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ANTI-MONEY LAUNDERING INITIATIVES FOR THE SOUTH AFRICAN REAL ESTATE MARKET

Jeffrey R. Boles*

INTRODUCTION

South Africa operates as a major African financial center, with its robust banking and financial sector and significant cash-based market, and it consequently exposes itself as an attractive target for criminal activity generally and money laundering in particular.¹ Long known as a money laundering hotspot,² “South Africa has a low prosecution rate under its main anti-money laundering legislation, which is a clear indication that money laundering and organized and related crime are not effectively dealt with” in the country.³ Former Finance Minister Trevor Manuel estimated in 2001 that “anything between 2 billion and 8 billion US dollars are laundered through South African institutions every year.”⁴

The South African real estate market in particular provides opportunities for criminals to launder their funds through purchasing and/or developing properties.⁵ Criminals can use the luxury real estate market in the Western Cape Province, for instance, to launder sizeable amounts of illicit funds through buying high-end properties via cash and offshore shell companies that hide their true owners, and the purchased real estate functions as the means to launder the criminal proceeds.⁶

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¹ Edcomm Group, Anti Money Laundering (AML) in South Africa, 2016, <http://bankersacademy.com/57-ba-free-tutorials/610-aml-southafrica-sp-280>.

² Karyn Maughan & Alex Eliseev, Druglords Target SA For Money-Laundering, Aug. 29, 2006, <http://www.iol.co.za/news/south-africa/druglords-target-sa-for-money-laundering-291405> (“British authorities have admitted that South Africa is being targeted as a money-laundering hotspot, and local authorities are fighting to make money laundering as difficult as possible.”).

³ Bernd Schlenker, *The Taxing Business of Money Laundering: South Africa*, 16 J. MONEY LAUNDERING CONTROL 126, 126 (2013).

⁴ Charles Goredema, Confronting Money Laundering in South Africa: An Overview of Challenges and Milestones, May 2007, <https://issafrica.org/chapter-4-confronting-money-laundering-in-south-africa-an-overview-of-challenges-and-milestones>.

⁵ See ISS Africa, Measures to Control Money Laundering in Real Estate, Apr. 24, 2009, <https://oldsite.issafrica.org/iss-today/measures-to-control-money-laundering-in-real-estate>.

⁶ See Marco Dugato *et al.*, *The Risks and Rewards of Organized Crime Investments in Real Estate*, 55 BR. J. CRIMINOLOGY 944, 944 (2015) (analyzing investments of criminal organizations in real

Money laundering in real estate “is a classic and proven method of laundering money [as the tainted funds] can be hidden in real estate by a number of transactions that cloak the genuine source or by investing in properties that provide a facade of legality.”⁷ This Article analyzes money laundering in the South African real estate sector, and in particular, “the darkest corner of the real estate market: all-cash purchases made by shell companies that often shield purchasers’ identities,” and recommends specific initiatives that may help combat the offense in this sector.⁸

I. THE MONEY LAUNDERING OFFENSE AND ITS PROHIBITIONS

Most types of criminal activity ultimately involve the acquisition of money,⁹ and after criminals obtain cash and other assets resulting from their illicit activities, they must “clean” these assets via money laundering, a process that turns tainted funds into ostensibly usable ones.¹⁰ “The act of transferring illegally obtained money through legitimate people or accounts so that its original source cannot be traced,”¹¹ money laundering enables perpetrators to disguise and move high volumes of funds, and without this practice, criminal enterprises would not be able to function effectively.¹²

Money laundering generally operates through a three-stage process: (1) placement, where tainted funds enter the financial system, often through deposit into a bank account;¹³ (2) layering, where the launderer engages into a set of transactions in order to divorce the funds from their illicit origins;¹⁴ and (3) integration, where the tainted funds disguised as legitimate funds flow into the

estate).

⁷ Jason Clout, *Money Laundering under Spotlight*, AUSTL. FIN. REV., Mar. 11, 2004, at Prop. § 56.

⁸ Louise Story, *U.S. Will Track Secret Buyers of Luxury Real Estate*, N.Y. TIMES, Jan. 13, 2016, <http://www.nytimes.com/2016/01/14/us/us-will-track-secret-buyers-of-luxury-real-estate.html>.

⁹ See UNODC, *Introduction to Money-Laundering*, 2016, <https://www.unodc.org/unodc/en/money-laundering/introduction.html?ref=menuaside>.

¹⁰ Jeffrey R. Boles, *Financial Sector Executives as Targets for Money Laundering Liability*, 52 AM. BUS. L.J. 365, 368 (2015).

¹¹ BLACK’S LAW DICTIONARY 1027 (8TH ED. 2004).

¹² Boles, *supra* note 10, at 369.

¹³ Jason Ennis, *Cleaning Up the Beaches: The Caribbean Response to the FATF’s Review to Identify Non-Cooperative Countries or Territories*, 8 LAW & BUS. REV. AM. 637, 639 (2002).

¹⁴ See FED. FIN. INSTITUTIONS. EXAMINATION COUNCIL (FFIEC), *BANK SECRECY ACT/ANTI-MONEY LAUNDERING EXAMINATION MANUAL 8* (2014), *available at* https://www.ffiec.gov/bsa_aml_infobase/documents/BSA_AML_Man_2014_v2.pdf.

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economy.¹⁵ The practice is globally rampant, with the United Nations Office on Drugs and Crime approximating that perpetrators laundered USD \$1.6 trillion in 2009 worldwide, an amount equaling 2.7% of global gross domestic product.¹⁶

The crime generates significant economic and social harm throughout the world,¹⁷ harming economies, for instance, by “distorting the demand for cash, generating volatility in interest and exchange rates, raising inflation rates, distorting asset and commodity prices, degrading investment quality, altering international cash flows and dampening foreign investments.”¹⁸ The practice also lowers tax revenues, consequently generating higher tax rates for all.¹⁹ These effects can collectively reduce resources and lower economic growth,²⁰ while raising law enforcement demands, health care costs, and other government expenditures needed to address the crime’s harmful social effects.²¹

II. COMBATTING MONEY LAUNDERING IN SOUTH AFRICAN REAL ESTATE MARKETS

Money laundering remains a significant challenge in South Africa. According to a PriceWaterhouseCoopers study, over one quarter (27%) of South African survey respondents reported having witnessed a money laundering offense

¹⁵ See UNITED STATES DEPT. OF THE TREASURY, 2015 NATIONAL MONEY LAUNDERING RISK ASSESSMENT 2 n.1, <https://www.treasury.gov/resource-center/terrorist-illicit-finance/Documents/National%20Money%20Laundering%20Risk%20Assessment%20%E2%80%93%202006-12-2015.pdf>; Scott Sultzer, *Money Laundering: The Scope of the Problem and Attempts to Combat It*, 63 TENN. L. REV. 143, 49 (1995) (summarizing money laundering stages).

¹⁶ See UNODC, ESTIMATING ILLICIT FINANCIAL FLOWS RESULTING FROM DRUG TRAFFICKING AND OTHER TRANSNATIONAL ORGANIZED CRIMES 5 (2011).

¹⁷ See, e.g., John McDowell & Gary Novis, *The Consequences of Money Laundering and Financial Crime*, 6 ECON. PERSP. 6, 6 (2001); Kathleen A. Lacey & Barbara Crutchfield George, *Crackdown on Money Laundering: A Comparative Analysis of the Feasibility and Effectiveness of Domestic and Multilateral Policy Reforms*, 23 NW.J. INT’L L. & BUS. 263, 268-69 (2003); Ronald K. Noble & Court E. Golumbic, *A New Anti-Crime Framework for the World: Merging the Objective and Subjective Models for Fighting Money Laundering*, 30 N.Y.U.J. INT’L L. & POL. 79, 90-91 (1998).

¹⁸ Jeffrey R. Boles, *Million Dollar Ghost Buildings: Dirty Money Flowing Through Luxury Real Estate Markets*, 45 REAL ESTATE L.J. 476, 481 (2017).

¹⁹ See John McDowell & Gary Novis, *The Consequences of Money Laundering and Financial Crime*, 6 ECON. PERSP. 6, 8 (2001).

²⁰ See Int’l Monetary Fund, *The IMF and the Fight against Money Laundering and the Financing of Terrorism*, Apr. 12, 2014, available at <http://www.imf.org/external/np/exr/facts/aml.htm>.

²¹ See McDowell & Novis, *supra* note 19, at 8.

within the last two years.²² While money laundering activity appears to transpire in many segments of South African society,²³ the luxury real estate market has been a particular hot spot for laundering activity.

South Africa has enacted a set of laws to combat money laundering. For instance, the Proceeds of Crime Act (No. 76 of 1996) criminalizes money laundering in South Africa,²⁴ and the Prevention of Organized Crime Act (no. 121 of 1998) requires suspicious transaction reporting in the country coupled with a safe harbor for good faith compliance.²⁵ Moreover, the Financial Intelligence Centre Act (No. 38 of 2001) (FICA) requires South African real estate agents to verify client identities, maintain records of sales transactions and report any suspicious transactions.²⁶ Penalties for money laundering include a potential 30-year imprisonment sentence and fines of up to 100 million rand.²⁷ Since 2001, the Financial Intelligence Centre functions as the principal anti-money laundering authority in South Africa.

The level of suspicious transaction reporting by real estate agents has reportedly been “poor”, with drug syndicates and others using South Africa’s real-estate markets to launder funds.²⁸ Property in Cape Town and Gauteng has been highly attractive to those interested in laundering money.²⁹ This area features some of the most expensive real estate in South Africa, and is particularly attractive for European and other foreign buyers.³⁰ South Africa places no legal restrictions on

²² PWC, Economic Crime Remains a Serious Issue Affecting SA Organisations, According to PwC Study, 2017, <http://www.pwc.co.za/en/press-room/economic-crime-news-sa.html>.

²³ See, e.g., Gavin Finch & Ambereen Choudhury, Barclays Probes Suspected Money Laundering at SA Unit, Mar. 1, 2016, <https://www.bloomberg.com/news/articles/2016-03-01/barclays-probes-suspected-money-laundering-at-south-african-unit> (“Barclays Plc identified potential money laundering linked to currency transactions at its business in South Africa, where the British lender plans to wind down its investment.”).

²⁴ Proceeds of Crime Act (No. 76 of 1996), http://www.saflii.org/za/legis/num_act/poca1996160/.

²⁵ Prevention of Organized Crime Act (no. 121 of 1998), https://www.unodc.org/res/cld/document/zaf/1998/prevention_of_organised_crime_act_1998.html/Prevention_of_Organised_Crime_Act_1998.pdf.

²⁶ Financial Intelligence Centre Act (No. 38 of 2001), <http://www.banking.org.za/consumer-information/legislation/financial-intelligence-centre-act>.

²⁷ Louis de Koker, Money Laundering in South Africa, Sept. 1, 2002, at 6, <https://oldsite.issafrica.org/uploads/1DEKOKERPROJECTPAPER.PDF>.

²⁸ Maughan & Eliseev, *supra* note 2.

²⁹ *Id.*

³⁰ Lisa Prevost, *House Hunting in ... South Africa*, N.Y. TIMES, Mar. 2, 2016 <https://www.nytimes.com/2016/03/06/realestate/real-estate-in-south-africa.html>.

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foreigners purchasing real estate within the country, but there are limits on their borrowing ability.³¹ Nonresidents must provide proof of earnings and supply other identification information in compliance with South Africa's existing AML laws.³²

In addition, it appears that there is virtually no FICA compliance with private sales of real estate; two private parties may engage in a real estate transaction without agents and with an all-cash purchase, obviating the need to engage lending institutions, which in turn sidesteps AML client-identification procedures.³³ If the purchasing party decides to buy property using a shell company³⁴ and an all-cash purchase, it becomes that much more difficult to detect the laundering activity.

In 2016, the United States Department of the Treasury Financial Crimes Enforcement Network issued a directive that “temporarily require[ed] certain U.S. title insurance companies to identify the natural persons behind companies used to pay all cash for high-end residential real estate in the Borough of Manhattan in New York City, New York, and Miami-Dade County, Florida.”³⁵ This agency issued the order to study if and how individuals engage in all-cash real estate purchases to mask their illicit assets and their identities through buying real estate via shell companies.³⁶ The order mandates that title insurance companies detect and relay to the government the beneficial owner existing behind any shell company involved in high-end residential real estate transactions in certain U.S. cities.³⁷

South African government officials at the Financial Intelligence Centre may find that the anti-money laundering initiatives that require all beneficial owners of domestic and foreign shell companies to reveal their identities to the government in connection with the purchase of real estate may help thwart laundering activity in the real estate sector. The problem demands active investigation because if left

³¹ *Id.*

³² *Id.*

³³ Gregory Mthembu-Salter, Money Laundering in the South African Real Estate Market Today, June 2006, <https://issafrica.org/chapter-2-money-laundering-in-the-south-african-real-estate-market-today> (“It appears there is almost no FICA compliance with private real estate sales.”).

³⁴ Money launderers often establish shell companies specifically for laundering their tainted assets. Mazars Forensic Services (Pty) Ltd, Money Laundering: How Does It Affect You?, Dec. 2011, <http://www.mazars.co.za/mazarspage/download/95744/19127704/file/Money%20laundering%20-%20how%20does%20it%20affect%20you.pdf>. Shell companies hide their true, beneficial owners.

³⁵ FinCEN, FinCEN Takes Aim at Real Estate Secrecy in Manhattan and Miami, Jan. 13, 2016, https://www.fincen.gov/news_room/nr/html/20160113.html.

³⁶ *Id.*

³⁷ *Id.* See Boles, *supra* note 18, at 494-96 (discussing money laundering initiatives).

unabated, money laundering in real estate markets “may (i) raise average sale prices, with a ripple effect down the real estate price chain, (ii) reduce the availability of housing stock in a community, (iii) shift developers’ priorities to high-end property and away from affordably-priced housing, and (iv) create ghost communities, where unoccupied homes with foreign owners reduce local tax and local business revenues and community life more broadly.”³⁸

CONCLUSION

Money laundering activity continues to present challenges to South Africa, and the real estate sector in particular poses special money laundering risks, given the potential for real estate purchases to function as a means to launder illicit proceeds. The South African government may initiate anti-money laundering compliance obligations requiring beneficial owner disclosure for any shell companies that may be parties to real estate transactions. The disclosure obligation may assist in reducing laundering in real estate markets by deterring criminals with such mandated transparency.

³⁸ *Id.* at 492.