.2.1.1.

The relationship that exists between the bank and customer is based on contract.⁸⁰ However, which type of contract has been concluded between the parties remains a contentious issue.⁸¹ It is generally accepted that the contract between a bank and customer is *sui generis* in nature.⁸² Once the bank has been instructed by the customer to deal with the funds in the account in a certain manner, it will be contractually bound to follow the instruction unless otherwise interdicted by a court.⁸³

2.1.4.2 Bank's Receipt of the Benefits of Fraud or Theft

Three issues are important when a fraudster or thief deposits the benefits of fraud or theft with a bank.⁸⁴ First, the contract between the bank and the customer remains legal unless *both* the bank (i.e. one of its employees) and the account holder colluded to conclude an agreement for an illegal purpose such as money laundering.⁸⁵ In the latter instance the rights of the bank as owner of the deposited money will be stronger so that the account holder will be unable to reclaim the deposited money.⁸⁶

Secondly, a bank that suspects an account holder of illegal dealings has a choice: it can continue the relationship despite its suspicions or it can terminate the relationship with the account holder.⁸⁷ However, a bank that suspects the account holder of illegal dealings continues with the relationship at its own peril.

Thirdly, a bank as recipient of the benefits of fraud or theft is under no obligation to pay the money to the customer (account holder) on demand because the latter is not entitled to the funds.⁸⁸ This statement, however, must be qualified; a bank should refuse payment of deposited money only where it has concrete evidence that the account holder is not entitled to it, or where the bank is informed by the victim of fraud or theft that the money is the subject of an ownership claim.⁸⁹ In the

⁸⁰ See ch 3.B.2.1.1.

⁸¹ See ch 3.B.2.1.1.

⁸² See ch 3.B.2.1.1.

⁸³ See ch 3.B.2.1.2.

⁸⁴ See ch 3.B.2.1.2.

⁸⁵ See ch 3.B.2.1.2.1.

⁸⁶ See ch 3.B.2.1.2.1.

⁸⁷ See ch 3.B.2.1.2.1.

⁸⁸ See ch 3.B.2.1.2.2.

⁸⁹ See ch 3.B.2.1.2.1.

absence of concrete evidence or knowledge of another claim to the deposited money, the bank may have little choice but to pay the deposited amount to the account holder on demand or risk being sued by him in civil court.⁹⁰

Where a victim of fraud or theft claims ownership of the deposited benefits of fraud or theft the bank would be best served to ignore the account holder's instruction to pay the money to it. The bank in the absence of concrete evidence that the money is the benefits of fraud or theft should further advise the victim to apply for an interdict⁹¹ to prevent it from paying the said money to the fraudster or thief. Ultimately, the bank should refrain from taking sides in a dispute pertaining to the ownership of deposited money.⁹² The reason is that it not only may have conflicting loyalties as far as the account holder is concerned, but taking sides between a customer and a victim of fraud or theft is likely to have a detrimental affect on the bank's ability to conduct business.⁹³ Even so, should the bank elect to continue with a suspicious transaction, it would do so at its own risk.

2.1.4.3 Bank's Duty of Care

Banks have a common-law duty of care to customers on account of the contract concluded between them.⁹⁴ A bank must exercise care and forethought in the interest of the customer with respect to his affairs.⁹⁵ In addition, when a bank opens an account for a new customer it must ascertain his identity and obtain information to establish his *bona fides*.⁹⁶

2.2 Bank Confidentiality

2.2.1 International Community

2.2.1.1 Basel Committee on Banking Regulations and Supervisory Practices

⁹⁰ See ch 3.B.2.1.2.2.

⁹¹ See ch 8.D.2.4, par D.4.5.

⁹² See ch 3.B.2.1.2.2.

⁹³ See ch 3.B.2.1.2.2.

⁹⁴ See ch 3.B.2.2.

⁹⁵ See ch 3.B.2.2.

⁹⁶ See ch 3.B.2.2; ch 8.C.4.2.3.2.

The Basel Committee is a supranational committee devoted to create non-binding supervisory principles and standards.⁹⁷ It has issued four key documents since 1988 which concern money laundering control.⁹⁸ The Basel Committee's Statement of Principles represents the first international recognition that was afforded to the KYC standard.⁹⁹

Although the Basel Committee aims to set global standards for money laundering control in banks, its AML guidelines fail to advise banks on the practical difficulties of money laundering control.¹⁰⁰ One difficulty includes the conflict that exists between the reporting duty of banks pursuant to AML legislation and their duty to observe customer confidentiality.¹⁰¹

The Basel Committee seems unaware that banks in complying with the Statement of Principles, which require banks to file STRs to the authorities, violate their confidentiality duty to customers.¹⁰² The fact that it fails to advocate protection against civil claims for banks which filed STRs is peculiar as the committee works under the auspices of the Bank for International Settlements, a major international financial institution.¹⁰³ It is therefore reasonable to expect the Basel Committee to acknowledge the conflict between the reporting duty of banks and their duty to observe customer confidentiality. The fact that it has thus far failed to do this is disappointing.

2.2.1.2 Financial Action Task Force on Money Laundering

The FATF is the only international body that specialises in strategies to control money laundering.¹⁰⁴ Its aims are two-fold, namely to educate banks about the risk of being used by criminals for money laundering purposes and to publish recommendations that member countries can employ to combat money laundering.

To this end the FATF released a set of forty recommendations in April 1990 which presents a prevention strategy to counteract money laundering in the banking system.¹⁰⁵ Subsequent documents followed whose content emphasises the FATF's commitment to be actively involved

⁹⁷ See ch 5.B.3.2.1.

⁹⁸ See ch 5.B.3.2.1–3.2.6.

⁹⁹ See ch 5.B.3.2.1–3.2.2.

¹⁰⁰ See ch 5.B. 3.2.6.

¹⁰¹ See ch 3.B.2.3.3; ch 6.B.2.2, par C.2.2; ch 7.B.2.

¹⁰² See ch 5.B.3.2.2.

¹⁰³ See ch 5.B.3.2.1.

¹⁰⁴ See ch 5.B.3.3.1.

¹⁰⁵ See ch 5.B.3.3.2.

in combating money laundering within the banking industry.¹⁰⁶ Its Revised Recommendations modernised key aspects of the Forty Recommendations.¹⁰⁷

Two of the FATF's Forty Recommendations afford elementary 'safe-harbour' protection to banks which filed STRs in good faith.¹⁰⁸ Although the FATF failed to elaborate further on the issue, its recognition that banks need protection against civil claims filed by a customer as a result of a disclosure may lead to member countries including similar provisions in their individual AML legislation.¹⁰⁹

More so, the FATF's safe-harbour provision demonstrates the need for a provision which could resolve some of the tension that exist between the reporting duty of banks and their duty to observe customer confidentiality. However, regardless of its laudable involvement in combating money laundering, more in-depth analysis of the challenges banks are facing in light of AML policies should come from the FATF if it hopes to retain a reputation of being an adviser for the banking industry in respect of money laundering control.

2.2.1.3 Other Organisations

Like the Basel Committee and the FATF, other international groups are actively participating in the global fight against money laundering.¹¹⁰ They include the UN, IMF, World Bank, Interpol and the Wolfsberg and Egmont Groups.¹¹¹

The international community regards the UN' Vienna Convention as the foundation of the global AML legal regime. However, despite providing that bank records must be made available to the authorities regardless of bank confidentiality laws,¹¹² the convention fails to include safe-harbour protection for banks that filed STRs.¹¹³

The other international organisation mentioned above also fail to acknowledge or address the dilemma of banks as regards the conflict between bank confidentiality and their reporting

¹⁰⁶ See ch 5.B.3.2.1, paras B.3.3.3–3.3.4.

¹⁰⁷ See ch 5.B.3.3.4.

¹⁰⁸ See ch 5.B.3.3.2.

¹⁰⁹ See ch 5.B.3.3.4.

¹¹⁰ See ch 5.C–D.

¹¹¹ See ch 5.C.1, paras D.2–5 respectively.

¹¹² See ch 5.C.1.2.

¹¹³ See ch 5.C.1.2.

obligation.¹¹⁴ The Wolfsberg Group in particular warrants mentioning.¹¹⁵ In its capacity as spokesperson for private banks the Wolfsberg Group thus far has neglected to acknowledge and address the practical difficulties experienced by banks as regards money laundering control.

Why it has not yet formally acknowledge the challenges posed to banks by the suspicious transaction reporting duty in its AML principles should be questioned. Organisations that are actively involved in the banking industry such as the Wolfsberg Group are excellent forums from which to explore the conflict between suspicious transaction reporting and bank confidentiality.¹¹⁶ They, therefore, need to be actively involved in forwarding solutions to the problems that banks are experiencing with the execution of their money laundering control duties.

2.2.2 European Union

2.2.2.1 General

In the EU bank confidentiality found its way into civil codes and in the customary and common-law of EU member states.¹¹⁷ Under EU law bank confidentiality is an element of the fiduciary duty imposed *ex contractu* on a bank.¹¹⁸

In contrast to the Strasbourg Convention,¹¹⁹ the EU's 2005 Directive provides carefully worded safe-harbour protection to banks that filed STRs.¹²⁰ Despite the safe-harbour provision, bank, however, may still face civil liability where it could be established that a disclosure was made contrary to the requirements of the directive. Nevertheless, it is evident that the EU legislature attempted to resolve some of the tension that exists between the confidentiality duty of banks and their disclosure duty.

2.2.2.2 England

¹¹⁴ See ch 5. D.2–5.

¹¹⁵ See ch 5.D.4.

¹¹⁶ See ch 3.B.3.3.2; ch 6.B.2.2, par C.2.2; ch 7.B.2.

¹¹⁷ See ch 6.B.2.2.

¹¹⁸ See ch 6.B.2.2.

¹¹⁹ See ch 6.B.3.2.

¹²⁰ See ch 6.B.3.6.

At English common-law a bank's confidentiality duty is an integral part of the bank-customer relationship.¹²¹ The duty of banks to protect the confidentiality of customers is often an implied term of the contract between a bank and the customer and extends to all customer information which the bank acquires in its capacity as a banking institution.¹²²

However, at common-law a bank's duty of confidentiality is not absolute but subject to certain exceptions, for example, where disclosure is mandated by AML legislation such as the Proceeds of Crime Act.¹²³ The PCA requires that a bank must disclose knowledge or suspicions about money laundering to the National Criminal Intelligence Service. It therefore ignores the confidentiality duty of banks.¹²⁴ However, the PCA also states that a disclosure that satisfies certain conditions will not breach the confidential duty that banks has towards their customers.¹²⁵

Irrespective of the PCA's aforementioned safe-harbour protection a bank may still face civil liability where it discloses information without knowing about, or suspecting money laundering, or where it did not have *reasonable* grounds for knowing about, or suspecting money laundering.¹²⁶

The PCA consequently fails to adequately resolve the tension that exists between the confidentiality duty of banks and their reporting obligation. Like the safe-harbour protection provided in the 2005 Directive,¹²⁷ the PCA's safe-harbour protection is far from perfect.

2.2.3 United States

At US common-law, the obligation of a bank to maintain the confidentiality of customers is an implied term of the contract between the parties.¹²⁸ However, like the AML legislation of other countries,¹²⁹ key US AML statutes accentuate the reporting duty of banks.¹³⁰ The US Privacy Act

¹²¹ See ch 6.C.2.2.

¹²² See ch 6.C.2.2.

¹²³ Or 'PCA' - see ch 6.C.3.4.3.1

¹²⁴ See ch 6.C.3.4.3.1.

¹²⁵ See ch 6.C.2.2.

¹²⁶ See ch 6.C.2.2.

¹²⁷ See ch 6.B.2.2.

¹²⁸ See ch 7.B.2.

¹²⁹ See ch 6.B.3.6, par C.3.4.3.1; ch 8.C.4.2.3.3.

¹³⁰ See ch 7.C.2.2, C.5.

curtails to some extent the reporting duty of banks with its requirements that must be satisfied before a bank can disclose customer information.¹³¹

Two US AML statutes contain safe-harbour provisions aimed at protecting a bank that filed a STR against criminal or civil liability. They include the Annunzio Wylie Anti-Money Laundering Act¹³² and the Patriot Act.¹³³ The Annunzio Act provides that a bank shall not be liable under state or federal law for disclosing information to the Financial Crimes Enforcement Network.¹³⁴ However, in the absence of clear parameters it is ambiguous as to which extent a bank will be protected against criminal or civil liability on account of filing a STR.

Pursuant to the Patriot Act banks which file STRs are protected only against civil liability emanating from breach of contract.¹³⁵ It follows that a bank may still face delictual liability if it filed a STR under circumstances where, for example, no *reasonable* grounds according to the plaintiff-customer existed for its suspicions or where it disclosed too much information. Overall, the safe-harbour protection afforded to banks under the US AML law is remarkably inadequate.¹³⁶

2.2.4 South Africa

A bank's confidentiality duty arises by way of an implied obligation that stems from the bank and customer relationship.¹³⁷ This duty is not absolute, but one with four qualifications. A bank, therefore, may violate the customer's confidentiality when mandated by law,¹³⁸ in the public's interest,¹³⁹ in the interests of the bank¹⁴⁰ or if the express or implied consent of the customer was given. It is evident that in South Africa little is left of true bank confidentiality.¹⁴¹

Section 29 of FICA requires that banks file STRs to the FIC.¹⁴² It further provides safe-harbour protection to banks against liability emanating from filing a STR. Section 38(1) of FICA

¹³¹ See ch 7.B.2.

¹³² Or 'Annunzio Act' - see ch 7.C.5.

¹³³ See ch 7.C.5, par C.8.2 respectively.

¹³⁴ See ch 7.C.5. See ch 7.E.1 as regards the Financial Crimes Enforcement Network.

¹³⁵ See ch 7.C.8.2.

¹³⁶ See ch 7.B.2, paras C.5, C.8.2.

¹³⁷ See ch 3.B.2.3.

¹³⁸ See ch 3.B.2.3.1.

¹³⁹ See ch 3.B.2.3.2.

¹⁴⁰ See ch 3.B.2.3.2.

¹⁴¹ See ch 3.B.2.3.

¹⁴² See ch 8.C.4.2.3.3. See ch 8.E.1 as regards the functions of the FIC.

provides that no criminal or civil action may be filed against a bank that complies in *good faith* with its reporting duties.¹⁴³

Unfortunately, as it currently reads section 38(1)'s safe-harbour protection is meagre to say the least. This is because a bank must file a STR in *good faith* before it can claim protection against criminal action or civil action instigated by a disgruntled customer.¹⁴⁴ However, the mere notion that a bank would file a report in bad faith or negligently is without merit which renders the good faith requirement of FICA's section 38(1) redundant. If the legislator intended section 38(1) of FICA as incentive to banks to comply with the Act's reporting provisions the section should have simply read that banks that file STRs to the FIC will be protected against litigation without the good faith-requirement.¹⁴⁵

A provision with similar wording as the latter would render complete safe-harbour protection against criminal or civil litigation to banks that file STRs to the FIC.

In the end, a bank that finds itself in a predicament as regards if and how much customer information to disclose to the FIC has two options.¹⁴⁶ First, it may take the position of a interested party and require the FIC to apply for an order compelling it to disclose the requested information or secondly, it may approach the court on its own for guidance which is a potential costly avenue to follow.

2.2.5 Synthesis

Based on the conclusions above the following research objective can be considered:

2. money laundering control carries unforeseen consequences for the bank-customer relationship.

The mandatory suspicious transaction reporting duty that FICA imposes on banks intrudes on key aspects of the bank-customer relationship.¹⁴⁷ In particular, it infringes on the common-law confidentiality duty that banks owe their customers.¹⁴⁸ A bank that files a STR pursuant to section

¹⁴³ See ch 3.B.2.3.3.2; ch 8.C.4.2.3.3.

¹⁴⁴ See ch 3.B.2.3.3.2.

¹⁴⁵ See ch 8.C.4.2.3.3.

¹⁴⁶ See ch 3.B.2.3.4.

¹⁴⁷ See ch 3.B.2.1–2.3.

¹⁴⁸ See ch 3.B.2.3.1–2.3.3.

29 of FICA may face criminal action or a civil suit instigated against it by the disgruntled customer. The customer's claim could be based either on breach of contract or delict.

Section 38(1) of FICA, which aims to provide protection to banks against criminal and civil actions emanating from the filing of a STR, is inadequate because it fails to resolve the tension between the confidentiality duty of banks and their reporting duties.¹⁴⁹ As a result, a bank that filed a STR to the FIC may still face civil action taken against it by the disgruntled customer.

The problem with FICA's section 38(1) concerns the inclusion of a 'good faith' requirement; banks that file STRs will be protected against civil or criminal action only where they filed the report in good faith. This means that a disgruntled customer may argue that the bank filed a STR in bad faith or negligently and, therefore, may in spite of the safe-harbour provision, file suit against the bank based on breach of contract or delict.

Section 38(1) of FICA should therefore be amended so that a bank that files a STR to the FIC will be protected against all subsequent criminal and civil litigation and not simply where a report was filed in good faith as it currently provides.¹⁵⁰ It is recommended that the amended section 38(1) should read as follows:

Protection of persons making reports

38. (1) No action, whether criminal or civil, lies against an accountable institution ... or any other person complying [...] with a provision of this Part...

Given the absence of proper guidance in this regard, it is further recommended that the bank industry in cooperation with the Reserve Bank should assume a leadership role.¹⁵¹ Guidance could be given in the form of guidelines that advise banks how to protect themselves against civil litigation and how to deal with disclosure requests.¹⁵² The banking industry should attempt to reach some type of consensus that due to the prevalence of money laundering and the dire consequences it carries for the industry, bank confidentiality rules apply only in situations where no suspicions of money laundering exist.

2.3 Ownership of Benefits of Crime Deposited with a Bank

¹⁴⁹ See ch 3.B.2.3.3.2; ch 8.C.4.2.3.3.

¹⁵⁰ See ch 8.C.4.2.3.3.

¹⁵¹ See ch 8.C.4.2.3.3.

¹⁵² See ch 3.D; ch 8.C.4.3.

2.3.1 England

At English law, a bank becomes owner of money deposited into an account albeit the benefits of crime.¹⁵³ Therefore, money in a bank account does not belong to the account holder but to the bank where the account is held. An account holder has a chose in action against the bank to demand payment of the amount of money that stands to his credit.¹⁵⁴

2.3.2 United States

Under US law the concept of ownership is often used synonymously with property and no precise definition for it exists.¹⁵⁵ At US common-law property rights in chattels may be transferred by a non-owner to a *bona fide* purchaser for value by application of *bona fide* purchaser doctrine.

In the absence of an agreement to the contrary, a bank becomes owner of all moneys deposited with it including the benefits of crime.¹⁵⁶ The legal title to the deposited benefits of crime and that of other funds in the bank account pass to the bank which may use it for its own benefit. The account holder consequently forfeits any claim to deposited money *in specie*; he only has a claim on the bank for an amount of money equal to the amount of money that was deposited into his bank account.¹⁵⁷

2.3.3 South Africa

The legal meaning of ownership under South African law is foremost determined by established common-law rules.¹⁵⁸ Ownership like any other right is not absolute and may be limited by the law.¹⁵⁹ A bank acquires ownership of deposited money by delivery¹⁶⁰ and mixing in a bank

¹⁵³ See ch 6.C.2.3.

¹⁵⁴ See ch 6.C.2.3.

¹⁵⁵ See ch 7.B.3.

¹⁵⁶ See ch 7.B.3.

¹⁵⁷ See ch 7.B.3.

¹⁵⁸ See ch 3.C.2.1–2.2.

¹⁵⁹ See ch 3.C.2.1.

¹⁶⁰ See ch 2.A.3, paras C.1.3, C.4.2; ch 3.C.2.2, par C.3.1.

account.¹⁶¹ Mere delivery is insufficient to transfer ownership of money: a mental element or intention to transfer rights must be present.¹⁶²

The delivery of ownership in money further occurs independently from the existence of a valid underlying contract. As soon as money is paid into a bank account it ceases to be the property of the account holder, but instead, becomes the property of the bank to deal with it as it pleases.¹⁶³ Money paid into an account ceases to be the property of the account holder for two reasons. First, the bank acquires ownership of the deposited money as necessitated by the business of banking.¹⁶⁴ Secondly, money that mixes with other funds in the account becomes indistinguishable as money *in specie* and is therefore the property of the bank.¹⁶⁵

Generally, the bank acquires ownership of the deposited money irrespective of whether *commixtio* occurred.¹⁶⁶ However, the bank's use of deposited money can be tempered by agreement to the contrary by the parties concerned.¹⁶⁷ Whilst the bank may deal with deposited money as it pleases,¹⁶⁸ the account holder gains a personal claim against the bank for repayment of the same amount.¹⁶⁹

Ownership of money that was acquired through fraud or theft presents an exception to the *nemo plus iuris* rule.¹⁷⁰ The benefits of fraud or theft become the property of the bank when deposited into a bank account irrespective of the fact that the account holder is not the owner thereof.¹⁷¹ Significantly, although deposited benefits of crime belong to the bank, this does not mean that someone else may not have a claim to the funds.¹⁷² The fact that deposited money constitutes the benefits of crime further does not affect the bank's ownership thereof.¹⁷³

However, it does hold two consequences for the bank-customer relationship.¹⁷⁴ First, a bank is precluded from paying the deposited money to the customer (account holder) on demand

¹⁶¹ See ch 2.C.1.3; ch 3.C.3.1.

¹⁶² See ch 3.C.2.2.

¹⁶³ See ch 2.C.4.2; ch 3.C.3.1, par C.3.2.1.

¹⁶⁴ See ch 3.C.3.1, par C.3.2.1.

¹⁶⁵ See ch 2.C.4.2; ch 3.C.3.1.

¹⁶⁶ See ch 2.C.4.1–4.2, ch 3.C.3.2.1–3.2.2.

¹⁶⁷ See ch 3.C.3.2.1–3.2.2.

¹⁶⁸ See ch 3.C.3.1, par C.3.2.1.

¹⁶⁹ See ch 2.C.4.2, ch 3.B.2.1, paras C.3.2.1–3.2.2.

¹⁷⁰ See ch 3.C.3.1.

¹⁷¹ See ch 3.C.3.2.1.

¹⁷² See ch 3.C.3.2.1–3.2.2.

¹⁷³ See ch 3.C.3.2.1.

¹⁷⁴ See ch 3.B.2.1.2.2.

where evidence exists that the money was acquired through criminal means. Secondly, if the deposited money is the benefits of fraud or theft the bank must hold it for the victim of fraud or theft who can claim it from the bank.¹⁷⁵ If the money is the benefits of a crime such as drug trafficking where there is no easily identifiable victim, the bank will hold the funds for the state which will confiscate them whilst applying to the court for a civil forfeiture order.¹⁷⁶

As soon as a victim of fraud or theft contests ownership of a deposited amount the bank as recipient of the benefits of the fraud or theft may be enriched to the tune of the victim's impoverishment.¹⁷⁷ Significantly, the fact that a bank used the benefits of fraud or theft set-off an overdraft does not mean that it was automatically enriched with the amount.¹⁷⁸

2.3.5 Synthesis

Based on the conclusions above the following research objective can be considered:

3. a bank as recipient of the benefits of crime obtains ownership of the funds despite the money's nexus to criminal activities.

The benefits of crime whether acquired through drug-trafficking, fraud or theft become the property of the bank when deposited into a bank account.¹⁷⁹ The reason for the bank's ownership is two-fold.¹⁸⁰ First, the bank acquires ownership of deposited funds in order to conduct the business of banking. Secondly, it acquires ownership of deposited money as a result of commingling which renders the money's identification *in specie* impossible. It follows that the bank becomes owner of the whole amount in the bank account regardless of whether some of it comprises the benefits of crime or legitimately earned money.

Ownership of the benefits of crime further has a two-pronged consequence for the bank.¹⁸¹ First, if the money is the benefits of fraud or theft the victim of fraud or theft who followed the

¹⁷⁵ See ch 2.C.4.2; ch 3.B.2.1.2.2, par C.3. See ch 8.D.2–3 as regards the potential ownership remedies of a victim of fraud or theft.

¹⁷⁶ See ch 3.C.3.1; ch 8.D.4 as regards POCA's civil forfeiture provisions.

¹⁷⁷ See ch 3.B.2.1.2.2, par C.3.2.1. See also ch 8.D.3 as regards unjust enrichment.

¹⁷⁸ See ch 3.C.3.3.

¹⁷⁹ See ch 3.C.3.2.1.

¹⁸⁰ See ch 2.C.4.2; ch 3.C.3.1, par C.3.2.1.

¹⁸¹ See ch 3.B.2.1.2.2, paras C.3.1, C.3.3.

fraudulently acquired or stolen money to the bank account of the fraudster or thief may instigate civil action against the bank in an attempt to recover his loss.¹⁸² Secondly, the bank may become embroiled in civil forfeiture proceedings.¹⁸³

3 Jurisprudence of Money Laundering

3.1 Nature of Money Laundering

3.1.1 Historical Context

Globalisation not only has presented new opportunities for organised crime syndicates to expand their activities, but has also led to an unprecedented increase in money laundering.¹⁸⁴ The benefits of crime are laundered for three main reasons.¹⁸⁵

First, criminals do not want to attract attention to the fact that their money was illegally acquired, secondly, they do not want the benefits of crime to be confiscated by the government and thirdly, they need to reinvest the benefits of crime in order to generate more. Money laundering is an important link in any criminal organisation.¹⁸⁶ It follows that effective money laundering control may also result in a decline in criminal activity.¹⁸⁷

3.1.2 Definition

In contrast to the legal definitions of money laundering which set forth certain activities in relation to the benefits of crime,¹⁸⁸ the various functional definitions of money laundering denote the objectives of a money laundering scheme.¹⁸⁹ In essence, money laundering is aimed at concealing the criminal origin of the benefits of crime so that criminals can use the funds without fear of

¹⁸² See ch 6.C.4.2–4.3; ch 7.D.2–3; ch 8.D.2–3.

¹⁸³ See ch 6.C.4.4.2; ch 7.D.4; ch 8.D.4.2.

¹⁸⁴ See ch 4.B.2.1–2.2.

¹⁸⁵ See ch 4.B.1–3.

¹⁸⁶ See ch 2.C.5.2.2; ch 4.B.2.1.

¹⁸⁷ See ch 4.B.1, paras B.2.2, E.4–5.

¹⁸⁸ See ch 6.B.3.4, par B.3.6; par C.3.4; ch 7.C.2–3; ch 8.C.3.2, par C.4.2.1.

¹⁸⁹ See ch 4.B.1.

prosecution. The techniques available to launder money are as infinite as the amount of criminally acquired money that is available for money laundering.¹⁹⁰

3.1.3 Scale of Money Laundering

Broad estimates suggest that the annual amount of money laundered ranges between two and five percent of the global gross domestic product.¹⁹¹ This means that money laundering earns criminals between 590 billion to 1.5 trillion US dollars annually.

However, it is important to point out that money laundering cannot be tabulated with any amount of certainty due to the clandestine nature of the money laundering process.¹⁹² It follows that statistics which attempt to measure the scale money laundering are famously unreliable and, therefore, should not be considered as scientifically fixed. Nevertheless, available money laundering statistics should not be dismissed because they are essential tools use to devise methods to combat crime in general and in particular, money laundering.

3.1.4 Stages in Money Laundering Process

The main objective of criminals is to stay ahead of the authorities.¹⁹³ It follows that innovative techniques to launder the benefits of crime often need to be invented. However, banks as money laundering conduits remain a firm favourite of criminals for two reasons.¹⁹⁴ First, a large variety of banking products are available for exploitation. Secondly, easy access to the global financial system enables movement of the benefits of crime to anywhere in the world.¹⁹⁵

Academics have attempted to categorised the different stages in the money laundering process. In general, the following three money laundering stages are recognised: placement, layering and integration.¹⁹⁶ A forth stage, namely legitimisation, takes place after the integration stage. Although not generally recognised as a stage in the money laundering process,

¹⁹⁰ See ch 4.B.4, paras C.1–4, D.1–4.

¹⁹¹ See ch 4.B.3.

¹⁹² See ch 4.B.3.

¹⁹³ See ch 4.A, par B.4.

¹⁹⁴ See ch 4.D.1–4.

¹⁹⁵ See ch 4.D.4.3 as regards laundering money over the Internet.

¹⁹⁶ See ch 4.B.4.

legitimation is required to make the laundered money available for use.¹⁹⁷ Legitimation therefore presents criminals with proof that the money laundering process was successfully completed.

3.2 Money Laundering Techniques

3.2.1 Use of Financial System

Money launderers use a variety of institutions and techniques as part of the money laundering process.¹⁹⁸ More specifically, besides banks and nonbank financial institutions,¹⁹⁹ all forms of corporate and trust structures²⁰⁰ and professionals such as attorneys²⁰¹ may be used as part of either the placement or the integration stages of the money laundering process. Irrespective of the technique used to launder the benefits of crime, ultimately, the funds will find their way back to the financial system through deposits made into a criminal's bank account.²⁰²

3.2.2 Legal Entities

Criminals employ legal entities as tools to launder the benefits of crime.²⁰³ They include companies, trusts, partnerships and close corporations. Consider, for example, shell companies which per definition undertakes little or no business in the country where registered.²⁰⁴ For this reason a shell company can easily be established and used by criminals as part of a money laundering scheme. They present a low risk to money launderers.

The use of legal entities for money laundering purposes may be prevented if effective mechanisms are established to obtain and share information internationally on the beneficial ownership and control of legal entities.²⁰⁵

¹⁹⁷ See ch 4.B.4.

¹⁹⁸ See ch 4.C–D.

¹⁹⁹ See ch 4.C.1.

²⁰⁰ See ch 4.C.2.

²⁰¹ See ch 4.C.3.

²⁰² See ch 4.C.4.

²⁰³ See ch 4.C.2.

²⁰⁴ See ch 4.B.4, par C.2.

²⁰⁵ See ch 4.C.2.

3.2.3 Professional Groups: Attorneys

Professionals are many times involved in money laundering schemes.²⁰⁶ Attorneys, for example, may inadvertently give a criminal access to the banking system through the use of their trust account. The benefits of crime that are commingled in a trust account become indistinguishable from other funds in the account.²⁰⁷ A criminal can then proceed with the money laundering process with little risk attached to himself.²⁰⁸

3.2.4 Use of Banking Institutions

3.2.4.1 General

Criminals use bank accounts to facilitate three of the four stages of the money laundering process.²⁰⁹ For this reason the legislature has imposed the KYC standard and other AML measures on banks as part of global and national money laundering control efforts.²¹⁰ A money launderer who is able to introduce the benefits of crime directly to the banking system lowers the risk of detection.²¹¹

For this reason banks are primarily targeted by money launderers. Offshore banks, correspondent and private banks coupled with cyberbanking and underground banking collectively offer ample opportunities to criminals to use as tools to launder the benefits of crime.²¹²

3.2.4.2 Correspondent Banks

²⁰⁶ See ch 4.C.3.

²⁰⁷ See ch 2.C.4; ch 3.C.3.2; ch 6.C.2.3; ch 7.B.3 as regards commingling of deposited money in a bank account.

²⁰⁸ See ch 4.C.3, par C.4.

²⁰⁹ See ch 4.B.4.

²¹⁰ See ch 5.C; ch 6.B.3.6, par C.3.4; ch 7.C.2–3; ch 8.C.4.2.3.

²¹¹ See ch 4.D.1–3.

²¹² See ch 4.D.1–4 respectively.

Correspondent banks are vulnerable to money laundering due to the specialised services they offer to selected individuals.²¹³ Correspondent banking involves one bank, the correspondent bank, that provides financial services to some other bank, the respondent bank. The result is that the correspondent bank has little choice but to rely on the respondent bank to verify the legitimacy of its customers' earnings and therefore, may be exposed to certain risks.²¹⁴ Proper identification of a correspondent bank's customers is likely to present various challenges to the correspondent bank.

3.2.4.3 Private Banks

Like correspondent banking the nature of private banking leaves it vulnerable to money laundering.²¹⁵ In particular, the role of private bankers as customer advocates, powerful customers discouraging questions, a corporate culture of secrecy coupled with the competitive nature of the industry are factors that leave private banks open to criminals seeking for ways to launder the benefits of crime.²¹⁶

Ultimately, the fact that private bankers are required to assume contradictory roles poses a serious problem to the effective detection of money laundering within the private bank relationship.²¹⁷ On the one side, private bankers are expected to develop a personal relationship with a customer and to increase deposits with the bank. On the other side, they must heed relevant AML legislation by monitoring customers' accounts for suspicious activity. These contradictory roles may cause a private bank employee to neglect his AML duties which in turn, leaves the bank vulnerable to be used by criminals for money laundering purposes.

3.2.4.4 Electronic Banking

Professional money launderers rely on electronic payment systems that offer the best attributes of traditional currency, ease of use and relative anonymity.²¹⁸ Cyberbanking enables the transfer

²¹³ See ch 4.D.2.

²¹⁴ See ch 4.D.2.

²¹⁵ See ch 4.D.3.

²¹⁶ See ch 4.D.3.

²¹⁷ See ch 4.D.3.

²¹⁸ See ch 2.B.2; ch 4.D.4.1.

of money without ever visiting a bank in person.²¹⁹ Cyberbanking is further characterised by anonymity as enhanced by cryptology which is exactly what a criminal desires. This banking option has presented criminals with innovative money laundering opportunities.²²⁰

Cyberlaundering, which is where the benefits of crime are laundered by means of the Internet,²²¹ is estimated to have earned criminals approximately 50 billion US dollars in 2001 alone.²²² Since e-money does not have a physical manifestation, it lends itself to being manipulated through any computer at any time and from any place in the world.²²³ As a result, money can be laundered by means of the Internet in a number of ways, for example, by using security and commodities markets and e-money to purchase fictitious goods or services.²²⁴

Criminals may target online money value transfer for money laundering purposes.²²⁵ Informal financial systems, which are commonly referred to as an underground remittance systems, are further used by criminals to launder the benefits of crime and include practices such as Hawala, Hundi and *Fei Ch'ien*.²²⁶

Very little success has thus far been had at combating cyberlaundering.²²⁷ The European Convention on Cybercrime of 2001 and related recommendations of the FATF are important measures which potentially can assist with combating cyberlaundering.²²⁸

3.3 Consequences of Money Laundering

3.3.1 Undermining of Financial System

It is evident that money laundering provides criminals with the means to manipulate national and international financial systems alike.²²⁹ The benefits of crime that are deposited into a bank account mix with legitimately derived funds which renders the former indistinguishable from the

²¹⁹ See ch 4.D.4.1–4.2.

²²⁰ See ch 4.D.4.3.1.

²²¹ See ch 2.B.2.3.4 as regards the characteristics of Internet transfers.

²²² See ch 4.D.4.3.2.

²²³ See ch 2.B.2–4; ch 4.D.4.2 as regards anonymity.

²²⁴ See ch 4.D.4.3.2–4.3.3.

²²⁵ See ch 4.D.4.3.2.

²²⁶ See ch D.4.3.2.

²²⁷ See ch 4.D.4.3.4.

²²⁸ See ch 4.D.4.3.4.1–4.3.4.2 respectively.

²²⁹ See ch 4.B.1, paras C.1, D.

latter.²³⁰ The mixed fund impacts negatively on both economic and financial systems because it distorts competition between global markets.

Other matters relating to the financial policies of a country may also be adversely influenced by money laundering.²³¹ Ultimately, the presence of the benefits of crime can erode both national and the global financial systems.

3.3.2 Corruption of Professionals

In spite of little evidence to substantiate the involvement of professionals in money laundering activities, it can be assumed that criminals sometimes need the services of professionals to assist with laundering the benefits of crime.²³² The mere association or mere alleged association with money laundering has the potential to cause significant damage to a business, particularly if the business is a bank.²³³

3.3.3 Harm to Banks

The natural importance of combating money laundering is evident in the fact that it allows criminals to generate and employ the benefits of crime outside of the legitimate banking system.²³⁴ Large volumes of the benefits of crime create the illusion of wealth in a bank. However, this lasts only for a while because the funds were not deposited with the bank for legitimate investment purposes, but as part of a money laundering scheme.²³⁵ Thus, in contrast to other transactions benefits of crime do not remain long enough in a bank account to encourage economic health because the bank is used only as a conduit for money laundering.²³⁶

Once the benefits of crime have been laundered, they remain in the banking system until they can be used to finance crime. Consequently, AML measures should not be taken solely to

²³⁰ See ch 2.C.4 as regards commingling; ch 4.E.2.

²³¹ See ch 4.E.2.

²³² See ch 4.C.1–3, par E.3.

²³³ See ch 1.A where the demise of the BCCI is discussed.

²³⁴ See ch 4.B.4.

²³⁵ See ch 4.B.4, paras D.1–4.

²³⁶ See ch 4.E.4.

safeguard the reputations of banks, but also to protect banks (read: their employees) against the lure of assisting with a money laundering scheme.²³⁷

3.3.4 Costs of Regulation

AML efforts have been hampered by the costs of implementing the newest technology and training software specialists.²³⁸ The costs involved in establishing a comprehensive AML framework present the key reason why the gap between money launderers and the authorities is widening. This reality calls into question the effectiveness of current AML measures.²³⁹

One thing that crystallised is that money laundering due to the fact that it allows criminals to benefit from their illegal activities is not an innocuous crime but one that has a detrimental effect on all aspects of the financial system.

3.4 Synthesis

Based on the conclusions above the following research objective can be considered:

4. the characteristics and consequences of money laundering warrant the imposition of stringent AML measures.

Whether money laundering indeed should be combated remains a contentious issue.²⁴⁰ Accepting the futility in combating money laundering is analogous to arguing that financial crime should be allowed because criminals need resources.²⁴¹ There is little doubt that combating money laundering is an expensive endeavour, but likewise is crime prevention in general.

In addition, any crime that carries the aforementioned consequences should be combated with fervour. Certainty in this regard is unnecessary and proof unlikely due to the clandestine nature of money laundering.²⁴² Moreover, the literature reviewed presents a strong argument in

²³⁷ See chs 5. B.3.2.5, 6.B.3.6, 8.C.8.3.1 where contemporary customer due diligence principles are considered.

²³⁸ See ch 4.E.5.

²³⁹ See ch 5.B–C; ch 6.B.3.6, paras B.5, C.3.4, C.5; ch 7.C, par E; ch 8.C.4, par E.

²⁴⁰ See ch 4.E.1.

²⁴¹ See ch 4.E.5.

²⁴² See ch 4.B.3–4, par D.4.2–4.3 as regard the money laundering techniques.

favour of money laundering control. In any event, conclusive proof that money laundering does hold dire consequences for a country that allows it without sanction may never be found as a result of the clandestine nature of the crime.²⁴³

The issue of whether money laundering should be combated therefore ought to be turned around so that it is not the value of combating the crime that is questioned.²⁴⁴ Instead, ways to streamline existing AML efforts with a view of minimising costs should be investigated.

4. Money Laundering Control Measures

4.1 International Community

4.1.1 Two Models

The international AML regime does not primarily target money laundering.²⁴⁵ Instead, it is aimed at reducing criminal activities which necessitate money laundering, protecting the integrity of the financial system and controlling corruption. Disparities exist among the countries used in this study for comparative purposes as regards the content and enforcement of AML policies.²⁴⁶ The disparities are due to the fact that these countries adopted one of the following two models for money laundering control, namely, the Objective Model of Money Laundering Control or the Subjective Model of Money Laundering Control.²⁴⁷

In terms of the Objective Model of Money Laundering Control banks report all cash transactions above a set amount regardless of whether or not they appear suspicious.²⁴⁸ In contrast, the Subjective Model of Money Laundering Control, which is most frequently employed

²⁴³ See ch 4.B.4, paras D.4.3, E.5.

²⁴⁴ See ch 4.E.5.

²⁴⁵ See ch 5.A.

²⁴⁶ See ch 6.B.3.6, B.5, paras C.3.4, C.5 as regards the AML measures of the EU and England respectively; ch 7.C.2–3, paras C.8, E for the US position; ch 8.C.4.2.3, par E for South Africa's AML measures.

²⁴⁷ See ch 5.B.1–2; ch 6.B.3.4, paras B.3.6, C.3.4; ch 7.C.2–3; ch 8.C.4.2.3.

²⁴⁸ See ch 5.B.1.

by international organisations in their AML guidelines,²⁴⁹ requires that banks determine for themselves which type of transaction is suspicious and, therefore, reportable.²⁵⁰

4.1.2 Know Your Customer Standard

The KYC standard forms the cornerstone of global AML efforts because it requires that a bank acquires sufficient information about its customers and uses it effectively.²⁵¹ The assumption is that unless a bank knows who a customer is and anticipates his behaviour, it can never reasonably distinguish potential suspicious activity from usual behaviour. Elementary KYC standard models impose four duties on a bank, namely, to establish the identity of customers, file STRs, keep record of all customer transactions and to train their employees sufficiently and continuously about internal AML rules.²⁵²

Contemporary KYC standard policies represent intricate models that cater for all money laundering eventualities and sprouted ancillary strategies which resulted in highly specialised protocols.²⁵³ In recent years the KYC standard has been replaced by advanced customer due diligence programmes which are advocated as a bank's best defence against money laundering.²⁵⁴

4.1.3 Basel Committee on Banking Regulations and Supervisory Practices

Over the years the Basel Committee has issued various documents that encourage banks to put AML measures in place.²⁵⁵ In its Statement of Principles the Basel Committee delineates four ground rules or ethical principles for how banks can protect themselves against money laundering.²⁵⁶

The Basel Committee issued the Core Principles for Effective Banking Supervision to strengthen prudential banking supervision whilst its Core Methodology advises when bank

²⁴⁹ See ch 5.B.3.2, para B.3.3.

²⁵⁰ See ch 5.B.2.

²⁵¹ See ch 5.B.3.1.

²⁵² See ch 5.B.3.2–3.4, par C.1; ch 6.B.3.4, par C.3.4; ch 7.C.2–3; ch 8.C.4.2.3.

²⁵³ See ch 5.D.2; ch 6.B.3.6, par C.3.5.

²⁵⁴ See ch 5.B.3.2.5, par B.3.3.4; ch 6.B.3.6, ch 7.C.8.3.1.

²⁵⁵ See Figure 5.1 in ch 5.B.3.2.1 which summarises the AML efforts of the Basel Committee and the FATF; ch 5.B.3.2.2–3.2.6; ch 4.D.4.3.4.2.

²⁵⁶ See ch 5.B.3.2.2.

assessments should be conducted.²⁵⁷ The Core Methodology is an assessment system that includes different criteria to ascertain compliance with the Core Principles. Collectively the two aforementioned documents aim to promote high ethical standards in banks which, in turn, should guarantee that banks have internal AML policies in place.

The Basel Committee's Client Due Diligence for Banks outlines standards for banks to follow when conducting business with both existing and new customers.²⁵⁸ Of significance, in the Client Due Diligence for Banks the Basel Committee acknowledges that banks may become subject to lawsuits as a result of their failure to observe mandatory KYC standards.

The Basel Committee therefore encourages banks to have KYC standard policies in place to protect themselves against litigation. Although failing to acknowledge the potential pitfalls of money laundering control, the Basel Committee had the foresight to warn banks of the potential consequences such as criminal prosecution and potential civil litigation should they fail to observe the KYC standard.²⁵⁹

4.1.4 Financial Action Task Force on Money Laundering

The FATF is the only international body that specialises in AML strategies.²⁶⁰ Its contribution in combating money laundering has been immeasurable. This is due to the fact that the FATF in pursuance of its mandate released different documents that contain prevention strategies to counteract money laundering in the banking system.²⁶¹

The FATF's initial Forty Recommendations revolved around the KYC standard.²⁶² Its Revised Recommendations are of particular importance because they set firmer, more detailed standards than the Forty Recommendations. In addition, they advocate a flexibility that corresponds with current AML policies.²⁶³ The Revised Recommendations further modernised key aspects of the Forty Recommendations.²⁶⁴ It is evident that the FATF's AML measures are neither stagnant nor call for the implementation of provisions which are unclear or impractical.

²⁵⁷ See ch 5.B.3.2.3–3.2.4.

²⁵⁸ See ch 5.B.3.2.5.

²⁵⁹ See ch 5.B.3.2.5.

²⁶⁰ See ch 5.B.3.3.1.

²⁶¹ See ch 5.B.3.3.2–3.3.4.

²⁶² See ch 5.B.3.3.2.

²⁶³ See ch 5.B.3.3.3–3.3.4.

²⁶⁴ See ch 5.B.3.3.4.

4.1.5 United Nations

International organisations form the frontline in overcoming some of the other practical obstacles generated by money laundering control strategies.²⁶⁵ The UN is no exception and has contributed to the global AML campaign by issuing treaties which represent global agreement on how money laundering can be combated. Its AML-related treaties are further aimed at combating both organised crime and its byproduct, money laundering.²⁶⁶

The UN' Vienna Convention of 1988 was the first binding multilateral agreement that comprised measures against money laundering.²⁶⁷ It was designed to promote cooperation among signatories so that drug trafficking and the laundering of its proceeds could be more effectively combated.²⁶⁸ The Vienna Convention refers only indirectly to money laundering; it criminalises conduct that amounts to money laundering but neglects to mention the concept of money laundering. Nevertheless, the Vienna Convention remains one of the most detailed and far reaching instruments ever adopted in international criminal law. If effectively implemented, it should provide a foundation for the synchronised enforcement of standard AML measures.²⁶⁹

The UN' Convention Against Organised Crime of 2000 emphasises the importance of the KYC standard as a tool to deal more effectively with money laundering control in banks.²⁷⁰ Signatories are required to establish a financial intelligence unit to collect, analyse and disseminate information on potential money laundering schemes.²⁷¹ The importance of the convention lies in the fact that it formally renders the KYC standard a matter of international law with all the benefits that this holds.

4.1.6 Auxiliary International Anti-Money Laundering Measures

²⁶⁵ See ch 5.C.1.1.

²⁶⁶ See ch 5.C.1–3.

²⁶⁷ See ch 5.C.1.1.

²⁶⁸ See ch 5.C.1.2.

²⁶⁹ See ch 5.C.1.2.

²⁷⁰ See ch 5.C.3.1.

²⁷¹ See ch 5.C.3.2.

The IMF has been involved in the fight against money laundering in various ways.²⁷² However, since the IMF by and large deals with matters pertaining to the global monetary system, the practical difficulties that banks are encountering as regards the KYC standard have yet to attract its attention.

Other international organisations such as the Wolfsberg Group and the Egmont Group of Financial Intelligence Units of the World are further a part of the global AML effort.²⁷³ Despite its failure to acknowledge that banks may struggle with certain aspects of money laundering control, the Wolfsberg Group provides an excellent forum from which to explore issues of concern to banks.²⁷⁴

The main objective of the Egmont Group of Financial Intelligence Units of the World is to stimulate international training and information exchanges among agencies that are responsible for receiving suspicious transaction reports.²⁷⁵ Although the Egmont Group encourages cooperation among financial intelligence units,²⁷⁶ facilitating the necessary cooperation is more complicated than is apparent.

4.2. European Union

4.2.1 General

4.2.1.1 Conventions

AML control in the EU has been ringfenced by conventions and directives.²⁷⁷ One of the conventions is the Strasbourg Convention which has proved key in preventing money laundering

²⁷² See ch 5.D.2.

²⁷³ See ch 5.D.3–5.

²⁷⁴ See ch 5.D.4.

²⁷⁵ See ch 5.D.5.

²⁷⁶ For example, the FIC of South Africa (see ch 8.E.1), the National Criminal Intelligence Service of England (see ch 6.C.3.4.3.1) and the Financial Crimes Enforcement Network of the US (see ch 7.E.1).

²⁷⁷ See Figure 6.1 in chapter 6.B.6 which summarises key AML measures taken by the EU legislature.

in the region.²⁷⁸ One of its objectives is to improve cooperation between EU member states in the confiscation of the benefits of crime.²⁷⁹

The greatest contribution of the Strasbourg Convention as regards money laundering control lies in the fact that it advocates use of both an objective and a subjective test to determine the potential liability of banks for a money laundering offence.

4.2.1.2 Directives

The AML directives of the EU legislature are a testimony to the EU's commitment to combat money laundering in banks. Although the first two AML directives were repealed, their content demonstrated the foresight of the EU legislature in matters pertaining to money laundering control.²⁸⁰ For this reason their content was for the most part included in the 2005 Directive.²⁸¹

The structure of the 2005 Directive is commendable and so are most of its provisions.²⁸² Similar to the Strasbourg Convention,²⁸³ the 2005 Directive determines that knowledge, intent or purpose required as an element of money laundering activities can be inferred from objective factual circumstances.²⁸⁴

The EU legislature further suggests that member states use the Subjective Model of Money Laundering Control.²⁸⁵ The concept 'customer due diligence' has been used in the 2005 Directive as an umbrella concept to denote customer identification and verification duties, suspicious transaction reporting, record-keeping and training.

The single most important provision of the 2005 Directive is the two categories of customer due diligence measures.²⁸⁶ Simplified due diligence is recommended in instances where a reduced risk of money laundering exists whilst member states should apply enhanced due diligence in instances where a high risk of money laundering exist. The 2005 Directive further

²⁷⁸ See ch 6.B.3.2.

²⁷⁹ See ch 6.B.3.2.

²⁸⁰ See ch 6.B.3.4–3.5.

²⁸¹ See ch 6.B.3.6.

²⁸² See ch 6.B.3.6.

²⁸³ See ch 6.B.3.2.

²⁸⁴ See ch 6.B.3.6.

²⁸⁵ See ch 5.B.1–2 as regards the two models of money laundering control.

²⁸⁶ See ch 6.B.3.6.

delineates criteria for determining which instances represent a low or a high risk of money laundering.²⁸⁷

Ultimately, the EU's AML measures have the potential for great efficiency should the innovative customer due diligence standard of the 2005 Directive be adopted by member states.

4.2.2 England

4.2.2.1 Proceeds of Crime Act

The Proceeds of Crime Act as principal AML statute of England set out various money laundering offences which include a bank employee's failure to disclose potential money laundering account activities of the bank's customers to the NCIS.²⁸⁸

The manner in which a bank employee's knowledge about money laundering can be established lies at the heart of the Act's money laundering offences.²⁸⁹ The court may use any one of five mental states of knowledge for the purpose of determining the potential liability of an accused.²⁹⁰

4.2.2.2 Anti-Money Laundering Regulations

Broadly regarded the English 2007 Regulations present a reproduction of the 2005 Directive.²⁹¹ This is because they comprise both original KYC standard obligations²⁹² as well as customer due diligence measures similar to those advocated in the 2005 Directive.²⁹³

4.3 United States

4.3.1 Anti-Money Laundering Legislation

²⁸⁷ See ch 6.B.3.6.

²⁸⁸ See ch 6.C.3.4.2–3.4.3.

²⁸⁹ See ch 6.C.3.4.3.1, par C.3.4.3.3–3.4.3.4.

²⁹⁰ See ch 6.C.3.4.1.

²⁹¹ See ch 6.C.3.5.

²⁹² See ch 6.B.3.4–3.5 as regards the EU's 1991 and 2001 Directives.

²⁹³ See ch 6.B.3.6.

Under federal law AML measures have been captured by a patchwork of provisions, each designed to address specific money laundering-related loopholes.²⁹⁴ However, the complex and fragmented model of AML control belies the fact that it fails to address the challenges banks face in executing their AML control obligations. This failure is likely to contribute to the eventual failure of money laundering control in the US.

Despite a myriad of AML statutes²⁹⁵ the Bank Secrecy Act and the Money Laundering Control Act function as the two principal AML statutes of the US.²⁹⁶ The Bank Secrecy Act does not criminalise money laundering, but instead, imposes reporting and record-keeping obligations on banks.²⁹⁷

The Money Laundering Control Act supplements the Bank Secrecy Act with two pivotal provisions.²⁹⁸ First, it expands the Bank Secrecy Act's reporting requirements, and secondly, it criminalises money laundering for the first time through the inclusion of specific unlawful activities.²⁹⁹

The kind of knowledge required for a money laundering offence pursuant to the Bank Secrecy Act has yet to be fixed.³⁰⁰ In contrast, the Money Laundering Control Act set out four unambiguous intent and knowledge requirements that the prosecution must establish before liability for a money laundering offence will be imposed on a bank or its employee.³⁰¹ In turn, the Racketeering Influence Corrupt Organisation Act criminalises various racketeering activities whilst the Annunzio Act compels banks to implement AML compliance programmes.³⁰²

The Patriot Act is the US most significant AML statute since the enactment of the Bank Secrecy Act in 1970.³⁰³ It amended existing AML legislation and created special due diligence procedures to identify the owners of private bank accounts.³⁰⁴ The Patriot Act further requires that banks modify their internal AML programmes. It therefore impacts directly on their AML

²⁹⁴ See ch 7.C.2–9.

²⁹⁵ See ch 7.C.1, paras C.2–8.

²⁹⁶ See ch 7.C.2–3 respectively.

²⁹⁷ See ch 7.C.2.2–2.4.

²⁹⁸ See ch 7.C.3.2.1–3.2.2.

²⁹⁹ See ch 7.C.3.2.

³⁰⁰ See ch 7.C.2.4.

³⁰¹ See ch 7.C.3.2.1.

³⁰² See ch 7.C.4–5 respectively.

³⁰³ See ch 7.C.8, par C.2 respectively.

³⁰⁴ See ch 7.C.8.3.2.

duties.³⁰⁵ Moreover, the international reach of the Patriot Act renders it a legal instrument with far-reaching consequences.³⁰⁶

4.3.2 Anti-Money Laundering Regulations

The Treasury in cooperation with other supervisory agencies continuously issue regulations to implement the AML measures of the Bank Secrecy Act.³⁰⁷ Recently issued regulations are aimed at enforcing the due diligence measures of the Patriot Act.

4.4 South Africa

4.4.1 Anti-Money Laundering Legislation

4.4.1.1 Prevention of Organised Crime Act (1998)

POCA and FICA in aggregate form the backbone of the South African AML regime.³⁰⁸ While POCA sets out substantive money laundering provisions, FICA supplies the administrative arrangements. The AML provisions of the two Acts must be read in conjunction with AML Regulations which were published pursuant to FICA.³⁰⁹

POCA is fundamentally based on the premise that organised crime in South Africa must be eradicated.³¹⁰ It is of twofold importance to money laundering control in South Africa. First, POCA defines the concept of money laundering which definition is cross-referenced by FICA.³¹¹ Secondly, it criminalises money laundering and activities committed either intentionally where the accused bank had ‘actual knowledge’ about the criminal origin of funds, or negligently where the accused bank ‘ought reasonably to have known’ that funds used in a transaction were acquired through criminal means.³¹²

³⁰⁵ See ch 7.C.8.2.

³⁰⁶ See ch 7.C.8.3.1–8.3.2.

³⁰⁷ See ch 7.C.9.

³⁰⁸ See ch 8.C.3–4 respectively.

³⁰⁹ See ch 8.C.5.

³¹⁰ See ch 8.C.3.1.

³¹¹ See ch 8.C.3.2, par C.4.2.1 respectively.

³¹² See ch 8.C.3.2.

POCA was amended on two occasions to rectify drafting faults, to insert further money laundering provisions and to afford some of its provisions retrospective application.³¹³ However, some additional amendments are required to clarify and streamline some of the Act's provisions.³¹⁴ The additional amendments should include the replacement of the concept 'proceeds' as used in 'proceeds of unlawful activities' with the concept 'benefits'.³¹⁵

The reason for the suggested amendment concerns the grammatical meaning of 'proceeds'; grammatically, the concept 'proceeds' limits illegally acquired property to include only benefits which were *generated* by unlawful activities as opposed to benefits which were acquired through unlawful activities. The unintended effect of this limitation is that POCA should apply only to money that was generated by crimes such as drug-trafficking as opposed to money that was illegally acquired from victims of crimes such as fraud or theft.³¹⁶ The concept 'proceeds' should therefore be replaced in POCA with the concept 'benefits'. A definition for 'benefits' should further be inserted in POCA's section 1. An example of the aforementioned amendments is set out below.³¹⁷

4.4.1.2 Financial Intelligence Centre Act (2001)

FICA is a progressive statute that takes cognisance of international AML measures in general and in particular, English AML legislation.³¹⁸ For this reason elementary KYC standard obligations have been included in the Act whilst the risk-approach to customer identification are explained in the AML Regulations.³¹⁹ The bulk of FICA's content comprises the KYC standard obligations which are imposed on the 19 accountable institutions to which the Act apply including banks.³²⁰

FICA imposes four AML obligations on banks which means that banks must establish the identity of customers, file STRs, keep records of transactions and train their employees to

³¹³ See ch 8.C.3.1.

³¹⁴ See paras B.4.5, B.7.4, C below; ch 8.C.3.2, par D.4.3.

³¹⁵ See ch 8.C.3.2.

³¹⁶ The same point is valid for FICA as well - see ch 8.C.4.2.1.

³¹⁷ See par B.4.5 below.

³¹⁸ See ch 6.C.3.4, par C.3.5 respectively as regards the PCA and the AML Regulations.

³¹⁹ See ch 8.C.4.2–4.3.

³²⁰ See Schedule 1 of FICA - ch 8.C.4.1, paras C.4.2.3, C.4.2.3.3 under 'Accountable Institutions'.

assist with money laundering control.³²¹ FICA's KYC standard provisions are therefore also similar to the FATF's Forty Recommendations.³²²

Identification Obligation

Section 21(1)(a) of FICA sets out the first obligation of a bank as an accountable institution, namely to establish and 'verify' the identity of customers unless an exemption is applicable.³²³ FICA further distinguishes among the three levels of identification and dictates the identification obligations of a bank accordingly.³²⁴ The AML Regulations provide in detail the manner in which identification and verification of various categories of customers should be conducted.³²⁵ Banks should not accept any evidence of identity offered by customers at face value, but should take reasonable measures to confirm the veracity of the evidence that a customer presents.³²⁶

FICA does not provide for simplified and enhanced customer due diligence.³²⁷ Instead, it subscribes to the KYC standard of customer identification³²⁸ whilst updates of the standard's requirements are accomplished through the FIC's guidance notes.³²⁹ The FIC's guidelines advise banks to adopt a risk-based approach when verifying customer information.³³⁰ This entails that the greater the perceived risk of money laundering the higher the level of verification should be.

In contrast to its international counterparts,³³¹ FICA provides that a bank may not conclude a transaction unless it has 'traced' all the accounts involved therein.³³² The idea is that a bank should be able to establish the legitimacy of both a customer and the transaction by tracing the path of the money involved. However, since there is a definite difference in the meaning

³²¹ See ch 8.C.4.2.3.2–4.2.3.5 respectively.

³²² See ch 5.B.3.3.2 as regards the Forty Recommendations of the FATF.

³²³ See ch 8.C.4.2.3.2 under 'Three Identification Levels' and 'Reasonableness'.

³²⁴ See ch 8.C.4.2.3.2 under 'Three Identification Levels'.

³²⁵ See ch 8.C.4.2.3.2 under 'Three Identification Levels', par C.5.

³²⁶ See ch 8.C.4.2.3.2 under 'Reasonableness'.

³²⁷ See ch 8.C.4.2.3.1, paras C.4.2.3.2 under 'Three Identification Levels', C.5.

³²⁸ See ch 5.B.3.1, paras B.3.2.2, B.3.3.2, B.3.4.

³²⁹ See ch 8.E.1.

³³⁰ See ch 8.C.4.2.3.2 under 'Risk-based Approach'.

³³¹ See ch 6.B.3.6, par C.3.5; ch 7.C.8.1.

³³² See ch 6.C.4.2.3.2 under 'When to Trace'.

between the concepts ‘trace’ and ‘follow’, the concept ‘trace’ should be repealed from section 21(2)(d) and replaced with the concept ‘follow’.³³³

Suspicious Transaction Reporting Obligation

In line with international trends³³⁴ the reporting obligation of FICA is a broad and onerous one which requires banks to report two types of transactions to the FIC, namely cash transactions above a prescribed limit and suspicious or unusual transactions.³³⁵ As a result of FICA’s reporting obligation South Africa like the US³³⁶ has adopted a hybrid model of money laundering control which encompasses both elements of the Subjective Model of Money Laundering Control and the Objective Model of Money Laundering Control.³³⁷

The concept of knowledge is pivotal as regards establishing the potential criminal liability of a bank for a money laundering offence.³³⁸ In contrast to the international AML legislation considered in this study for comparative purposes,³³⁹ FICA delineates the circumstances under which a person is deemed to have or ought to have knowledge that a transaction is suspicious or unusual.³⁴⁰ Ultimately, the required element of knowledge is deemed present where a bank actually *knows* that a transaction meets with the section 29-reporting requirements,³⁴¹ or where it willfully turns a ‘blind eye’ to the fact.³⁴² It is evident that Parliament set down both an objective test and a subjective test to determine the presence of knowledge. For a valid suspicion to exist some foundation will have to be present before an obligation arises to file a STR.³⁴³

However, Parliament’s definition of the knowledge element of liability does not contribute to certainty as to when to file a STR to the FIC.³⁴⁴ As a result banks continue to find

³³³ See ch 8.C.4.2.3.2 under ‘When to Trace’.

³³⁴ See ch 5.B.3.2–3.3, par B.3.4.3; ch 6.B.3.6, par C.3.4.2; ch 7.C.2.3–2.4, paras C.3.2, C.8.2.

³³⁵ See ch 8.C.4.2.3.3 under ‘Accountable Institutions’.

³³⁶ See ch 7.C.2–3.

³³⁷ See ch 5.B.1–2 as regards the two models of money laundering control.

³³⁸ See ch 8.C.4.2.2.

³³⁹ See ch 6.B.3.6, par C.3.4; ch 7.C.2–8.

³⁴⁰ See ch 8.C.4.2.2.

³⁴¹ See ch 8.C.4.2.3.3 under ‘Knowledge or Suspicion’.

³⁴² See ch 8.C.4.2.3.3 under ‘Knowledge or Suspicion’.

³⁴³ See ch 8.C.4.2.3.3 under ‘Knowledge or Suspicion’.

³⁴⁴ See ch 8.C.4.2.3.3 under ‘Knowledge or Suspicion’.

themselves in unfamiliar territory as regards the recognition of the benefits of crime and suspicious or unusual transactions and when to file STRs. Clearly, when to file a section 29-report to the FIC remains one of those ‘you will know it when you see it’ situations. Banking experience and extensive customer profiling may assist a bank employee to recognise when a transaction is suspicious or unusual.³⁴⁵ The complexity of a particular transaction coupled with its purpose may further alert banks to a potential money laundering scheme.

In the absence of clear-cut rules the courts may need to determine whether an accused bank employee knew or should have known that a transaction is suspicious or unusual and, therefore, should have filed a STR.³⁴⁶ Their interpretation of the particular circumstances surrounding a transaction may be a deciding factor before criminal liability for a money laundering offence can be imposed on the bank. The courts may also take other factors such as the bank’s internal AML rules coupled with the AML training it provided to the accused into consideration to determine his potential liability.³⁴⁷

Since reasonableness is used in FICA as measure to determine whether an accused bank employee had knowledge that a transaction was reportable,³⁴⁸ the court in order to determine his potential liability for failure to file a STR will use a reasonable bank employee test.³⁴⁹

However, section 29(1) and section 29(2) of FICA fail to specify that reasonableness will be used by the court as standard to determine the potential liability of a person who failed to file a STR.³⁵⁰ This is an omission that should be rectified in order to clarify which standard the courts will use to determine liability for the contravention of section 29 of FICA.³⁵¹

Section 33 of FICA provides that a bank may continue with a transaction after it has filed a STR.³⁵² This means that a bank that filed a STR and continued with the transaction may have been assisting the customer with laundering the benefits of crime. For this reason section 33 of FICA should be amended so that it affords a bank respite from continuing with a suspicious transaction until the matter has been resolved by either the authorities or the judiciary.³⁵³

³⁴⁵ See ch 8.C.4.2.3.3 under ‘Knowledge or Suspicion’.

³⁴⁶ See ch 8.C.4.2.2.

³⁴⁷ See ch 8.C.4.2.3.3 under ‘Knowledge or Suspicion’, paras B.4.2.3.5, B.4.3.

³⁴⁸ See ch 8.C.4.2.2.

³⁴⁹ See ch 8.4.2.3.3 under ‘Knowledge or Suspicion’.

³⁵⁰ See ch 8.C.4.2.3.3 under ‘Knowledge or Suspicion’.

³⁵¹ See paras B.4.5, C below.

³⁵² See ch 8.C.4.2.3.3 under ‘Knowledge or Suspicion’.

³⁵³ See par B.4.5, par C below; ch 8.C.4.2.3.3 under ‘Knowledge or Suspicion’.

Suspicious or unusual transaction reports are further confidential and may be disclosed only to designated institutions such as the SAPS or SARS.³⁵⁴ The rationale for the provision is self-evident; the obligation to report suspicious transactions is of not much use if the suspected criminal and money launderer is informed of the fact that he is under investigation.

Record-Keeping Obligation

Pursuant to FICA banks are required to keep records for five years pertaining to certain customer information.³⁵⁵ Information that should be kept include the manner in which the bank established a customer's identity, the nature of the business relationship and the number of accounts held by him.

Training Obligation

Section 43(b)(I) FICA provides in general terms for the appointment of a 'person' whose main responsibility is to ensure compliance to AML measures by a bank and its employees.³⁵⁶ Internationally, this person is known as a so-called 'money laundering reporting officer'.³⁵⁷ For this reason the concept 'person' used in section 43(b)(i) of FICA should be replaced with the concept 'money laundering reporting officer in order to update FICA according to international trends and to ensure that there are no doubts as regards the obligations of the appointee'.³⁵⁸

Other amendments aimed at improving FICA's provisions are further necessary, the likes of which are set out below.³⁵⁹

4.4.2 Anti-Money Laundering Regulations

³⁵⁴ See ch 8.C.4.2.3.3 under 'Tipping-off Offence'.

³⁵⁵ See ch 8.C.4.2.3.4.

³⁵⁶ See ch 8.C.4.2.4.5.

³⁵⁷ See ch 6.C.3.4.3.1.

³⁵⁸ See paras B.4.5, C below.

³⁵⁹ See paras B.4.5, C below.

The gist of the AML Regulations is encapsulated in FICA's section 21: accountable institutions are prohibited from conducting business with *unidentified* clients.³⁶⁰ It follows that the AML Regulations comprise guidelines that inform banks how to identify specific categories of customers.³⁶¹

However, instead of representing the more practical component of FICA, the AML Regulations are a mere copycat of other similar regulations.³⁶² For this reason their conventional content should be rethought, especially in light of the potential civil liability that may be imposed on banks as a result of their failure to identify both a potential money launderer and the benefits of crime.³⁶³

4.5 Synthesis

Based on the conclusions above the first research objective can be considered:

5. the KYC standard has evolved over the years for the purpose of combating ever changing money laundering techniques.

Undoubtedly the identification obligation of the KYC standard once played a key role in money laundering prevention, because it provided a template to banks of how elementary AML policies should be formulated.³⁶⁴ However, this form of customer identification has become obsolete in light of the advanced customer due diligence measure of money laundering control.³⁶⁵ It should therefore be replaced across the board by simplified and advanced customer due diligence measures.³⁶⁶

Contemporary customer due diligence models of money laundering control have the potential to assist banks with the practical dilemmas they are facing as regards money laundering

³⁶⁰ See ch 8.C.4.2.3.2.

³⁶¹ See ch 8.C.5.

³⁶² See ch 6.C.3.5 and ch 7.C.9 respectively.

³⁶³ See ch 3.B.2.3.3; ch 8.C.4.3, par D.2–3 as regards the potential criminal and civil liability of a bank.

³⁶⁴ See ch 5.B.3.1, par B.3.2–3.4, par C.1; ch 6.B.3.4, par C.3.3; ch 7.C.2–3.

³⁶⁵ See ch 6.B.6, par C.3.5; ch 7.C.8.1.

³⁶⁶ See ch 6.B.3.6, par C.3.5; ch 7.C.8.1.

control.³⁶⁷ The main problem with the KYC standard is that its obligations are elementary and, therefore, may contribute to uncertainty rather than uniformity in their application.³⁶⁸

For this reason the EU legislature extended itself to address these negative aspects of the KYC standard and devise an AML model that comprises elementary principles and unambiguous examples of the scope of preventative measures.³⁶⁹

From the conclusions above a second research objective can be considered:

6. some of the provisions of FICA and POCA fail to conform with contemporary foreign money laundering control measures.

FICA's AML measures are based on the outdated KYC standard obligations which should be replaced with more contemporary AML principles.³⁷⁰ Some of the provisions of POCA are likewise in need of some revision in order to clarify and simplify their content.³⁷¹ The following amendments which aim to improve the money laundering control measures of the two Acts above are therefore recommended:

1. The use in POCA and FICA of the concept 'proceeds' to denote property that was acquired through criminal means is incorrect because it has the unintended effect of limiting the scope of the two Acts.³⁷²

In this respect POCA and FICA should be amended as follows:

- G first, the concept 'proceeds' should be replaced with the concept 'benefits' in the concept 'proceeds of unlawful activities';³⁷³
- G secondly, a definition for 'benefits' should be inserted in section 1(xv) of POCA to read as follows:³⁷⁴

³⁶⁷ See ch 5.D.2; ch 6.B.3.6, par C.3.5.

³⁶⁸ See ch 5.B.3.2.3, paras B.3.3.2, B.3.4; ch 6.B.3.4; ch 8.C.4.2.3.

³⁶⁹ See ch 6.B.3.6.

³⁷⁰ See ch 8.C.4.3.2.

³⁷¹ See ch 8.C.3.2.

³⁷² See Figures 1.2 and 1.3 in ch 1.A.2; ch 2.C.5.3 as regards the concept of benefits of crime; ch 8.C.3.2, par C.4.2.1, par D.4.2.1.

³⁷³ See ch 8.C.3.2, par C.4.2.1, par D.4.2.1.

³⁷⁴ See the Strasbourg Convention's definition of 'benefit of criminal conduct' - ch 6.B.3.2, B.4.2.2.

'benefits' means any economic advantage acquired from unlawful activities.

2. Schedule 1 of POCA lists various offences which are referred to in the Act's definition of an instrumentality of an offence.³⁷⁵ The purpose of Schedule 1 remains unclear, particularly because the concept 'unlawful activity' is defined in POCA as *any* criminal conduct whether it occurred in the Republic or abroad.³⁷⁶

There is therefore no clear reason why a list of specific offences should be included in a schedule of the Act. Therefore, for the purpose of realigning POCA's provisions and rendering the Act more user-friendly the following two amendments to POCA are necessary:³⁷⁷

- G First, Schedule 1 of POCA should be repealed because it fails to serve a purpose.
- G Secondly, the concept 'instrumentality of an offence'³⁷⁸ should be amended in section 1 to 'instrumentality of an unlawful activity', which concept should be defined as follows:

(vii) **'instrumentality of an [unlawful activity]'** means any property which is concerned in the commission or suspected commission of an **[an unlawful activity]** at any time before or after the commencement of this Act, whether committed within the Republic or elsewhere.

3. The short title of FICA is a misnomer because it fails to indicate the objectives of the Act which stretch well beyond the FIC's activities.³⁷⁹

In addition, the administrative arrangement of the FIC cover only a small part of the Act's provisions as opposed to its AML provisions. Therefore, FICA's short title should be amended to:³⁸⁰

'Counter-Money Laundering and Reporting Act'.

The short title above is recommended because it embodies not only the objectives of the Act, but also includes its key obligation, namely, to report activities which may be indicative of a money laundering scheme.

³⁷⁵ See ch 1.A.2; ch 8.C.3.2, paras C.4.2.1, D.4.2.1.1.

³⁷⁶ See ch 1.A.1; ch 8.C.3.2, paras C.4.2.1, D.4.2.1.2.

³⁷⁷ See ch 8.C.3.2.

³⁷⁸ See ch 8.D.4.2.1.4.

³⁷⁹ See ch 8.C.4.1.

³⁸⁰ See ch 8.C.4.1.

4. Four points as regards FICA's identification obligation are of importance.³⁸¹ First, some of the Act's identification exceptions are likely to restrict its effectivity.³⁸²

G For this reason the exceptions should be removed from FICA so that banks are required to establish the identity of every customer they conduct a transaction for.³⁸³

Secondly, a review of the identification obligation of the KYC standard pursuant to FICA is required to elevate the Act to the standard of its counterparts. Guidelines are not always sufficient to cultivate a culture of efficient risk assessment in banks.³⁸⁴

The insertion of simplified and enhanced customer due diligence measures into section 21 of FICA will revamp the Act's provisions and elevate it to the standard of its international counterparts.³⁸⁵ This will not only give credence to the AML regime of the country, but may also serve as testimony of the serious commitment of Parliament to control money laundering.

G Parliament therefore should amend section 21(1) of FICA in order to provide for simplified and enhanced customer due diligence akin to the EU's 2005 Directive.³⁸⁶ The amended section 21(1) of FICA should read as follows:

Identification of clients and other persons

Section 21. (1). An accountable institution may not establish a business relationship or conclude a single transaction with a client unless the accountable institution has [used simplified or advanced customer due diligence] (a) to establish [...] the identity of the client.

G The concepts 'simplified' and 'advanced' due diligence should therefore be inserted in the AML Regulations to clarify the risk-based approach to customer identification which the regulations are advocating.³⁸⁷ As a result Regulations 2 to 19 (customer identification) should be amended in order to rearranged their content according to simplified and enhanced customer due diligence principles.

Ultimately, by implementing the EU's innovative customer due diligence measures a bank should be able to identify the benefits of crime before the money can be introduced into the banking

³⁸¹ See in general ch 8.C.4.2.3.2.

³⁸² See ch 8.C.4.2.3.2 under 'Reasonableness'.

³⁸³ See ch 8.C.4.2.3.2 under 'Risk-based Approach'.

³⁸⁴ See ch 8.C.4.2.3.2 under 'Risk-based Approach'.

³⁸⁵ See ch 6.B.3.6; ch 7.C.8.3.1.

³⁸⁶ See ch 6.B.3.6 as regards the EU's 2005 Directive.

³⁸⁷ See regulation 2 to 19 (customer identification) - ch 8.C.5, par F.

system for money laundering purposes.³⁸⁸ In doing so a bank may be able to circumvent and even protect itself against the consequences of money laundering and money laundering control. This outcome not only affords credence to money laundering control but also returns credibility to statutory AML measures irrespective of their potential negative consequences.

Thirdly, faultless verification by banks of customer information is an impossible task for two reasons which were spelt out elsewhere in the study.³⁸⁹

G The concept ‘verify’ should thus be repealed from section 21(1).

G In addition, a definition for ‘establish’ should be inserted in section 1 of FICA.³⁹⁰ The definition should read as follows:

‘to establish’ means to form a *reasonable* belief about the true identity of a customer.

In turn, the concept ‘reasonable belief’ should be defined in section 1 of FICA as follows:

‘reasonable belief’ means what a reasonably diligent and vigilant person might have believe having both the general knowledge, skill, training and experience that may reasonably be expected of a person in his or her position, and the general knowledge, skill, training and experience that he in fact has.³⁹¹

Fourthly, section 21(2)(d) of FICA provides that banks should ‘trace’ all accounts that are involved in a transaction.³⁹² However, legally the concept ‘trace’ refers to an English equity remedy which is different from the meaning of the concept ‘follow’.³⁹³

G For this reason section 21(2)(d) of FICA should be amended to read as follows:

Identification of clients and other persons

21 (2) If an accountable institution had established a business relationship with a client ... the accountable institution may not conclude a transaction ... unless the accountable institution has taken the prescribed steps— ... (d) to **[follow]** all accounts at that accountable institution that are involved in transactions ...

³⁸⁸ See ch 6.B.3.6.

³⁸⁹ See ch 8.C.4.2.3.2 under ‘Risk-based Approach’.

³⁹⁰ See ch 8.C.4.2.3.2 under ‘Risk-based Approach’.

³⁹¹ See section 1(3) of FICA on which the proposed definition is based.

³⁹² See ch 8.C.4.2.3.2 under ‘When to Trace’.

³⁹³ See ch 1.B; ch 6.C.4.1, par 6.D.4.3.

For the purpose of section 21 the process of following money would be sufficient to establish information given by the customer to the bank.³⁹⁴ In short, when Parliament requires that banks assist with ‘tracing’ an account, it in actual fact requires that banks pinpoint the source of the money with a view of determining whether it was legitimately or illegally acquired.

5. Three amendments are recommended as regards the suspicious transaction reporting obligation of banks in terms of section 29 of FICA. First, the listing of 19 accountable institutions in Schedule 1 of FICA is superfluous.³⁹⁵ In this respect the 2005 AML Directive of the EU is better arranged; it is simply stated that the instrument applies to banks, financial institutions, non-financial and businesses that carried out life insurance activities.³⁹⁶

G Schedule 1 should therefore be repealed from FICA and a definition for ‘accountable person’ should be inserted in section 1 of the Act which reads as follows:³⁹⁷

‘accountable institution’ means banks as defined by the Banks Act 94 of 1990, financial institutions, non-financial institutions, businesses that carried out life insurance activities and persons who transact on behalf of customers.

The latter provision should be included to insure that any person who deals with money or currency on behalf of some other such as attorneys and money-lenders falls within the ambit of FICA as well.

Secondly, reasonableness is used by FICA to determine whether an accused had knowledge of a certain fact which he should have reported to the FIC.³⁹⁸ Section 29 of the Act fails to specify that reasonableness is used by the courts as standard to determine the potential liability of a person who failed to file a STR.³⁹⁹

G For this reason the section should be amended with the insertion of ‘reasonably’ before the phrase ‘knows of suspects’. The relevant part of the amended section should read as follows:

Suspicious and Unusual Transactions

29. (1) A person ... who [**reasonably**] knows or suspects ...

³⁹⁴ See ch 8.C.4.2.3.2 under ‘When to Trace’.

³⁹⁵ See ch 8.C.4.2.1, par C.4.3.3.3 under ‘Accountable Institutions’.

³⁹⁶ See ch 6.C.3.4–3.6.

³⁹⁷ See ch 8.C.4.2.3.3 under ‘Accountable Institution’.

³⁹⁸ See ch 8.C.4.2.2.

³⁹⁹ See ch 8.C.4.2.3.3 under ‘Knowledge or Suspicion’.

(2) A person ...who [**reasonably**] knows or suspects that a transaction.

The insertion of ‘reasonably’ before ‘knows or suspects’ should clarify which standard will be used by the court to determine potential liability for failure to file a STR.

Thirdly, section 33 of FICA provides that a bank may continue with a transaction after it has filed a STR.⁴⁰⁰ This means that a bank that filed a STR and continues with the transaction may in actual fact be assisting the customer with laundering the benefits of crime.

G For this reason section 33 of FICA should be amended so that it affords a bank respite from continuing with a suspicious transaction until the matter has been resolved by either the authorities or the judiciary. The amended section 33 should read as follows:

Continuation of transactions

33. An accountable institution ... may [**not**] continue with and carry out the transaction in respect of which the report is required to be made unless the Centre directs the accountable institution .. to proceed with the transaction.

Section 43(b) of FICA provides in general terms for the appointment of a ‘person’ by a bank whose main responsibility is to ensure compliance of AML measures.⁴⁰¹ However, the concept ‘money laundering reporting officer’ more aptly describes the functions that such a person should have in a bank.

G For this reason section 43(b) of FICA should be amended to read as follows:

Training and monitoring of compliance

43. An accountable institution must— ...
(b) appoint a [**money laundering reporting officer**] with the responsibility to ensure compliance by ...

The aforementioned amendments if implemented should improve the AML provisions of POCA and FICA whilst at the same time elevate the Acts to the same standard as some of their international counterparts.⁴⁰² South Africa should further be in a position to combat money laundering with more efficacy which in turn, should reduce criminal activity in general.

5. Individualised Anti-Money Laundering Measures

⁴⁰⁰ See ch 8.C.4.2.3.3 under ‘Knowledge or Suspicion’.

⁴⁰¹ See ch 8.C.4.2.3.5.

⁴⁰² See ch 6.B.3.6, par C.3.4; ch 7.C.8.3.1.

5.1 European Union

5.1.1 General

In an effort to assist with the AML effort of the EU legislature,⁴⁰³ the EU Council took two steps to combat money laundering in the region.⁴⁰⁴ They are first, the formation of an EU policing agency and secondly, action plans to combat organised-related crime and money laundering. The action plans emphasise that the fight against money laundering should be concentrated on harmonising the definitions and sanctions of the national AML legislation of EU member states.⁴⁰⁵

5.1.2 England

English Parliament enacted the Proceeds of Crime Act and AML regulations to combat money laundering in the country.⁴⁰⁶ However, other role players also become involve in efforts to bring about money laundering control in the financial sector. They include the Financial Services Authority, Joint Money Laundering Steering Group and the Money Laundering Advisory Committee which represent three organisations that are committed to combat money laundering in England.⁴⁰⁷

The Financial Services Authority's greatest contribution to the AML efforts in England lies in its money laundering rules which parallel statutory provisions. The rules generally advise on compliance with statutory AML requirements, the determination of money laundering risks and internal systems aimed at money laundering prevention.⁴⁰⁸

The Joint Money Laundering Steering Group was established to offer guidance on money laundering prevention to firms operating in various financial sectors.⁴⁰⁹ It issued a set of guidance notes which conform with the AML Regulations.⁴¹⁰

⁴⁰³ Which comprises the enactment of AML legislation - see ch 6.B.3.2, par B.3.6.

⁴⁰⁴ See ch 6.B.5.2–5.3.

⁴⁰⁵ See ch 6.B.5.3.

⁴⁰⁶ See ch 6.C.3.4, par C.3.5 respectively.

⁴⁰⁷ See ch 6.C.5.1–5.3 respectively.

⁴⁰⁸ See ch 6.C.5.1.

⁴⁰⁹ See ch 6.C.5.2.

⁴¹⁰ See ch 6.C.3.5.

In turn, the Money Laundering Advisory Committee attempts to unite various role players which can assist in combating money laundering.⁴¹¹ This additional level of expertise may render valuable assistance to the Treasury in devising money laundering related advice of importance to banks.

5.2 United States

Although money laundering is mainly being combated in the US through legislation,⁴¹² various US organisations are also involved in the AML effort.⁴¹³ One of three key organisations involved in combating money laundering in the US is the Financial Crimes Enforcement Network.⁴¹⁴ It constitutes the US version of a financial intelligence unit which coordinates the dissemination of money laundering-related information.⁴¹⁵

Other federal agencies such as the Federal Deposit Insurance Corporation, Office of Thrift Supervision, Office of the Comptroller of the Currency and the Federal Reserve Board are assisting banks to meet statutory AML requirements.⁴¹⁶ The Bank Secrecy Act Advisory Group was established pursuant to the Annunzio Act⁴¹⁷ and aims to assist the Treasury in its efforts to prevent money laundering in the banking industry.⁴¹⁸ To this end, it provides a forum for the exchange of views and is geared towards furthering cooperation between enforcement agencies and the financial industry. Overall the Banks Secrecy Advisory Group is a original AML initiative of the Treasury and adds value to the AML effort in as far as securing cooperation between enforcement agencies and the financial industry.

5.3 South Africa

⁴¹¹ See ch 6.C.5.3.

⁴¹² See ch 7.C.1n 116, paras C.2–8.

⁴¹³ See ch 7.E.1–3.

⁴¹⁴ See ch 7.E.1.

⁴¹⁵ See ch 5.B.1–2, paras B.3.3.4, C.3, D.4–5 as regards the purpose of financial intelligence units in money laundering control.

⁴¹⁶ See ch 7.E.2.

⁴¹⁷ See ch 7.C.5.

⁴¹⁸ See ch 7.E.3.

The FIC, Counter-Money Laundering Advisory Council and the Eastern and Southern Africa Anti-Money Laundering Group in aggregate are committed to combating money laundering in the Southern African region.⁴¹⁹

The FIC's guidelines were formulated to encourage compliance with FICA and not to protect the interests of banks.⁴²⁰ Although the FIC released guidelines pertaining specifically to the filing of STRs, their content is conspicuously lacking in practical advice.⁴²¹ The greatest problem with FIC's AML guidelines is that they demonstrate a lack of understanding in the practical difficulties that bank experience in identifying suspicious transactions and the benefits of crime.⁴²²

The Counter-Money Laundering Advisory Council⁴²³ was established pursuant to FICA for the purpose of advising the Minister of Finance on combating money laundering. It also acts as a forum in which the FIC, representatives of financial organisations, organs of state and supervisory bodies can confer with one another.⁴²⁴ For this reason the Council has the potential to contribute substantially to the money laundering control effort of South Africa providing that bureaucracy within its structures is curbed.

However, at present there is no indication that the Council has actual insight about the practicalities of money laundering control and the reasons for South Africa's failure to control money laundering.⁴²⁵ This could why salient challenges within the regime have not been addressed yet with the fervour they deserve. Unless the Council demonstrates a real interest in addressing the difficulties that banks, *inter alia*, experience with money laundering and its control, it is destined to become yet another meaningless creature of statute that falls short of contributing anything useful to the AML effort.

The Eastern and Southern Africa Anti-Money Laundering Group is a regional FATF-style organisation in Africa.⁴²⁶ Despite the best efforts of the ESAAMLG to engender unified policies

⁴¹⁹ See ch 8.E.1–3 respectively.

⁴²⁰ See ch 8.C.4.2.3.2 under 'Three Identification Levels', paras C.4.2.3.3 under 'Knowledge or Suspicion', E.1.

⁴²¹ See ch 8.C.4.2.3.3 under 'Knowledge or Suspicion', par E.1.

⁴²² See h 8.C.4.2.3.2 under 'Three Identification Levels', paras C.4.2.3.3 under 'Knowledge or Suspicion', E.1.

⁴²³ Or 'Council' -see ch 8.C.4.1, par E.2.

⁴²⁴ See ch 8.E.2.

⁴²⁵ See ch 8.E.2.

⁴²⁶ See ch 8.E.3.

on money laundering prevention, a lack of modern payment systems and the absence of modernised FIUs such as the FIC are likely to impede efforts to combat money laundering in the region.⁴²⁷

5.4 Synthesis

Based on the conclusions above the following research objective can be considered:

7. AML measures other than legislation can expedite the money laundering control efforts of a country provided they are correctly implemented.

The countries used in this study for comparative purposes each elected to supplement their AML legislation with additional money laundering control measures.⁴²⁸ Country-specific financial intelligence units and other governmental groups have the ability to identify and address the difficulties that banks experience with heeding AML obligations.⁴²⁹ Their guidelines may further supplement existing AML policies.

The AML initiatives of the non-governmental groups, in particular, demonstrate that money laundering control initiatives do not, and should not, come from the international community or the legislature alone, but should emanate from the private sector as well.⁴³⁰

However, a concerted approach involving all the role players of the bank industry in particular may redress pertinent difficulties that banks are experiencing in the execution of statutory AML obligations. Organisations such as the FATF, UN, Wolfsberg Group and the ESAAMLG have the potential to devise innovative and original solutions to money laundering control in the banking industry.⁴³¹ But solutions to money laundering control problems are worthless unless they are practical and fervently implemented.

6 Civil Remedies and Banks

⁴²⁷ See ch 8.E.3.

⁴²⁸ See ch 6.B.5.1–3, par C.5.1–3; ch 7.E.1–3; ch 8.E.1–3.

⁴²⁹ See ch 6.B.5.2–5.3, par C.5.1–5.3; ch 7.E.1–3; ch 8.E.1–2.

⁴³⁰ See ch 5.B.3.2–3.3, paras C, D.1–5.

⁴³¹ See ch 5.B.3.3, par C.1, C.1, D.4 respectively.

6.1 European Union

6.1.1 General

One of the syntheses of this study holds that civil liability may be imposed on a bank as former recipient of the benefits of fraud or theft.⁴³² The claimant is a victim of fraud or theft who attempts to recover loss suffered from the bank where the fraudster or thief deposited the benefits of the fraud or theft. The bank paid the deposited amount to the fraudster or thief who subsequently absconded with it, or who is a man of straw. As a result, the bank is left to face the proverbial music. Whether a victim of fraud or theft is likely to succeed with a claim for loss suffered against the bank that parted with the benefits of fraud or theft is henceforth explained.

EU law in the union is a sensitive issue because EU member states are autonomous as far as enacting laws.⁴³³ The inquiry imparted that any notion of EU legal uniformity as regards civil litigation is fractured by the absence of an EU *ius commune*.⁴³⁴ As a result there is no statute that advises specifically on the enforcement of civil remedies in the EU. EU member states decide individually how to resolve civil claims between parties that reside in different EU member states.

However, EU law does have specific rules on jurisdiction and the conflict of laws which may assist a claimant in claiming from a bank which resides in another jurisdiction. The Brussels Convention, Brussels Regulation and Rome Convention determine jurisdiction in legal matters arising *ex contractu*⁴³⁵ whilst the Rome II Regulation regulates non-contractual matters where a conflict of laws exists.⁴³⁶

Articles 15 to 17 of the Brussels Regulation afford special status to claimants in *contractual* disputes.⁴³⁷ It therefore applies to scenarios where a customer who resides in one EU state endeavours to file suit against a bank which is incorporated in a different EU state based on breach of bank confidentiality because it filed a STR.⁴³⁸ The Brussels Regulation determines that

⁴³² See ch 1.B.

⁴³³ See ch 6.B.4.1.1.

⁴³⁴ See ch 6.B.4.1.1.

⁴³⁵ See ch 6.B.4.1.2–4.1.4.

⁴³⁶ See ch 6.B.4.1.5.

⁴³⁷ See ch 6.B.4.1.3.

⁴³⁸ See ch 6.B.2.2 as regards civil suits emanating from a breach of bank confidentiality rules.

the customer as claimant must prior to filing suit against the defendant bank ascertain whether the AML laws of the EU member state where the defendant bank will be sued affords safe-harbour⁴³⁹ protection to the bank.⁴⁴⁰ If the AML laws of the member state contains no safe-harbour provisions or if the defendant bank has acted contrary to the safe-harbour provisions when it filed the STR, the customer must ascertain whether the defendant bank will also be facing criminal charges as a result of its conduct. If criminal proceedings are under way against the defendant bank the claimant must file suit against the bank in the same EU member state where the criminal matter will be adjudicated.⁴⁴¹

The Rome II Regulation is applicable to cases where a conflict of laws exists as regards non-contractual obligations in civil and commercial matters.⁴⁴² It therefore applies to a scenario where a bank unwittingly assisted in a money laundering scheme which resulted in the victim of fraud or theft suffering loss.⁴⁴³ If the fraudster or thief absconded with the benefits of fraud or theft or is a pauper, the victim can file suit against the bank which paid the benefits of fraud or theft to the fraudster or thief.⁴⁴⁴

However, in spite of the provisions of the Rome II Regulation great difficulty is likely to ensue for the victim of fraud or theft if he and the defendant bank reside in different EU member states.⁴⁴⁵ If that is the case the victim must file suit against the bank in the EU member state where the bank paid the benefits of fraud or theft to the fraudster or thief. The victim's chance of success in filing suit against the bank appears minimal simply because of all the elements that he must establish before the matter will be adjudicated in his favour.⁴⁴⁶

6.1.2 England

6.1.2.1 Constructive Trust

General Principles of Liability

⁴³⁹ See ch 6.B.2.2, par C.3.6.

⁴⁴⁰ See ch 6.B.4.1.3.

⁴⁴¹ See ch 6.B.4.1.3.

⁴⁴² See ch 6.B.4.1.5.

⁴⁴³ See ch 6.B.4.1.1.

⁴⁴⁴ See ch 6.B.4.1.1.

⁴⁴⁵ See ch 6.B.4.1.5.

⁴⁴⁶ See ch 6.B.4.1.5, par B.6.

The PCA does not purport to compensate victims of crimes such as fraud or theft where they have suffered loss, hence the need for an appropriate civil remedy.⁴⁴⁷ At English common-law a victim of fraud or theft can use only constructive trust as remedy to recover loss from a bank that paid the benefits of fraud or theft to the fraudster or thief who absconded with the money.⁴⁴⁸

Consider the scenario where X followed money that was stolen from him by Y to Y's bank account at B Bank. X as a victim of theft whose money has been deposited with B Bank has two options to recover the loss he suffered as a result of the theft. First, he may claim loss *directly* from the thief, Y, who unlawfully appropriated his money. However, if Y absconded or is a man of straw who withdrew the stolen money from his account and gambled it away X's claim against him will be a futile exercise.⁴⁴⁹

Secondly, X may attempt to recover loss directly from B Bank as former recipient of the stolen money. This is because X has *ex lege* rights over the stolen money even if Y withdrew the money from his bank account.⁴⁵⁰ English literature suggests that X's civil claim against B Bank as former recipient of the stolen money may, depending on the circumstances, be based on any of the following four common-law restitution actions, namely, knowing receipt, knowing assistance, common-law tracing or tracing in equity.⁴⁵¹ Liability under the first and second civil actions above is based on breach of constructive trust and is possible even in cases when the benefits of fraud or theft were deposited with a bank and subsequently withdrawn by the fraudster or thief who absconded with the money.

The tracing remedies are ultimately a means to an end and can be used by a victim of fraud or theft to determine what transpired to his money.⁴⁵² A victim of fraud or theft who traced the benefits of fraud or theft to a bank account can file suit against the bank based on one of the tracing actions provided that the funds remain under the bank's control.⁴⁵³

As mentioned above, there are two types of constructive trust remedies, namely, knowing receipt and dishonest assistance.⁴⁵⁴ Although the courts are willing to entertain civil claims

⁴⁴⁷ See ch 6.C.3.4, par C.4.1.

⁴⁴⁸ See ch 6.C.4.2.1.

⁴⁴⁹ See ch 6.C.4.1.

⁴⁵⁰ See ch 6.C.4.1.

⁴⁵¹ See ch 6.C.4.2–4.3.

⁴⁵² See ch 6.C.4.3.

⁴⁵³ See ch 6.C.4.3.

⁴⁵⁴ See ch 6.C.4.2.3–4.2.4.

against banks as former recipients of the benefits of fraud or theft, civil claims based on the two actions above do not always bring in predictable results.

At English common-law the operation of constructive trust means that the judiciary may use their discretion and allow an extension of traditional constructive trust principles.⁴⁵⁵ A bank that received the benefits of fraud or theft and parted with the money may consequently incur constructive trust liability in two instances.⁴⁵⁶ First, it may be *prima facie* liable for knowing receipt or secondly, it may be *prima facie* liable for *dishonest assistance*. There is one principal difference between the two actions above. In the case of knowing receipt the bank must have used the fraudulently acquired or stolen money for its own benefit, for example, to repay the fraudster or thief's overdraft. As a result, it will be liable for the amount that it has used rather than being potentially liable for the whole of the amount lost by virtue of the fraud or theft which would be the case in an action based on knowing assistance.⁴⁵⁷ In contrast, use by the defendant bank of the deposited benefits of fraud or theft is not a requirement for a claim based on dishonest assistance.⁴⁵⁸ Significantly, in both actions guilty knowledge must be established on the side of the bank (employee) before the court will impute liability to the bank.⁴⁵⁹

The concept of knowledge poses a key difficulty in as far as establishing the liability of a bank based on breach of constructive trust. This is because it implies an awareness on the side of a bank that the deposited money is the benefits of fraud or theft and, therefore, may belong to someone other than the account holder.⁴⁶⁰ There are five categories of knowledge which the courts may use to determine the *prima facie* civil liability of a bank.⁴⁶¹ Knowledge by the bank within any of the five categories is sufficient to impose vicarious liability on the bank.

Knowing Receipt

Banks are most likely to face civil liability based on knowing receipt because they receive deposits from the public.⁴⁶² Consider the scenario where a partner of a law firm withdrew funds

⁴⁵⁵ See ch 6.C.4.2.1.

⁴⁵⁶ See ch 6.C.4.2.1.

⁴⁵⁷ See ch 6.C.4.2.3.1

⁴⁵⁸ See ch 6.C.4.2.4.1.

⁴⁵⁹ See ch 6.C.4.2.2.

⁴⁶⁰ See ch 6.C.4.2.2.

⁴⁶¹ See ch 6.C.4.2.2.

⁴⁶² See ch 6.C.2.1 as regard the business of a bank.

from the firm's bank account and deposited the funds into his own bank account. The bank subsequently used the stolen money towards paying the partner's overdraft. As a result, the other partners of the law firm decided to sue the bank for knowing receipt in an attempt to recover their loss.

The partners as victims of theft in order to impose liability on the bank on the basis of knowing receipt must establish that the bank accepted a deposit comprising the benefits of theft and used the money whilst being aware that its customer is not entitled to the money.⁴⁶³ A bank that received the benefits of fraud or theft without any knowledge about the source of the funds, but subsequently found out that the money was acquired through criminal means, may also be liable for knowing receipt.⁴⁶⁴

Dishonesty or actual knowledge by a bank (employee) about the criminal origin of the money is not a requirement for liability.⁴⁶⁵ However, it is evident that sometimes the courts may substitute liability for knowing receipt from knowledge to dishonesty.⁴⁶⁶ Turning a blind eye to obviously dishonest conduct is tantamount to having actual knowledge of fraud.⁴⁶⁷ The irony is that a bank (employee) who filed a STR pursuant to the PCA⁴⁶⁸ may inevitably have assisted the victim of fraud or theft to establish the required degree of knowledge in order to impose civil liability on the bank as recipient of the benefits of fraud or theft. It follows that a bank may be exposed to potential civil liability simply because it wanted to prevent liability for a money laundering offence.

Most notably, the importance of bringing an action for knowing receipt against a bank as recipient of the benefits of fraud or theft resides in the fact that the victim of fraud or theft will be able to recover in monetary terms the loss he suffered on account of the bank using the money.⁴⁶⁹ The research emphasises that a bank will only be liable for knowing receipt where it received the benefits of fraud or theft and used the funds to its own benefit whilst its employee was aware or suspicious that the money was fraudulently acquired or stolen by the customer. It

⁴⁶³ See ch 6.C.4.2.3.1–4.2.3.2.

⁴⁶⁴ See ch 6.C.4.2.2.

⁴⁶⁵ See ch 6.C.4.2.3.1.

⁴⁶⁶ See ch 6.C.4.2.2.

⁴⁶⁷ See ch 6.C.4.2.2.

⁴⁶⁸ See ch 6.C.3.4.3.1.

⁴⁶⁹ See ch 6.C.4.2.3.1.

follows that a bank's knowledge will be a determining factor for establishing its potential liability to the victim of fraud or theft.

Consider again the example above of the law firm partners who sued the bank that applied stolen money to reduce the overdraft of one of its customer who is a thief. If the partners can establish that a bank employee filed a STR report because she suspected that the deposited money may be stolen and thereafter continued to use the money for the bank's benefit, it is likely that the court will impose constructive trust liability on the bank based on knowing receipt. In that case the bank will have to repay the money it used to reduce the thieving partner's overdraft to the law firm.

Dishonest Assistance

Civil liability based on dishonest assistance requires that a bank assisted in dishonest or fraudulent conduct in relation to deposited benefits of fraud or theft.⁴⁷⁰ The danger for a bank is that individual bank employees can assist criminals with their money laundering schemes. The latter see the benefits of fraud or theft being moved around among bank accounts and banks despite the fact that the banks may have stringent AML policies in place.⁴⁷¹ As a result the bank may be held liable for the dishonest conduct of one of its employees.

A victim of fraud or theft must establish four elements before the bank is likely to incur liability based on dishonest assistance.⁴⁷² First, there must have been a breach of trust or fiduciary duty by someone other than the defendant bank, namely, the thief or fraudster. Secondly, a bank employee must have assisted in the breach, which is a question of fact. Thirdly, the employee's assistance must have been dishonest. Fourthly, his conduct must have resulted in the victim of fraud or theft suffering loss.

The *degree* of assistance that a bank employee provided to the fraudster or thief as customer in laundering the benefits of fraud or theft may be a determining factor in whether the court will impute liability to the bank for dishonest assistance.⁴⁷³

⁴⁷⁰ See ch 6.C.4.2.4.1.

⁴⁷¹ See ch 6.C.3.4.3.1, par C.5.1 as regards internal AML policies.

⁴⁷² See ch 6.C.4.2.4.1–4.2.4.2.

⁴⁷³ See ch 6.C.4.2.4.1.

There are three possible standards to establish the potential dishonesty of a bank employee.⁴⁷⁴ First, a subjective standard in terms of which the bank will only be regarded as dishonest if the employee breached its standard of dishonesty. Secondly, an objective standard in terms of which the defendant bank will be regarded as dishonest if the employee's conduct was dishonest if he breached the ordinary standards of reasonable people, and thirdly, a combined standard that comprises both subjective and objective elements.

Where the court uses the combined standard to determine potential dishonesty on the side of the bank employee, it will consider first whether the employee's conduct was dishonest in terms of the objective standard.⁴⁷⁵ Thereafter, the victim of fraud or theft must prove that the employee realised that his conduct was dishonest in terms of the subjective standard. Research suggests that the courts prefer the combined standard to establish whether the bank employee was dishonest to such a degree that the bank could be held vicariously liable based on dishonest assistance.⁴⁷⁶ It follows that dishonesty requires knowledge by the bank employee that honest people would regard his conduct as dishonest.

Consider where a member of a crime syndicate, M, fraudulently acquired money from X, a pensioner. With the assistance of Y, a service clerk of B Bank, M deposited the benefits of fraud into the account of a shell company. Y subsequently transferred the money to M's account whilst knowing that it did not belong to him whereafter M used a part of the benefits to pay for utilities whilst the balance was transferred to an offshore account. Since M has absconded with the benefits of fraud, X instigated action against B Bank based on dishonest assistance for the purpose of recovering his loss.

Due to the requirements for liability based on dishonest assistance and the reigning uncertainty as regards the degree of dishonesty required to impute liability to Y, it is unlikely that X will be successful in a claim based on dishonest assistance against B Bank.⁴⁷⁷ B Bank may find itself in either one of two situations.⁴⁷⁸ In the first situation B Bank may avoid liability to X on the basis of dishonest assistance by asserting that Y believed that the said benefits of fraud were legitimately earned by M. Information kept by B Bank pursuant to the 2007 Regulations as

⁴⁷⁴ See ch 6.C.4.2.4.1.

⁴⁷⁵ See ch 6.C.4.2.4.1.

⁴⁷⁶ See ch 6.C.4.2.4.1–4.2.4.2.

⁴⁷⁷ See ch 6.C.4.2.4.2.

⁴⁷⁸ See ch 6.C.4.2.4.2.

regards the nature of M's business and transactions is likely to be a determining factor for establishing the reasonableness of Y's belief.⁴⁷⁹

In the second situation the court will inquire whether Y discharged his obligations as regards the transaction in good faith, or whether he failed to make the inquiries that an honest and prudent bank employee would have made in the prevailing circumstances. Either way, only if Y filed a STR about the transaction in issue would it be possible for X to establish that he had guilty knowledge about the deposited money and that constructive trust liability based on dishonest assistance should be imputed to B Bank.⁴⁸⁰ Negligence on the side of Y is insufficient for imposing liability based on dishonest assistance on the bank.⁴⁸¹

6.1.2.2 Tracing

Common-Law Tracing

Tracing is more a means to an end than a remedy. It enables a victim of fraud or theft to recover either the benefits of fraud or theft or a traceable substitute that was deposited with a bank.⁴⁸² The victim may use common-law tracing or tracing in equity as basis for a claim against a bank that received the benefits of fraud or theft or a traceable substitute into a bank account.⁴⁸³ Significantly, a victim of fraud or theft can use the two tracing remedies above only against a bank which still exercises control over the benefits of fraud or theft or a traceable substitute.⁴⁸⁴

A victim of fraud or theft must establish the following four requirements to succeed against a bank with a claim based on common-law tracing.⁴⁸⁵ First, he has a legal title to the benefits of fraud or theft in issue, secondly, the defendant bank received the benefits, thirdly, the defendant bank did not give consideration for the benefits of fraud or theft, and fourthly, the benefits of fraud or theft are *identifiable* in the hands of the bank. Due to the identifiability requirement difficulties are likely to arise where a victim of fraud or theft attempts to recover

⁴⁷⁹ See ch 6.C.3.5 as regards the 2007 AML Regulations.

⁴⁸⁰ See ch 6.C.4.2.2, par C.4.2.4.1 as regards the requirements of knowledge.

⁴⁸¹ See ch 6.C.4.2.4.2.

⁴⁸² See ch 6.C.4.3.1.

⁴⁸³ See ch 6.C.4.3.2–4.3.3.

⁴⁸⁴ See ch 6.C.4.3.1, par C.4.3.5.

⁴⁸⁵ See ch 6.C.4.3.2.

benefits of fraud or theft that were deposited into a bank account where the funds commingled with other funds in the account.⁴⁸⁶

Significantly, case law demonstrates that the courts are sometimes willing to ignore the identifiability requirement for common-law tracing.⁴⁸⁷ Instead, they may allow common-law tracing on account of the right of the victim-claimant to trace the value of the fraudulently acquired or stolen money into the hands of the defendant bank.⁴⁸⁸

But, in general, due to the identifiability requirement it is unlikely that a bank that received the benefits of fraud or theft that commingled in a bank account will be held liable to a victim of fraud or theft in an action based on common-law tracing.⁴⁸⁹ Common-law rules that govern tracing therefore have been disregarded due to the practical problems associated with their use.⁴⁹⁰ For this reason tracing in equity is used more often because its rules are more flexible.⁴⁹¹

Tracing in Equity

Tracing in equity allows a victim of fraud or theft to trace the value of the benefits of fraud or theft as the money is transferred between banks accounts. Most notably, the benefits may be followed through different forms of property.⁴⁹² In an equitable tracing claim the victim must demonstrate that he has a beneficial interest in the money deposited by the fraudster or thief with the bank as substitute for money that was fraudulently acquired or stolen from him and that equity can be raised against it.

The process of tracing money in equity held in a bank account involves not money *in specie*, but instead, a *debt* that represents the credit balance of the fraudster or thief.⁴⁹³ Where the bank balance showed a credit balance the bank stood as debtor against the fraudster or thief.⁴⁹⁴ Consequently, when a victim of fraud or theft traces money in equity it is not the physical notes

⁴⁸⁶ See ch 6.C.4.3.2

⁴⁸⁷ See ch 6.C.4.3.2.

⁴⁸⁸ See ch 6.C.4.3.2.

⁴⁸⁹ See ch 6.C.4.3.5.

⁴⁹⁰ See ch 6.C.4.3.2, par C.4.3.5.

⁴⁹¹ See ch 6.C.4.3.3.

⁴⁹² See ch 6.C.4.3.2.

⁴⁹³ See ch 6.C.2.3.

⁴⁹⁴ See ch 6.C.2.1.

and coins that are being traced but their underlying value.⁴⁹⁵ It follows that the victim of fraud or theft need not identify the benefits of fraud or theft *in specie*, but instead, can claim their value as substitute from the bank as recipient thereof.⁴⁹⁶

For this reason tracing in equity is the preferred remedy instead of common-law tracing which with its identifiability rule renders it unsuitable where the said money was deposited into a bank account and commingled with other money in the account.⁴⁹⁷

Before a court will allow a victim of fraud or theft to trace into the bank account of the fraudster or thief he must establish three requirements.⁴⁹⁸ First, that he has a claim to money held by the defendant bank as well as a proprietary right to trace. Secondly, that a nexus exists between the money in the account and the money that was fraudulent acquired or stolen from him to enable him to establish that the one represents the other. Thirdly, that the deposited benefits of fraud or theft existed *continuously* in the hands of the defendant bank. Where the said money was mixed in a joint account, the ‘first in, first out’ rule or the *pari passu* rule may be used to determine the order in which money was withdrawn from the mixed account.⁴⁹⁹

Overall the research imparted that the divergence between common-law and equitable tracing is unnecessary.⁵⁰⁰ Tracing in equity allows substitution of the original fraudulently acquired or stolen money for its value and, therefore, a victim of fraud or theft needs not to identify the money *in specie*, but instead, can claim its value as substitute.⁵⁰¹ Moreover, it is possible to simplify and even unify the different tracing rules if the courts discard the distinction between common-law tracing and tracing in equity.⁵⁰² Simplification of the different tracing rules may result in predicable and reliable outcomes in tracing cases.

6.1.2.3 Defences

⁴⁹⁵ See ch 6.C.4.3.4.

⁴⁹⁶ See ch 6.C.4.3.4, par C.4.3.5.

⁴⁹⁷ See ch 6.C.4.3.2, par C.4.3.5.

⁴⁹⁸ See ch 6.C.4.3.3.

⁴⁹⁹ See ch 6.C.4.3.3.

⁵⁰⁰ See ch 6.C.4.3.4, par C.4.3.5.

⁵⁰¹ See ch 6.C.4.3.3.

⁵⁰² See ch 6.C.4.3.4.

There are generally three defences that may avail a defendant bank against a restitution claim instigated against it by a victim of fraud or theft. They are the defences of *bona fide* purchaser for value, change of position and ministerial receipt.⁵⁰³

The *bona fide* purchaser for value defence may only be claimed by the bank where it acquired the benefits of fraud or theft in good faith and without knowledge of the victim of the fraud or theft's claim. Whether a bank employee should have known or suspected that the money in issue is the benefits of fraud or theft will determine the outcome of the matter. In this regard the conduct will be judged according to any one of the established five categories of knowledge.⁵⁰⁴ However, actual or constructive knowledge on the part of the bank employee of, for example, the criminal origin of the funds or the impropriety of a transaction should be as much a requirement of tracing as it is of constructive trust claims.

Change of position as defence against a restitution claim involves a balance of the interests of the parties involved in the claim.⁵⁰⁵ It is evident that the change of position defence will succeed only if the defendant bank's change of position is causally linked to the money it received from the fraudster or thief. The bank's employee must have also acted in good faith and without knowledge of the facts leading to the victim of fraud or theft's claim.

A bank that invokes the defence of ministerial receipt must establish that it received the benefits of fraud or theft and paid the funds away by mistake.⁵⁰⁶ It must further establish three elements in order to escape liability. They are first, that the bank received the benefits of fraud or theft in good faith, secondly, a mistaken payment was made, and thirdly, it acted as a principal during the transaction.⁵⁰⁷

Ultimately, the defence of *bona fide* purchaser for value has the most potential to avail a bank against a claim based on constructive trust or tracing.⁵⁰⁸ However, the success of the defence obviously depends on whether the bank can establish that it acted in good faith when it received the benefits of fraud or theft and gave value for the funds.

6.2 United States

⁵⁰³ See ch 6.C.4.3.6.

⁵⁰⁴ See ch 6.C.4.2.3.1.

⁵⁰⁵ See ch 6.C.4.3.6.

⁵⁰⁶ See ch 6.C.4.3.6.

⁵⁰⁷ See ch 6.C.4.3.6.

⁵⁰⁸ See ch 6.C.4.3.6.

6.2.1 Constructive Trust

US restitution law derives from English common-law principles and has been codified in the American Law Institute's Restatement of Restitution.⁵⁰⁹ Civil claims against a bank as recipient of the benefits of fraud or theft may be based on one of the following four codified restitution actions, namely, constructive trust, action for money had and received, tracing and *replevin*.⁵¹⁰

Constructive trust may be used by a victim of fraud or theft if he can demonstrate that the bank either had direct *knowledge* that it was assisting a fraudster or thief, or where the bank intentionally participated in defrauding the plaintiff.⁵¹¹ Most notably, it is likely that a bank by filing a STR may have assisted the victim of fraud or theft to establish the required degree of knowledge on its side in order to establish constructive trust liability. In the absence of a STR it may be impossible for the victim of fraud or theft to establish guilty knowledge on the side of the bank.⁵¹²

The money which is the subject of the action must further be *identified* as belonging in good conscience to the victim of fraud or theft even though the bank may have a legal right to it.⁵¹³ Significantly, the claim of the victim is not based on a legal right; he does not claim a legal right to the money but an *equitable interest* in a particular fund.⁵¹⁴ A victim of fraud or theft may further experience some difficulty to convince a court to impose constructive trust liability where the benefits of fraud or theft commingled in the bank account. The reason is that it is impossible to be a constructive trustee of unidentified assets.

The research illustrates that the requirements for imposing constructive trust liability on a bank that received the benefits of fraud or theft may prove too onerous for the victim of fraud or theft to establish.⁵¹⁵ Ultimately, it may be impossible for the victim to establish guilty knowledge on the side of the bank that failed to file a STR. Moreover, due to the identifiability requirement it is unlikely that the victim can succeed in claiming loss from the bank where the benefits of fraud or theft commingled with other money in the bank account.

⁵⁰⁹ See ch 7.D.1.

⁵¹⁰ See ch 7.D.2–3.5.

⁵¹¹ See ch 7.D.2.2.

⁵¹² See ch 7.D.1.

⁵¹³ See ch 7.D.2.2.3.

⁵¹⁴ See ch 7.D.2.2.1–2.2.2.

⁵¹⁵ See ch 7.D.2.2.2–2.2.3, par D.2.3.

Even if the victim can establish the three requirements above for constructive trust liability, the claim will be successful only where the benefits of fraud or theft remain in the bank account at the time of *litis contestatio*.⁵¹⁶ Liability based on constructive trust will therefore be seldom imposed on the bank if the fraudster or thief withdrew the money and absconded with it. The reason is that constructive trust liability under US codified common-law is strict unlike its English counterpart which allows liability based on extended restitution principles.⁵¹⁷ A court may impose constructive trust liability on a bank to the benefit of a victim of fraud or theft who was unjustly deprived of his rights to the deposited benefits of fraud or theft.

However, in contrast to English courts that have applied extended principles of constructive trust liability on a bank that parted with the benefits of fraud or theft,⁵¹⁸ US law seems to need the security of set principles rather than allowing the judiciary to use their discretion and extend remedial constructive trust principles to cases where they normally would not find application.⁵¹⁹ A bank that paid the benefits of fraud or theft to the fraudster or thief will therefore not be held liable to the victim of fraud or theft based on constructive trust.

6.2.2 Tracing

US restitution law knows only a generic tracing action.⁵²⁰ Tracing provides a way to track money to substituted property even if the latter has increased in value.⁵²¹ The process of tracing money deposited into a bank account does not involve money *in specie*, but rather a *debt* which represents the credit balance of the account holder. The victim of fraud or theft must establish which part of the debt owed by the bank to the fraudster or thief should be paid to him to counteract the loss he suffered.⁵²² Tracing focuses on value rather than specific assets or property and is, therefore, a perfect method to use to recover commingled money. What is then traced is the *value* inherent to things.⁵²³

⁵¹⁶ See ch 7.D.2.2.2, par D.2.4.

⁵¹⁷ See ch 6.C.4.2.3, par C.4.2.4.

⁵¹⁸ See ch 6.C.4.2.3.2, par C.4.2.4.2.

⁵¹⁹ See ch 7.D.2.4.

⁵²⁰ See ch 7.D.3.1–3.2. In contrast, see ch 6.C.4.3.2–4.3.3.

⁵²¹ See ch 7.D.3.1.

⁵²² See ch 7.D.3.3.

⁵²³ See ch 7.D.3.3.

Tracing funds to a commingled fund does not present many difficulties.⁵²⁴ Although the victim of fraud or theft should have little difficulty in establishing a claim over part of the commingled funds, there are practical difficulties⁵²⁵ in determining whose money is left in the commingled account in a situation where some of the money has been withdrawn from the account.⁵²⁶ The courts addressed some of the difficulties through the use of various bookkeeping rules.⁵²⁷

6.2.3 *Replevin* Action

In theory the *replevin* action allows a victim of fraud or theft to recover personal property to which he is entitled.⁵²⁸ However, central to the action is the existence of an *identifiable* object. The identifiability requirement renders the *replevin* action unsuitable to recover deposited benefits of fraud or theft which commingled in a bank account with other moneys of the bank from the bank.⁵²⁹

6.2.4 Defences

In the main, there are two defences that a bank may use to counter an unjust enrichment claim, namely, *bona fide* purchaser for value and change of position.⁵³⁰ The *bona fide* purchaser for value defence is pivotal where a bank innocently accepted a deposit of money in which the victim of fraud or theft has some kind of interest. If the case, the defendant bank must demonstrate three elements to satisfy the *bona fide* purchaser for value defence. First, the bank was unaware of any equitable interests in the benefits of fraud or theft at the time it received the money; two, it received the benefits by purchase and three, it gave value in return for the funds.⁵³¹

⁵²⁴ See ch 7.D.3.3–3.4.

⁵²⁵ See ch 7.D.3.3.

⁵²⁶ See ch 7.D.3.3.

⁵²⁷ See ch 7.D.3.3.

⁵²⁸ See ch 7.D.3.5.

⁵²⁹ See ch 7.D.3.5.

⁵³⁰ See ch 7.D.3.6.

⁵³¹ See ch 7.D.3.6.

A bank that received the benefits of fraud or theft and parted with the money will not be able to raise the defence of *bona fide* purchaser for value.⁵³² This is because it will be unable to establish that it gave value for the money.

6.3 South Africa

6.3.1 Ownership Remedies

6.3.1.1 *Rei Vindicatio*

The *rei vindicatio* is aimed at the recovery of loss of possession. It is a legal action by which a the plaintiff demands that the defendant returns property belonging to him.⁵³³ Significantly, money may be only be vindicated if the plaintiff is the owner thereof and if it is '[i]dentifiable with or earmarked as a particular fund to which the applicant is entitled'.⁵³⁴

In general the *rei vindicatio* raises a number difficulties in as far as assisting a victim of fraud or theft to recover the benefits of fraud or theft from the bank with which the fraudster deposited the money.⁵³⁵ Not only is the victim of fraud or theft no longer owner of the deposited benefits of fraud or theft because the bank is,⁵³⁶ but identifying specific currency in the bank account as the benefits of fraud or theft is an exercise clouded in futility.⁵³⁷ As a result the *rei vindicatio* is unsuitable for the purpose of recovering money *in specie* from a bank as recipient of the benefits of fraud or theft.⁵³⁸

6.3.1.2 Quasi-Vindictory Action

A quasi-vindictory action is a useful remedy where money claimed is not the same notes and coins which were stolen or fraudulently acquired from the victim.⁵³⁹ The action is quasi-

⁵³² See ch 7.D.3.6.

⁵³³ See ch 8.D.2.1.1.

⁵³⁴ See ch 8.D.2.1.1.

⁵³⁵ See ch 8.D.2.1.1, paras D.2.1.3.1–2.1.3.2.

⁵³⁶ See ch 8.D.2.1.1, par D.2.1.3.1.

⁵³⁷ See ch 8.D.2.1.3.

⁵³⁸ See ch 8.D.2.1.3.

⁵³⁹ See ch 8.D.2.1.2.

vindictory because money that was deposited into a bank account belongs to the bank and, therefore, the victim does not owe it.⁵⁴⁰ The quasi-vindictory-part of the claim exists in that the money was fraudulently acquired or stolen from the victim of fraud or theft.⁵⁴¹

In contrast to the *rei vindicatio* where the victim must establish ownership to the benefits in issue, he can use a quasi-vindictory action to claim money that he has right to possess.⁵⁴² It follows that where a fraudster or thief deposited the benefits of fraud or theft with a bank, the latter's ownership of the money will not present an impediment to the victim of the fraud or theft's claim. The facts that the stolen money commingled in the thief's bank account with other moneys in the account⁵⁴³ and that the bank acquired ownership thereof are irrelevant.

Significantly, like the *rei vindicatio*, a quasi-vindictory action can only be used to vindicate money that remains under the bank's control at the time of *litis contestatio*.⁵⁴⁴ Thus, where a bank parted with the benefits of fraud or theft, the victim of the fraud or theft will be out of luck and, hence without a remedy.⁵⁴⁵

6.3.1.3 *Actio Pauliana*

The *actio Pauliana* traditionally finds application in insolvency cases to set aside fraudulent dispositions.⁵⁴⁶ There are four problems with the requirement that the disposition must have been made for the benefit of the bank which hinders use of the action to recover the benefits of fraud or theft from a bank as recipient thereof.⁵⁴⁷

First, the *actio Pauliana* is fundamentally an insolvency remedy and as such, unsuitable for use by a victim of fraud or theft to recover loss from a bank which received the money in a bank account. Secondly, although a disposition was made because the bank became owner of the benefits of fraud or theft as soon as the funds commingled with other funds of the bank, the disposition fails to reduce the assets of the bank.⁵⁴⁸ Thirdly, as recipient of the benefits of fraud

⁵⁴⁰ See ch 8.D.2.1.2

⁵⁴¹ See ch 8.D.2.1.2.

⁵⁴² See ch 8.D.2.1.2, par D.2.1.3.1

⁵⁴³ See also par D.2.3 below as regards interim interdicts.

⁵⁴⁴ See ch 8.D.2.1.2, par D.2.1.3.2.

⁵⁴⁵ See ch 8.D.2.1.1–2.1.3.

⁵⁴⁶ See ch 8.D.2.2.1.

⁵⁴⁷ See ch 8.D.2.2.1

⁵⁴⁸ See ch 3.C.3.1–3.2.

or theft the bank does not benefit from the deposit because it does not receive the money *ex titulo lucrativo*, but on an onerous title.⁵⁴⁹

It follows a victim of fraud or theft who endeavours to use the *actio Pauliana* against a bank as recipient of the benefits of fraud or theft must establish that a disposition was made by the fraudster or thief from which the bank benefited. This is a futile endeavour.⁵⁵⁰

Fourthly, a victim of fraud or theft must establish knowledge by the bank that the transaction was conducted for an unlawful purpose before liability based on the *actio Pauliana* will be imposed on a bank.⁵⁵¹ In most cases it is unlikely that the required knowledge by the bank could be established.⁵⁵² It follows that there are significant shortcomings insofar as using the *actio Pauliana* to claim the benefits of fraud or theft from the bank as recipient.

6.3.1.4 Interdict

An interdict is the finest way for a victim of fraud or theft to prevent a bank from dealing or parting with the deposited benefits of fraud or theft until the matter can be adjudicated..⁵⁵³

There is no reason why an interdict may not be used to prevent dissipation of the benefits of fraud or theft pending adjudication of the issue of ownership. It is, however, advisable that banks adopt the stance of a stakeholder whilst the court determined where the money's ownership laid.⁵⁵⁴

6.3.2 Unjust Enrichment *Conditiones*

6.3.2.1 *Condictio sine Causa*

When a fraudster or thief deposited the benefits of fraud or theft with a bank account neither he nor the bank has a right to the deposited amount.⁵⁵⁵ It follows that the bank may be unjustly

⁵⁴⁹ See ch 8.D.2.2.2.

⁵⁵⁰ See ch 8.D.2.2.1–2.2.2.

⁵⁵¹ See ch 8.C.3.2, paras C.4.2.2–4.2.3.3.

⁵⁵² See ch 8.C.4.2.2, par D.2.2.2.

⁵⁵³ See ch 8.D.2.3.

⁵⁵⁴ See ch 8.D.2.3.

⁵⁵⁵ See ch 3.B.2.1.2.1, par B.2.1.2.2.

enriched and the victim of fraud or theft impoverished with the corresponding amount.⁵⁵⁶ However, since our judiciary does not recognise general enrichment,⁵⁵⁷ the victim must use one of the unjust enrichment *condictiones* to establish that the enrichment of the bank was unjustified.⁵⁵⁸

The question as to whether the *condictio sine causa* may lie to recover loss from the bank as recipient of the benefits of fraud or theft must be answered in reference to two requirements for the *condictio* to lie, namely was the bank enriched and if so, was the enrichment *sine causa*.⁵⁵⁹

The main difficulty with using the *condictio sine causa* to recover loss from a bank lies with the *sine causa* requirement.⁵⁶⁰ Prior to conducting a transaction, a bank needs an instruction from the customer in the regard.⁵⁶¹ The customer's instruction constitutes a valid *causa* for the purpose of the *condictio sine causa*.⁵⁶² Since the *condictio sine causa* lies only in the absence of a *legal causa*, it cannot lie against a bank as recipient of the benefits of fraud or theft.⁵⁶³

6.3.2.2 *Condictio Indebiti*

The *condictio indebiti* usually lies to recover transfers made under mistake.⁵⁶⁴ It is a widely used unjust enrichment remedy for which detailed rules exist.⁵⁶⁵ To recover loss from a bank as recipient of the benefits of fraud or theft a victim needs to establish that the benefits of fraud or theft were paid by himself to the bank under the mistaken belief that payment was due and that the mistake was excusable in the circumstances.⁵⁶⁶

It is evident that there are glaring problems with using the *condictio indebiti* to recover loss from the bank as recipient of the benefits of fraud or theft.⁵⁶⁷ First, the *condictio indebiti* is

⁵⁵⁶ See ch 8.D.3.1–3.2.

⁵⁵⁷ See ch 8.D.3.1.

⁵⁵⁸ See ch 8.D.3.3.1.

⁵⁵⁹ See ch 8.D.3.3.2.

⁵⁶⁰ See ch 8.D.3.3.2, par D.3.4.

⁵⁶¹ See ch 3.B.2.1.

⁵⁶² See ch 8.D.3.3.2, par D.3.4.

⁵⁶³ See ch 8.D.3.4.

⁵⁶⁴ See ch 8.D.3.3.3.

⁵⁶⁵ See ch 8.D.3.3.3.

⁵⁶⁶ See ch 8.D.3.3.3.

⁵⁶⁷ See ch 8.D.3.3

unlikely to lie in three-party enrichment matters.⁵⁶⁸ Secondly, the *condictio indebiti* does not fit a scenario where a victim of fraud or theft seeks to recover loss from the bank where the fraudster or thief deposited the benefits of fraud or theft.⁵⁶⁹ Therefore, the *condictio indebiti* is unsuitable in as far as claiming loss from a bank as recipient of the benefits of fraud or theft.

6.3.2.3 *Condictio ob Turpem vel Iniustam Causam*

The *condictio ob turpem vel iniustam causam*⁵⁷⁰ is an unjust enrichment action that is used to recover money that was transferred for a dishonourable cause.⁵⁷¹ For the *condictio ob turpem causam* to lie against a bank a victim of fraud or theft must establish that the fraudster or thief deposited the benefits of fraud or theft with the bank pursuant to an illegal agreement; he as claimant did not act dishonourably or with turpitude and that the bank had knowledge of the illegal nature of the agreement and the fact that it is tainted by turpitude.⁵⁷²

At first blush the *conditio ob turpem causam* seems perfectly suited to recover loss from a bank as recipient of the benefits of fraud or theft.⁵⁷³ This is because the bank dealt with the benefits of fraud or theft. The purpose of the transaction would also be illegal if the fraudster or thief attempted to launder the benefits of fraud or theft.⁵⁷⁴ However, the biggest problem with using the *condictio* against a bank lies in the fact that the victim of fraud or theft must establish that the bank either had knowledge that it is dealing with the benefits of fraud or theft or that the purpose of the transaction was to launder.⁵⁷⁵ In most cases a victim will be hard-pressed to establish knowledge of turpitude on the side of the bank.⁵⁷⁶ Even if the bank filed a STR to the FIC pursuant to section 29 of FICA,⁵⁷⁷ its suspicions do not amount to knowledge.⁵⁷⁸ It follows that unless the victim of fraud or theft can establish guilty knowledge of turpitude on the side of

⁵⁶⁸ See ch 8.D.3.3.3.

⁵⁶⁹ See ch 8.D.3.4.

⁵⁷⁰ Or '*condictio ob turpem causam*'.

⁵⁷¹ See ch 8.D.3.3.4.

⁵⁷² See ch 8.D.3.3.4.

⁵⁷³ See ch 8.D.3.3.4.

⁵⁷⁴ See ch 8.D.3.3.4.

⁵⁷⁵ See ch 8.C.4.2.3.3 under 'Knowledge or Suspicion', par D.3.4.

⁵⁷⁶ See ch 8.D.3.3.4, par D.3.4.

⁵⁷⁷ See ch 8.C.4.2.3.3.

⁵⁷⁸ See ch 8. C.4.2.2–4.2.3.

the bank,⁵⁷⁹ it is unlikely that the *conditio ob turpem causam* will assist him to claim loss from the bank where the fraudster or thief deposited the benefits of fraud or theft.

6.4 Synthesis

Based on the conclusions above the following research objective can be considered:

8. traditional common-law remedies are inadequate for the purpose of availing a victim of fraud or theft who followed his loss to the fraudster or thief's a bank account to claim loss from the bank after it paid the benefits of the fraud of theft to the fraudster or thief on demand.

Neither the traditional ownership remedies nor the unjust enrichment *condictiones* can assist a victim of fraud or theft against the bank parted with the benefits of fraud or theft and paid it to the fraudster or thief or used it towards payment of the latter's debt.⁵⁸⁰ A victim of fraud or theft may, however, use a quasi-vindictory action to recover the benefits from the bank where the fraudster or thief deposited the benefits of fraud or theft with provided that one key requirement is met.⁵⁸¹ This is, namely, that the benefits of fraud or theft remain in the bank account and under the control of the bank at the time of *litis contestatio*.

Since the *actio Pauliana* is an insolvency-related remedy, it is unsuitable to recover the benefits of fraud or theft from a bank that received the funds as deposit from the fraudster or thief.⁵⁸² This reality coupled with the fact that there can never be a disposition *ex titulo lucrativo* in relation to benefits of fraud or theft deposited with a bank renders it fair to surmise that a few significant shortcomings exist insofar as using the *actio Pauliana* to recover loss from a bank as recipient of the benefits of fraud or theft.⁵⁸³ Ultimately, in absence of codification the *actio Pauliana* is unsuitable to assist a victim of fraud of theft to recover loss from the bank where the fraudster or thief deposited the benefits of fraud or theft.⁵⁸⁴

⁵⁷⁹ See ch 3.B.2.1.2.1, ch 8.D.3.3.4.

⁵⁸⁰ See ch 8.D.2.1.1, paras D.2.1.3.2, D.2.2, 2.3.

⁵⁸¹ See ch 8.D.2.1.2, par D.2.1.3.1.

⁵⁸² See ch 8.D.2.2.1.

⁵⁸³ See ch 8.D.2.2.1.

⁵⁸⁴ See ch 8.D.2.2.2.

Like the traditional ownership remedies, the unjust enrichment *condictiones* can not avail a victim of fraud or theft to claim loss from a bank whether or not it exercised control over the benefits of fraud or theft at the time of *litis contestatio*.⁵⁸⁵ The reason concerns the various requirements for each of the *condictiones* which the victim of fraud or theft must establish before the court will allow his claim.⁵⁸⁶ An actual example may best illustrate when and if a victim of fraud or theft will be able to use the South African common-law remedies to recover loss from the bank with which the fraudster or thief deposited the benefits of fraud.

Consider a scenario where X made payments to Y as advisor for a medical aid scheme. After paying twenty thousand rand to Y as contribution to the medical aid scheme, X receives information from a colleague that the medical aid scheme in fact does not exist. Y fails to return X's phone calls and it subsequently becomes clear that Y is a fraudster who absconded to parts unknown. As a result, X is faced with two possible situations: either the benefits of fraud remain in Y's bank account with B Bank, or Y instructed B Bank to transfer the funds to an offshore bank account from where the money was distributed among other offshore accounts.

If Y instructed B Bank to transfer the benefits of fraud to an offshore account, X will be unable to use any of the common-law remedies for the protection of ownership.⁵⁸⁷ This is because South Africa's courts do not use extended unjust enrichment principles in cases where a victim of fraud such as X followed the benefits of fraud or theft to the fraudster or thief's bank account only to discover that the bank parted with the money.⁵⁸⁸ As a result, X in the example above will be out luck and, therefore, unable to file suit against B Bank to recover loss suffered at the hand of Y.⁵⁸⁹

However, the outcome of the matter is slightly different if the benefits of fraud remained in Y's bank account at the time of *litis contestatio*.⁵⁹⁰ Even though X will be unable to use the *actio Pauliana* and any of the *condictiones* to claim from B Bank,⁵⁹¹ he may still be able to recover the benefits of fraud from it. The *rei vindicatio* is unsuitable to recover the benefits of fraud from B Bank, because the money cannot be identified *in specie* as the medical aid

⁵⁸⁵ See ch 8.D.3.1–3.4.

⁵⁸⁶ See ch 8.D.3.3.2–3.3.4.

⁵⁸⁷ See ch 8.D.2.1.2.2.

⁵⁸⁸ See ch 8.D.3.3.1–3.3.4.

⁵⁸⁹ See ch 8.D.2.1.3.2.

⁵⁹⁰ See ch 8.D.2.1.2, par D.2.1.3.1.

⁵⁹¹ See ch 8.D.2.2, paras D.3.1–3.3.

contributions that X paid to Y and X Bank become owner of the money when it was deposited.⁵⁹² However, X should be able to recover the benefits of fraud from B Bank with a quasi-vindictory action provided that it exercises control over the funds at the time of *litis contestatio*.⁵⁹³ The outcome above may be demonstrated as follows:

Figure 9.1:

Remedy	Potential outcome of claim against B Bank	Reason for outcome
<i>Rei Vindicatio</i>	*No success if benefits of fraud commingled in Y's bank account. *Potential success if benefits are kept separately, eg., in a safety deposit box.	*Benefits are unidentifiable from other money in Y's bank account & B Bank is owner thereof. *Money is identifiable as the benefits of fraud & B Bank did not become owner thereof.
Quasi-Vindictory Action	*Potential success.	*X has a legal right to the benefits of fraud.
<i>Actio Pauliana</i>	*No success.	*Insolvency action.
<i>Condictio Sine Causa</i>	*No success.	*Bank-customer contract provides valid legal <i>causa</i> .
<i>Condictio Indebiti</i>	*No success.	*Y made no mistake when benefits were deposited with B Bank.
<i>Condictio ob Turpem Causam</i>	*No success.	*Impossible to establish B Bank's knowledge of Y's turpitude or that money is benefits of fraud.

From the aforementioned evaluation it is evident that a lacuna exists in our law where a fraudster or thief absconded with the benefits of fraud or theft.

Traditional English unjust enrichment principles have been successfully by victims of fraud or theft against a bank that parted with the benefits of fraud or theft.⁵⁹⁴ In particular, the constructive trust remedy of knowing receipt is more likely to succeed against a bank which

⁵⁹² See ch 8.D.2.1.1, par D.2.1.3.

⁵⁹³ See ch 8.D.2.1.2, par D.2.1.3.1.

⁵⁹⁴ See ch 6.C.4.2, par C.4.2.4.

received and parted with the benefits of fraud or theft than a claim based on dishonest assistance.⁵⁹⁵ In turn, tracing in equity can be used with success by a victim only where the bank exercised control over the benefits of fraud or theft at the time of *litis contestatio*.⁵⁹⁶ Reasons for these syntheses are spelt out above.⁵⁹⁷ The victim's claim is substantiated by the bank's compliance to statutory due diligence measures, in particular the filing a STR which provides one of the elements that the victim of fraud or theft must establish to succeed in his claim against the bank.⁵⁹⁸

Only the conciseness of the US restatements of the law render them more suitable to than their English counterparts.⁵⁹⁹ This is because the evaluation imparted that US courts are as yet unwilling to extend codified unjust enrichment principles to avail a victim of fraud or theft's against a bank that parted with the money.⁶⁰⁰ Nevertheless, the fact that US unjust enrichment principles have been codified renders the outcome of a matter more certain than at English common-law where the judiciary may, or may not extend unjust enrichment requirements for the purpose of allowing a victim of fraud or theft to claim from the bank that parted with the benefits of fraud or theft.⁶⁰¹

Our courts should therefore draw from the jurisprudential experience that has developed around unjust enrichment to broaden our common-law. There are two options to rectify the lacuna in our law. They are namely:

1. introduction of certain English common-law actions to our law; and, or
2. codification in FICA of a generic unjust enrichment remedy similar to the US restatements of the common-law.

More specifically, the two English common-law remedies of knowing receipt and tracing in equity have been applied with success against a bank that received and parted with the benefits of fraud or theft.⁶⁰² Although these remedies are not by a far stretch perfect, our courts should

⁵⁹⁵ See ch 6.C.4.2.3, par C.4.2.4 respectively. See also ch 6.C.4.2.3.2, par C.4.2.4.2.

⁵⁹⁶ See ch 6.C.4.3.3, par C.4.3.5.

⁵⁹⁷ See paras B.6.1.2.1, B.6.1.2.2 above.

⁵⁹⁸ See ch 6.C.3.4.3.1, paras C.4.2.2, C.4.2.4.

⁵⁹⁹ See ch 7.D.2–3.

⁶⁰⁰ See ch 7.D.3.4.

⁶⁰¹ See ch 6.C.4.2.3.2, paras C.4.2.4.2, D.

⁶⁰² See ch 6.C.4.2.3.2, paras C.4.2.4.2, D.

nevertheless consider augmenting the common-law by giving credence to the aforementioned English remedies.

In the alternative, the legislature should consider codification of a general unjust enrichment remedy similar to the US Restatements to redress the consequences of using banks as depositories for the benefits of fraud or theft.⁶⁰³ Although the remedy's application will be restricted to cases involving the benefits of crimes such as fraud or theft which left a victim seeking to recover his loss, in the event that the judiciary is unwilling to import and apply English law in cases pertaining to money laundering, this option would be a suitable alternative to cement optimum results for victims of financial crime. Despite the fact that FICA was not designed to avail civil litigants there is no reason why a common-law remedy for the protection of ownership should not be inserted into the Act akin to the civil forfeiture remedy which already has been codified in POCA.⁶⁰⁴ The US has followed this path with success; its restatements of unjust enrichment constitutes a perfect example for our legislature to emulate.⁶⁰⁵

Therefore, it is proposed that a provision with wording similar to the following is inserted in FICA's Chapter 3 (Money Laundering Control Measures), Part 4 (Measures to promote compliance by accountable institutions) to succeed after section 43 (Training and monitoring of compliance):

Section 43A (Consequences of receipt of the benefits of unlawful activities)

- (1) A bank which receives into a bank account a deposit of the benefits of unlawful activities and parted with the money whilst suspecting that its ownership vested in some other must compensate that person to the extent to which it suffered loss.
- (2) The amount of compensation is measured by the extent to which the claimant has suffered loss.
- (3) The extent of loss suffered is determined at the time the action is brought.
- (4) A bank may raise as defence that it is a *bona fide* purchaser for value, or that its position reasonably changed since it received the benefits of unlawful activities.

The wording of the provision has been intentionally simplified to avoid the pitfalls of the traditional remedies for the protection of ownership and the requirements of the unjust enrichment *condictiones*.

⁶⁰³ See ch 4.D–E as regards the consequences depositing the benefits of crime with banks; ch 7.D.2–3 for the US Restatements of unjust enrichment principles.

⁶⁰⁴ See ch 8.D.4.

⁶⁰⁵ See ch 7.D.2–3.

7. Civil Forfeiture

7.1 European Union

7.1.1 General

The Strasbourg Convention comprises measures that signatories can take to confiscate the benefits of crime.⁶⁰⁶ Apart from promoting international cooperation with respect to confiscation related matters, the Strasbourg Convention compels signatories to adopt national legislation in order to assist with the confiscation of the benefits of crime and to assume any other measures necessary for a confiscation order. Article 22(2)(a) of the Strasbourg Convention provides wide protection to innocent owners of deposited money that is the subject of civil forfeiture proceedings.⁶⁰⁷

The Schengen Agreement further provides for civil forfeiture proceedings across EU borders.⁶⁰⁸

7.1.2 England

Civil forfeiture enables the recovery of the benefits of crime in civil proceedings where no criminal conviction have been sought or obtained.⁶⁰⁹ Significantly, the application does not need to be brought against the perpetrator, but may be brought against the account holder where the benefits of crime were deposited whether he has acted unlawfully or not.⁶¹⁰ A bank may become directly as mortgagee or indirectly as borrower of the benefits of crime involved in civil forfeiture proceedings.

Although title to deposited benefits of crime passes to the bank when a deposit is made, the account holder is owner of the debt that the banks owes on account of the deposit.⁶¹¹ It is, however, that debt and not the original deposited benefits of crime that the government seeks to

⁶⁰⁶ See ch 6.B.4.2.2.

⁶⁰⁷ See ch 6.B.4.2.2.

⁶⁰⁸ See ch 6.B.4.2.3.

⁶⁰⁹ See ch 6.C.4.4.1.

⁶¹⁰ See ch 6.C.4.4.2.1.

⁶¹¹ See ch 6.C.2.1.

forfeit when it brings a civil forfeiture application against moneys in the account. It follows that it is the account holder and not the bank whose property is being seized, and therefore, who will contest the civil forfeiture application.⁶¹²

Two distinct civil forfeiture law systems are codified in the PCA in order to deprive criminals of the benefits of their crimes.⁶¹³ The benefits of crime remain recoverable even after the funds were disposed by the person who originally acquired the funds through crime. In general, the benefits of crime cease to be recoverable if it were passed to a *bona fide* purchaser for value though a case could be made that the money remains recoverable as representative property.⁶¹⁴

The PCA as opposed to the Strasbourg Convention⁶¹⁵ provides only limited protection to innocent owners of property that is earmarked for civil forfeiture.⁶¹⁶ Consider, for example, where a bank as mortgagee learns that a residence in which it holds an interest was confiscated because it was used for criminal purposes. Pursuant to the PCA the bank may approach the court as an innocent owner for an order that it will be just and equitable not to make a recovery order in relation to its interest in the property.⁶¹⁷ However, if a victim of fraud or theft followed the fraudulently acquired or stolen money to a bank account, he will be unable to use the innocent owner defence to safeguard it from a recovery order simply because of how the defence is worded in the PCA.⁶¹⁸

Further, the court must consider both the degree of detriment that an innocent owner of property is likely to suffer as a result of a recovery order as well as the Assets Recovery Agency's interest in receiving the realised proceeds of the property before deciding whether a recovery order will be just and equitable.⁶¹⁹ The court must also balance the two divergent interests above in an effort to decide what would be just and equitable in the prevailing circumstances.

⁶¹² See ch 6.C.4.4.1.

⁶¹³ See ch 6.C.4.4.2.1–4.4.2.3.

⁶¹⁴ See ch 6.C.4.4.2.1.

⁶¹⁵ See ch 6.B.4.2.2.

⁶¹⁶ See ch 6.C.4.4.3.

⁶¹⁷ See ch 6.C.4.4.3.

⁶¹⁸, See ch 6.C.4.4.3.

⁶¹⁹ See ch 6.C.4.4.3.

An injunction may be serve on a bank where moneys in a bank account are the subject of civil litigation.⁶²⁰ Significantly, the bank does not owe a duty of care towards the party who obtained the order except if he is one of its customers.⁶²¹

7.2 United States

In line with the US AML legislation its civil forfeiture provisions are spread across the federal law. However, key provisions are found in the Civil Asset Forfeiture Reform Act of 2000 and the Patriot Act.⁶²² Under the doctrine of constructive control US courts are granted control over benefits of crime located abroad.⁶²³ The burden of proof in civil forfeiture proceedings is placed on the government which must establish by a preponderance of the evidence that the property such as money acquired through crime is subject to forfeiture.⁶²⁴

Innocent owners which have an interest in property earmarked for civil forfeiture are afforded protection under US civil forfeiture law.⁶²⁵ For example, a bank as mortgager and innocent owner of an interest in a residence used to manufacture heroine that is subject to civil forfeiture proceedings must establish that it has followed a due diligence process prior to granting the mortgage to the suspected criminal- property owner.⁶²⁶ The reason is that the bank in order to protect its interest from civil forfeiture must convince the court of its *bona fide* belief in the legitimacy of the customer and the source of his funds. The bank must further demonstrate that it has done everything *reasonably* required to ensure that a transaction was legitimate and that the customer's dealings were above board.⁶²⁷

US law provides for various interim measures, including restraining orders, to ensure that the property in issue such as the benefits of fraud deposited with a bank remains available for civil forfeiture purposes.⁶²⁸

⁶²⁰ See ch 6.C.4.4.4.

⁶²¹ See ch 6.C.2.1.

⁶²² See ch 7.D.4.2.3, par D.4.2.4 respectively.

⁶²³ See ch 7.D.4.2.2.

⁶²⁴ See ch 7.D.4.2.3.

⁶²⁵ See ch 7.D.4.2.1, par D.4.3.

⁶²⁶ See ch 7.D.4.3.

⁶²⁷ See ch 7.D.4.3.

⁶²⁸ See ch 7.D.4.4.

7.3 South Africa

South Africa's civil forfeiture regime is based on the US law.⁶²⁹ POCA distinguishes among three categories of property that may be forfeited, namely the 'proceeds'⁶³⁰ of unlawful activities; real or personal property used in a crime; and property which is otherwise *connected* to a crime.⁶³¹

Before money can be designated as the 'proceeds' of unlawful activities the NDPP must establish on a balance of probabilities a connection between it and an offence.⁶³² It follows that money may be forfeited only where it falls into one of two categories; it must be either the proceeds of 'unlawful activities',⁶³³ or the instrumentality of an 'offence'.⁶³⁴ Since there is no clear purpose for POCA's distinction between property that was acquired through 'unlawful activities'⁶³⁵ and property that was used to commit an 'offence' listed in Schedule 1 of the Act, it is recommended that Parliament repeals Schedule 1 of POCA.

Reference in the Act to offences listed in Schedule 1 should also be repealed and section 1's definition of 'instrumentality of an offence' should be amended as follows:

(vii) **'instrumentality of an offence'** means any property which is concerned in the commission or suspected commission of an **[unlawful activity]** at any time before or after the commencement of this Act, whether committed within the Republic or elsewhere.

Pursuant to POCA deposited money constitutes the proceeds of an unlawful activity only where the source of the money is criminal and where the NDPP can establish on a balance of probabilities a reasonably direct link to the commission of the unlawful activity.⁶³⁶ Overall proportionality has been used by the courts as yardstick to determine on a balance of probabilities whether property should be forfeited.⁶³⁷

Persons who have an interest in property used as an instrumentality of an offence as opposed to having a claim to deposited benefits of fraud or theft may raise the innocent owner

⁶²⁹ See ch 8.D.4.1.

⁶³⁰ See ch 8.C.3.2, paras C.4.2.1, D.4.2.1.3 as regards the concept 'proceeds'.

⁶³¹ See ch 8.D.4.2.1.1.

⁶³² See ch 8.D.4.4.2.1.3.

⁶³³ See ch 8.C.3.2, paras C.4.2.1, D.4.2.1.1, 4.2.1.4.

⁶³⁴ See ch 8.C.3.2, par D.4.2.1.4.

⁶³⁵ See ch 8.C.3.2, paras C.4.2.1, D.4.2.1.2

⁶³⁶ See ch 8.D.4.2.1.1, par D.4.2.1.3.

⁶³⁷ See ch 8.D.4.2.1.4.

defence pursuant to POCA.⁶³⁸ For example, a bank that claims to be an innocent owner of, for example, a residence that was used as a brothel must establish on a balance of probabilities that it acquired the interest in the house legally and neither knew nor had *reasonable* grounds to suspect that it was used as an instrumentality of an offence.⁶³⁹ However, it is evident that POCA fails to protect innocent owners of the benefits of fraud or theft who followed their loss to a bank account only to discover that it is the subject of civil forfeiture proceedings.⁶⁴⁰ The victim of the fraud or theft will experience difficulty in establishing his interest in the deposited benefits of fraud or theft as opposed to the interest of the NDPP which applied for the civil forfeiture order. POCA therefore fails to offer protection to this type of innocent owner.⁶⁴¹

Further, POCA allows the courts to issue interim orders for the preservation, inspection or custody of property that is the subject of a civil forfeiture application.⁶⁴² There is no duty on the NDPP to give notice to creditors of a civil forfeiture application.

7.4 Synthesis

Based on the conclusions above the following research objective can be considered:

9. POCA provides inadequate protection to a victim of fraud of theft where the deposited benefits of theft or fraud are earmarked for civil forfeiture.

Centuries ago the loss of property was regarded as a fitting penal measure.⁶⁴³ This view linked-up with the contemporary realisation that different penal measures are needed in the place of incarceration which currently is of little deterrence value. Whether civil forfeiture is more likely than incarceration to have a deterrence value is a matter of opinion.⁶⁴⁴ Whilst organised crime syndicates and the corrupted may often consider the monetary rewards of their conduct, it is doubtful that common fraudsters give it any thought. Nevertheless, there is something quite

⁶³⁸ See ch 8.D.4.3.

⁶³⁹ See ch 8.D.4.3.

⁶⁴⁰ See ch 8.D.4.3.

⁶⁴¹ See ch 8.D.4.3.

⁶⁴² See ch 8.D.4.5.

⁶⁴³ See ch 6.B.4.2.1, par C.4.4.1; ch 7.D.4.1; ch 8.D.4.1.

⁶⁴⁴ See ch 8.D.1.

satisfactory in the thought that at the very least, monetary rewards can no longer be the determining factor in the decision to commit crime - civil forfeiture ensures that.⁶⁴⁵

Banks that acted in good faith can use the innocent owner defence to protect their interest in an instrumentality of an offence such as property used for illegal purposes that is earmarked for civil forfeiture.⁶⁴⁶ In contrast, a victim of fraud or theft who followed his loss to a bank account will experience difficulty to establish a legal claim to the funds where they are the subject of civil forfeiture proceedings.⁶⁴⁷ Parliament should therefore amend section 52(2) of POCA as follows:

Exclusion of interest in property

(2) The High Court may make an order under subsection (1), in relation to the forfeiture of the **[benefits]**⁶⁴⁸ of unlawful activities, if it finds on a balance of probabilities that the applicant for the order—

(a) had acquired the interest concerned legally and for a consideration, the value of which is not significantly less than the value of that interest; and

(b) where the applicant *had acquired the* interest concerned after the commencement of this Act, that he or she neither knew nor had reasonable grounds to suspect that the property in which the interest is held is the **[benefits]** of unlawful activities crime; **[or**

[(c) has a legal interest in the property which vests in him rather than in the defendant.]

Amending POCA as recommended above should ensure that the interest of a victim of fraud or theft who followed the fraudulently acquired or stolen money to the fraudster or thief's bank account is protected by the Act against civil forfeiture.⁶⁴⁹ As a result the victim who has a legal claim to the deposited benefits of fraud or theft which are simultaneously the subject of civil forfeiture proceedings will be afforded the same protection as any other innocent owner that has an interest in the property concerned.

C. SUMMARY OF RECOMMENDED AMENDMENTS TO FICA, POCA AND THE AML REGULATIONS

⁶⁴⁵ See ch 6.B.4.4.2–4.4.3, par C.4.4.2; ch 7.D.4.2; ch 8.D.4.2.

⁶⁴⁶ See ch 6.C.4.4.3; ch 7.D.4.3; ch 8.D.4.3.

⁶⁴⁷ See ch 8.D.4.3.

⁶⁴⁸ See ch 8.C.3.2.

⁶⁴⁹ See ch 8.D.4.3.

This study indicated that various amendments to the AML legislation of South Africa, which includes FICA, POCA and the AML Regulations,⁶⁵⁰ are essential to improve its structure and the content of some of its provisions as well. The recommended amendments to the above mentioned legislation may be summarised as follows:⁶⁵¹

1. The short title of FICA should be amended from ‘Financial Intelligence Centre to **‘Counter-Money Laundering and Reporting Act’**.
2. The concept ‘proceeds of unlawful activities’ should be replaced in FICA with **‘benefits of unlawful activities’**.
3. Schedule 1 of FICA should be repealed in order to remove the difference between so-called ‘accountable institutions’ and other businesses to which the Act applies.
4. A definition for ‘accountable institution’ should be inserted in section 1 of FICA.
5. The exceptions to section 21 of FICA should be repealed so that banks must establish the identity of every customer with whom they come in contact with.
6. The concept ‘verify’ should be repealed from section 21 of FICA and a definition for the concept **‘establish’** should be inserted in section 1 of the Act.
7. A definition for the concept ‘reasonable belief’ should be inserted in section 1 of FICA so that bank employees know exactly what is expected of them in respect of establishing customer information.
8. The concept ‘trace’ should be replaced in section 21(2)(d) of FICA with the concept ‘follows’ in order to indicate the difference in meaning between the two concepts. The amended section should read that banks must **‘follow all accounts’** as opposed to ‘trace all accounts’ involved in a transaction.
9. Section 21 of FICA should be amended in order to provide for simplified and enhanced customer due diligence.
10. Section 29 of FICA should be amended so that it specifies that the courts will use ‘reasonableness’ to determine the potential liability of a bank employee who failed to file a STR.
11. Section 33 of FICA should be amended so that it affords a bank respite from continuing with a suspicious transaction after it filed a STR until the matter has been resolved by either the authorities or the judiciary.

⁶⁵⁰ See ch 8.C.3–5 respectively.

⁶⁵¹ See par B above where the suggested amendments are discussed in detail.

12. Section 38(1) of FICA should be amended so that a bank that files a STR to the FIC is protected against all subsequent criminal and civil litigation and not simply where it filed a report in good faith as the Act currently provides.
13. The concept 'person' should be replaced in section 43(b) of FICA with the concept '**money laundering reporting officer**' to update the Act according to international trends and to ensure that there are no doubts as regards the obligations of the appointed person.
14. A general civil remedy should be inserted in FICA to assist victims of crimes such as fraud or theft to recover loss from the bank which knowingly parted with the benefits of the fraud or theft.
15. The concept 'proceeds of unlawful activities' should be replaced in POCA with the concept '**benefits of unlawful activities**'.
16. The structure of POCA should be rearranged so that all offences are contained in one chapter of the Act followed by the confiscation and civil forfeiture provisions in the other chapters.
18. The concept 'instrumentality of an offence' should be amended in POCA so that it instead provides for the '**instrumentality of an unlawful activity**'. This amendment is necessary in order to repeal the unneeded concept 'offence' from the Act.
19. Schedule 1 of POCA should be repealed in order to remove the current list of 'offences' from the Act.
20. A definition for the concept '**instrumentality of an unlawful activity**' should be inserted in POCA to include all unlawful activities whether committed within the Republic or elsewhere.
21. Section 52(2) of POCA should be amended in order to provide innocent owner protection to all persons who have a **vested interest** in property that is the subject of civil forfeiture proceedings.
22. The AML Regulations should be amended to clarify what is meant by simplified and enhanced customer due diligence.
23. Regulations 2 to 19 (customer identification) of the AML Regulations should be amended in order to rearranged their content according to simplified and enhanced customer due diligence principles.

D. CONTRIBUTION OF THIS STUDY

This study set out to describe money laundering control approaches in South Africa and other jurisdictions whose selection was explained in Chapter 1.⁶⁵² Academic material used showed conclusively the mechanics of money laundering and the requirements of the remedies which can address the unforeseen consequences that AML measures are likely to have for banks. It follows that the study outlined a picture of global money laundering control strategies and their impact on banks which can be used as point of departure for future research and academic inquiry. Some assumptions as regards the consequences of money laundering and the applicability of traditional ownership remedies which may avail victims of financial crimes such as fraud or theft against banks as recipients of the benefits of the fraud or theft were refuted.

It was illustrated that the hallmark of money laundering control should be the protection of banks. Instead, banks have been left to fend for themselves as regards resolving the conflict between combating money laundering and protecting themselves against civil and criminal liability alike. The study emphasised the unfortunate consequences of money laundering control. It can therefore be said that this study contributed threefold to existing notions on the subject.

First, it identified various unforeseen consequences that money laundering control carries for banks. Secondly, it revealed the weaknesses of current AML legislation. Thirdly, the study demonstrated the inadequacy of traditional ownership remedies to assist a victim of fraud or theft to claim loss from a bank that parted with the benefits of fraud or theft whilst suspecting that the moneys ownership vested in some other. These are novel consequences of our AML regime which to date have not being identified by the research community.

The study further described and explored contemporary money laundering control measures. It illustrated that internationally, the renowned KYC standard has been replaced by advanced customer due diligence principles. In exploring measures which could assist banks with identifying the benefits of crime before the money can be deposited into a bank account, advanced customer due diligence measures stood out. This study emphasised the importance for banks to have advanced customer due diligence policies in place. Customer due diligence measures may assist a bank in identifying both the benefits of crimes such as fraud or theft and a potential criminal when an application for a new account is considered. Most significantly, the

⁶⁵² See ch 1.C.

study revealed that FICA must be amended to elevate it to the standard of international AML legislation.

Furthermore defying notions that money laundering controls will protect banks against criminal and civil liability alike, the study illustrated that whilst compliance with the AML legislation may assist a bank to avoid prosecution for a money laundering offence, it may also expose the bank to civil litigation instigated by either a customer or a victim of fraud or theft. Banks which are seeking to protect themselves against civil liability will be well advised to have sufficient measures in place which enable them to recognise the benefits of crime before the money can be deposited into a bank account.

This study illustrated that a bank that is able to identify the benefits of crime before the money can be introduced into the banking system for, *inter alia*, money laundering purposes, is likely to circumvent and even protect itself against the unforeseen consequences of money laundering control. This outcome not only affords credence to money laundering control, but also returns credibility to statutory AML provisions irrespective of their unforeseen consequences.

Whether individualised AML measures by interested parties or industry guidelines in the place of legislation will present a more effective way of resolving the conflicting bank obligation, are issues that should be considered at some length and further investigated. This unlocks the potential for further research possibilities.

E. FINAL CONCLUSION AND SUGGESTIONS

He who wants to educate himself in Chess must evade what is dead in Chess - artificial theories ... the custom of avoiding difficult tasks; the weakness of uncritically taking over ... the incapacity for admitting mistakes; in brief, everything that leads to a standstill or to anarchy.⁶⁵³

There is no gainsaying that errors have been made in efforts aimed at money laundering control. In particular, it was a gross error to underestimate the consequences that money laundering control carries for banks and the effectivity of established AML measures. Where do we go from here - can the conflict between contemporary money laundering control measures and the business of banking be resolved?

⁶⁵³ Lasker *Chess* 338.

The analogy of the chess game between the police authorities as represented by White on the chess board and a criminal as represented by Black imparted that the winner of the game will be determined by the stealth and foreseeability of the players. At this point, the game continues. To draw from the chess analogy, money laundering and money laundering control have one element in common: strategy. Arguably, legislation is the most concrete method to prevent money laundering and thereby reduces criminal conduct in general. However, if legislation fails to address the practical challenges posed by money laundering control it can end up to pervert rather than promote money laundering control. In some ways this is where we are at presently.

This study portrays a grim picture of money laundering control in South Africa. Not only has FICA failed to keep abreast with international AML trends, but key AML obligations, namely, customer identification and suspicious transaction reporting have been exposing banks to unnecessary civil liability. Whether the suggested amendment to FICA's safe-harbour provision would finally resolve the tension that exists between the confidentiality duty of banks and their reporting duty is a matter of wait and see. It is, however, clear that a bank that fails to identify money as the benefits of fraud or theft before the funds can be inserted in the financial system effectively may not only have to make good to a victim of the fraud or theft, but may further become entangled in civil forfeiture proceedings. This outcome is a certainty if the recommended amendments to FICA are not enacted.

Banks are in desperate need of some common sense rules of their own. AML measures lay to encourage accountability and responsibility by banks. Thus far, one can marvel at what has been accomplished with money laundering control. But, money laundering control has failed to serve banks well. The complexity of the picture portrayed in this study suggests that current money laundering control strategies should be seriously reconsidered. In my view, South African banks cannot afford to buy into the notion that money laundering is uncontrollable. The solution to the problem of having effective AML legislation which not only criminalises money laundering activities, but also protects banks against the pitfalls of money laundering control commences with the acknowledgment that money laundering controls imposes hardship on banks.

Despite the need for panoptic money laundering controls it is necessary to make sure that they are effective. The time has arrived to inquire how concretely does contemporary AML measures prevent money laundering whilst protecting banks from civil liability. In an era of globalisation it is each country's responsibility to recognise the pitfalls of its own AML regime.

Unless the concerns for contemporary AML measures which are spelt out in this study receives immediate attention, it is a certainty that banks will become more vulnerable to money laundering than ever before.

ADDENDUM

BIBLIOGRAPHY

A. REFERENCE TECHNIQUES

A complete table of contents is provided at the beginning of the study. An abridged version of the table of contents is repeated at the beginning of each chapter for ease of reference.

Authorities are referred to in footnotes by way of keywords taken from the titles of the references, for example, Pretorius JT 'Section 72B of the Bill of Exchange Act 1964' (2005) 17 *SA Mercantile Law Journal* 56 referred to as Pretorius (2005) *SA Merc L J* 1; Goredema, Charles 'Money Laundering Control in Southern Africa' referred to as Goredema *Money Laundering in Goredema Profiling Money Laundering*.

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A list of abbreviations is included at the beginning of the study. Concepts included in the list of abbreviations are referred to in full in the first instance with an abbreviated name in brackets thereafter. The latter abbreviation is subsequently used in the study, for example, Financial Action Task Force on Money Laundering ('FATF'). In the list of abbreviations the concept is listed as follows:

FATF Financial Action Task Force on Money Laundering.

The male gender used in the study also implies the female gender and the neutral gender.

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