Financial
Intelligence Centre

Assessment of the inherent money laundering and terrorist financing risks

KRUGER RAND DEALERS

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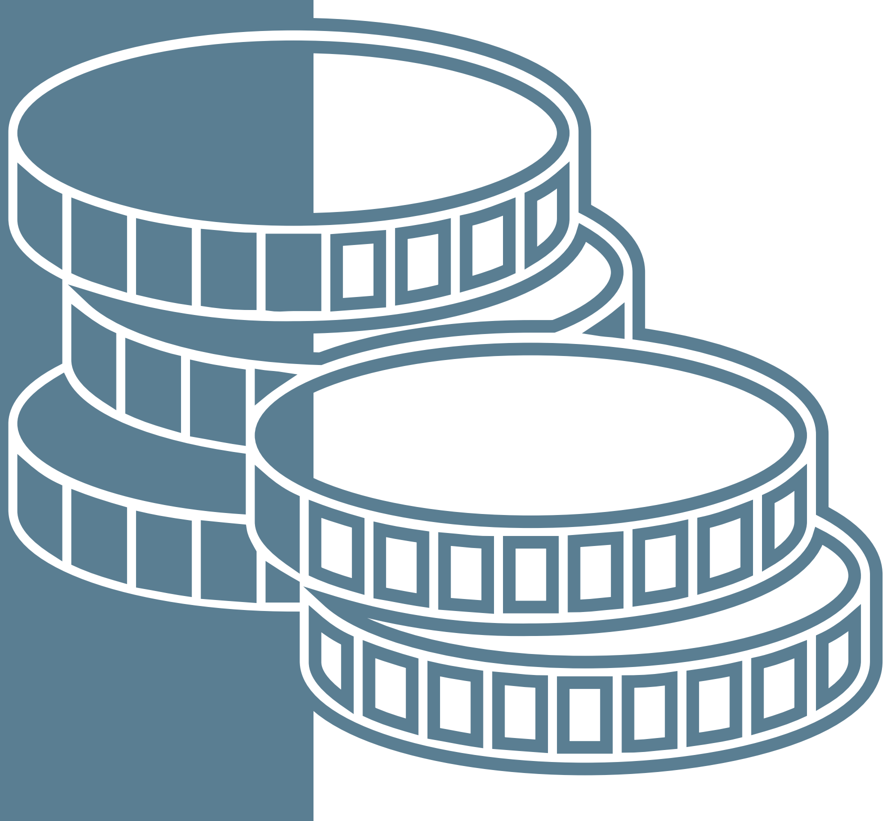

Contents

1. INTRODUCTION

Money laundering can be described as the process whereby criminals attempt to conceal the proceeds of their criminal activities from the actual crime, thereby giving the funds derived from criminal activities an appearance of legitimacy. This may be done by investing in different immovable and movable assets. Dealers in high-value goods, which include Kruger rand dealers, are among the sectors the international community has identified as potentially vulnerable for money laundering. Terrorist financing is the process by which individual terrorists and terrorist organisations obtain funds to commit acts of terrorism.

In 2019, the Financial Intelligence Centre (FIC) conducted a preliminary risk assessment of the inherent money laundering and terrorist financing (ML and TF) risks affecting Kruger rand dealers in South Africa. Kruger rand dealers were surveyed to ascertain their views on the sector's vulnerability to money laundering and terrorist financing. This report captures the feedback provided and open-source information on national and international money laundering risks in the Kruger rand dealers' sector. In addition, the FIC's regulatory knowledge of the sector and the analysis of the regulatory reports submitted by Kruger rand dealers to the FIC were also considered.

The survey offers valuable insights for the sector, the relevant industry bodies and the FIC. While it is understood the ML and TF environment may change from time to time, the risks identified from the survey feedback and from other sources are significant observations.

2. SCOPE, LIMITATIONS AND METHODOLOGY OF THE RISK ASSESSMENT

This sector risk assessment report addresses principally the inherent ML risks that face the Kruger rand dealers' sector pertaining to products, clients, transactions, distribution channels, and geographical location. Although it is recognised that these risks could be mitigated by introducing processes and procedures in accordance with the requirements and obligations of the Financial Intelligence Centre Act, 2001 (Act 38 of 2001) (FIC Act), such mitigation factors were not included in this report.

3. OVERVIEW OF THE KRUGER RAND DEALERS SECTOR IN SOUTH AFRICA

3.1 Nature and regulation of the sector

3.1.1 The first 22 karat gold Kruger rand was produced in 1967, as an initiative of the Chamber of Mines to add value to South African gold.

3.1.2 Kruger rands are legal tender in South Africa. The Kruger rand is denominated in ounces of pure gold. The value of each coin is its fine gold content, which is linked to the prevailing gold price. A small premium is charged to cover manufacturing and distribution costs. Kruger rands attract VAT at a rate of zero, in line with the provisions of section 11(1)(k) of the Value Added Tax Act, 1991 (Act 89 of 1991), and have no fixed nominal value as its value depends on the daily fixed gold price.

3.1.3 The Rand Refinery was established by the Chamber of Mines of South Africa in 1920. Acting on behalf of Prestige Bullion, Rand Refinery sells Kruger rands to Kruger rand dealers in South Africa and international precious metal dealers who act as primary distributors of the coins. Prestige Bullion is a joint venture between the South African Mint (a 100 percent held subsidiary of the South African Reserve Bank) and Rand Refinery.

3.1.4 In addition to this primary market, second-hand Kruger rands are also traded in a secondary market where any jewellery store, dealers in coins or precious metals or second-hand dealers further down the value chain, can trade in Kruger rands.

3.1.5 Kruger rand coins can be purchased internationally through primary distributors, such as banks and precious metal dealers in, among other countries, Germany, the United Kingdom and the United States of America.

3.1.6 Kruger rands are produced and distributed by Prestige Bullion, through a series of agreements with Rand Refinery and the South African Mint. Rand Refinery is contracted by Prestige Bullion to sell and distribute the bullion (investment) Kruger rand, while the South African Mint independently manages and controls the distribution of the collectible Kruger rand range. These arrangements result in the primary market being controlled through a limited number of role players who are involved in primary trades. The traders in the secondary market, however, include a wide variety of businesses, which also increases the risks of abuse for illicit purposes.

3.1.7 Throughout history, gold has had universal appeal as a haven for investors who still view gold as a safe harbour for their wealth. Gold is a hedge against inflation, deflation and geopolitical macro-economic factors. The Kruger rand makes this investment in gold possible for ordinary people. Furthermore, because of its content, a Kruger rand can be readily liquidated into currency in most countries.

3.1.8 Although small in number, the Johannesburg Stock Exchange offers trading in Kruger rands through a well-regulated secondary market. Here Kruger rands are traded in the same way as any listed equity market instrument, with prices quoted on the various types (weights) of coin. Kruger rands appeal to professional and private investors who wish to make a direct investment in gold bullion to hedge their portfolios against the US dollar or to further diversify their portfolio.

3.1.9 Kruger rand dealers do not have to be licensed and they do not have a licensing authority that can act as a supervisory body as envisaged in Schedule 2 of the FIC Act. Kruger rand dealers are regarded as dealers in high-value goods. This pose a high risk for money laundering and terrorist financing, and as such, they are included in Schedule 3 of the FIC Act as reporting institutions. This means that currently their compliance obligations under the FIC Act are limited to registration, reporting and complying with the targeted financial sanctions requirements.

4. MONEY LAUNDERING RISKS ASSOCIATED WITH KRUGER RAND DEALERS

4.1. Kruger rands are an attractive vehicle for money laundering, as they contain gold. Criminals often target lucrative products in the precious metals industry to launder their illicit funds. Another factor making Kruger rands highly attractive to potential money launderers is the anonymity of gold being traded as cash or a form of legal tender. This makes it difficult to track the origin and to verify the ownership of the gold. Furthermore, Kruger rands are easy to move between different locations and across borders, while its shape and form can be changed.

Although illegal, these activities make Kruger rands highly attractive to criminals who intend to conceal, transfer or invest their illicit proceeds, particularly in the secondary market.

4.2. Internationally, gold and precious metals such as Kruger rands are recognised as attractive vehicles for money laundering. Gold is internationally considered a high risk for money laundering since it offers a sound investment, is cash intensive, is traded globally – often anonymous – and is a form of global currency. These risks are also applicable to Kruger rands as a form in which gold is stored.

5. REPORTING BY KRUGER RAND DEALERS UNDER THE FIC ACT

5.1 The volume of reports received from Kruger rand dealers

From April 2016 to March 2021 Kruger rand dealers filed a total of 5 679 cash threshold reports (CTRs[1]) at an average of 1 136 per year. During the same period, a total of 498 suspicious and unusual transaction reports (STRs[2]) were filed at an average of 100 per year. The average number of reports filed per registered Kruger rand dealer is approximately five per year, with a high of just over seven in the 2017/18 financial year. This is relatively low, compared to other sectors.

The number of regulatory reports filed by Kruger rand dealers with the FIC in each financial year from 2015 to 2020 is depicted below.

Table 1: Regulatory reports filed by Kruger rand dealers

Reports filed by Kruger rand dealers	2016 /17	2017 / 18	2018 / 19	2019 / 20	2020 / 21	Average no of reports
CTRs	954	1458	1135	860	1 272	1 136
STRs	3	26	98	262	109	100
TPRs	0	0	0	0	0	0
Total reports	**957**	**1 484**	**1 233**	**1 122**	**1 381**	**1 236**
Registered Kruger rand dealers	192	206	223	236	260	223
Average no of reports filed by Kruger rand dealers per year	957 / 192 = 4.9	1 484 / 206 = 7.2	1 233 / 223 = 5.5	1 122 / 236 = 4.8	1 381 / 260 = 5.3	1 236 / 223 = 5.5

[1] Reports on cash transactions exceeding R24 999.99
[2] Reports on transactions that are regarded as unusual or suspicious, as explained in section 29(1) of the FIC Act

5.2 The nature of reports filed by Kruger rand dealers

5.2.1 The number of reports received from Kruger rand dealers and the number of individual dealers reporting, is relatively low, which may point to possible compliance failures.

5.2.2 Kruger rand dealers file regulatory reports in terms of section 28, section 28A and section 29 of the FIC Act. The majority of regulatory reports filed to the FIC have been cash threshold reports, filed in terms of section 28 of the FIC Act. This indicates that cash (in the form of notes and coins) is still being used in the sector. The use of cash (paid and received by Kruger rand dealers in the secondary market) makes the sector vulnerable to possible abuse by money launderers.

6. RISKS BASED ON THE SECTOR SURVEY AND RESEARCH

The risk factors used in this report align with the FIC's Guidance Note 7, which is available on www.fic.gov.za. Refer especially to paragraph 37 of the guidance note, which highlights risks associated with transactions and terrorist financing.

The risk factors mentioned below were taken into consideration when the results of the survey were analysed. Kruger rand dealers need to consider these risks factors when conducting their daily business.

6.1 Products and services risks

6.1.1 Only Rand Refinery, acting under a distribution agreement with Prestige Bullion, has the authority to conduct primary sales of Kruger rands, including to other dealers. However, there is no limitation on selling of Kruger rands on the secondary market.

6.1.2 The nature of Kruger rands makes it a popular high-value investment instrument that is easy to trade and transport. The fact that it is sold by a wide variety of dealers, such as jewellers and commemorative coin dealers, increases the ML risks associated with Kruger rands.

6.1.3 Kruger rands can also be sold as "Kruger bits" meaning that the client or investor only buys a part of a Kruger rand. In addition, Kruger rands can be sold as part of jewellery like a necklace or a bracelet.

6.1.4 The FIC has issued public compliance communication 17 (PCC 17) which provides a definition of a person who carries on the business of dealing in Kruger rands. Any person who, as a regular feature of his/her business, deals in jewellery, ornaments, watches or other objects that contain Kruger rands, is considered to be a dealer in Kruger rands. These dealers in the secondary markets are not subject to strict control measures and may potentially increase the ML risks associated with Kruger rands, including other products that contain Kruger rands.

6.2 Client risk

6.2.1 The clients of an accountable institution and a reporting institution, including Kruger rand dealers, may also be an indicator of the ML/TF risks that face an entity. Although restricted in the primary market, the secondary market could include a wide variety of client types.

6.2.2 The ML/TF risks associated with clients that are legal institutions, as opposed to individuals, would be different. In addition, clients that are regarded as domestic prominent influential persons (DPIPs) or foreign prominent public officials (FPPOs) are potentially a higher risk for ML. It must, however, be noted that Kruger rand dealers, as reporting institutions do not have an obligation to determine whether a client falls within these categories.

6.2.3 Where domestic dealers sell Kruger rands to foreign nationals, sales are likely to be through tourism or online platforms, which potentially complicates client identification and verification, resulting in such a client possibly being categorised a higher risk for ML purposes.

6.2.4 Conducting business means that an institution either obtained the Kruger rand for investment purposes or they are in the retail business and acquired the coins to sell to an end user. A Kruger rand dealer should know what the purpose of the sale is to determine the ML risk associated with the transaction.

6.2.5 As reporting institutions, Kruger rand dealers do not have an obligation to perform customer due diligence (CDD) on their clients as envisaged in the FIC Act. However, to mitigate the potential ML/TF risks associated with clients, Kruger rand dealers should gather sufficient information to submit financial intelligence reports if necessary. Kruger rand dealers are advised to obtain as much information as possible on their clients, the client’s reason for acquiring the Kruger rands and the source of funds for the purchase.

6.2.6 The ML risks associated with clients are potentially high due to the fact that they include foreign buyers while Kruger rand dealers do not have an obligation to conduct CDD, risk rate their clients or conduct transaction monitoring.

6.3 Transaction risk

6.3.1 Kruger rand dealers still accept cash at their premises which is evident from the number of CTRs that were reported to the FIC, as referred to in Table 1 above. The use of cash further increases the ML risks to Kruger rand dealers.

6.3.2 Certain Kruger rand dealers place a restriction on the number of coins sold to individual customers to make customer monitoring easier.

6.4 Risks associated with distribution channels

6.4.1 Kruger rand dealers also sell Kruger rands online, which may expose them to anonymous or fictitious clients, in particular when transactions take place through agents or third parties acting on behalf of the actual client.

6.4.2 Alternative distribution channels such as door-to-door deliveries, a retail network and online sales facilities are also used in the sale of Kruger rands which makes it difficult to properly identify and verify clients.

6.4.3 The use of alternative distribution channels makes it difficult to complete the CDD process. In addition, Kruger rand dealers are currently not accountable institutions, which could result in an increase in anonymity within the sale of Kruger rands. The ML risks associated with distribution channels are high.

6.5 Geographical areas

In terms of geographical area risks, most Kruger rand dealers conduct business in the area where they reside, and little business appears to be done with clients from high-risk areas.

Examples of high-risk areas are countries identified by the Financial Action Task Force[3] as having a low level of AML/CFT compliance, tax havens, countries regarded as jurisdictions with high levels of secrecy and countries where citizens are subject to a travel ban.

Sales through the internet and to foreign visitors (the tourism industry) also take place, which could result in uncertainty among the dealers about where Kruger rands may eventually end up, resulting in the inherent ML risks associated with the geographic areas being high

6.6 Terrorist financing risks

Kruger rand dealers have not submitted any terrorist property reports during the review period and indicated they have never experienced a situation that may have resulted in possible exposure to terrorist financing. However, Kruger rand dealers are reporting institutions and are under no obligation to submit terrorist property reports under section 28A of the FIC Act.

7. INDICATORS OF MONEY LAUNDERING AND TERRORIST FINANCING ACTIVITY FOR THE SECTOR

7.1. The FIC has compiled risk indicators based on information from FATF, regional anti-money laundering and combating of terrorist financing bodies, and analysis of regulatory reports received from the Kruger rand dealers sector.

7.2. The following could be regarded as ML/TF vulnerabilities and risks associated with the sector:

- Highly cash intensive sector
- Kruger rands are a form of global currency and act as a medium for exchange in criminal transactions
- Investments in Kruger rands generally yields high returns
- The gold market is highly liquid
- Asset diversifier – gold is a long-term store of value, highly liquid, and an internationally recognised asset of last resort. It can diversify and stabilise an investment portfolio and

[3] The Financial Action Task Force is the international standard setting body for combating money laundering and the financing of terrorism and proliferation. South Africa is a member of the Financial Action Task Force and has to comply with its standards.

protect it against market fluctuations. It is easy to buy and sell, anytime, anywhere in the world

- Kruger rands are easily traded and can be smuggled easily
- Small and easy to transport across borders
- Low barriers to entry in the sector
- Stolen Kruger rands could be melted down, recast into another gold form and sold for cash.

7.3 The following scenarios can be regarded as potential indicators for money laundering associated with the Kruger rand dealers' sector:

- Significant cash withdrawals from bank accounts by participants within the gold trading sector
- The transaction involves the use of front or shell companies where the client is an entity
- Original source of funds to buy Kruger rands cannot be established
- Transactions between domestic buyers and sellers with proceeds sent to unknown third parties overseas
- Unusual pattern of Kruger rand transactions and the nature of the transactions are inconsistent with the customer profile
- Established customer (including bullion dealers) dramatically increasing the purchase of Kruger rands for no apparent reason
- Foreign nationals purchasing gold bullion through multiple transactions over a short period
- Purchases for no apparent commercial or investment purpose
- Kruger rands are moved from/to a jurisdiction designated as high risk for money laundering activities or sensitive or non-cooperative jurisdictions.

8. CONCLUSIONS

Entry barriers in the secondary sales of Kruger rands are low and are traded by using cash and online platforms, which increases the money laundering risks. The online sales platforms and the sale of coins to tourists results in the involvement of international clients who could potentially conceal the nature and identity of other persons or institutions on behalf of which they act when buying Kruger rands.

The inherent ML risks associated with Kruger rand dealers are high and the terrorist financing risks are low.

Money laundering risk factors for Kruger rand dealers

Money laundering risk factors	Likelihood	Consequence	Overall risk rating	Priority
Compliance: Lack of mitigating circumstances through compliance – e.g. CDD, training, record keeping	4	4	21	1
Market entry levels	5	4	23	1
Products and services/delivery channels – Use of cash, online platforms, transaction size	4	5	24	1
Risk/threats associated with clients – Politically exposed persons, source of funds, complex structures	3	4	18	2
Risk/threat associated with geographical area – sales to clients outside geographic area, sales to clients in restricted area	5	3	5	4

Overall money laundering risk for Kruger rand dealers – Heat map

Likelihood scale (probability)	5 Almost certain likelihood/ probability	11	16	20 Geographic risks	23 Market entry levels	25
	4 Highly probable likelihood	7	12	17-	21 Compliance Risk	24 Products, services and distribution channels
	3 Possible likelihood	4	8	13	18 Clients risks	22
	2 Unlikely probability	3	5	9	14	19
	1 Improbable likelihood	1	2	6	10	15
		1 Low impact	2 Minor impact	3 Moderate impact	4 Major impact significant	5 Severe impact
	CONSEQUENCE SCALE (IMPACT)					