



FATF REPORT

MONEY LAUNDERING AND TERRORIST FINANCING THROUGH TRADE IN DIAMONDS

October 2013





FINANCIAL ACTION TASK FORCE

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ACRONYMS

AML	Anti Money Laundering
ATA	<i>Admission Temporaire</i> /Temporary Admission
AWDC	Antwerp World Diamond Centre
CFT	Counter Financing of Terrorism
CTR	Currency Transaction Report
CDD	Customer Due diligence
DD	Diamond dealer
DDA	Designated Diamond Account
DNFBP	Designated Non-Financial Business and Professions
DPMS	Dealers in Precious Metals and Stones
EDD	Enhanced Due diligence
FC	Foreign Currency
FIU	Financial Intelligence Unit
FTZ	Free Trade Zone
HS	Harmonized Commodity Description and Coding System
JA	Jewellers of America
KP	Kimberley Process
KPCS	Kimberley Process Certification Scheme
KYC	Know Your Customer
ML	Money Laundering
MSB	Money Service Business
RTGS	Real Time Gross Settlements
STR	Suspicious Transaction Report
TBML	Trade Based Money Laundering
TF	Terrorist Financing
UAR	Unusual Activity Report
UTR	Unusual Transaction Report
WFDB	World Federation of Diamond Bourses

EXECUTIVE SUMMARY

This report, examining Money Laundering (ML) and Terrorist Financing (TF) vulnerabilities related to the trade in diamonds, began as an Egmont Operational Working Group project in February 2012. In June 2012, the project was also adopted by the Financial Action Task Force (FATF) and it became a joint FATF and Egmont typologies initiative. There were two main reasons for the Egmont Group of Financial Intelligence Units (FIUs) and FATF to commission typologies research into the diamond trade:

- a) Neither FATF, Egmont Group nor any of the FSRBs had ever conducted an in-depth research of the diamond trade and its exposure to ML/TF risk.
- b) During the last ten to fifteen years, Egmont and FATF delegations noted a number of indications that the diamonds trade was being exploited for ML/TF purposes.

Given the limited research into ML/TF through the trade in diamonds, the report provides a basic overview of the subject matter and then focuses on ML and TF issues. **Chapter 2** provides a general overview of the international trade in diamonds. The distinction between the use of diamonds themselves and the exploitation of the trade in diamonds which is conducted through financial institutions or alternative/internet payment mechanisms is important to note. Diamonds and the diamond trade can be used in all stages of ML (placement, layering and integration) and for the stages of TF (collection, transmission, and use).

The research conducted has brought to light evidence that the diamonds trade is subject to considerable vulnerabilities and risks, creating a challenge for both stakeholders within the industry and relevant national authorities for AML/CFT. The contributions from the project team and consultation with private sector have shown that the various entities within the diamond industry on both national and international level have made efforts to counter ML and TF risks.

The diamonds trade has existed for centuries. It has developed a unique culture and trade practices, which have their own characteristics and variations across countries and continents.

However, the international diamond trade has changed in the last few decades:

- De Beers no longer holds the same all inclusive diamonds monopoly.
- A number of smaller diamond dealers have entered the market.
- Distribution channels have become more diverse.
- New trade centres have emerged with billions of dollars' worth of diamonds, and financial transactions go in and out of newly founded bourses and their ancillary financial institutions.
- Cutting and polishing has shifted (except for the most valuable stones) from Belgium, Israel and the US mainly to India and China, with smaller cutting centres emerging.
- Cash transactions are still prevalent but the usage of cash is diminishing.

- The internet, as in all other facets of life, is rapidly taking its place as a diamonds trading platform.

These significant changes in the "diamonds pipeline" structure and processes raised the question of whether the risks and vulnerabilities remain the same and whether current AML/CFT standards and national regulations are sufficient to mitigate the different ML/TF risks and vulnerabilities identified in the research.

While the level of risk posed by the misuse of the diamond trade may not be accurately established within the scope of this report, the analysis conducted within the framework of the current research identifies issues affecting the level of risk posed by criminals seeking to misuse the trade. **Chapter 6** provides a detailed analysis of the risks and vulnerabilities, including

- a) **Global nature of trade** - The trade in diamonds is transnational and complex, thus convenient for ML/TF transactions that are, in most cases, of international and multi-jurisdictional nature. This, in turn, may create difficulties for national law enforcement to conduct investigations and necessitates international cooperation between law enforcement agencies across countries in which the trade is taking place.
- b) **Use of diamonds as currency** - The research noted criminals' use of diamonds as a form of currency¹ is a characteristic unique to the diamond trade². Diamonds are difficult to trace and can provide anonymity in transactions.
- c) **Trade Based Money Laundering (TBML)** - This is one of the most common methods used by criminals to launder illegally gained funds. The specific characteristics of diamonds as a commodity and the significant proportion of transactions related to international trade make the diamonds trade vulnerable to the different laundering techniques of TBML in general and over/under valuation in particular. This should be viewed in light of the significant world annual trade volume which includes rough diamonds, polished diamonds and diamond jewellery³.
- d) **High amounts** - cases show that the trade in diamonds can reach tens of millions to billions of US dollars. This has bearing on the potential to launder large amounts of money through the diamond trade and also on the level of risks of the diamonds trade.
- e) **Level of awareness of law enforcement and AML / CFT authorities** (including FIU awareness) to potential ML/TF schemes through trade in diamonds is low in most countries. This can be seen in the trade statistics provided by the project team: there are almost no reports that were filed by precious stones dealers to FIUs and very few intelligence reports have been disseminated by FIUs to law enforcement agencies. The complexity of the diamonds trade requires particular study and expertise to analyse and evaluate the financial

¹ For example, instances have been found where diamonds were used to pay for and to finance drug trafficking.

² Within the regulated sectors according to the FATF recommendation, this is a characteristic of precious metals and stones in general.

³ In 2011 the rough trade in diamonds amounted to approximately USD 51 billion and the polished trade in diamonds amounted to USD 214 billion (see Figure 5, p. 33).

and trade transactions. The opaque and closed nature of the diamond industry are also obstacles to investigations of ML/TF by Law Enforcement Agencies, which in many cases are unaware of the benefit and the possibilities for ML which diamonds may allow.

- f) There are cases, even though relatively few, indicating that the diamonds trade has also been used for TF during the last 10 to 15 years.
- g) All this is conducted within an industry where, although efforts to reduce such trade practices have been made, the traditional ethics of trust are an integral part of the trade culture and record keeping is minimal.

Chapter 7. of the report provides red flags and indicators based on analysis of country contributions and red flags derived from submitted cases:

- a) Red flags and indicators for regulated entities.
- b) Red flags and indicators for diamond dealers and jewellers.
- c) Red flags and indicators for customs.

Chapter 8 and **Chapter 9** provide an analysis of the different methods and techniques used for ML and TF. In total, 64 cases were received from team members or retrieved from open sources. From the cases collected, 38 cases were used in the report. Cases collected displayed links between the different stages of the diamonds trade and various predicate offences. These include drug trafficking, fraud, smuggling, theft and robbery, large scale tax offences, forgery and fictitious invoices among other offences. Drug trafficking and smuggling were found to be the most prevalent predicate offences.

Almost 50% of the cases concerned non-cash payment means. Cash as the sole method of payment was reported only in 10% of the cases. These figures echo one of the main conclusions of the report that the extent of cash usage in the trade is growing smaller. This has significance with respect to the FATF definition of *Dealers in Precious Stones* and the AML/CFT standards which apply to Diamond Dealers only when they engage in cash transactions with their customers. Taking into account the risk and vulnerabilities identified in the report which does not relate to cash usage the FATF definition of Dealers in Precious Stones is an issue to be further considered.

The vulnerabilities and risks of the diamonds trade noted in the report are made in general terms. However, it should also be stressed that since the trade in diamonds is dependent upon the trade characteristics pertaining to each jurisdiction in question, it is important to understand that there may be considerable differences in the level of risk between countries and a more country specific evaluation of risk is required. With respect to jurisdiction where diamond trade is a significant part of the economy or where trade volumes are high it should be considered by relevant national authorities to incorporate the diamonds trade as part of their national ML/TF risk assessment.

Generally speaking, international AML/CFT regulation must be as consistent as possible, in order to obstruct the laundering of proceeds of crimes and to prevent terror financiers to achieve their goals. Wherever loop holes exist in the AML/CFT standards, regulations or enforcement, criminals will tend to utilise them for their ML/TF transactions.

Other precious stones – Finally, the scope of the project was narrowed in February 2013 from ML and TF through trade in diamonds and other precious stones to the diamond trade only.

Information collected, before limiting the scope to diamonds, shows the use of gold and other precious stones for ML/TF purposes. The information is provided here without further analysis as an awareness raising step and as an indication that further research is required on this topic.

Important remarks - In this report, when reference to the diamond trade is made, this is taken to mean all the sectors noted in **Figure 1 – diamond pipeline diagram**. Where possible, the different parts of the industry will be distinguished: production, rough diamond sales, cutting and polishing, jewellery manufacturing and jewellery retailers.

The term diamond dealers refers, throughout the report, to a person dealing in rough or polished loose diamonds (mostly business to business). Unless otherwise specified, the term does not include diamond jewellers (mostly business to consumer).

CHAPTER 1.

INTRODUCTION

Banks and other financial services have traditionally been the preferred conduit for ML and often the ultimate destination for laundering proceeds of crime. Global efforts to mitigate the risks of ML/TF through financial services have reduced the likelihood of ML/TF through this sector. Through country specific legislation and international cooperation promoted by the FATF and Egmont Group, criminals have been challenged in their ML/TF activities. The implementation of AML/CFT measures has forced criminals to seek out other methods to launder the proceeds of their crimes. The ML aspect of the criminal enterprise has become more complex and sophisticated in order to conceal and disguise profits gained by their criminal activity and the origin of such profits. As a result, other business sectors have been targeted by criminals including the precious metals and precious stones industries, and specifically the trade in rough and polished diamonds and diamond jewellery.

The diamond sector as a Designated Non-Financial Business and Profession (DNFBP) is different in some respects from financial institutions and other DNFBPs. Diamonds are a commodity traded in international markets. The diamond trade is a dynamic international trading sector, where a significant amount of business is transacted through financial institutions. They are used not only for trade but also for investment purposes, although probably to a limited extent. Diamonds are traded mainly through dozens of bourses and cutting and polishing ('manufacturing') centres around the globe. As this research has discovered diamonds are also used as a form of currency, which distinguishes this industry from other trade based DNFBPs such as real estate agents and most trade based industries. The use of diamonds as a form of currency or as a means of payment is of significance from an AML/CFT perspective.

The FATF recognised that diamonds and other precious stones are vulnerable to ML/TF by including the diamonds and precious stones dealers under the definition of DNFBP when they engage in cash transactions with their customers above an applicable designated threshold. The FATF Report on Money Laundering Typologies 2002-2003⁴ recognised the inherent risk that diamonds and other precious stones pose as a ML commodity.

This 2002–2003 typologies report identified cases where diamonds and the trade in diamonds have been exploited for ML and TF purposes. However, the team undertaking this project found that in many cases, Financial Intelligence Units (FIUs) and Law Enforcement agencies know little about diamond trade business practices, the methods of its utilisation for ML or TF and the typologies of the criminal exploitation of the diamonds trade, in comparison to their awareness of other types of ML/TF activities.

As will be detailed later in this report, the diamond trade was found to be linked to different predicate offences, including to offences conducted by organised crime, such as drug trafficking, illegal weapons trade and tax offences, as well as to ML offences. Additionally, one of the

⁴ FATF (2003)

complexities noted in the laundering activities that utilize diamonds is that diamonds can be both the vehicle to generate criminal profits as well as the vehicle to launder them.

Documented⁵ cases of terrorist utilization of diamonds are few; however it should not automatically be assumed that terrorist utilization is uncommon because of the limited case examples that have been published. Often, law enforcement and intelligence organisations have documented the factual details that are not released to the public. Unless the use of diamonds leads to an arrest or criminal charges as the case may be, these details will not be made public. In addition, this knowledge may not be shared as willingly as criminal use of diamonds due to national security concerns.

Before the implementation of the *Kimberley Process*, research had shown that diamonds had been exploited extensively by war criminals in many African civil wars by a multitude of rebel and government forces, to exercise the acquisition of munitions. Some of the war lords and militia commanders had mastered the art of converting illicit diamonds into arms. Historically this may be the greatest example of terrorist or terrorist-like utilisation of diamonds.

The business practices prevalent in the diamonds trade are unique:

- Confidentiality of transactions.
- Agreements made by word of mouth.
- Deals conducted via a diamond bourse located in Free Trade Zones (FTZs)
- "memo" transactions.

Alongside, these factors, the diamonds trade is also characterised high value to mass ratio, million dollars' worth of diamonds may be carried across borders either legitimately through trade or illegally (*e.g.*, smuggling) with relative ease. These characteristics make diamonds a commodity vulnerable to exploitation by transnational criminal organisation and terrorist groups seeking to transfer value or legitimise illicit transactions and profits⁶. These characteristics, among others, also mean that the trade is difficult to monitor by regulators and law enforcement agencies.

The FATF definition of ML is based on the definitions included in the UN Vienna and Palermo Conventions. These definitions note that ML includes the acquisition, possession, concealment or disguising or conversion / transfer of property derived from criminal offences (listed as designated categories of offences by the FATF). Examining ML in its broadest sense, diamonds may be:

- a) acquired as a "property of an offence" (theft of diamonds);
- b) used to conceal or disguise "proceeds of crime" (as they are a high value/low mass good and relatively easy to hide from detection); and
- c) converted into other financial instruments or conveyed or transferred relatively easily across borders and hold their value for a very long period of time. *I.e.*, diamonds are liquid assets.

⁵ See for example: GAO (2003); Global Witness (2003); and Douglas Farah (na).

⁶ FATF (2003), pp. 21- 24.

The flexibility of diamonds as a commodity that can generate profit, retain value and serve as means of payment, in conjunction with traditional ethics of trust and undocumented trade practices, indicate the potential for diamonds to be used as a laundering mechanism and why this industry is worthy of further examination by AML and CFT authorities.

I. REASONS FOR CONDUCTING THE RESEARCH

The FATF last conducted a typologies research on the topic of diamonds in 2002-2003. This typologies report was not dedicated fully to the topic of diamonds but rather covered several issues each in a very limited way. Diamonds as a topic for a typologies research has not been dealt with by the FATF nor by FATF-Style Regional Bodies (FSRBs) leaving the issue in need of attention. The purpose of this research is to create a better understanding of the diamond trade and in particular the "diamond pipeline", including the vulnerabilities and risks facing the trade.

The diamond industry (rough, polished and jewellery) is international in character, and demand for diamonds remains high. The whole industry "pipeline" needs to work so that rough diamonds can find their way from the earth as a rough diamond to a cut and polished diamond in someone's necklace, watch or ring. While the value of rough diamond production amounts to USD 14.06 billion⁷ annually, the financial volumes of the trade on all its parts amount to hundreds of billions of dollars every year. In many countries the diamond industry has become an important economic factor.

Indications exist that point to the misuse of the legitimate diamond trade. NGOs such as Partnership Africa Canada, and government bodies, such as the US Government Accountability Office (GAO) have researched and published information revealing investigations involving the use of diamonds for ML. However, it remains an open question as to what extent the diamond industry itself has been exploited for ML/TF.

AML/CFT authorities recognise the potential risk of misuse of the diamond industry. The IMF has been engaged in Technical Assistance with African countries that produce and deal in diamond, gold, and precious metals to strengthen their defences against ML, smuggling, and TF. The IMF noted that: "the trade in precious minerals has been linked to illicit financial flows, corruption, drug trafficking, arms smuggling and the financing of terrorism⁸."

II. AIM AND OBJECTIVES

The diamond trade is global in nature and can be highly complex. The characteristics of the trade vary along the supply chain and by location, whether it is African mining countries, diamond trading centres like Belgium, US, Israel and Dubai, or manufacturing centres such as India and China. For this reason this report aims at the outset to provide a general overview of the diamond industry, the way it works and the characteristics of diamonds as merchandise, through an AML and CFT lens. The aim is to provide the basic knowledge needed in order to have a better understanding of the

⁷ According to KPCS statistics for the year 2011.

⁸ IMF (2010).

manner in which the diamond trade / industry operates and the way this sector might be exploited for ML and TF purposes. This overview is provided in **Chapter 2** of the report.

In 2008 the FATF, in consultation with the private sector⁹, published a ***Risk Based Approach (RBA) for dealers in precious metals and stones*** (DPMS). This document conducted an analysis of risks which may be considered by both dealers in precious metals and precious stones in the application of the risk-based approach to the dealers' activity. One of the main aims of this typologies project is to identify up-to-date ML and TF vulnerabilities along the different parts of the "diamond pipeline", with a specific focus on international trade and the unique characteristics of rough and polished diamonds that make them vulnerable to criminal activity, as well as an evaluation of the risks associated with the vulnerabilities of the trade. This may also assist concerned parties in enhancing their application of a RBA for precious stones with respect to the diamond trade.

Additionally, the typologies report also aims to:

- a) Identify "red flags" and indicators which will enable financial institutions, diamond dealers and law enforcement to recognise cases of abuse of the diamond trade and increase unusual/suspicious activity reports to FIUs. Identifying "red flags" will also assist the relevant entities in assessing the risk of their own transactions.
- b) Identify known and new typologies / case examples in the diamond industry based on case examples and open source information, and establish ML/TF trends in the global diamond trade. In particular, the project aims to contribute to a better understanding of the extent to which the diamond trade is used by criminals to launder proceeds generated in predicate offences and to what extent diamonds are used for this purpose.
- c) The report also aims to outline relevant policy implications by:
 - i. Examining the current FATF standards with respect to the diamond trade and identifying any need for further consideration, enhancement or amendment.
 - ii. Identifying best practices for AML/CFT regulatory and supervisory approaches to the precious stones industries and specifying policy implications where needed. Furthermore, if required, develop a specific set of issues for consideration that may assist both the diamond and financial sectors and national competent authorities.

III. METHODOLOGY

The methodology adopted in this project deviated from the common practice of sending a questionnaire to all FATF/Egmont members to collect information. It was decided, rather, to create a diverse group of team members from countries of importance and/or relevance to all facets of the diamond trade to collect country-specific information and to take part in the report drafting. All countries where diamond centres or diamond mines are located were invited to take part in the

⁹ The following diamond and jewellery industry representative bodies were consulted for the 2008 report: Antwerp World Diamond Centre (AWDC), International Precious Metals Institute, World Jewellery Confederation (CIBJ), Jewelers Vigilance Committee (JVC), World Federation of Diamond Bourses (WFDB), and the Canadian Jewellers Association.

project. The countries that joined the project included: Argentina, Australia, Belgium, Canada, India, Israel, Mexico, the Netherlands, Russia, South Africa, Switzerland and the US. Two FSRBs (GIABA and ESAAMLG) joined the project to serve as liaisons to African mining countries. The members represent a significant part of the international "diamond pipeline", namely: Mining¹⁰ and production, trade and manufacturing centres, distribution and jewellers¹¹.

However, it is important to note that, the report would have benefitted from additional information from specific input of production countries and major trade centres. For example, United Arab Emirates, one of the world largest trading centres for diamonds (with trade volumes amounting to more than USD 40 billion). The lack of information from the United Arab Emirates leaves an intelligence gap which may cause an imbalance in the results of the research. This is also true for most of the African mining countries which supplied little or no information on the mining sector (*e.g.*, Botswana, Sierra Leone, Namibia and the Democratic Republic of Congo (DRC)).

A comprehensive collection plan was devised and distributed among team members. The objectives of the collection plan were as follows:

- a) **Create a better understanding** of the manner in which the diamond trade is operating from mining of rough diamonds through trade and cutting centres to the retail level of jewellery shops where polished diamonds contained in jewellery are at the end of the value chain. This included information on customs, cross-border regulation, taxation and funding made available via financial institutions.
- b) **Identify "red flags"** both in the trade of rough and polished diamonds to help diamond dealers and jewellers¹² recognise transactions which may be linked to ML or TF activities; these may also assist the financial sector providing services to the diamond sector. Red flags may also be used by FIUs and law enforcement while investigating cases involving the trade in diamonds.
- c) **Diagnose the vulnerabilities and the level of risk** associated with different parts of the trade.
- d) **Collect information on money flows** related to ML or TF from the different countries, in order to identify discrepancies between countries and indications for possible ML and/or TF activities.
- e) **Collect information on sanitized and actual cases** from FIUs and law enforcement.
- f) **Identify associated predicate offences** with the trade and financing of the trade in diamond.

¹⁰ There is a previous stage to mining which is the exploration stage whereby governments and specialized diamond companies such as Alrosa, De Beers and Rio Tinto search for new site of diamond mining. The report is not looking into this phase since it precedes the actual trade in diamonds.

¹¹ Based on KP statistics for the year 2011 (rough diamonds only) the team members covered in terms of trade volume 95% of the mining sector and approximately 83% of the import and export of rough diamonds.

¹² The FATF definition applies to dealers in precious metals and stones. The scope of the report is the diamond trade only; however, the identified red flags may also aid dealers in precious stones in general.

- g) **Engage national players** relevant to the diamond trade in each member jurisdiction to facilitate the collection of information.

A limited collection plan was also sent to additional countries identified by the project team as relevant to the diamond trade. These included: China; Hong Kong, China; Singapore; Switzerland, Thailand; the United Arab Emirates; and the United Kingdom.

An open source survey for actual ML/TF cases involving diamonds was conducted and information on these cases was requested from the relevant countries (Australia; Belgium; Brazil; Hong Kong, China; Israel; South Africa; Switzerland; United Kingdom; United States; Zimbabwe¹³). These open source cases were also used in the typologies analysis section.

In November 2012, a typologies workshop was held in Dakar, Senegal within the GIABA/FATF joint expert meeting on typologies, produced relevant material to the report. Several presentations were given by the participants. Additionally, team meetings were held to discuss findings¹⁴.

Several team meetings included consultations with the private sector aimed at better understanding the trade in diamonds and its vulnerabilities as perceived by the private sector and verifying the information previously collected. Consultations were conducted with Jewelers of America and the World Federation of Diamond Bourses (WFDB).

Additional private sector consultations took place during the end of August 2013 and the beginning of September 2013, just prior to the final project team review and submission of the report to the FATF and Egmont for approval, to verify the factual information regarding the diamond trade. The draft report was sent for comments to the following private sector representatives: WFDB, Jewellers of America, a consultant gemmologist to the crown in Canada, an expert from the UN Group of Experts on Côte d'Ivoire and a representative from Kimberley Process to review information on KP sections of the report.¹⁵

IV. SCOPE

The project was initially envisioned in two-phases, with the first stage focusing on ML / TF through the trade in diamonds and other precious stones and the second phase focusing on ML / TF through the use of precious metals. This was in accordance with the FATF definition of precious stones dealer as a sector included in the Designated Non-Financial Businesses and Professions (DNFBPs). The project was initiated at the first stage with an aim to conduct a typologies research to cover both diamond and other precious stones but would not cover precious metals.

¹³ As of 3 June responses had been received from Australia, Brazil, Israel, Switzerland, the United Kingdom and the United States.

¹⁴ Team meetings were held in July 2012 in St. Petersburg, Russia in the margins of the Egmont Own meeting; January 2013 in Ostend, Belgium in the margins of the Egmont OpWG meeting; February 2013 in Paris, France in the margins of the FATF WGTYP meeting; June 2013 in the margins of the FATF WGTYP held in Oslo, Norway a meeting which included consultation with private sector representatives.

¹⁵ The authors of the report noted that the same terminology was sometimes used differently by some private sector experts that contributed to this report. Every effort has been made to use the same terminology consistently.

During the team meetings in February 2013, the project team decided to narrow down the research to cover only diamonds. As the project progressed, and as more information became available giving a better picture of the scope of the issue, it became clear that the diamond trade alone is a vast area of research justifying a focused effort of its own. For the same reason, synthetic diamonds were also excluded from the scope of the research.

Since one of the objectives of this report is to create a better understanding of the misuse of the diamond trade for the purpose of ML or TF and to understand how the diamond trade is used by criminals to launder funds from illegal activities or to finance terrorism, the project team also decided that "conflict diamonds" would not be part of this research.

Each part of the "diamond pipeline" has its own characteristics and different geographical locations. In many cases the "players" are different, and the vulnerabilities and risks correspond to the nature of each "pipeline" segment. The project team found that the collection of information on all of these parts, and the analysis of this information within the framework of AML/CFT vulnerabilities and risks, was a difficult and time-consuming task. Based on all the information collected, the project team identified vulnerabilities. However, since not all of the jurisdictions approached by the project team provided information, there are some intelligence gaps¹⁶. In order to stay within the timeframe allocated to this project, these intelligence gaps have not been included in the report, leaving the diamond trade in need of further research (particularly with reference to African mining countries and some trade centres like China, Panama and the United Arab Emirates).

Given that the diamond trade is very complex, involving numerous players spanning across continents, it would be difficult within the framework of this report to conduct a country by country analysis of the vulnerabilities and risks relevant to the diamond trade. As a result, the report speaks mainly in general terms with regard to vulnerabilities and risks associated with each part of the trade, and considers geographical vulnerabilities and risks where appropriate.

Finally, the quality of diamonds can be divided into *gem*, *near gem* and *industrial* grade categories. Industrial grade diamonds have different markets and are not used for the production of jewellery due to their low quality. According to the WFDB, 30 - 35% of the volume (less than 1% by value) of mined diamonds and a large proportion of synthetic diamonds are used for industrial purposes. Since the ML and TF vulnerabilities of industrial diamonds are lower than gem quality diamonds, industrial diamonds are not part of this research. When speaking about diamonds, this research is referencing only those diamonds which are eventually used for the manufacturing of jewellery, *i.e.*, gem and near gem quality.

¹⁶ Some intelligence gaps remain since information was not received from all jurisdictions approached by the project team.

CHAPTER 2.

THE INTERNATIONAL TRADE IN DIAMONDS - OVERVIEW

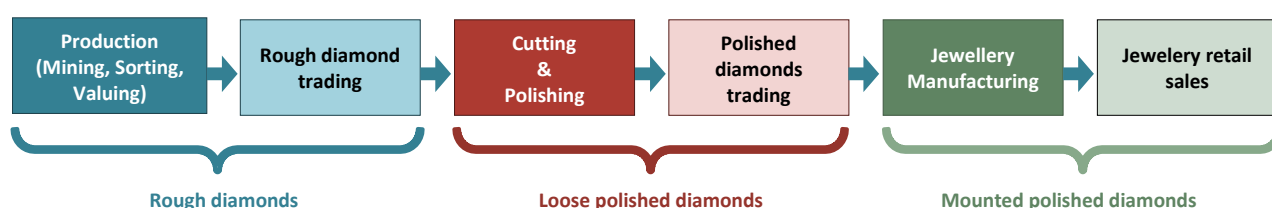
In order to understand the vulnerabilities of the diamonds trade throughout the various stages of the "diamond pipeline" and the risks associated with these vulnerabilities, it is required to understand how this unique and complex industry works, what are the processes bringing diamonds from the mine to the market, who are the "players" involved in the trade, what is the size of the industry, etc. While it is not the purpose of this report to provide a comprehensive analysis of the diamond industry, a synopsis of the sector from mining of rough diamonds to the retail level, is provided.

THE DIAMONDS PIPELINE

Bringing diamonds from production (mining) to the retail consumer involves several stages of processing and a variety of transactions (also known within the industry as the "diamond pipeline"). The stratification of the diamond industry is as follows:

- Production (including mining, sorting and valuing)¹⁷
- Rough diamond trading / sales
- Cutting and polishing
- Polished diamond sales
- Jewellery manufacturing
- Jewellery retail sales

Figure 1: Diamond pipeline diagram

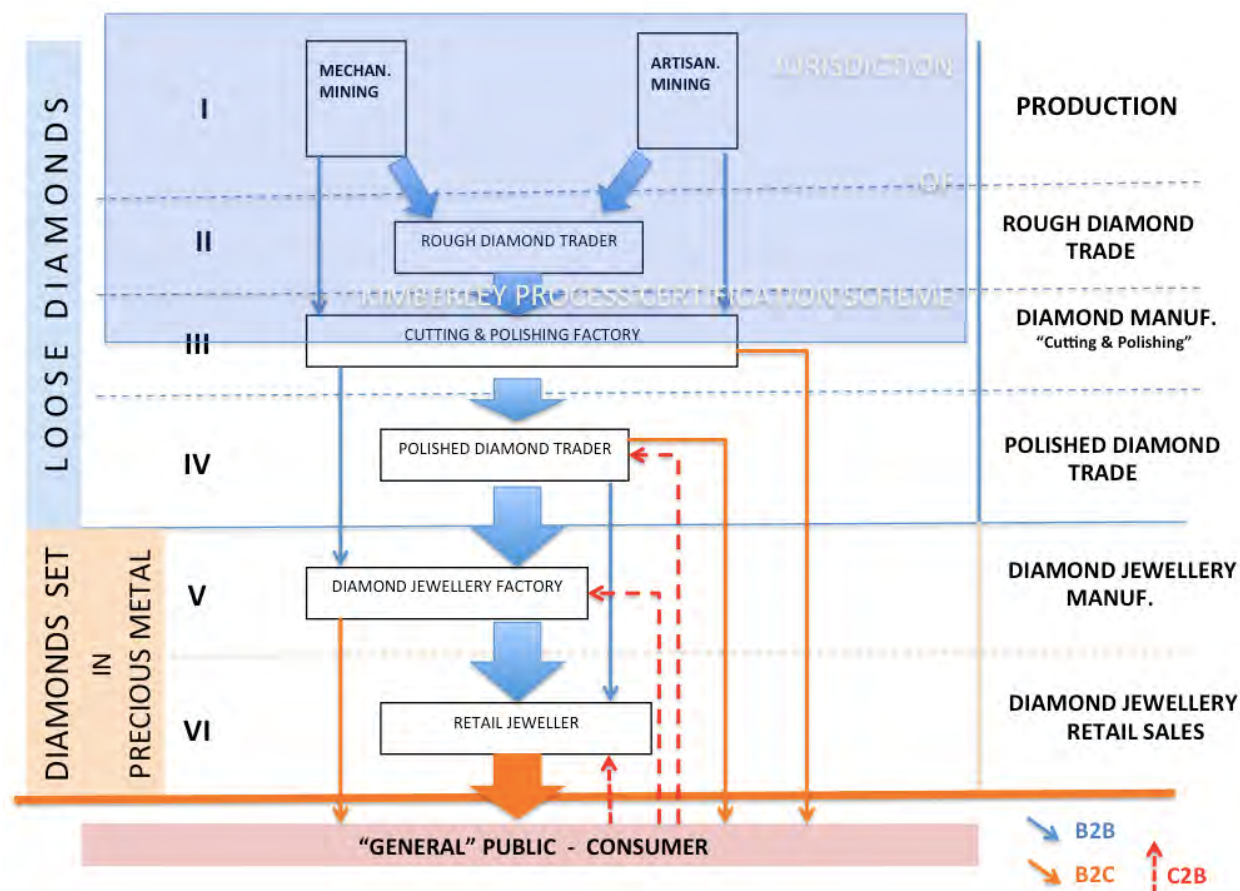


Note: This only represents this licit diamond trade.

A more complex version of the "diamond pipeline" from the post rough diamond sales step in the previous graphic, is the following version provided by industry organisations. However, even this is a far from comprehensive demonstration of the reality.

¹⁷ There is a previous stage of exploration where diamond mines are searched for. This stage precedes the trade in diamonds and therefore it is not covered in the report.

Figure 2: Diamonds distribution system



Source: Information provided by industry organisations (2013)

Within this string of transactions and processes, the diamond industry has two distinct components¹⁸:

Mining and Manufacturing, which is the segment of the industry that deals with rough diamonds and includes diamond mining through to rough diamond cutting and polishing.

Jewellery Manufacturing and Sales, which is the segments that deals in finished (cut and polished) diamonds and includes polished diamond dealing on through to jewellery retailing.

Production - The diamond industry begins with the mining of diamonds in the production segment. Generally speaking there are a few primary locations for diamond mining the world over. These are **South, Central and West Africa, Russia, Australia and Canada**¹⁹. The diamond trade in most of the African mining countries is of high economic importance accounting for a large part of the GDP and export earnings.

¹⁸ In recent years this delineation has become, to some extent, less distinct due to vertical integration of diamond trading companies and branding of diamond jewellery. In some cases even rough diamonds companies are linked to jewellery companies.

¹⁹ There are also additional locations with a small mining sector in South America. India also produces rough diamonds worth several million dollars a year.

Diamonds occur in *kimberlitic* hard rock deposits or *alluvial*/fluvial deposits. Hard rock mines are those in which a kimberlitic pipe (and occasionally lamphorite), the host rock where diamonds are found in, is blasted from the surrounding rock and crushed to release the diamonds contained within it. *Alluvial* mining is the extraction of diamonds from river bed, sea floor, or beach deposits. They are referred to as secondary sources, since the diamonds in alluvial deposits were removed from kimberlitic mines (primary source) by natural erosion. Techniques used to collect the alluvial diamonds can be divided to industrial mechanized mining when specific conditions which make alluvial industrial mining economical are met or artisanal mining which involves diggers working in teams with simple implements such as picks, shovels and sieves. According to the literature review²⁰, contributions received from some of the mining countries (Australia, Botswana, Canada, Russia Sierra Leone and Zimbabwe) and discussions conducted in the workshop held in Dakar, kimberlitic mines are smaller in terms of geographical area and are much easier to secure than alluvial mines which may spread across huge geographical area which cannot be isolated. Kimberlitic mines are also highly mechanised with strict controls, while alluvial deposits (mainly artisanal) are more difficult to control because the diamonds can be extracted without large industrial machinery²¹.

Loose / mounted diamonds

A distinction exists between *loose* and *mounted* diamonds.

Loose diamonds are cut and polished diamonds which have not yet been set in jewellery while mounted diamond is a polished diamond which was set in jewellery such as ring, watch necklace, etc. The regulation of loose and mounted diamonds are usually very different.

The next step of the production stage will be to sort and evaluate the diamonds and have them ready for sale. Sorting and valuation are done by dividing the diamonds into different groups according to their quality and value. This process will provide added value to the price of the rough diamonds. An important issue to understand is that when the report refers to diamonds, it covers a range of products. The price of a diamond, rough to polished, can vary from few tens of dollars per carat to tens of thousands of dollars per carat for a cut and polished diamond²².

Rough Diamond Trading and Sales - Diamonds recovered from mining processes are purchased by rough diamond dealers through the global diamond markets. Purchases are usually arranged through diamond bourses (although there are different methods for the purchasing of rough diamonds) in countries such as **Belgium, UK, India, Israel, and the United Arab Emirates (Dubai)**. While many of these centres are located in countries that have no diamond production themselves, their rough diamond trading industry has evolved over decades or hundreds of years. A diamond bourse or exchange is a private commercial business with membership restricted to individuals only (not companies). The bourse provides a trading floor where members and buyers

²⁰ For explanation on the difference between the two types of mines (kimberlitic and alluvial) please refer to World Diamond Council (nc). See also Diamonds A to Z (nc).

²¹ Comments from received from AWDC and information from World Diamond Council (nc).

²² See for example Pricescope (nc). See also, Evan-Zohar, C. (2004), pp. 97-98.

meet to trade in rough and polished diamonds²³. Globally there are 29 diamond bourses affiliated with the World Federation of Diamond Bourses²⁴. Other localised markets may exist in proximity to diamond mining locations, where street vendors purchase diamonds from artisanal miners. This is a vulnerable stage since it is very hard to control, as will be explained later. The diamonds are sold to regional dealers and then often to global diamond markets. The rough diamonds may be sold several times between rough diamond dealers and several diamond bourses before they are ultimately sold to a diamond cutter/polisher²⁵.

Rough Diamond Cutting and Polishing - The beauty of a diamond is realised through cutting, faceting and polishing. Cutting and polishing centres exist in several parts of the world, with major centres existing in **Belgium, India, Israel and China**. Once the diamonds are cut and polished they are ready for use in jewellery and are moved along the "pipeline" to be utilised in diamond jewellery manufacturing and sales. The transformation from a rough to a polished diamond is another vulnerable stage, as a diamond becomes much more difficult to track once it has been cut and polished²⁶. Whilst it is possible to judge when certain diamonds were polished using antiquated techniques, for the vast majority of polished diamonds on the market it is virtually impossible to ascertain when they were polished. All diamonds one might view in a shop window might not be first hand goods.

Diamonds Dealers – Once the diamonds have been cut and polished, they are ready to be sold for use in jewellery and, to a very limited but growing market, as an investment product. Diamond dealers are the first merchants of diamonds after they have been cut and polished, and often handle hundreds of millions of dollars' worth of diamonds every year. These dealers usually operate from the major diamond dealing centres of the world including **Antwerp, London²⁷, New York, Tel Aviv** and in **Dubai, India and China**. Their clients include other diamond dealers, large diamond jewellery manufacturers and diamond wholesalers.

Diamond Wholesalers – This segment of the industry deals in smaller amounts of diamonds. They often deal with specific products, such as size or quality spectrums of diamonds or diamonds with fancy cuts or patented cut styles and they are often involved in branding their diamonds. This segment of the industry usually sells to jewellery retailers, but is increasingly selling directly to the consumer.

Diamond Jewellery Manufacturers – Structurally, organisationally, and operationally the jewellery sector is quite distinct from the diamond sector. The jewellery sector also deals in gold, other precious stones, silver, platinum and a range of other raw materials. The financing and capital structure are also entirely different. Some of the larger diamond jewellery manufacturing centres now exist in Asia (**China, Chinese Taipei and Indonesia**). Jewellery is manufactured and may be

²³ Although most transactions today are conducted through diamond dealers' offices.

²⁴ World Federation of Diamond Bourses (nc).

²⁵ According to Chaim Even-Zohar the diamond goes through six to ten hands from the mine until it reaches the final customer, Evan-Zohar, C (2007b), pp 114.

²⁶ The Kimberley Process Certification Scheme (KPCS) only covers rough diamonds.

²⁷ In November 2013 De Beers will move its operations from London to Gaborone, Botswana.

sold to jewellery wholesalers and then on to jewellery retailers. Increasingly, the manufacturer is selling directly to jewellery retailers and consumers.

Jewellery Retailers – Diamond jewellery sales is the driver of the diamond industry and this occurs through retail jewellery sales. All of the processes that have previously occurred are in support of this segment of the industry. Diamond jewellery sales occur in virtually all countries of the world through brick and mortar vendors. Vendors exist as single independent stores or large corporate chains with hundreds of stores. Increasingly the internet is being utilised to market and directly sell diamonds and diamond jewellery to the consumer.

Pawn shops – polished diamonds and jewellery are also sold through pawn shops (*i.e.*, diamonds or diamond jewellery will be placed as collateral for loans extended, and only when the borrower defaults, the pawn shop owner takes possession of the collateral). Jewellery can then be resold to jewellery stores, pawn shops, lately to wholesalers, and at special fairs conducted for this purpose. Someone who wishes to sell his or her personal jewellery (in order to repay debts, sell jewellery from inheritance, etc.) can do so at these venues.

BUSINESS PRACTICES AND CHANGES IN THE DIAMOND TRADE

In many respects, the diamond and jewellery industry is not unlike any other trade industry but there are practices specific to the diamond trade. Some of these practices with relevance to AML/CFT considerations are detailed below.

Sightholders/tenders – **Sightholders**²⁸ are clients of De Beers who are authorised to buy bulk rough diamonds from the Diamond Trading Company (DTC) held by De Beers thus ensuring a steady supply of rough diamonds. Similar systems of rough diamond supply exist with other large mining diamond companies. The *tender* system is an alternative way to buy rough diamonds where bulk diamonds are offered for sale to diamond dealers through tenders. This system however is not limited to sightholders and large mining companies only; it allows ‘smaller’ rough diamond traders to sell their diamonds in a secure and controlled environment.²⁹

Payment methods - Common to the diamond industry is a cash remittance system that is historically-based. Diamond sales at virtually all levels of the market function were made on cash purchases. Nonetheless, while acceptance of cash is still common, this practice has subsided in recent times and modern forms of remittance such as wired funds or credit systems are becoming more prevalent, even in cash based economies such as India and Namibia³⁰.

Trust – the diamond industry has always functioned on the basis of trust. Million dollar deals are sealed with a handshake. There is an accepted code of conduct and internal arbitration system. Rough or polished stones worth millions of dollars may be sent to another dealer for consignment without a written contract. For example, the owner of the stones will trust that a consignee will

²⁸ See Diamonds A to Z (nc).

²⁹ For example: Antwerp World Diamond Centre (nc).

³⁰ The limited use of cash in these jurisdictions is based on the reply to the collection plan submitted by India and Namibia.

transfer the correct payment upon selling or otherwise return the exact same stones. Consultations conducted with the WFDB revealed that a breach of this trust would ruin the diamond dealer's reputation³¹ and consequently end his career.

Memo transactions - A practice that continues to be used in the diamond industry is the lending of a diamond or a mix of diamonds to others in the diamond industry so that they may have the opportunity to sell them – this is known as a “memo transaction.” Under this arrangement, the conditions of the loan are specified, including for how long the diamond will be lent, the price of the diamond, and the terms of remittance to the owner if the diamond is sold. The vendor who has the diamond on memo may sell the diamond at a mark-up and then pay the owner in the time and amount specified by the memo. Sometimes the vendor that has the diamond on memo may lend it to another vendor on another memo. Some issues have arisen in the industry around the use of memos, including fraud. There have also been questions around who is responsible for reporting the sale of the diamond under ML reporting requirements (the owner or the seller). In addition, there have been cases in which the diamonds on memo have been sold, but the seller refuses to pay. This would be considered an outright conversion theft.

Related to the use of memos and ownership of diamonds is the variance in inventory practices at different levels of the industry and in different regions of the world. Generally speaking, while diamonds may be counted as individual units, they can also be accounted for by weight. For example, one carat of diamond could be a single one carat stone or 100 diamonds of 0.01 carat each (the per carat valuation is what will distinguish the two parcels in this case, as the one carat diamond may sell for USD 4 000/carat, whereas the 0.01 carat diamonds may only sell for USD 500/carat). While each stone has been weighed, the inventory, which has implications on the profit and hence on tax paid to the tax authority, may be registered differently, *i.e.*, some inventory practices may record diamonds by piece, others may do so by weight. This leaves room for manipulation and “playing” with tax reports, making it difficult for tax authorities to verify the level of inventory on the date of reporting, thus also allowing for manipulation of profit and income tax.

It is also common to negotiate a final price for a diamond. While there are industry suggested prices for a given quality of diamond they are in fact only guidelines, *i.e.*, a starting point from which the negotiation of the final price begins.

Special expertise - Training in gemmology requires a unique skill set, or, at the very least, industry experience. As a result those who enter the jewellery industry or trade are often those whose family is already in the industry, and through whom they can learn the business and garner the necessary experience to succeed. The independent jeweller must be a business person with savvy market-specific knowledge, keen gemmology skills (that need to be constantly upgraded), and, perhaps most importantly, industry contacts to acquire product to sell. Similarly, each level of the industry requires its own specific training, and this knowledge is only learnt through experience in the industry itself.³²

³¹ See Even-Zohar, C. (2004), *pp.* 35; and Siegel, D. (2009), *pp.* chapter 4.

³² Rough diamond sorting and diamond grading of polished diamonds are regularly offered at specialized training institutes throughout the world. Well-known institutes include the Gemmological Institute of

This makes it very difficult for a person to enter the jewellery and diamond trade, as the experience required and practical market knowledge is not readily available³³. For example, in order to become a diamond bourse member, it may be necessary to be in the business for several years and to be recommended by an existing bourse member³⁴. These barriers to entry, including with regard to obtaining product from wholesalers, has made it possible for the diamond industry to protect itself from criminals infiltrating the trade. This is especially the case in countries where special 'license' needs to be obtained from the government in order to become a diamond dealer. In the past, one would receive a referral to a wholesaler from an established jeweller and then obtain an account with the wholesaler to purchase products. Once a few accounts had been set up and business arrangements with diamond/jewellery wholesalers made, these accounts could be leveraged to establish one's legitimacy as a jewellery business. However, without the initial referral from someone already in the business and the subsequently use of primary suppliers to obtain accounts with others, it was virtually impossible to become established.

Some families have been in the diamond business for several generations and have developed strong alliances and networks over time. The involvement of both religious and ethnic groups is very much a reflection of the industry's history, although, in recent times, there has been a shift in the geographic concentration of the diamond trade. This is more of a phenomenon of the finished diamond sector, particularly with respect to the wholesaler to the retailer end of the business.

So far, the overview of the diamond trade has discussed the various levels of the diamond market, presenting a simplified view of the supply chain from mine to consumer. It is important to understand that the processes of mining, the trading of rough diamonds, and even the processes of cutting and polishing diamonds may differ from country to country³⁵. In addition, these processes have been subject to market forces and regulatory changes in the last 20 years that are creating new paths for bringing diamonds from mine to market.

While some of the market changes are having a dramatic effect on business practices the world over, these changes may be both positive for the relevant jurisdiction, but may also entail a shift in the level of risk posed by the diamonds industry. The following sections discuss changes in the diamond trade.

De Beers no longer holds a monopoly³⁶ - up until the 1980s, the rough diamond supply was controlled largely by De Beers through their African holdings. While there were a few other sources of diamonds, including from Russia, this control amounted to a market monopoly. With the emergence of a more open market for global rough diamond sales, a number of international

America in New York and Carlsbad (Calif.), the HRD Antwerp –Institute of Gemmology and the International Gemmological Institute in Antwerp, Hong Kong and Mumbai.

³³ See Even-Zohar, C. (2004), *pp.* 35 – "A closed industry guild with a high entry barriers".

³⁴ This is the one of the rules set up by the WFDB for all its members.

³⁵ Differences may lay in the type of mine (alluvial or kimberlitic, closed or open pit), in the manner in which the rough diamonds are distributed from the mine to the rough market, in the level of local beneficiation, in the level of regulation and control over the mining, rough or polished trade, etc.

³⁶ For a discussion on the change in the role of De Beers in the rough trade see Bain & Company (2011), *pp.* 11 "Expansion of rough-diamond sales channels".

diamond companies, such as Alrosa, BHP Billiton, Harry Winston, and Rio Tinto, increased their involvement, and Russia, Canada, and Australia have become major producers. In the past 20 - 30 years, many companies have chosen their own path for bringing rough diamonds to market instead of selling them to De Beers. It is expected that with the increasing diversity of supply, an equally diverse rough diamond trading market will follow. However, the more the market opens up for new actors, the greater the risk that money launderers will abuse the trade, potentially requiring greater oversight of the industry.

De Beers rough trade moves from London/Antwerp to Gaborone - Up to now, the rough diamond trade was mainly channelled through Europe where De Beers sorted and sold its rough diamonds from London. After an eight years transition period, from November 2013, all the sorting and selling of the global De Beers rough diamond production will have been relocated to Gaborone, Botswana, which is expected to become a major rough diamond “transit trading centre” and, in many respects, play the role hitherto played by Belgium and, to a lesser extent, Israel. Over a hundred rough diamond clients (“sightholders”) of De Beers will now travel to Botswana to make their rough diamond purchases. The Botswana banking system may become recipient of some USD 6 billion of inward remittance from these sales alone. This is expected to draw new banking and trading actors to the diamond industry and the trading pattern may significantly change in the years ahead.

Beneficiation – Beneficiation covers the manufacturing of polished diamonds and the creation of diamond-set jewellery. In recent years, African mining countries have been focussing on local diamond beneficiation to sustain employment in the industry and to generate additional added values. As a result, traditional diamond producing countries are increasingly setting up domestic cutting and polishing centres to expand their involvement in the diamond supply chain³⁷. The move of De Beers to Botswana means that a significant part of diamond beneficiation will move to southern Africa – mostly Botswana, South Africa, and Namibia. This is expected to have a spill over effect on neighbouring countries which are major diamond producers in their own right, such as Angola, Zimbabwe and the Democratic Republic of Congo (DRC) which may follow suit and develop their own beneficiation. This trend may have significance in terms of ML/TF which will be discussed further in the section referring to vulnerabilities of the rough trading stage.

New trading centres³⁸ - New diamond trading centres in **China, India, and the United Arab Emirates (Dubai)**, among others, have emerged alongside the traditional **trades centres** - The diversity in rough diamond dealers and increasing supply from multiple sources has afforded opportunity for new rough and finished diamond dealing centres to emerge and historical diamond centres are being challenged by these new diamond centres. The United Arab Emirates has become a 40 billion USD free trade zone trade market. India, and to a lesser extent China, became the major cutting and polishing centres with trade amounting to many billions of dollars. Smaller trade

³⁷ See for example De Beers (nc).

³⁸ For discussions on the new and traditional trade centres see Even-Zohar, C. (2007b), which provides an extensive survey of the different jurisdictions involved in the diamond trade. A short review of the trade centres of Antwerp (Belgium), Ramat-Gan (Israel) and Dubai (the United Arab Emirates) is provided in Siegel, D (2009), chapter 5.

centres like Panama, have also recently emerged with a view to serving South America. The emergence of these new centres is primarily a function of the aforementioned supply chain shift, and also reflects the changing tax and regulatory environments. In addition, increasing consumption of diamonds in some of these markets has drawn many diamond manufacturers (cutters / polishers) to these new centres. New trade centres should be aware of the ML/TF risks this shift might entail.

Industry regulation - Kimberley process - There have been some dramatic changes in the regulation of the industry in the past ten years, primarily through the implementation of the Kimberley Process Certification Scheme (KPCS) for rough diamonds. The Kimberley Process (KP) is a voluntary export/import control regime, supported by the United Nations, and focussed on stopping the illicit trade in rough diamonds to finance armed conflict (*i.e.*, the use of rough diamonds as an alternate currency used mainly to by weapons). It is not an international legally enforceable agreement, and its compliance flows from the national implementation legislation in participating countries. From an AML/CFT perspective what is important to note here is that the KPCS does not deal with ML or with TF activities and is limited to rough diamonds only. Thus polished diamonds are not covered by the KPCS as it is assumed that all polished diamonds come from KP Certificated rough diamonds.

The KP does not include all countries. Only 81 countries currently participate in the KP (including 28 countries of the EU).

AML/CFT legislation - In the last 10 – 15 years, diamonds and precious metals have been recognised as vehicles for laundering the proceeds of crime. To deal with this issue, Governments have implemented or amended their ML legislation to include diamonds. Some countries have been quick to implement AML/CFT regulatory controls on this commodity and industry.

Industry efforts - the various entities within the diamond industry on both national and international level have made efforts to counter ML and TF risks. This includes the issuance of AML guidance, participation in FATF consultative forums and industry seminars, establishing the Responsible Jewellers³⁹ Council, De Beers' publication of their Best Practice Principles (BPPs) which De Beers, their joint venture partners, contractors and Sightholders all subscribe to, and the industry's System of Warranties which seeks to complement the Kimberley Process Certification Scheme further down the value chain, including the trade in polished and the jewellery retail sector.

Use of the internet as a trade platform - On the wholesale and retail side of the diamond supply chain, the internet has been a driver for bringing dealers and sellers closer to consumers while squeezing out many intermediaries. In recent years there has been a flattening of the chain of participants that bring diamonds from the producer to the retailer. However, the greatest flattening has been observed in the polished diamond market, especially in the mid-market level involving diamond wholesalers. Diamond dealers who would traditionally sell their products through to diamond wholesalers are increasingly selling them through to the diamond retailer. Similarly, diamond wholesalers, who would traditionally sell diamonds to the retailer, are now offering them up direct to the consumer through the internet and by-passing the retailer. The practicality of

³⁹ Responsible Jewellers Council (2009).

offering diamonds through the internet is enhanced by third-party diamond grading certification, as well as cost-effective and efficient courier services (such as FedEx and UPS).

The trade platforms on the internet web site are mainly *Business to Business* (B2B) but *Business to Customer* (B2C) websites also exist. Both **rough** and polished diamonds are offered for sale. Payment means vary from bank transfers and credit cards, as well as checks and money orders, to internet payment systems such as PayPal. Platforms like eBay also enable this direct trade in diamonds, which can amount to millions of USD for polished diamonds. These practices raise challenges for a diamond dealer selling his or her product (both rough and polished diamonds) on how to conduct *Know your customer/ Customer Due Diligence/Enhanced due diligence* procedures to either business or private customers. How are the ML/TF vulnerabilities of the trade mitigated when business is conducted through the internet? How is it possible to trade in rough stones via the internet? ⁴⁰ How is a Kimberley certificate issued in this case and how can a buyer establish the value of a rough stone without physically verifying its value⁴¹?

Rough diamonds are offered regularly on the internet at discount prices. Several fraud cases reported by Belgium in their collection plan were conducted through the internet. The exchange of cash for fraudulent diamonds took place in a remote unpopulated place. Exchanges are often arranged in Africa or close to locations of the diamond trade in Europe, and the means of payment and the inspection of the goods take place under quite tight timelines and in remote places. Such deals may be accompanied by dubious certificates of origin, inaccurate evaluations or lack of evaluation by an expert and sometimes without proper documentation.

Recycled market - Recycling of diamonds that have been previously used in jewellery encompasses a huge secondary market estimated to be in the billions of dollars globally. This is a rather unique feature of this industry as the commodities do not need to undergo any preparation for return to the market; the diamonds may simply be inserted into new jewellery or sold as an investment diamond. The WFDB commented that it is estimated that the world probably has about 0.75 – 1 trillion USD of polished diamonds at current prices (or about 1 – 1.5 billion carats) in consumer hands⁴². About 40-50% of these would be held in America. Recycled diamonds are generally being recut to meet today's consumer preferences. This recutting is mostly done in the United States (for expensive goods), or India.

Investments in diamonds – One jurisdiction highlighted this activity as a growing phenomenon. Websites offering diamonds for sale as an investment demonstrate how the dramatic rise in the price of diamonds over the last decade has resulted in them becoming a possible investment tool.

⁴⁰ The fact that buying a rough diamond through the internet is problematic in terms of establishing the price was raised in a consultation conducted with the WFDB. In additional consultation with diamond experts it was stated that whilst it is possible to buy rough on the internet no diamond professional would purchase rough diamonds without seeing them first unless they were buying from an LSM (*i.e.*, De Beers, Rio Tinto, etc.) and often then a viewing will take place. If a seller over the internet is not known and offers rough stones that should be an immediate red flag.

⁴¹ In 2010 and 2011, the KP discussed at length the problems associated with the internet-trading of rough diamonds. It became clear that most of this trade was B2C instead of B2B.

⁴² Estimated by "Tacy Ltd".

While it is not possible to determine the amount of investment in the industry, the larger the investments, the easier it would be to commingle funds from non-trade sources.

Synthetic diamonds - Another important change to the diamond market has been the emergence of synthetic and treated diamonds on the retail diamond market. While these man-made cousins of natural diamonds were not included in the typology review, it is important to provide a brief overview of them here. Synthetic diamonds are made of the same composition as natural diamonds (aside from some slight atomic differentiations); the fundamental difference is that synthetic diamonds are made in a factory. The quality of the synthetic diamonds and number of methods to create them has improved tremendously over the past decade and they are being sold commercially within the diamond industry. In addition, diamonds that were once considered unsuitable for commercial jewellery use are now being treated with different processes to enhance their colour or clarity. While the project has not examined synthetic or treated diamonds in respect of laundering proceeds of crime, the use of these types of diamonds in cases of fraud has been recorded⁴³. Moreover, the use of synthetics substituted for real diamonds in relation to commodity-based ML should not be underestimated. What further muddles this issue is that there is no common international nomenclature for synthetic or treated diamonds. Some legislation may refer to diamonds or natural diamonds without making distinctions between, or allocations for, synthetic or treated diamonds. Since the quality of synthetic diamonds has improved, it is important to keep in mind that the vulnerabilities and typologies identified for the trade in natural diamonds may also be relevant for synthetic ones. As the trade in synthetic diamonds expands the risks posed by the trade in this type of diamonds will grow. It was noted in the private sector consultations that as the number of diamonds available to be mined decreases, synthetic diamonds may become more of an issue. Also of importance is the fact that in most if not all cases synthetic diamonds are not part of AML/CFT legislation, although the vulnerabilities may be similar.

OVERVIEW OF DIAMONDS AND MONEY LAUNDERING AND TERRORIST FINANCING

That this report has highlighted the different and unique characteristics of diamonds and the diamond trade which make the industry vulnerable to ML and TF activities should not be taken to mean that the industry is more vulnerable relative to others. Nonetheless, it is important to keep in mind that the complexity of the international diamond trade means that the ML and TF vulnerabilities and risks may differ from one segment of the "pipeline" to another and from one jurisdiction to another.

Beyond more conventional cases of ML, including the laundering of the proceeds of crime and the generation of criminal profits, some research⁴⁴ has shed light on the use of diamonds and diamond jewellery as an alternate currency by criminals. This is particularly notable in the case of diamonds used by criminal enterprises engaged in drug trafficking, (*i.e.*, the trade of diamonds for drugs).

⁴³ See for example Flanders News (2012) where it was said that "The quality of synthetic or man-made diamonds is so good, that even experienced diamond dealers can't tell real from fake ones". See also JCK (2012).

⁴⁴ Nelson, D., Collins, L. & Gant, F. (2002).

Diamonds are also used by such criminals for wealth movement, storage and preservation, and use as a status symbol.

It is useful to make a distinction between ML through the diamonds trade and laundering diamond proceeds of crime. The first type of activity is where a criminal will launder cash or other payment means acquired through predicate offences he commits⁴⁵ by placing and layering through the diamonds trade. This can be done by conducting transactions with the proceeds of crime as if they were trade in diamonds where in fact the diamonds trade will only be used to transfer funds from one account to another, whether locally or internationally, or by purchasing diamonds with cash proceeds of crime and then selling the diamonds to obtain cash at a later date or a different location. The second type of activity is where illicit diamonds (e.g. stolen/robbed diamonds, or diamonds received as a form of payment for drugs) will be laundered by selling or trading the diamonds, by cutting/re-cutting and polishing the illicit diamonds etc.' so as to conceal their illicit source. In both cases the criminal has laundered proceeds of crime, but only in the former case we can formally speak about ML as such, i.e. money which is laundered through the trade. The diamond industry is a perfect example where both can occur.

This distinction may be lost among law enforcement practitioners, intelligence officers and industry representatives, who almost exclusively refer to ML as encompassing all processes related to the proceeds of crimes involving diamonds. However, with respect to the development of typologies, this distinction is very important, especially as it relates to the use of diamonds as alternate currencies and in remittance systems used by criminals. For example, Pablo Escobar laundering drug profits through jewellery stores in a massive ML scheme⁴⁶. And in 2003, USD 150 million worth of diamonds were stolen from a central diamond vault in a single theft event⁴⁷. In this case, selling the diamonds is profiting from the proceeds of crime. Both cases utilised the diamond market.

TF can involve the use of unlawfully and lawfully provided funds to finance terrorism activities. Diamonds could therefore be used to finance terrorism in a scenario where a donor or financier purchases diamonds legitimately, using lawfully derived funds, and then transfers the diamonds to a terrorist or terrorist organisation who use the diamonds in exchange for equipment or cash intending to finance terrorist activities.

Buying and selling diamonds within rough and polished diamond markets is critical to understanding the vulnerabilities of the criminal use of diamonds, it is important to discuss the diamond and jewellery cycles. Diamonds are often reintroduced to the diamond market to be resold. The sale and resale of diamonds within the national and international diamond industry is a function of the diamond and jewellery cycle, which in turn provides an opportunity for laundering proceeds of crime. Illicit funds that are generated can be hidden, moved and entered into financial institutions or traded for other tangible assets within the diamond and jewellery cycle. The

⁴⁵ These may be predicate offences not connected to the diamond trade, i.e., drug trafficking, fraud, weapons trade, etc.'.

⁴⁶ Robinson, J. (2003).

⁴⁷ See The New York Times (2013).

diamond industry may be a stepping stone for criminals who utilize these commodities to enter illicit funds into the banking system, whether in their own or in an offshore jurisdiction.

This cycle is rather unique for commodities (although it also applies to precious metals and gemstones, to some extent), especially as the diamond remains in the same form from the time that it first enters the market after being cut and polished. The simplicity and ease with which diamonds can be purchased and sold, and the special characteristics of these precious stones, provides tremendous opportunity to exploit the commodity and the industry with regard to the laundering of the proceeds of crime.

In summary, the diamond supply chain at all of its stages, from production to consumption, can be the gateway to profitability, for laundering proceeds of crime, for ML or TF and for moving proceeds of crime into the financial system.

THE DIAMOND TRADE IN NUMBERS

The purpose of this section of the report is to give the reader unfamiliar with the diamond trade information on all its facets a rough idea as to the volume of the different parts of the trade (rough, polished and jewellery manufacturing levels) and to draw some inferences from available trade data.

ROUGH DIAMOND TRADE

The KP publishes annual statistics on the rough diamond trade, which include the annual volume in carat and the annual value in USD. The information is published on the KP website with respect to each of the member countries and includes data on: rough diamond production, import and export; the average price per carat⁴⁸ for both import and export; and the number of certificates issued within each jurisdiction⁴⁹. These statistics provide a very general picture of the leading countries at each level of the rough "diamond pipeline" and the overall volume and value of the global rough diamond trade.

What is important to remember is that The KP data does not capture the entire global production. These figures exclude trade within the EU (*i.e.*, between the United Kingdom and Belgium for which no certificates are required) or internal trades on local markets. There are some suspended or sanctioned countries whose production is not recorded. In quite a few instances the production values are not correctly reported. Smuggling is still taking place, and those diamonds do somehow end up in the diamond pipeline. The Kimberley system figures should be viewed as indicative only.

The KPCS was not designed to curb ML/TF activity; it was designed to put an end to the trade in conflict diamonds. While it is not possible to draw firm conclusions based on these statistics some

⁴⁸ The average price per carat is also published for each member state on the KP web site.

⁴⁹ KPCS rough diamond public statistics area, https://kimberleyprocessstatistics.org/public_statistics. Additional statistics as to the country to country rough diamond trade are not published, but may provide a more deeper understanding of the rough diamond trade and may point to additional ML/TF issues and concerns.

indication of ML/TF activity related to rough diamond trade are provided by this information which should be addressed by participants of the KP.

DIAMOND PRODUCTION COUNTRIES

Mining activity takes place across different geographic areas around the world. The figures below provide some information on mining countries at the first level of the "diamond pipeline", i.e. supplying rough diamonds which will eventually be manufactured into jewellery. Rough diamond production is spread across different geographical areas around the world but almost 80% of the total rough diamond production is concentrated in 5 countries.

Figure 3: Countries of rough diamond production

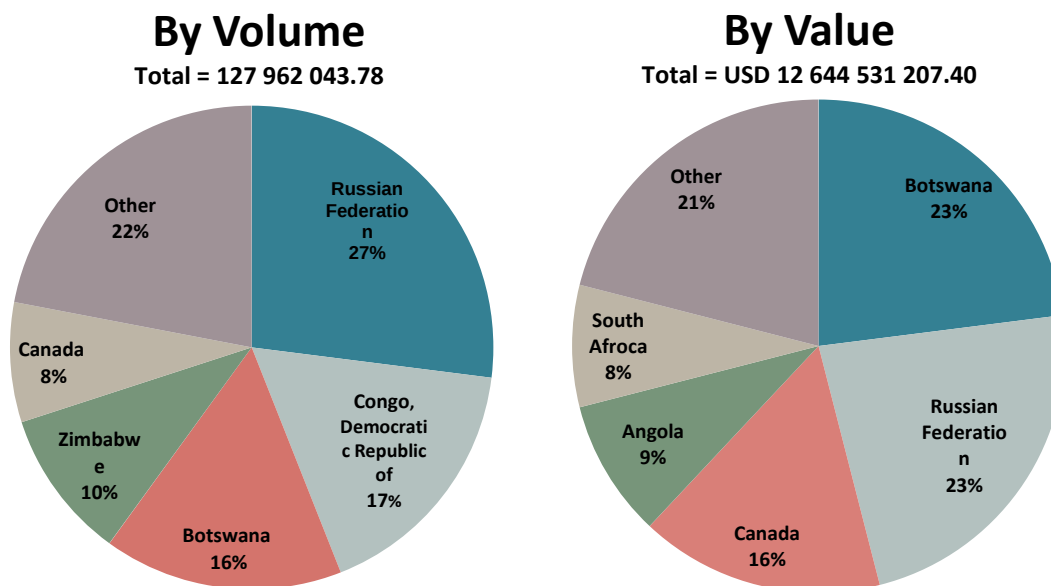


Source: www.info-diamond.com⁵⁰

Note: Lesotho, Guyana, Togo, Cameroon, Congo (Brazzaville) and Indonesia are also producers of rough diamonds. At the moment there is a total UN embargo on the import of diamonds from Côte d'Ivoire, and a KPCS "embargo" on diamonds from Venezuela and Central African Republic.

⁵⁰ www.info-diamond.com/rough/map.html#prettyPhoto/0/.

Figure 4: Countries of rough diamond production – 2012 Production



Source: Kimberly Process Certification Scheme

According to the KP statistics for 2012, the total volume of production of rough diamonds was close to 128 million⁵¹ carats, amounting to a total value was over USD 12.6 billion⁵². However, imports and exports of rough diamonds have reached USD 50.92 billion and USD 50.27 billion respectively. The volume of export and imports are much higher than the volume of production since rough diamonds go through many several "industry actors" in several trade and polishing centres before they are cut and polished. Mining countries may also stockpile production. The production, export and import figures of the major diamond producing countries (in terms of volume and value) are included in table below:

⁵¹ 127 962 043.78 carats.

⁵² USD 12 644 531 207.40.

Table 1: **Production, Exports and Import of rough diamonds in major Producing countries – 2012**

Country name	Production		Import		Export	
	Volume (Carats, Carat (Millions))	Value (Billions of USD)	Volume (Carats, Carat (Millions))	Value (Billions of USD)	Volume (Carats, Carat (Millions))	Value (Billions of USD)
Botswana	20.55	2.98	7.49	2.14	23.35	3.99
Russian Federation	34.93	2.87	0.14	0.15	29.81	3.90
Canada	10.45	2.01	0.76	0.16	11.12	2.16
Angola	8.33	1.11	0	0	9.20	1.15
South Africa	7.08	1.03	11.47	1.08	8.01	1.36
Namibia	1.60	0.90	0.13	0.16	1.68	0.98
Zimbabwe	12.06	0.64	0	0	14.96	0.74
DRC	21.52	0.18	0	0	19.56	0.26

Source: KP statistics⁵³

As can be seen in the table above, Botswana is currently the largest producing country in terms of value, (USD) and the Russian federation is the biggest producer in terms of volume (carat). Most of the production is exported to trading centres and then onwards to polishing and cutting centres. Botswana and South Africa are also significant importers of rough diamonds of very high volumes. The Russian Federation's exports amount to almost a billion dollars more than the value of its production. This raises a question as to the source of the diamonds exported. Since the volume in terms of carat is almost the same, this means that the average price of diamonds exported is much higher than those which were mined.

There are additional countries producing from just a few million dollars to several hundred millions dollars in diamonds (Australia, Brazil, Central African Republic, Congo, Ghana, Guinea, Guyana, India, Lesotho, Liberia, Sierra Leone and Tanzania). The Democratic Republic of Congo is the second largest producer in terms of volume (carat). Diamond mines also exist in Venezuela, but according to the KP statistics, the country has voluntarily suspended exports and imports of rough diamonds in 2008 and until further notice. However, reports exist that suggest that mining in Venezuela continues and the rough diamonds are smuggled out of the country⁵⁴.

⁵³ Data from KP web site for the year 2012 (statistics are provided on the web site from year 2004) - Kimberly Process (2012).

⁵⁴ See Time (2012).

DIAMOND TRADE CENTRES

Table 2: Production, Exports and Import of rough diamonds in major trade centres – 2012

	Production		Import		Export	
Country name	Volume (Carats, Carat (Millions))	Value (Billions of USD)	Volume (Carats, Carat (Millions))	Value (Billions of USD)	Volume (Carats, Carat (Millions))	Value (Billions of USD)
European community	0	0	124.80	16.79	126.80	17.81
Israel	0	0	13.27	4.66	13.79	3.61
Switzerland	0	0	8.68	1.99	8.88	2.29
United Arab Emirates	0	0	59.74	4.56	60.44	6.82
United States	0	0	3.49	0.48	1.45	0.40

Source: KP statistics⁵⁵

In 2012 the main trade centres for rough diamond were Belgium, Israel, Switzerland and the United Arab Emirates. Belgium is the largest trade centre with a USD 34.6 billion rough diamond industry followed by the United Arab Emirates (USD 11.38 billion) and Israel (USD 8.27 billion). The role of rough diamonds trade centres is to provide the link between mining countries and polishing centres and provide the supply needed by cutters and polishers who produce polished diamonds. What stands out from the figures in the table above is the role played by the United Arab Emirates, and its significance in terms of the world-wide trade. The volumes (carat) imported to and exported from the United Arab Emirates are almost the same and stand at around 60 million carats. However the value of the exported rough diamond and the average price per carat is almost 50% higher than the value of imported rough diamonds. For 2011, the average price per carat for export in the United Arab Emirates is 74% higher than the average price per carat on import. These are the same rough stones going in and out only they are sold at a much higher price, an increase that perhaps includes more than the entire production chain mark-up. A small part of the difference may be explained by 'sorting' which may produce 10–15 % mark up. Since the United Arab Emirates is not a polishing centre the added value for the diamonds going in and out of the country is unclear and would merit further investigation⁵⁶.

⁵⁵ Kimberly Process (2012)

⁵⁶ Earlier research has been done on the situation in Dubai. See Even-Zohar, C. (2004), chapter six, for a discussion on transfer pricing with reference to Dubai and FTZs. In particular Even-Zohar states that "In essence, diamond multinationals will channel their rough diamond purchases ... through Dubai. Often, the parcels are not even opened and, after re-invoicing, are shipped to the final destination, often Belgium, India or far-east cutting centres. The invoice will inevitably provide a higher figure ... As a result, the local company produces a profit – which is a purely paper profit, because it generally remain a transaction between affiliated companies" (Ibid, pp. 101).

CUTTING & POLISHING CENTRES

Table 3: **Production, Exports and Import in major cutting & polishing countries – 2012**

	Production		Import		Export	
Country name	Carat (Millions)	Volume (Billions of USD)	Carat (Millions)	Volume (Billions of USD)	Carat (Millions)	Volume (Billions of USD)
India	0	0	151.87	14.88	34.44	1.80
China	0	0	21.14	2.73	15.00	1.66
Thailand	0	0	0.87	0.40	0.40	0.15

Source: KP statistics⁵⁷

Most of the cutting and polishing is done today in India⁵⁸. China has also become in recent years a major cutting and polishing centre. The traditional polishing centres were Belgium, Israel and the US (see KP data in the tables above), much of the polishing and cutting has recently moved to the Far East. Additionally, African countries such as Botswana and South Africa have invested in developing the local beneficiation industry and are becoming to some extent cutting and polishing centres. Smaller manufacturing operations are located in Angola, Armenia, Brazil, Democratic Republic of Congo, Mauritius, Namibia, Russia, Sri Lanka and Thailand.

Changes in export/import to production ratio – in the last 5 years the ratio between the volumes in USD of rough diamonds export to rough diamond production⁵⁹ has risen by 33%. During the same period of time the rate of export to production in terms of volume (carat) has gone up by 27.3%. Compared to 2008, the same stones are exported and then re-exported more times than five years ago and at a higher price per carat than the price of carat at the production level. The diamonds are going through additional "hands". In terms of ML/TF this may be an indication that there are more "circular transactions" in diamonds (and correspondently in financial transactions conducted through financial institutions supporting the trade, mainly banks) which might be a result from ML or TF activity. It is not within the scope of this project to analyse the reasons for this additional circular trade, but this should be a reason for concern for importing and exporting countries.

⁵⁷ Kimberly Process (2012)

⁵⁸ According to open source information India accounts today for more than 90% of cutting and polishing of rough diamonds (by volume), e.g., Bain & Company (2011), pp. 45, "Before the recent recession, Indian craftspeople cut 14 out of 15 diamonds worldwide" and Even-Zohar, C. (2013).

⁵⁹ The export and import are almost identical in terms of both value in USD and volume in carat since the same diamonds which are exported are also imported in another KP member state.

Table 4: **Rough diamonds export/import to production ration for 2008 - 2012**

	2008	2009	2010	2011	2012
Export/import ratio (value, USD)	3.04	3.03	3.29	3.63	4.02
Export/import ratio (volume, carat)	2.49	2.64	3.22	3.14	3.17

Based on KP statistics

Illegal trade – the KP statistics account only for the legitimate trade between KP member states. While team members have indicated that illegal trade is taking place, there is no source of data to evaluate the extent of such trade making it hard to establish the overall global volumes of rough diamond trading. Cases provided by team members or from open source show that **smuggling accounts for a large portion of the illegal activity**, indicating that the illegal trade in diamonds is very significant. The following countries have either provided cases involving smuggling and/or indicated that smuggling of diamonds occur within their jurisdiction: Belgium, Canada, Israel, Netherland, Russia, South Africa, Sierra Leone, United Kingdom, and United States of America.

The illegal diamond trade can be divided as follows:

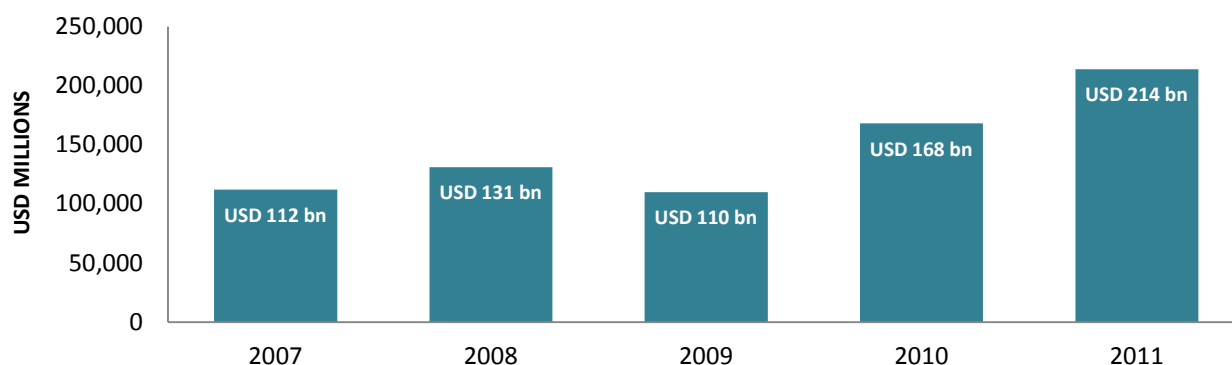
1. **Illegal mining** which takes place in mining countries. The illicit diamonds will then be either inserted to the trade of a local mine or smuggled to a neighbouring country with a mining industry and then commingled with the produce of a legal mine.
2. **Stolen diamonds** which are inserted to the legal trade as a laundering method (for example, it is estimated by DeBeers that USD 100 million is stolen from them annually).

From an AML/CFT perspective the illegal diamond trade may also be used for ML/TF purposes.

POLISHED DIAMOND TRADE

In order to further understand the volume of the diamond trade and the leading countries involved in it, one must also look at the trade in polished diamonds. The polished diamond trade refers to trade in *loose* diamonds after they have been transformed from rough diamonds through cutting and polishing. As the chart below shows, the volume of trade in polished stones is much larger than the trade in rough stones amounting to approximately USD 214 Billion⁶⁰.

⁶⁰ These figures include also movement of diamonds, such as memo transactions where in many instances the diamonds do not change ownership and are returned to the diamond dealer or when the diamonds are sent for appraisal.

Figure 5: **World Polished Diamonds Trade**

Source: www.diamondshades.com

The charts show a significant development in the traded value of diamonds during 2007-2011. There is one exception, the financial crisis in 2008-2009 which resulted in a shortage of rough stones as the volume in carat weight declined sharply. The general trend is a development of the extracted value by strides and jumps. There appears to be a significantly disproportionate ratio between the turnover of polished diamonds and the traded turnover of rough diamonds. This may be attributed to higher prices of polished diamonds, since the real added value in the phase of the transfer of diamonds from rough and uncut stones to polished gems is relatively small. Although not indicated, this may also be attributed to an inclusion of return shipments of polished diamonds, where polished diamonds are sent for inspection by a customer while some of the diamonds are returned to the diamond dealer.

The US is today the largest consumer market for diamond jewellery. There is also a significant polished diamond trade in China; Hong-Kong, China; India; Japan and the Persian Gulf. Trade centres such as Belgium, Israel and the United Arab Emirates also see high volumes of trade in polished diamonds with turnover reaching USD 28.67 billion in Belgium, USD 12.88 billion in Israel and USD 29.73 billion in the United Arab Emirates (for the year 2011). Finally, cutting and polishing centres also account for a large portion of the trade, with USD 47.25 billion in India and USD 4.7 billion in China⁶¹.

JEWELLERY MANUFACTURING

At the last stage, jewellery manufacturing hold an additional large portion of the trade in volumes amounting to tens of billions of USD annually. The US is considered to be the largest consumer market for diamond jewellery with volumes amounting to billions of USD. India is one of the major manufacturing countries of diamond jewellery with volumes reaching a few tens of billions of USD. Jewellery manufacturing is also conducted in countries like China, Thailand and in western Europe. Some of the manufacturing is made by large international chain store companies where manufacturing can reach several billion USD.

⁶¹ For statistics see Diamond Shades (n.c.).

CHAPTER 3.

REGULATION AND LEGISLATION RELATING TO DIAMOND DEALERS AND CROSS-BORDER TRANSPORTATION OF DIAMONDS AND CURRENCY RELATED TO THE TRADE IN DIAMONDS

FATF STANDARDS

FATF STANDARDS RELATED TO DESIGNATED NON-FINANCIAL BUSINESSES AND PROFESSIONS

In 2008, FATF adopted a Risk-Based Approach Guidance document for dealers in precious metals and stones⁶². The guidance supported the development of a common understanding of what a risk-based approach involves, to outline the high-level principles involved in applying a risk-based approach and to indicate good practice in the design and implementation of an effective risk-based approach. In the guidance, the term ‘dealer’ encompasses a wide range of persons engaged in these businesses:

- Those who produce precious metals or precious stones at mining operations.
- Intermediate buyers and brokers.
- Precious stone cutters and polishers and precious metal refiners.
- Jewellery manufacturers who use precious metals and precious stones.
- Retail sellers to the public, and buyers and sellers in the secondary and scrap markets.

In addition to financial institutions, the FATF Recommendations⁶³ also cover a number of Designated Non-Financial Businesses and Professions (DNFBPs). DNFBPs cover dealers in precious stones, including diamond dealers. No further explanation of definition on dealers in precious stones is provided by FATF.

The following FATF Recommendations are applicable to diamond dealers.

- **Recommendation 22** mandates that customer due diligence and record-keeping requirements set out in Recommendations 10, 11, 12, 15, and 17 apply to dealers in precious stones when they engage in any *cash transaction* with a *customer* equal to or above the applicable designated threshold (USD/EUR 15 000).

⁶² FATF (2008a).

⁶³ FATF (2012).

- **Recommendation 23** indicates that the requirements set out in FATF Recommendations 18 to 21, regarding measures to be taken with respect to countries that do not or insufficiently comply with the FATF Recommendations, internal AML/CFT controls and the reporting of suspicious transactions, apply to dealers in precious stones when they engage in any *cash transaction* with a *customer* equal to or above the applicable designated threshold (USD/EUR 15 000).
- **Recommendation 28** requires that dealers in precious stones be subject to effective systems for monitoring and ensuring compliance with AML/CFT requirements, which should be performed on a risk-sensitive basis by a supervisor or by an appropriate self-regulatory body.

FATF STANDARDS RELATED TO CASH COURIERS

With regard to **Recommendation 32** on Cash couriers and its interpretative note, precious stones **are not included**, despite their high liquidity and use in certain situations as a means of exchange or storing and transmitting value. These items may be otherwise covered under customs laws and regulations. If a country discovers an unusual cross-border movement of precious stones, it should consider notifying, as appropriate, the customs service or other competent authorities of the countries from which these items originated and/or to which they are destined. The country should cooperate with a view toward establishing the source, destination, and purpose of the movement of such items, and toward taking appropriate action. Countries are not required to have measures in place to detect the physical cross-border transportation of diamonds through a declaration/disclosure system.

NATIONAL AML/CFT REGULATION/LEGISLATION IN DIAMOND TRADING COUNTRIES

As part of the project, countries were asked if they have national AML/CFT regulation applicable to diamond dealers in place, and, if so, what the reporting and record -keeping duties contained and how registration and supervision of the sector was carried out. Information was also gathered about the regulation of the cross-border transportation of diamonds, and currency related to the trade in diamonds.

It is important to note that the definition of a diamond dealer differs from country to country. For example in the US a retailer can be under certain conditions seen as a diamond dealer. However, in most countries a diamond dealer is only dealing in rough or polished loose diamonds. Further information on difference in regulation and legislation can be found in **Chapter 5**.

NATIONAL AML/CFT REGULATION ON DIAMOND DEALERS, REPORTING DUTIES AND RECORD KEEPING DUTIES

With regard to current international AML/CFT legislation, several countries do not have AML/CFT regulations pertaining to diamond dealers. As a result, businesses that buy and sell diamonds are

not obliged to implement due diligence procedures or report⁶⁴ transactions to an FIU (STRs⁶⁵, and / or CTRs)⁶⁶ or undertake AML/CFT risk assessments.

In some cases, countries without national AML/CFT regulations pertaining to diamond dealers have other legislation for the regulation of the sector. For example, legislation making it illegal to trade in rough diamonds - or are in the process of enacting an AML/CFT regime for diamond dealers.

- **South Africa** does not have industry-specific AML/CFT regulations directed at diamond traders. Diamonds are only covered under the Diamond Act, which deals with the regulation of the diamond industry as a whole.
- **Israel** indicated that, in 2012, parliament approved an amendment to the AML/CFT law to include dealers in precious stones. In the near future, diamond dealers will be regulated and supervised for AML/CFT by a supervisor and they will become subject to Administrative Sanctions for non-compliance.
- In **Mexico**, an AML/CFT law applicable to the trading in diamonds, among other non-financial businesses, entered into force on July 17, 2013. Through this law, both individuals and legal entities trading in diamonds and other precious stones and metals are subject to AML/CFT compliance measures, such as CDD and filing of transaction reports.
- The **Australian government** has also proposed amendments to its AML/CFT Act to include diamond dealers.
- Although **Switzerland** has no specific AML/CFT regulations specifically applicable to diamond dealers, it does have a reporting obligation in place for instances in which dealers are considered financial intermediaries.

In most of countries that contributed to the report, however, diamond dealers are subject to a national AML/CFT regime. Depending on the country, this includes implementing an AML/CFT programme designed to prevent the dealer from being used to facilitate ML or TF, and usually entails designating a compliance officer, providing on-going education and training, customer identification, and a customer acceptance policy, as well as record-keeping requirements, Know Your Customer (KYC) procedures, reporting requirements and a risk-based approach. De Beers provides training and awareness to law enforcement, *e.g.*, Interpol and customs.

The customer identification and identity verification range from remote identification, the identification of the ultimate beneficiaries, to the identification of the clients and sometimes identification of the suppliers. In Belgium, the identification and identity verification of clients is a legal obligation when establishing a business relation, when entering an occasional relationship for

⁶⁵ While The FATF uses the term Suspicious Transactions Reports there are other types of reports such as SAR (Suspicious Activity Report), UTR (Unusual Transaction Report) and UAR (Unusual Activity Report) which are the legal requirement in different team member jurisdictions.

⁶⁶ More details on the countries and numbers can be found in the chapter on statistics.

a transaction exceeding EUR 10 000, or generally when there is a risk or suspicion of ML or TF. Furthermore, it is required to identify such diamond suppliers for which purchasing transactions lead to payments that are wholly or partly, directly or indirectly, carried out by other means than by transfer to bank accounts held with credit institutions.

When AML/CFT legislation is applicable to diamond dealers, they are obliged to submit Suspicious Transaction Reports (STRs) / Suspicious Activity Reports (SARs) to the FIU and establish different procedures and policies for AML/CFT prevention. The statistics show that half of the countries that participated in the project received some or several STRs/SARs from diamond dealers. The reporting duties depend on the country but several of them have set a threshold (from USD 6 500 to USD 65 500) with regard to cash transactions in the diamond trade or business. In The Netherlands, consistent with the limitations set out in the European Union, diamond dealers are obligated to report cash transactions above a threshold of EUR 15 000 and on suspicion of ML.

In most countries, diamond dealers have the obligation to maintain verifiable records of all activities for a period of five years. In Argentina, diamond dealers keep documents for ten years in such a way that enables the reconstruction of transactions and allows such documents to be used as evidence in any ML and TF investigation. In general, diamond dealers need to keep, protect, safeguard and prevent the destruction or concealment of information and documentation supporting trade practices (invoices, KP certificates), as well as the information used to identify their clients. Depending on the country, diamond dealers also have to submit an annual declaration about the stocks and activities, put in place a written AML/CFT policy or keep a copy of every suspicious transaction report that they forward to the FIU.

The overall self-assessment of those countries that provided information was that the level of AML/CTF compliance of the diamond sector as medium.⁶⁷ In Canada, deficiencies related to entities' compliance programmes have been primarily identified (e.g. policies and procedures, training, risk-based assessment, etc.). Canada's AML/CTF regime for diamond dealers is more comprehensive on other elements, such as appointment of a compliance officer, record-keeping and client identification. In Belgium, an extra focus on compliance was put forward by the sector representative with an AML/CFT and Compliance Helpdesk assisting diamond dealers with their regulatory and compliance obligations and the introduction of Compliance as the 5th "c" of diamonds (next to Cut, Clarity, Carat and Colour).

LICENCE REGIME AND SUPERVISION OF THE SECTOR

Only in a few countries are licences and registration required for business activity in the diamond trade. This can be with the FIU or another licensing authority. In Belgium, all diamond dealers need to be registered with the Federal Public Service Economy for business activity in the diamond trade and a licence is required for the import and export of diamonds coming from or going to non-EU countries. By contrast, in the United States, diamond dealers are not required to register or be licensed for AML/CFT purposes. The strictest rules apply in South Africa and Namibia, where it is illegal for any unlicensed person to be in possession of or trade in uncut diamonds.

⁶⁷ There were some outliers. One country assessed their level of compliance as low and one medium to high.

Compliance with the regulations imposed on diamond dealers is checked by an independent authority or the FIU (depending on the country). These regulators/controlling bodies have the authority to issue administrative fines and, in some cases, criminal penalties (monetary and imprisonment) to diamond dealers who are non-compliant with their AML/CFT obligations or to revoke the license of a diamond dealer. In the USA, some warning letters regarding the lack of a required AML/CFT programme were issued. Nonetheless, in most countries no fines have been imposed on diamond dealers, and no AML/CFT civil enforcement actions have taken place over the last two years. In Namibia, the diamond sector has not been assessed for AML/CFT compliance as of yet, thus no enforcement has taken place. Consequently, no sanctions were imposed in the last two years. This is a clear indication that the level of AML/CFT enforcement of the sector in most team members' jurisdictions is low, perhaps apart from the mining sector of some kimberlitic mines jurisdiction where level of control over the risk of theft is considered to be high. During the FATF/GIABA expert workshop held in Dakar, some participants noted that there is a need for strong enforcement on the sector and that the low level of enforcement, particularly in some African mining countries, poses a problem in terms of AML/CFT supervision.

NATIONAL AML/CFT REGULATION ON CROSS-BORDER TRANSPORTATION OF DIAMONDS AND CURRENCY RELATED TO THE TRADE IN DIAMONDS

There are several ways of transporting diamonds, via parcel or mail, courier service or by personal transport. Lower value shipments may enter by way of FedEx/UPS, whereas Brinks, G4S or other secure or armoured car services (Malca Amit) are in most cases used for the highest value shipments and bulk rough diamonds. In most cases, diamonds enter a country as paid parcels and taxes are incurred, less frequently the diamonds are entered on Memo and also under ATA Carnet⁶⁸ (tax-free – for display/show purposes). In Israel, the courier service will also deal with the documentation and transmit the information of the shipment to the customs. According to the Israeli contribution, the courier service company does not verify if the content of the shipment corresponds with the diamond dealer declaration. All Kimberley Process (KP) members have implemented domestic legislation that requires rough diamonds be exported in tamper-resistant containers.

Within the Kimberley Process Certification Scheme (KPCS), rough diamonds can only be traded between KP participants, and all imports and exports of rough diamonds must be accompanied by a KP Certificate.⁶⁹ In Russia, diamonds are transported in boxes that contain a mixture of diamonds of given types, collected in compliance with the adopted structure. The certified (validated) copy of the KP certificate and the shipping documents are enclosed with the parcel within the tamper-resistant plastic bag, the KP certificate is visible through a transparent window in the bag. The number of the KP certificate is indicated on the bag and in the shipping documents.

⁶⁸ ATA Carnet cannot be used for sending rough diamonds.

⁶⁹ Although it is illegal for KP participant countries to ship rough diamonds to non-KP participant, KPCS is not an international binding treaty and therefore it is not illegal for non-KP participating countries to trade in rough between themselves.

There are some major differences between countries with regard to customs control, especially on polished stones. For example, in Israel all rough diamonds imported to or exported from Israel are examined and assessed in order to collect due taxes and receive proper documentation by a special diamonds customs station located within the diamond exchange operated by three diamond and gem specialists. Similarly, the value of polished diamonds is randomly checked. In Belgium, every shipment that goes in or out is checked, verified and cleared by sworn experts, while each step is carefully monitored by the government (triple control). In Russia, customs clearance of diamonds is performed exclusively at the special customs station, where they undergo clearance and government inspection. In South Africa, where a levy is payable whenever a registered person imports or exports diamonds into or out of the country, all diamonds are transported in parcels sealed by the diamond regulator after evaluation so that the exporter cannot change the content of the parcel after evaluation.⁷⁰

In most of the other countries there are no specific import /export customs controls on diamonds. The imported and exported diamonds fall under the same provisions as any other goods imported or exported and only have a *Harmonised Commodity Description and Coding System* code to indicate the category of diamonds (*i.e.*, rough sorted or unsorted, polished, etc.). For example, in the UK, Customs require a declaration for all imported or exported goods (including diamonds) for customs duty and or VAT purposes and there are no further controls by Border Force (Customs) on polished diamonds. In Canada and the USA, diamonds are classified using the Harmonized Tariff classification system. In Canada, imports/exports do not necessarily specify the four Cs of diamond valuation or the number of pieces, and therefore valuation exploitation can occur. This is more often the case for diamond parcels rather than single diamonds. In Namibia, diamonds are classified for shipment purposes as polished or rough diamonds and the carats are taken into consideration.

Even though all countries have either specific or general Custom regulations in place regarding the import and export of diamonds, all team members indicated that no specific AML/CFT requirements are in place to declare diamonds while entering/leaving the country. The AML/CFT requirement to declare cross-border transportation of currency related to the trade in diamonds often falls under a more general requirement for cross-border transportation of currency. For example, there is no specific legislation in Switzerland for the declaration of cross-border transportation of currency related to the trade in diamonds. This is regulated by federal legislation and is applicable to any kind of cross-border transportation of currency. In Russia, natural persons who exit or enter the country are obliged to declare cash in amounts equal to or exceeding USD 10 000. Origin of currency is indicated in the customs declaration. However, the customs authorities do not use this information, but instead file it with law enforcement agencies, including the FIU, for further use within the scope of powers vested in them. In Belgium, Israel, and the Netherlands, the FIUs received several currency Cross-Border Reports related to diamonds. In the Belgium, the Netherlands, and the UK, all movements of EUR 10 000 (or equivalent) or more entering or leaving the European Union must be declared. Some of these declarations may relate to the trade in diamonds. The declaration requests details of the owner, origin and use of the cash. Border Force

⁷⁰ Which is a general KPCS requirement valid in all KP countries.

agents may also detain cash found on a person at the border where the cash has been concealed and they believe it to be the proceeds of crime. In Namibia and the USA, there is a general requirement for diamond dealers to declare currency and monetary instruments that are being transported internationally.

Diamond are covered for AML/CFT in some countries as part of a list of precious stones (Canada, Israel, Mexico, United States, etc.) where if a certain precious stone is not included in the list than the law does not apply to trade in that specific precious stone.

CHAPTER 4.

FUNDING THE DIAMOND TRADE

In many countries, the diamond trade is funded (primarily) by financial institutions such as banks, although the participants may finance a part of the trade solely with their own equity. Some countries have specialised diamond banks or banks with designated divisions or branches that diamond dealers use for doing business and/or that provide financial services to them. In Israel where these special branches within banks exist, the financial services are only provided to licensed diamond buyers, sellers or manufacturers, where they manage a diamond designated account (DDA) in USD. Without a license, the bank will not open a DDA. specialised banks themselves hold a diamond dealer license. In those countries that do not have specialised diamond banks or designated diamond divisions/branches, financial services to the diamond industry are provided just as to any other trade. This means that many, though not necessarily all, of the following financial services are most commonly provided: bank guarantees, loans, use of diamonds as collateral, receipt and remittance of money. Israel indicated that when diamonds are used as collateral the bank will evaluate the diamonds with its specialist and after providing a loan, the bank will keep the diamond as the collateral. This is not a common practice but rather, represents exceptional cases where the account is problematic. The banks specialised in diamond trade offer a wide range of tailor-made financial services. Diamond dealers are usually treated as any other customer when providing credit, meaning that the same collateral will be requested in order to secure the loan. Vulnerabilities arise when diamond trade credit is extended at concessionary terms, thus making it more attractive in comparison to rates of credits in other sectors.

In most countries, the banks and credit institutions do not apply special Know Your Customer (KYC) or Customer Due Diligence (CDD) procedures to diamond dealers. This means that the same normal or enhanced due diligence procedures apply whether it is a diamond dealer or any other client (depending on the designated risk of the customer). However, some banks and credit institutions may consider the business as such higher risk or may take additional due diligence measures if their client is a diamond dealer. These measures can include extensive monitoring (including monitoring of transactions, site visits, etc.). Some banks or credit institutions may even have employees with a specialised technical knowledge of the industry. The diamond banks, like traditional banks, have policies and procedures for preventing ML and TF and their own monitoring and prevention systems. The specialised diamond banks perform an extensive compliance check of all diamond dealers before granting a loan. In one country, a special diamond office acts as a neutral party, verifying the copies of trading documents handed in by diamond dealers to the banks. This is because the bank works only on the basis of the documents and customer declarations and has no information on the actual diamond deal, thus making it difficult to evaluate the transactions.

The main methods of payment used by diamond dealers are *wire transfers* or *electronic funds transfer*. Cheque and cash are also used. In one country, the use of informal promissory notes for trade between diamond dealers is also accepted. These notes are generally tradable and notes that are not “crossed” are treated like ordinary cash. In many countries the use of cash is on the decline and not being used very commonly anymore. One country stated that cash is not used at all. However, cash may still be commonly used at the retail stage where small payments are sometimes

made in cash or used by smaller dealers. The use of cash is still a common method of payment in the diamond business in countries where cash is widely used such as in African and Latin American mining centres, or in trade centres like Hong Kong, China.

The prevalence of consignment agreements (or “memo” transactions) to purchase diamonds varies from country to country. A consignment is a private contractual arrangement as explained previously (see page 21). This necessitates the identification of the same diamonds by the consignor. Although consignment agreements are a very common trade method in some jurisdictions, especially in international trade, they may bear some ML/TF risks. These risks would be elaborated in the trade financing vulnerabilities.

CHAPTER 5.

STATISTICS (REPORTING, INVESTIGATIONS, INDICTMENTS ETC.)

A sample of **17** countries submitted contributions from team members and a few additional jurisdictions approached by the project team. While these jurisdictions do not include the entire diamonds industry, as mentioned previously team members represent a significant part of the international "diamond pipeline" (mining and production, trade and manufacturing centres, distribution and jewellers⁷¹). Not all project-participants were able to submit relevant **statistical data** in regard to the reporting and dissemination of STRs (suspicious transactions reports) by Dealers in Precious Metals and Stones (DPMS). In some cases, countries do not (yet) have reporting obligation for DPMS, thus no information concerning DPMS-reports could be submitted. This section aims to create an overview of the available information, by summarizing the project team member's input and by identifying common denominators in countries' individual AMC/CFT reporting obligations.

Based on team members contributions the following issues were looked at: is there a reporting obligation for DPMS and if so what is the reporting threshold for CTRs; what is the number of reports received from DPMS; what is the total number of reports related to DPMS (i.e. reports filed by DPMS or by other reporting entities relating to DPMS); number of reports disseminated to law enforcement authorities.

The table below presents the most important information provided by the 17 sample countries.

Table 5: **Overview DPMS reporting obligation and its results**

Co	Reporting obligation DPMS?	CTR Threshold (USD)	Number of reports from DPMS	Total number of reports related to precious stones (incl. DPMS)	Reports DPMS disseminated	Total number of reports disseminated related to precious stones (incl. DPMS)	Analysis period
1	No	n/a	n/a	n/a	n/a	n/a	n/a
2	No	n/a	n/a	n/a	n/a	n/a	n/a
3	Yes	9 600	112 STRs	n/a	23	23	2010-2012 (2 years)
4	No	n/a	n/a	n/a	n/a	n/a	n/a
5	No	n/a	n/a	n/a	n/a	n/a	n/a
6	Yes	63 600	11 836 CTRs 3 STRs	n/a	n/a	n/a	2012-2013 (1 year)

⁷¹ See footnote 11 for the percentage of rough diamond trade covered by team members.

Co	Reporting obligation DPMS?	CTR Threshold (USD)	Number of reports from DPMS	Total number of reports related to precious stones (incl. DPMS)	Reports DPMS disseminated	Total number of reports disseminated related to precious stones (incl. DPMS)	Analysis period
7	Yes	20 000	10 179 CTRs STRs – n/a	n/a	0	0 ¹	2009-2012 (2 ¾ years)
8	Yes	10 000	0 STRs	1 524 STRs	n/a	0	2012 - 2013 (1½ years)
9	Yes	No	10	115	3	139	Reporting period: 2005 – 2012 (8 years). Dissemination period: 2000 – 2012 (13 years)
10	No	No	n/a	5 820 UARs	n/a	23	Reporting period: 2007 – 2012 (6 years). Dissemination period: 2011-2012 (2 years)
11	Yes	2 500	36	n/a	n/a		2009-2012 (4 years)
12	Yes	8 550	2 UTRs	110	0	18	2008-2012 (5 years)
13	Yes	n/a	90 CTRs 24 STRs	n/a	n/a	n/a	n/a
14	Under implementation	n/a	n/a	n/a	n/a	n/a	n/a
15	No	n/a	n/a	20 STRs	n/a	n/a	n/a
16	No	n/a	n/a	n/a	n/a	n/a	n/a
17	Yes	No	0 STRs	n/a	0	0	n/a
TOTAL	Yes: 9 Under implementation: 1, No: 7	Yes: 7; range from 2 500 to 65 600, No: 3 n/a: 7	If yes (7), range from 0 to 112 for STRs; range from 490 to 11 839 for CTRs.	If yes (5), range from 20 to 5 820	In the case of filed reports (3), range from 3 to 23	In the case of filed reports (4), range from 18 to 139	

Note 1 : According to the contribution received, a total of 335 criminal cases related to the trafficking of precious stones have been opened in 20 different country regions since 2010 (based on law enforcement officials).

Reporting obligation DPMS: Out of the 17 countries that have submitted relevant data, 9 countries have a legal reporting obligation in place for DPMS to report STRs to the FIU (some

countries have also CTR reporting obligations). In 7 countries, AML/CFT legislation has led to CTR or STR reports by DPMS (between 0 to 112 STRs for periods which vary from one to five years). Several countries indicated that they receive reports concerning diamonds and/or other precious stones from other sectors than DPMS (mostly banks and customs). In one country, a large number of reports emanate from the banking sector (5 686 reports). In all, the information collected over the periods of time specified show low level of STRs reported by DPMS in the relevant countries.

Dissemination of reports to law enforcement: Only 2 out of 7 countries that have received reports from DPMS indicated that transactions related to diamonds and precious stones have been disseminated to investigative authorities. Two (2) additional countries have disseminated reports based on reports filed by reporting institutions other than DPMS. This information also show low level of FIU reporting to law enforcement and may be an indication of low awareness level of FIUs with regard to the diamonds industry.

CHAPTER 6. THREATS⁷² AND RISKS⁷³ RELATED TO VULNERABILITIES⁷⁴ IN THE TRADE IN DIAMONDS

Diamonds have the ability to earn, move and store value. They are a liquid and transferable asset. These are some of the features that make diamonds appealing to criminals⁷⁵ seeking to move, conceal and store the proceeds of crime. Diamonds have unique physical and commercial properties which carry value in small, easily transportable quantities.

The worldwide trade varies from modern international transactions conducted through the financial system, to localised informal markets. Dealers range from very poor individuals in some of the most remote and troubled places on the planet, to the wealthiest individuals, to large multinational companies working in major financial centres through specific unique trade mechanisms and diamond bourses. Transaction methods also range from anonymous exchanges of handfuls of stones for cash, to exchange-based government-regulated deals. A single one carat polished diamond can be worth more than USD 15 000, and, unlike cash, diamonds are often not required to be reported when transported or sent across borders.

This section of the report is based both on literature review conducted by the team members, the specific country contribution addressing the vulnerabilities and risks of their respective countries, and consultation conducted with the private sector at the national and international level.

PRODUCT VULNERABILITIES

Diamonds can be vulnerable for misuse for ML/TF purposes because they can transfer value and ownership quickly, often, with a minimal audit trail. They provide flexibility and an easy transportation of value.

A 2003 Report⁷⁶ assessed various alternative financing mechanisms that could be used to facilitate ML and/or TF. Trading in commodities, remittance systems, and currency were assessed on each of

⁷² A threat is a person or group of people, object or activity with the potential to cause harm to, for example, the state, society, the economy, etc. In the ML/TF context this includes criminals, terrorist groups and their facilitators, their funds, as well as past, present and future ML or TF activities.

⁷³ Risk can be seen as a function of three factors: threat, vulnerability and consequence. An ML/TF risk assessment is a product or process based on a methodology, agreed by those parties involved, that attempts to identify, analyse and understand ML/TF risks and serves as a first step in addressing them.

⁷⁴ The concept of vulnerabilities as used in risk assessment comprises those things that can be exploited by the threat or that may support or facilitate its activities. In the ML/TF risk assessment context, looking at vulnerabilities as distinct from threat means focussing on, for example, the factors that represent weaknesses in AML/CFT systems or controls or certain features of a country. They may also include the features of a particular sector, a financial product or type of service that make them attractive for ML or TF purposes.

⁷⁵ GOA (2003), p 10.

⁷⁶ GAO (2003).

their abilities to earn, be moved, and store value. Diamonds were the only alternative financial device that fit into all of these assessment criteria.

Diamonds possess several characteristics which make them vulnerable to ML/TF. These include⁷⁷:

- **Very high value** – diamonds can store very high value. The higher the value, the more vulnerable a commodity is to ML/TF.
- **Low weight/mass and relatively small size – high value to mass ratio (easy to transport/smuggle)** – diamonds are easy to move and conceal, which makes them susceptible to smuggling. The transfer of value between countries is in many cases part of a ML/TF scheme and diamonds allow for the transfer of very high value.
- **High durability with stable pricing and an ability to retain value over long periods of time** – this makes them good for investment purposes (origin of money may be outside the industry). Also, it may attract criminals as they can distance the funds from their origin by transferring proceeds of crime into diamonds with minimum risk of confiscation and low risk of loss of value.
- **Ability to go undetected** (non-metallic and odourless) – diamonds will show on x-ray but because of the low density to x-rays they remain 'difficult' to detect.
- **Untraceable** - once the items change hands and enter the licit market they are difficult to trace, in terms of both their original ownership and value. Additionally, once the diamonds have gone through the beneficiation process and the rough diamonds are cut and polished, it becomes almost impossible to determine the origin of a stone, since Kimberley process only applies to rough diamonds.
- **Easily bought and sold outside the formal banking system** – AML/CFT measures are higher in the formal banking systems, but diamond transactions can be conducted outside this system and the value is carried between countries without having to go through the KYC procedures in the banking sector. Also, diamonds can be bought and sold in all parts of the world at almost any jewellery or pawn shop.
- **Unmarked** - It is virtually impossible to distinguish between rough diamonds that were illegally obtained and those that were legally obtained. Technology allows for the marking of diamonds so it would be possible to follow the trail of the diamonds, i.e. who is involved in the sale/purchase of the diamonds, however, most diamonds are unmarked. Diamonds are also

⁷⁷ See for example Farah, Douglas (2005), which relates to some of the characteristics making diamond vulnerable to ML/TF: "Gemstones are ideal for several reasons: they hold their value; they are easy to transport; they do not set off metal detectors in airports; and they can be easily converted to cash when necessary".

easily disguised as other stones of much lesser value; the use of diamond simulants and synthetics can be used to commit frauds (predicate offence). Diamond marking can mitigate the risk of ML/TF the more it comes into practice and if documentation of the transactions include this data.

- **Evaluation of price** - The subjectivity of valuation of diamonds is a significant vulnerability. There are no official or agreed tariffs for rough or polished stones. The per-carat price of a diamond can vary considerably based on the crystalline shape, the carat weight, the colour and the clarity, i.e. the four (4) C's. Each qualifier imparts an individual measure of a diamond while also affecting the valuation of the other qualifiers; each measure is subjective and cannot be precisely stated (except carat weight). For rough diamonds there may be thousands of prices which are published by companies such as De Beers and Rio Tinto⁷⁸. As stated previously, what is important to understand is that *diamonds are not one product*. From rough to cut and polished diamonds, *the price per carat can vary from few tens of USD to tens of thousands of USD*, based on the 4C's and the specific evaluation of the gemmologist or evaluator. Different professional evaluators may provide two reasonably and considerably different evaluations to the same diamond. This is one of the features enabling the manipulation of price for any specific deal (see also vulnerabilities of trade based ML/TF.). This may also cause difficulties in investigation and in judicial proceedings since it will be difficult to establish the price of a diamond where there is no true and unique value. On the other hand, it is just as difficult for criminals as for law enforcement to determine the value of diamonds.
- **Changeability** - From rough to polished, changing the dimensions of illegally gained diamonds make identification virtually impossible and can inhibit law enforcement from pursuing criminal charges.
- Readily exchangeable for other commodities or forms of currency (separate section broadens this issue below).
- **Susceptible to fraud** - The ease with which diamonds and other precious stones can be substituted for inferior or fake stones makes fraud more possible (see also vulnerabilities of the retail level). Diamonds are also susceptible for investment fraud.

These distinctive characteristics create not only vulnerabilities for ML/TF, but also for other criminal activity, including theft, smuggling and fraud. A vulnerability analysis of the diamond

⁷⁸ Even-Zohar Chaim (2004), pp. 97, "the De Beers' Diamond Trading Company, for example sort them ... into some 14 000 different categories". In the Hebrew addition it is stated that Rio Tinto sort the rough diamonds to 7 000 categories, *Ibid* pp. 113.

sector with regard to organised crime⁷⁹ awarded great vulnerability to 'the nature of the economic product'. The following properties/indicators were discussed.

- **Stability of the product:** As diamonds do not have an expiry date, no restrictions are imposed on criminal strategies by the physical nature of the product itself.
- **Mobility:** This indicator was awarded very great vulnerability since diamonds are very easy to be transported covertly.
- **Compatibility/flexibility:** Diamonds offer the criminal a lot of possibilities for setting up and continuing an extremely flexible organisation and activity.
- **Product differentiation:** diamonds, as a 'white product' cannot be individually identified or traced at any time, apart from marked diamonds. The laser inscription on marked diamonds can always be removed by a laser but this will still leave a mark of an inscription.
- **Elasticity:** Diamonds are extremely interesting as a means of payment or investment, also in relation to criminal activities of fraudulent entrepreneurs.

Certain product properties, such as the degree of mobility, as well as compatibility and flexibility, ensure that diamonds can be fit neatly into the illegal strategies of criminal groups, without a structural link to the diamond sector being necessary.

USE OF DIAMONDS AS CURRENCY

Diamonds display a high value-to-weight ratio, retain their value and are not affected by inflation or exchange rates, and are easily exchanged for other commodities or forms of currency. Diamonds can have similar characteristics as cash⁸⁰.

"Conflict diamonds" are not within the scope of this report. However, in conflict areas, diamonds were frequently used to finance wars by way of buying weapons. The KPCS was initiated to prevent the actual use of diamonds as hard currency in such a manner. These characteristics can be also used for ML/TF.

In practice, diamonds are being used as an alternate currency by criminals who use them to acquire other goods such as tobacco, guns, and, most commonly, drugs. Some countries (Australia, Belgium, Canada, Israel, USA) indicated that diamonds can or have been used as a form of currency. Canada noted that diamonds are also used by criminals for payment of debt, usually for drug debt.

⁷⁹ Research carried out from 2001 to 2003. Cuyvers, L.; De Ruyver, B. & Vander Beken, T. (2004)

⁸⁰ See also Even-Zohar, C. (2004), *pp.* 26 ("The easily concealable, readily transportable, high value nature of diamonds represent another factor which makes diamonds the currency par excellence for those motivated to avoid the use of "real" money").

In terms of ML/TF vulnerabilities, this is a particularly important feature since diamonds are not included in the concept of cash/currency or a bearer negotiable instrument (FATF recommendation 32)⁸¹ even though it is possible to both launder with diamonds themselves and use diamonds as a means of payment to finance criminal activity, e.g. for the purpose of buying drugs or paying for illegal arms. The use of diamonds as a form of currency was also supported in the case studies submitted by team members. This will be illustrated below in the section analysing cases and STRs.

TRADE BASED ML

The typology of trade based ML (TBML) is defined quite clearly and was dealt with extensively by the FATF and FSRBs in recent years. In 2008 the FATF published a best practices paper on TBML⁸². The first section of the report states that:

"The Financial Action Task Force (FATF) has recognised misuse of the trade system as one of the main methods by which criminal organisations and terrorist financiers move money for the purpose of disguising its origins and integrating it into the formal economy. As the anti-money laundering (AML) and counter-terrorist financing (CFT) standards that have been applied to other ML techniques have become increasingly effective, such abuse of the trade system is expected to become increasingly attractive".

This statement is very relevant to the trade in diamonds. In 2006, the FATF published a typologies report on TBML⁸³ and in 2012 the APG updated and extended the FATF report⁸⁴. Both reports included TBML cases relating to the trade in diamonds, exposing the vulnerabilities of the trade to TBML. Moreover, the APG report indicated that there are goods which are more susceptible to TBML due to the difficulty in identifying the true value of the goods, especially where the goods are subjected to higher taxes/duties or where the goods are of high turnover/value. Diamonds were amongst the goods identified⁸⁵.

One of the main methods through which TBML is conducted is by way of over or under valuation. The diamond industry is tremendously vulnerable to TBML primarily because of the high subjectivity in the valuation of diamonds⁸⁶, the ability of diamonds to change their form, the trade-

⁸¹ "For the purposes of Recommendation 32, gold, precious metals and precious stones are not included, despite their high liquidity and use in certain situations as a means of exchange or transmitting value. These items may be otherwise covered under customs laws and regulations. If a country discovers an unusual cross-border movement of gold, precious metals or precious stones, it should consider notifying, as appropriate, the Customs Service or other competent authorities of the countries from which these items originated and/or to which they are destined, and should cooperate with a view toward establishing the source, destination, and purpose of the movement of such items, and toward the taking of appropriate action." (Interpretive Note to Recommendations, 32 paragraph 8).

⁸² See FATF (2008b), section 5 for a TBML definition.

⁸³ FATF (2008b).

⁸⁴ APG (2012).

⁸⁵ *Ibid*, page 36, section 139.

⁸⁶ See previous section on product vulnerabilities and the discussion on price evaluation.

based and global nature of the diamond market, and the long production chain involving many actors.

To compound the problem, there is no commodity or market price or "price list" for diamonds since there is no specific product⁸⁷. With respect to parcels of bulk diamonds, which may include different diamonds of different size and quality, it is impossible and impractical for the evaluator to examine each and every diamond that is set for export and thus can be easily overvalued or undervalued to facilitate TBML schemes.

Transactions conducted by diamond dealers can amount to millions and even tens of millions of USD. This makes it easier to launder very high sums through the trade by over or under valuing the shipment by 5 to 10 per cent. In the day to day trade, this will not be taken as unusual and will not alert customs official or banking institutions funding the trade and facilitating the transactions. Under these circumstances, Customs officers, who in many cases lack the expertise to evaluate a shipment, particularly bulk shipments, have no choice but to accept the shipper's self-assessment of the value of the goods. An inspection by an expert gemmologist on behalf of customs⁸⁸ may improve the situation and narrow the room for price manipulation based on expertise evaluation.

Tariff for customs declarations based on only carat - not only diamonds are hard to evaluate it is also, in many if not all countries, not necessary. Several team members stated that the declaration provided by the diamond dealer to customs as to the value of the diamonds is based only on carat, which is easier to verify since it is possible to weigh the diamonds. However, as previously explained, the price of diamonds is based on all 4 Cs and may change considerably with variation of Colour, Cut and Clarity. For example, the US has stated that the Harmonized Tariff Schedule (HTS)⁸⁹ is the primary recourse for determining tariff classifications for imports into the United States. The HTS classifies a good/commodity based on its name, use and/or the material used in its construction. US customs authorities believe that the HTS may aid in price manipulation, because the only valuation criterion it uses for diamonds is weight. In the US there are only two HTS subheadings for nonindustrial diamonds, worked but not mounted or set:

1. Weighing not over 0.5 carats each;
2. Weighing over 0.5 carats each

This means that only one of the 4 Cs (carat) is used to assess the value of a consignment of diamonds.

This is a gap built within the export/import systems which may also be easily exploited for over/under valuation while making it hard to establish whether there is an infringement of customs laws and regulation.

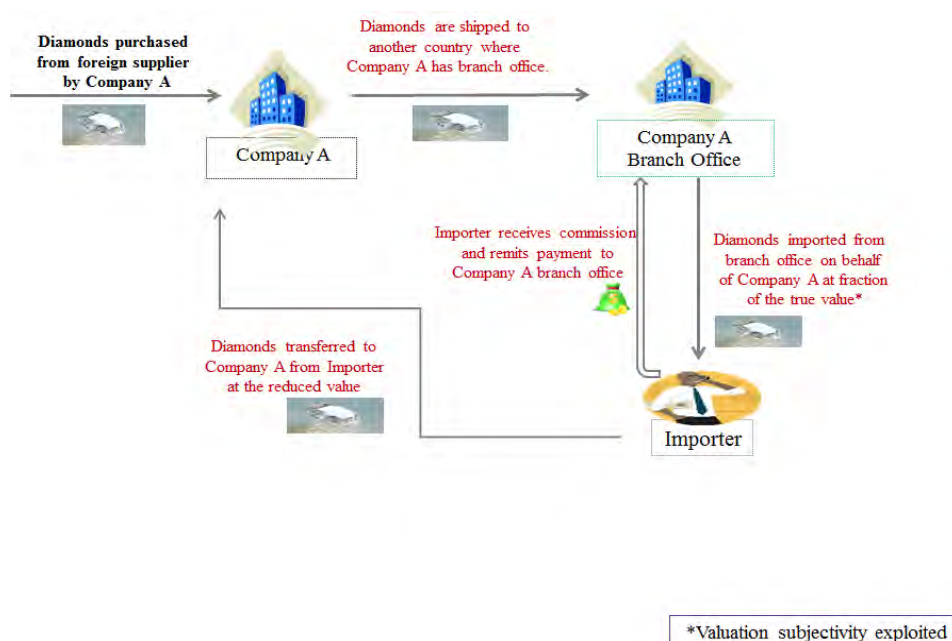
⁸⁷ Every diamond has to be evaluated on its own merit. See also footnote 22.

⁸⁸ Customs valuation of diamonds is subjected to the GATT 1994 Rules on Customs Valuation (Cascade system off 6 steps).

⁸⁹ All members of the WTO/WCO apply the Harmonized Commodity Description and Coding System (or HS). In US it is named HTS, in EU GN, etc.

Thus, diamonds sold may be shipped from one jurisdiction to another and be assigned low value to minimize inland revenue or export duty, then traded in the other jurisdiction or re-exported from it with a much higher “price tag”. The value generated from the final sale of the diamonds will be much higher than their original stated value, but no real value will be added along the trade path, except for the “mark-up” by the traders. According to KP statistics, some trade centre’s show considerable differences between the average price per carat coming into the jurisdiction compared with the average per carat price leaving the jurisdiction. As previously detailed this difference can be explained to a certain extent by sorting and valuation of the diamonds which may produce an added value of between 10 to 15 per cent⁹⁰. But, it can also provide an indication of tax evasion schemes, or ML/TF trade-based activities.

Figure 6: Trade Based Money Laundering / Tax Evasion



REGULATION OF DIAMOND DEALERS

FATF Recommendations on dealers in precious stones - Recommendation 22 only applies to dealers in precious stones when they engage in any cash transaction with a customer equal to or above the applicable designated threshold. Analysis showed that the extent of cash usage seems to be diminishing and that most of the transactions are not conducted in cash. There is no obligation for customer due diligence or record-keeping requirements when dealers in precious stones use wire transfers or other means of payment. This makes the sector more vulnerable to ML/TF, particularly because precious stones including diamonds can be used as a form of currency/payment.

⁹⁰ Price increases between import and export are largely due to sorting and valuation activities, an essential element in the diamond pipeline. Sorting diamonds into different sizes & grades is time consuming, requires very specific know-how and is a value adding activity along the supply chain. This is an essential stage in the diamond dealing process.

Since the AML/CFT duties are only relevant to cash transactions, it is possible to establish the method of payment only when the payment is received, which can be a long time after the deal has been made and the diamonds have already changed hands. Again, this is important since it is possible to launder with diamonds, as they are themselves of intrinsic value and a form of currency.

National AML/CFT regulation of the industry - There are still several countries where diamond dealers are not subject to AML/CFT legislation and therefore have no reporting responsibilities. These businesses that buy and sell diamonds are not obliged to undertake AML/CFT risk assessments, implement due diligence procedures or report transactions to the national FIU.

The issue here is the KYC, which is neither legally required nor ordinarily carried out by the traders in diamonds who are not under an AML/CFT regulation. For diamond dealers, the risk of being involved in or being used for ML or TF is not limited to the customers (subjects to whom they sell diamonds). There is also a risk when establishing a business relationship with diamond suppliers, when purchasing transactions give rise to payments that are wholly or partially, directly or indirectly carried out by other means than by transfer to bank accounts held with referred credit institutions. Payment by other means than by transfer to bank accounts is considered a high-risk situation for illicit trafficking, which always has to be taken in account.

In order to deal with these high-risk situations, the identification requirement not only needs to be obligatory for diamond dealers, but also needs to extend to suppliers in diamonds when the delivery of diamonds results in cash payment.

AML/CFT regulation applicable according to precious stones lists - Even though the project is focusing on the trade of diamonds, it was established during the collection of information from the relevant countries that the definition of a precious stones dealer is in many cases based on a list of precious stones (Canada, Israel, US) which cover only part of the market, leaving other parts of the precious stones sector uncovered by AML/CFT regulation. This creates a ML/TF vulnerability since a money launderer or a terrorism financier can make transactions of high value without being covered by AML/CFT legislation (no KYC, no reporting, etc. will be conducted).

Record-keeping - As noted above, there are very limited AML/CFT record-keeping obligations for dealers in precious stones. Some countries reported that, due to specific business practices where the diamond trade is based on trust and verbal agreements, diamond dealers may not fully record transactions in cases where they know each other. Vague and inconsistent records within the industry complicate financial investigations for law enforcement.

False records and invoices and, more importantly, lack of detail on records precipitate laundering with these commodities. The lack of detail is important to note: while false invoice is definitively criminal, lack of detail on an invoice is not. However, without sufficient detail, law enforcement has difficulty determining the extent of criminal activity, if any, and then may not be able to articulate such in court. Additionally, lack of details may prevent banking institutions from reporting transaction to FIUs with all required information.

Physical cross-border transportation of diamonds and currency - Although diamonds can be used as a currency and to store value, they are not included in the concept of cash/currency or a

bearer negotiable instrument (FATF Recommendation 32)⁹¹. Countries are not obliged to have measures in place to detect the physical cross-border transportation of diamonds through a declaration/disclosure system. The Customs declarations on cross-border transportation of cash that an FIU receives do not include diamonds.

Loose vs. mounted diamonds – in general terms the legislation applying to loose diamonds is different from that which applies to mounted diamonds.

Compliance of the sector - Although the AML/CFT legislation applies to diamond dealers, FIUs have not yet received many disclosures. This may be an indication that there is not enough awareness in the sector of the importance of combating ML and TF within the diamond sector and that diamond dealers are not sufficiently aware that their sector is being misused by criminal organisations to launder their proceeds. Improved awareness of the AML/CFT legislation could result in a diminished restraint to report.

SUPERVISION, CONTROL AND ENFORCEMENT VULNERABILITIES

SUPERVISION

Registration and licenses - Only in a few countries are licences and registration required for business activity in the diamond trade. This has a major impact on supervision of the sector and this makes the KYC procedure for diamond dealers and financial institutions handling diamond dealer accounts very difficult.

Fines and penalties on non-compliance - Due to the lack of AML/CFT obligations in several countries, few AML compliance assessments on diamond dealers have been carried out. Although the overall compliance of the sector is assessed as medium in those countries with AML/CFT obligations, no fines have been issued to diamond dealers and no other AML/CFT civil enforcement actions have taken place over the last two years.

CONTROL

Customs Control and over - and under-valuation - In several countries there is no separate set of guidelines or procedures for monitoring the import/ export of diamonds by the Customs Department. The import and export of diamonds are dealt with in the same manner as those of any other article or commodity. Given the specifics of diamonds (high value in small size and not detectable by specialised equipment), effective and specific control by customs is necessary.

⁹¹ “For the purposes of Recommendation 32, gold, precious metals and precious stones are not included, despite their high liquidity and use in certain situations as a means of exchange or transmitting value. These items may be otherwise covered under customs laws and regulations. If a country discovers an unusual cross-border movement of gold, precious metals or precious stones, it should consider notifying, as appropriate, the Customs Service or other competent authorities of the countries from which these items originated and/or to which they are destined, and should cooperate with a view toward establishing the source, destination, and purpose of the movement of such items, and toward the taking of appropriate action.” (Interpretive note to recommendation 32 paragraph 8).

Furthermore, the size of the industry makes it extremely difficult to verify each and every diamond consignment set for import or export. Additionally, it is sometimes not possible for customs to identify the correct value of the consignments (a lot of under- and overvaluation of diamonds takes place). Shortage of expertise in gemmologists makes it difficult for customs to assure the real value of every shipment of diamonds or other precious stones against invoices and freight documents.

Issues related to KP certificates - Since the implementation of the Kimberley Process Certification Scheme (KPCS), no conflict diamonds can enter a KP member country in a legal manner. All shipments of rough diamonds require a certificate specifying the origin of mining, volume and value, and are checked and confiscated immediately when no certificate is available. All trading countries are required to submit data on production, import and export of rough diamonds. The risk is situated in the fact that current enforcement efforts related to diamonds are directed more at ensuring compliance with the KPCS rather than preventing smuggling, fraud, or ML. Therefore, the primary legal and regulatory focus regarding diamond smuggling is on rough, rather than cut and polished diamonds. While important, it does little to prevent the use of finished diamonds in TBML schemes.

The KPCS lacks transparency for controlling officers at the border. There are specific requirements for KP certificates to have certain security features in place and known certificate forgeries and examples of certificates and authorised signatures are shared between KP members. Due to the lack of a universal standard for the format and/or specifications of a Kimberley Certificate (KC), it is almost impossible for customs officers not experienced in the diamond trade to intervene or recognize forgeries. This also applies to official certificates of origin and invoices of certain countries. The validity period of the Kimberley Certificate is often too long, opening up the possibility of misusing the certificate for more than one shipment⁹². The section on the KC where the weight (carat) of the diamonds needs to be filled in is sometimes not appropriate for adding numbers, which is why it is easy to manipulate the total weight (carat). This also applies to changes made on a KC - these need to be officially confirmed by means of a signature and official stamp.

Issuing new KPC also raises questions. According to the KPCS the KPC that come with imported diamonds are kept in a country and not sent with the following export of the diamonds. The rough diamonds that leave the country for export receive a new certificate issued by the responsible authority in the exporting country. This legitimate procedure may be exploited by criminals and is one of the major vulnerabilities of the KPCS whereby the actual origin of the rough diamonds is often concealed and practically impossible to retrieve⁹³ by moving the rough diamonds through trade centres for the purpose of issuing a new KPC. When exported from the mining country the KPC will include the country where the diamonds were mined. In a later phase, since the shipment of rough diamonds may include diamonds from several mining countries, the exported diamonds receive a certificate indicating that the diamonds originate from more than one country without

⁹² Legally it is not possible to use the same certificate twice.

⁹³ The KP is not a certificate of origin and therefore the origin cannot be traced by it. This leaves the ML/TF vulnerability uncovered, not even by the KPCS.

specifying which countries⁹⁴. This is mandatory according to the KPCS and a common trade practice; however it may create an opportunity for criminals to misuse this practice. Information received from one jurisdiction indicated that this practice has taken place.

It should be noted that the KPCS does not regulate the movement of cut and polished stones but only focuses on rough diamonds.

ENFORCEMENT

Limited awareness - Enforcement of the diamond sector is exposed to a degree of vulnerability due to the limited number of skilled experts to appropriately enforce the regulations applicable to the sector. All enforcement of legislation and rules relevant to this industry is only enforceable through the right set of skills. The skills needed for valuing diamonds are quite rare and expensive to obtain; this makes it difficult for governments to provide the necessary investment. Most law enforcement professionals do not possess the necessary skills to identify a diamond, let alone to evaluate it. Few countries possess a specific diamond squad within their police department to tackle these cases. There is little specific enforcement of any crimes related to diamonds. Law enforcement looks at these crimes/commodities the same as all others and does not relegate specific resources towards it. In general, law enforcement has little knowledge about crimes and criminal activity involving these commodities/industry.

Collection of evidence - The diamond sector has refrained from proper documentation and book keeping for almost 90 years. As a result, there is hardly any evidence of the terms of agreements made by diamond industry representatives. The only evidence of transactions is the invoice and shipping documents presented to customs. The strict confidentiality practiced by the actors in the trade imposes secrecy even in conflict situations, breach of contract, fraud attempt, etc. There are also many unknown factors in law enforcement about what evidence is even available and then how to collect it/use it.

International police cooperation - The bottleneck in effective law enforcement remains international cooperation and confirming the relation with TF. In order to address the problem of fraud in the diamond sector, international awareness and cooperation in harmonizing and implementing legislation needs to be established. The diamond trade is characterised by international financial flows, and also by flows of goods. In order to have a successful police investigation and have the criminal assets confiscated, international cooperation of the authorities is a prerequisite. In particular, the countries **involved** in the different stages of the trade be it mining countries, trade centres, cutting and polishing centres or retail centres, such as the Lebanon, Switzerland, the United Arab Emirates and countries on the African continent. A deficiency in the information exchange could seriously undermine the investigation and the success of a conviction. The police stated with regard to one of the billion dollar trade centres that even though it is a full participant of the KP Process, it refuses to share basic KP information such as statistics on import

⁹⁴ Only if positive proof exists that the goods in the shipment consist of rough diamonds from one (KP) production country only will that be mentioned, in all other cases “*****” must be filled out on the KP Certificate.

and export of companies. The inflexible position of such jurisdiction within the trading route creates issues for other partners seeking to investigate ML and TF.

Judicial follow-up – Few examples were found of cases that were reported to judicial authorities or brought before court. Also, statistics are not available. Many files concerning ML from illicit trafficking in diamonds from the FIU reported to the judicial authorities are dismissed. The non-punishment of diamond trade-related offences is a major vulnerability in the prevention of ML/TF.

VULNERABILITIES IN THE DIFFERENT STAGES OF THE TRADE⁹⁵

As detailed previously, the diamond industry has a very long chain of production from the mining to the final customer, known in the industry as the "diamond pipeline". This "pipeline" involves practically all parts of the globe when taking into account the retail level, including internet trading platforms. On top of the vulnerabilities of each jurisdiction in terms of the regulation, supervision and enforcement, there are vulnerabilities associated with each level of the trade where the level of risk may change from jurisdiction to jurisdiction (in light of the specific characteristics of the trade in the jurisdiction). Some vulnerabilities are relevant for all stages of the trade (e.g. theft, commingling).

MINING

Vulnerabilities of alluvial vs. kimberlitic mines – Kimberlitic and alluvial mines differ in their level of their vulnerability to ML/TF. The vulnerability of the mining stage is dependent on the level of supervision and control put in place by the relevant national authorities⁹⁶. In general, the vulnerabilities of the mining stage are those associated with *illegal mining*, *commingling* of illicit diamonds and *theft*. Since kimberlitic mines are usually much easier to secure and control, they are less vulnerable and less exposed to these risks. In contrast, since alluvial deposits are much harder to secure and, as previously detailed, since mining may span over very large geographical areas, conducted to a large extent by artisanal and "informal" miners by hand, the risk of abusing these vulnerabilities is much higher. Thus, countries where alluvial, particularly artisanal mining⁹⁷, are more prevalent are more vulnerable to ML/TF activity.

Sierra Leone indicated that the diamond trade in Sierra Leone has been, and will remain to be, a major flashpoint for criminality and a high risk sector for ML and TF and has pointed to a link which can be made between ML **and** trade in diamonds to the trade in conflict diamonds. During the workshop in Dakar it was indicated that there are people coming to the country from abroad with cash and then fly out with diamonds.

⁹⁵ For a short discussion on some of the vulnerabilities in the different stages of the diamonds pipeline, see Siegel, Dina. (2009), pp. 160-161.

⁹⁶ See previous discussion on the characteristics of kimberlitic and alluvial mines on page 17.

⁹⁷ See World Diamond Council (n.c.) - "Prevalence of small-scale alluvial diamond digging is highest in Angola and the Democratic Republic of Congo (DRC) but also takes place, on a smaller scale, in the Central African Republic, Cote d'Ivoire, Guinea, Ghana, Liberia, Sierra Leone, Tanzania and Togo. It is estimated that 1.3 million people in Africa work in this sector".

Canada indicated **that** despite the highly controlled mining and security environment, increased diamond flows will provide more opportunity for attempts by criminal groups to infiltrate diamond mining and trading.

Illegal mining – This is one of the major issues for mining countries. South Africa indicated that there is a trend of illegal mining in the country that is becoming more prevalent. The trend is facilitated by the fact that some of these illegal miners are either mine workers or former employees who know the workings of the mines they target. Because of their size, diamonds are smuggled out of the mine premises without detection as they can be slipped under fingernails or by being swallowed; the use of homing pigeons was even noted. There are unfortunately certain players in the industry who are willing to buy illegal diamonds without questioning their origin. It was also indicated that the issue is that once the illegal diamonds have entered the industry it is impossible to track them. The diamond will be presented as if they were mined legally, and afterward they will be sold to diamond dealers who would export the diamond with a KP certificate issued by the appropriate authorities. This method of commingling illegally mined diamonds is also conducted when diamonds are mined in neighbouring countries, smuggled across the border and then inserted into the legitimate trade. The problem of illegal mining and smuggling was brought up by two additional African mining countries in the 2012 FATF / GIABA Typologies workshop.

ROUGH TRADING

The product vulnerabilities discussed above are characteristics of the trade in rough diamonds. There are additional vulnerabilities with respect to the KP certificate which should also be noted.

Kimberley certificate is required only on import and export – According to section II (a) of the Kimberley Process Certification Scheme *"Each Participant should ensure that: (a) a Kimberley Process Certificate (hereafter referred to as the Certificate) accompanies each shipment of rough diamonds on export⁹⁸".* When a rough diamonds is traded locally there is no need for a Kimberley certificate. Thus, it is possible to cut an illegally mined or otherwise illegally gained rough diamond, polish it locally in order to conceal its source and export the polished diamond without the need to issue or present a KP certificate⁹⁹. While a change in the scale of beneficiation has a positive side, the more mining countries, particularly African countries, expand their beneficiation process the risk of cutting and polishing the rough diamonds locally and avoid the need for a KP certificate, as a ML/TF tool, may increase. This may also mean that the risk of rough diamonds being smuggled and then cut and polished as a mean to conceal their illegal source may also increase. For example, it would be easier to conceal rough diamonds bought with cash proceeds of crime by cutting and polishing the stones locally and exporting the polished diamonds without the need to issue a KP certificate.

Kimberley certificate and ML/TF – the KPCS was established for the purpose of curbing the trade in "conflict diamonds". While there may be some bearing on ML/TF activities in that the predicate

⁹⁸ See Kimberly Process (nc), page 5.

⁹⁹ For this reason the World Diamond Council has created the WDC System of Warranties, by adding a warranty stating the conflict free nature on each invoice.

offence may be committed by those who are involved in the trade in "conflict diamonds" (such as smuggling), this is not ML or TF per se. However, when a shipment of rough diamonds is accompanied by a KP certificate, this may give legitimacy to the shipment to customs officials and bank employees.

TRADE CENTRES (ROUGH/POLISHED)

Transfer pricing – transfer pricing can take place at a variety of stages of the trade, but FTZ centres are most vulnerable. As mentioned, the diamond trade is international in nature. The diamond industry includes multinational companies with operations spanning across many countries, serving as trade centres of rough and polished diamonds. The term 'transfer pricing' is usually used in the context of tax regimes where related companies (subsidiaries, affiliates) conduct international transaction between themselves¹⁰⁰. Such practices are also prevalent in the diamond industry. While transfer pricing may be conducted in a legitimate fashion (i.e. in accordance with relevant tax regimes), it opens up the possibility to commit tax fraud and ML. Diamond trade centres like Dubai, which operate as FTZ are susceptible to vulnerabilities as specified in the FATF report regarding the ML vulnerabilities of FTZ.¹⁰¹ This, in combination with the specific vulnerabilities of the diamond trade and the mechanism of transfer pricing, creates a significant vulnerability for ML and TF activities. By way of over or under invoicing with affiliate diamond companies located in FTZ, it is possible to illegitimately shift profits from diamond companies in high tax rate countries to FTZs and thus avoid taxes¹⁰². It is also possible to use the same scheme for ML/TF purposes. The combination of a lack of transparency in the diamond trade with a lack of transparency in a FTZ provides an excellent atmosphere to conduct large volume transactions without being detected.

Transfer pricing can occur during different stages of the trade, such as rough diamond trading from African mining countries to diamond trade centres where by African countries will be losing huge amounts of due tax to FTZs. One African mining jurisdiction indicated that the risk of transfer pricing is ever eminent. It can also occur as stated above between two trade centres of both rough and polished diamonds where one jurisdiction will have high tax rates and the other jurisdiction will be a FTZ or have very low tax rate.

Issuing of new KP to conceal the source of diamonds - Belgian investigators have noticed that shipments are being diverted to one of the billion dollars trade centres where the original certificate and invoice were, still in accordance with the rules of the Kimberley Certificate, turned into a new KP certificate (origin: mixed or unknown) **with a higher price** and sent further to a trading centre. Although each member state of Kimberley is obliged to make a new Certificate, the police suspect

¹⁰⁰ For a definition of transfer pricing see TP Analytics (n.c.).

¹⁰¹ In March 2010 the FATF published a typologies report – *Money Laundering Vulnerabilities of Free Trade Zones*. The documents illustrates the vulnerabilities associated with FTZ particularly TBML including over and under invoicing. According to the report a FTZ provides among other things a relaxed oversight and lack of transparency. The report also states that "The existence of vulnerabilities in a system makes it attractive for money launderers and terrorist financiers".

that this trade centre is used as a transit country that produces “new” documents to hide the origin of the diamonds and facilitate the diversion of payments.

The full purchase price, as mentioned on the invoice, is transferred and channelled to different accounts all over the world, private accounts or accounts of individuals. In the accounting, all transfers are recorded on the supplier situated in this particular trade centre. The relation between the beneficiaries of the funds and the supplier in the trade centre is unclear. Police investigations showed a strong relationship between the final buyers and the companies in the trade centre. Once a supplier was identified by the police, the relationship ended and the trade went on through another supplier.

Facilitating corruption - From a trading centre perspective - through under-invoicing of the rough diamonds in mining countries, acquired margins may be created to facilitate payments to PEPs, military or other invisible stakeholders in the transaction.

CUTTING AND POLISHING

Diamonds are not bound by any certification requirements to identify origin once cut and polished – This is another feature which makes diamonds very easy to move and conceal high value, and is also what lends polished diamonds similar characteristics as those of cash. This means that it is easy to move the diamond up the supply chain through trade centres for polished diamonds without an ability to verify the origin of the diamond; the larger and less supervised the market is, the easier to move the stones. Moreover, as there is no requirement to document the origin of the diamond while conducting a business transaction in polished diamonds, it may be impossible to verify who the previous sellers were, i.e. it is easy to lose the polished diamond trail. However, there are technologies in place which enable diamond marking. This technique allows a polished diamond to be traced to its origin and facilitates a better documentation of transactions by including the details of the diamond as part of the documents accompanying the transaction. However, marking is not done on all diamonds and is not documented on all transactions, leaving the possibility to lose the “diamond trail”.

Untraceable diamonds - Cutting and polishing is often an important part of illicit diamond trading. A diamond's size and form can be significantly altered, making it more difficult to trace the stone back to its origin as illicit rough. It is also possible to further cut an illicit polished stone so as to avoid the identifying of the polished stone which was illegally gained (E.g., recut a stolen polished diamond). Thus, one part of disguising the origin of an illegally gained rough or polished stone can be to cut or recut it, polish the diamond and then sell it within the local or international market. It should be noted that whilst there is an increasing trend for diamonds to be cut and polished in the country of origin (beneficiation), the vast majority of diamonds continue to be processed in the ‘cutting centres’ that are outside of the producing nations. There have been suspicions that clandestine diamond operators in some producing nations, particularly African alluvial, have been cutting and polishing. Whilst this might be true on a very limited scale there is a continued lack of evidence to support the notion of any scaled up polishing being carried out. Consequently the main focus should remain on rough diamonds.

RETAIL LEVEL

The retail level is perhaps the largest part of the diamond trade chain. It includes jewellery shops, pawn shops, trade fairs and wholesalers of jewellery, and encompasses both new products as well as the recycled market. While mining and trade centres are located in specific countries, it is estimated that there are more than a quarter-million retailers who sell jewellery to consumers around the world¹⁰³. The entire jewellery manufacturing and retail market are too great for the scope of this report, but they may be touched upon based on the analysis conducted on the different stages of the trade and the vulnerabilities identified by team members. The following vulnerabilities were identified:

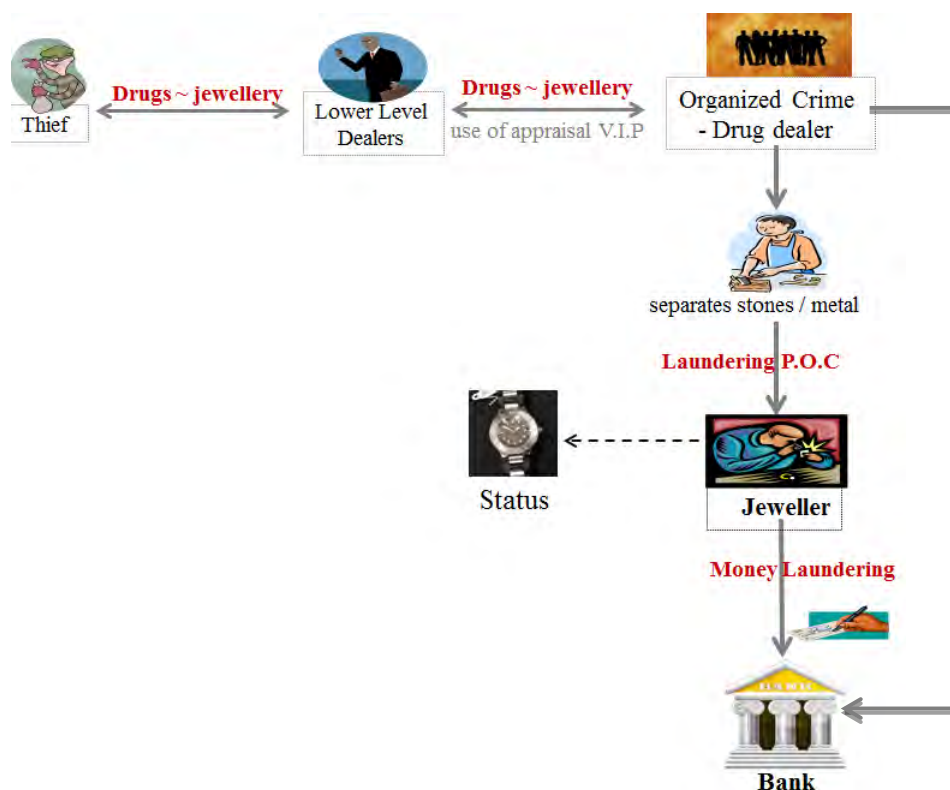
Supervision and enforcement are difficult - due to the extent of the sector it was indicated that it is very hard to conduct supervision and enforcement. Jewellery retailers can vary from very small individual jewellery shops up to worldwide chains with hundreds of outlets. Some jewellers do not have enough capacity or are not legally required to dedicate resources to AML/CFT campaigns or reporting. They may also be less wary of AML/CFT in general and could be a target for criminals to launder goods.

Use of cash - It was noted by Canada that further down the supply chain, i.e. the jewellery/retail level, the trade becomes more cash-based. Large cash deposits provide an opportunity for jewellers to introduce illicit funds into the legitimate economy disguised as proceeds of cash sales from diamonds.

Laundering of stolen jewellery/drug proceeds – this is perhaps the main vulnerability identified, particularly through actual cases submitted by team members where the retail level was used to launder funds or illicit diamonds. Second-hand jewellery shops and pawn shops were identified as vulnerable by allowing stolen diamonds or diamonds which were used to pay for the purchase of drugs to be re-entered into the market by selling the goods at the retail level, in many cases as accomplices of the criminals. As mentioned above some of the cases emphasised this vulnerability of the retail level by showing how laundering is taking place in actual means. The US indicated that small jewellery shops may deal with extremely large amounts of sales (millions of dollars annually). This provides the possibility to launder very large sums of money. This vulnerability is basically not different from that which characterises other parts of the trade, i.e. *commingling* of illicit diamonds. Commingling can be done at each and every part of the trade chain.

¹⁰³ Bain & Company (2011), pp 50.

Figure 7: Criminal Organisation Importing / Producing with several lower level syndicate dealers



KYC/CDD measures – retailers will buy polished diamonds either from a local wholesaler or from foreign wholesalers. Conducting CDD procedures with foreign suppliers/customers can be difficult as it is not always possible to establish the identity of the beneficial owners of the foreign company and to verify that the information provided is genuine. It is often easier to conduct KYC/CDD procedures with local retailers or wholesalers since identifying information is more available.

As reported by authorities, in consultation with the relevant private sector in each country, KYC or CDD requirements for dealers in diamonds are usually not legally required for two main reasons:

- there is an informal knowledge of the actual and potential customers due to the recurring business activities and transactions conducted, or
- these requirements are covered by other reporting and registry obligations, mainly related to taxes or accounting.

While this is true for B2B transactions, the situation is different with retail transactions or sales directly to the customer.

Fraud - One jurisdiction indicated that the main vulnerability of the retail level is fraud which can be divided into several types:

- a) False grading – where a stone's true grade is not reflected in the nominated grading.
- b) False certificates – where a grading certificate has been counterfeited, subject to unauthorised amendment, duplicated and attached to stones of varying quality.

- c) Misrepresentation of stone – where other stones are passed off as diamonds.
- d) Non-disclosure of type – where synthetic diamonds and fracture-filled diamonds are not declared as such and are passed off as undamaged, naturally-mined diamonds.
- e) Valuation fraud – where a stone is undervalued to avoid customs duty and/or tax.

Theft/Robbery – as other sectors of the trade, it is susceptible to theft and robbery (see also below vulnerabilities related to all stages of the trade).

VULNERABILITIES IN THE USE OF THE INTERNET

The internet has been for many years now a trading platform for goods and services of every kind, and this includes the diamond and jewellery trade. In the United States, such trade sites began operation mostly during the last decade. While the average retail sale on the internet is under USD 10 000, internet sites have become celebrated by both large and small buyers for its "price quotes". These sites give buyers across the country access to New York wholesale market prices for diamonds. Since it has no advertising overhead and gets customers through word of mouth, it may save consumers up to 40% from retail prices. This relatively new trade platform also brings with it vulnerabilities which may be applicable to all sales and purchases on the internet, including buying of rough and polished stones and diamond jewellery. A quick survey on the internet reveals that the largest diamond companies offer online platforms (De Beers, Alrosa, Rio Tinto and BHP Billiton), with a very developed international online market of diamond dealers of every size.

KYC/CDD measures – internet trading platforms allow for both B2B and B2C transactions. Conducting transactions over the internet allow for increased anonymity of the customer, making it harder to conduct KYC/CDD procedures. For example, it is possible for a customer situated in one part of the world to buy diamonds which will be sent from another part of the world via courier services such as FedEx without the diamond dealer and the customer ever meeting. The price of the diamond can be very high (for example, the price of 12.01 Carat D-IF Excellent Cut GIA Certified Round Diamond 14.69-14.73x9.13mm, up for sale on EBay, has reached 2.725 million USD, see Figure 5). When speaking about a sector which is not regulated as well as financial institutions, it is hard to enforce on diamond dealers the application of AML/CFT regulation, including KYC/CDD measures.

However, and perhaps of more importance, since the FATF definition of dealers in precious stones includes only cash transactions, the internet trading platform for diamond dealers is not covered by the AML/CFT standards¹⁰⁴, since payment is facilitated almost entirely through banking and credit institutions or internet payment means. While these financial institutions may perform their KYC duties based on the applicable regulation of the jurisdiction, it will be performed on the party transferring the funds only and not necessarily on the customer buying the diamond over the internet.

¹⁰⁴ There may be instances when national legislation goes beyond the FATF Recommendations and may cover this activity.

Checks conducted by the project team located trading sites providing a platform for buyers to meet sellers, conducting tens of thousands of gem stones auctions, including rough and polished diamonds, where in registration all that is required is a username password and email to verify registration:

"In order to participate in the auctions ... you must first register to become a member. First, you must select a username, which is the name you will be known by while you're on our site. Please note your Username will be viewable by all ... members. You will also be asked for a password to secure your account. Please note that once you've chosen a username, you will not be able to change it.

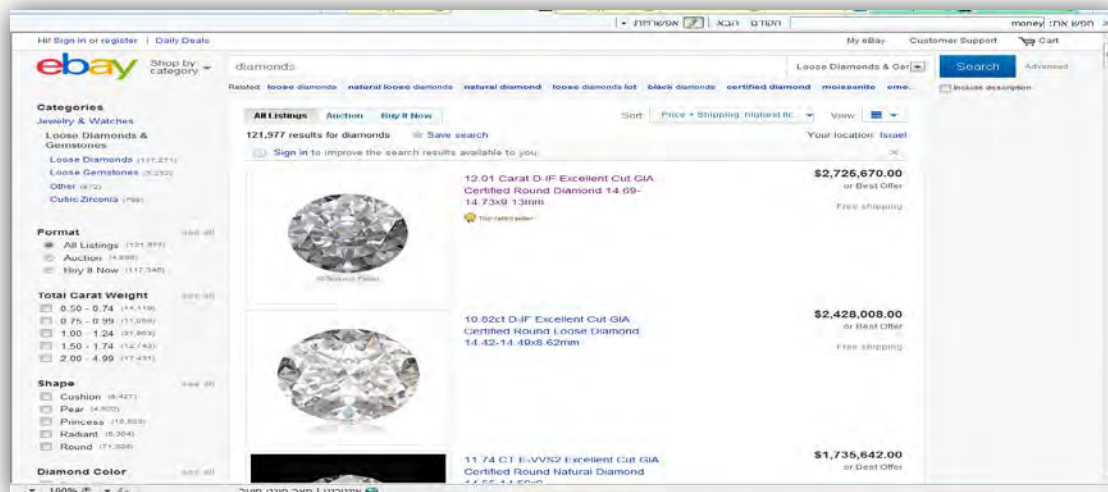
You must provide valid contact information and a valid e-mail address. This is required so that buyers and sellers will be able to contact one another once an auction closes"

"After you submit your registration, you will receive a confirmation e-mail message ... You may begin bidding immediately"

This registration procedure of minimal identifying requirements is similar to some internet payment means which in the past facilitated ML activity (e.g., E-gold¹⁰⁵).

This means that trading platforms may be used to easily move very high value stones internationally without either establishing the identity of the buyer or the identity of the seller.

Figure 8: Example of eBay online trading site – cut & polished diamonds worth millions of USD



Source: Internet screen shot July 2013

Rough diamond online sales – as mentioned above, it is also possible to buy and sell rough diamonds via the internet. This may also be done globally using international courier services. It is not clear in all websites whether a Kimberley certificate is attached to the shipments in these transactions. One web site indicated that *"all international shipments will receive a UN "Kimberley*

¹⁰⁵ See US Department of Justice (2007).

Certificate". All domestic shipments come with the appropriate guarantees that they are non-conflict diamonds as laid out by the United Nations¹⁰⁶".

In a consultation with WFDB it was noted that it would be difficult to buy rough diamonds online since it is necessary to physically examine the stone in order to evaluate the price. Online sites offer a refund in case a customer is not 100% satisfied; however, this is vulnerable to fraud¹⁰⁷.

Internet payment systems – in 2010, the FATF published a typology report on "Money Laundering Using New Payment Methods" (NPMs)¹⁰⁸. The report identified the vulnerabilities associated with NPMs, including anonymity and the global access to cash through ATMs, but also stated that "where NPM providers are subject to AML/CFT obligations and appropriately supervised for AML/CFT purposes, NPMs can make payment transactions more transparent and help prevent corruption or other abuses". This is because a transaction via NPMs leaves an "electronic record". The vulnerabilities that were identified in the above mentioned report create risks to the trade in diamonds over the internet, in light of the previously discussed characteristics of the product and the fact that diamond dealers are not routinely subjected to AML/CFT obligations for the majority of their transactions over the internet. However, to the extent that AML/CFT obligations apply to both NPMs and diamond dealers on the internet, the "electronic records" may serve as a mitigating factor by providing an audit trail.

Trading platform as a mean to launder funds – it is relatively easy for a criminal or money launderer/terrorism financier to establish a diamond trading platform online to disguise the source of funds.

Fraud – a customer buying a diamond via an internet trading platform is exposed to the risk of fraud. Fraud-related vulnerabilities were previously specified with regard to the retail level of the trade (false grading, false certificate, misrepresentation of the stone, non-disclosure of type and valuation fraud). All of these vulnerabilities also apply to the online trading platform. However, there is an additional vulnerability of no supply, where a customer pays in advance but does not receive the stones he or she paid for. There are payment and delivery methods whereby a customer can avoid such an occurrence. For example, a diamond may be shipped to the customer for inspection and payment is made only after the customer has examined the stones and the documentation to his or her satisfaction. The stones are shipped upon proof of payment to the secure courier service. According to the consultation conducted with the Jewellers of America, in most cases the customer will see a diamond prior to purchasing it.

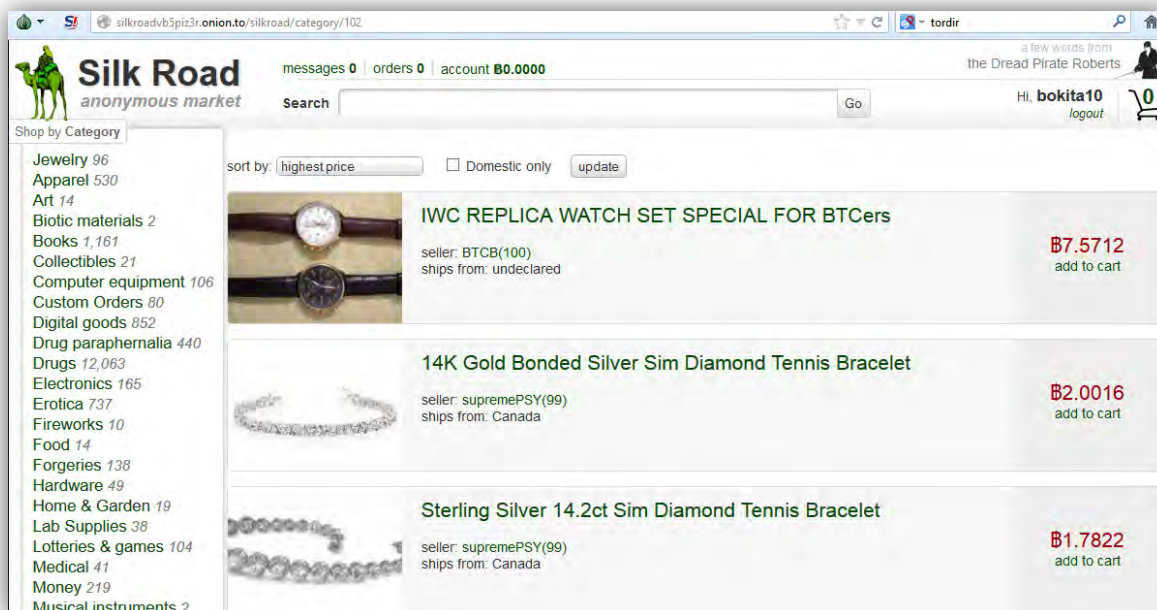
Laundering stolen diamonds via the "Darknet" –In spite of not being a common activity, Silk Road offers jewellery with diamonds of unknown origin. It can be purchased and paid in Bitcoins. It is delivered by Fedex or any other courier service in a plain envelope without a description of the goods inside.

¹⁰⁶ While the UN indeed supports the KP, it doesn't have any formal/legal relationship with the KP (indeed, the KP itself is not a legal entity). In other words, KP certificates have nothing to do with the UN.

¹⁰⁷ This is not unique to online diamond trading platforms.

¹⁰⁸ FATF (2010).

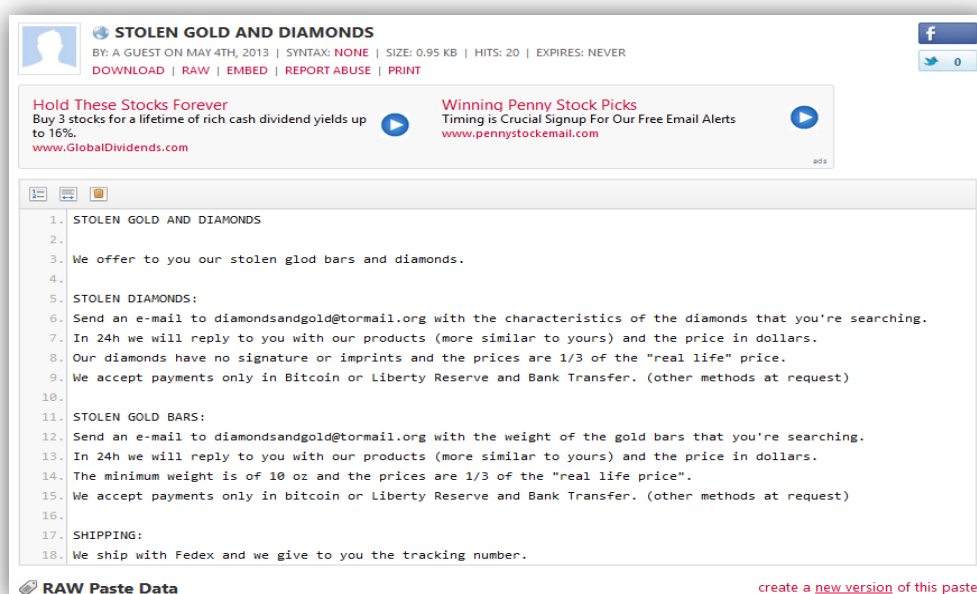
Figure 9: Jewellery with diamonds offered for sale on “Silk Road”



Source: Internet screen shot July 2013, Exchange Rate: 1 Bitcoin = 98 USD

There are sites that offer stolen gold and diamonds that can be pre-ordered according to customer preferences. The payment is made in Bitcoins or bank transfers and shipped by Fedex. Liberty reserve was also accepted. This illustrates one of the venues by which stolen diamonds are offered for sale and laundered using Bitcoins.

Figure 10: Stolen gold and diamonds for sale



Source: Internet screen shot July 2013

VULNERABILITIES RELATING TO ALL STAGES

Theft/Robbery – Theft or robberies of diamonds can occur at all stages of the trade. Since diamonds are of very high value, they are targeted by artisanal miners, employees of diamond companies, and criminals including criminal organisations. Several countries pointed to theft as being one of the most prevalent risks of the trade. This can be seen by the cases¹⁰⁹ submitted by team members and also by open source information on cases of theft or robbery of diamonds in values which can reach many tens of millions of US dollars.

Heists of diamonds have probably occurred in all times, but the value and volume of diamonds' heists in the last decade has developed in leaps and bounds. In the first half of 2013 alone two robberies of very high value took place in Brussels Airport¹¹⁰ and in the French Riviera¹¹¹. The theft of diamonds and jewels owned by Israeli billionaire Lev Leviev could be the largest jewellery heist in years, the worth of the stolen jewels was estimated at USD 136 million.

The recovery rate of stolen diamonds is usually very low. Open source cases show that stolen diamonds / jewellery are usually not found. Since diamonds are laundered in many cases through the trade, this is an indication of the ease with which very high -value diamonds can be laundered without a trace. Some cases showed that criminals used diamond dealers/jewellers to dispose of the illicit diamonds in their possession.

What is interesting here from a ML/TF perspective is that since the case is that, even for such extremely high amounts, the diamonds simply disappear then the same may be said with regard to ML/TF schemes through the diamond industry – the possibility today to trace such schemes where proceeds of crime are traded for diamond and then laundered through the trade is very low¹¹².

However, Australia noted that there is a misconception that theft is a key vulnerability at the jewellery manufacture and retail stage. While the jewellery retailers are often targets of theft, these robberies (generally 'smash and grab' jobs where quality jewellery is not necessarily targeted) account for only a small percentage of Australian thefts.

Australia also noted that theft in the diamond industry is more likely to occur in transit than at any of the six stages of the diamond pipeline. Diamonds in transit are particularly vulnerable to third party and opportunistic theft. Many diamond industry participants view transit as their largest risk.

According to the WFDB, most of the kimberlitic mining process of the mining stage is mechanised and is laser sorted. This has reduced considerably the risk of theft from kimberlitic mines. There are indications that in general, the frequency of theft has gone down significantly.

Smuggling - Despite controls put in place by authorities and mining companies, the smuggling of diamonds remains a problem. According to the information collected by the project team, it is

¹⁰⁹ See for example case no. 8 and case no. 16.

¹¹⁰ See CNN (2013).

¹¹¹ See Jewish Daily Forward (2013).

¹¹² Dina Siegel looks at the largest robberies of the 21st century in which diamonds worth many tens of millions of euros were stolen and never recovered. She provides six different ways in which the diamonds could have been laundered. See Siegel Dina (2009), pp. 173 - 178.

difficult to ascertain the extent of the smuggling and that of the illicit market in illegally-obtained diamonds. South Africa has indicated that once the smuggled stones have entered or left a country, they are virtually impossible to trace.

Instances of smuggling were noted in the contributions of Australia, Canada, Israel, Namibia, Netherlands, Sierra Leone, South Africa, Russia and USA. The cases in the United States concerned smuggling of uncut rough stones on the body of couriers, via commercial flights. The operations were linked to a "ML organisation". The organisation provided contact points for a broker and facilitated the payments for the smuggled stones. There were indications that the stones originated from conflict areas or that they were illegally obtained. The insertion of such smuggled stones into the legitimate market is accomplished by the "ML organisation", in cooperation with local dealers and through trade shows.

Nearly all rough diamonds found in the world today are controlled by a relatively small number of governments and private mine owners and conglomerates. There are some smugglers who pilfer from the concessions of those who control the rough diamonds from both government and private mines. Another country indicated that diamond smuggling is usually perpetrated by the employees of those companies.

The larger the extent of smuggling of diamonds, the easier it is for criminals to use smuggling for ML/TF purposes, *i.e.*, buying illegal diamonds with cash, smuggling the diamonds to a different jurisdiction and inserting them into the legitimate trade with almost no possibility for the diamonds to be traced. South Africa noted that there have been cases where criminals have been found trying to smuggle diamonds into/out of the country, especially through the airport, most of these destined for Europe.

In 2007¹¹³, an assessment by an independent diamond expert provided information on several countries where smuggling took place:

- It is stated that with regard to Brazil that most of the diamonds mined in the country are smuggled out. Locals estimate that production may reach **USD 550 million annually** where formal production is several million USD;
- With regard to Central African Republic it is argued that the total export from Central African Republic is reportedly at least twice the official export data.
- A large part of the production in Sierra Leone is smuggled through Guinea, Liberia and other countries¹¹⁴.

Commingling - Once diamonds are stolen, whether rough or polished, loose or mounted diamonds, in most cases, the offender will have to reinsert them into the legitimate trade in order to receive a pay-off. The same is true for illegally mined diamonds, which, in many cases, will be reinserted into the trade through another diamond mine. Thus commingling of diamonds is actually part of the ML/TF process and every stage of the "diamond pipeline" is vulnerable to commingling.

¹¹³ Even- Zohar, C. (2007).

¹¹⁴ *Ibid*, pp. 125, 197, 234.

South Africa identified a risk whereby small-scale operators may be tempted to buy illegal diamonds from other countries and try to pass them as legally mined diamonds. This in fact is an example of commingling through the mining sector.

TRADE FINANCING VULNERABILITIES

Use of cash - In order to better understand the extent of cash use in the trade of diamonds, it must be divided into two categories: wholesale and retail.

In general terms, the trade of diamonds through wholesale or other large dealers and brokers is **becoming less dependent on cash transactions, with wire transfers becoming the preferred method of payment**. While an overall decrease in the use of cash was reported, including in cash-based economies, by financial institutions and by team members, it is difficult to assess whether the level of risk generated by the use of cash being used remain significant. Analysis of the cases provided by team members show numerous cases involving cash transactions, including some cases where by cash proceeds of crime are placed, as part of a laundering scheme, in the diamond industry by means of buying diamonds with cash or depositing cash into diamond dealers accounts. Thus, it is possible to infer that even though cash is diminishing, cash usage still poses a risk for ML/TF in the diamond trade.

There are risks involved with the use of cash in large-scale transactions. A number of African or Latin American countries, some of them being diamond producers, still have a cash based economy. This makes cash the main payment method to conclude business with such countries. There are cases in which these transactions lack documental support, thus making them a very attractive means for ML and financing of terrorism. Moreover, as reported by one of the countries, depending on the local regulations, companies or individuals are able to conduct business in cash with foreign diamond bourses or fairs without the requirement for them to file a corresponding report. Therefore, we can conclude that, while most countries agree that the use of cash for large scale business to business (B2B) is being used less frequently, there are still transactions concluded this way that create a vulnerability within the AML/CFT regime.

At the retail level, transactions are typically smaller (when compared to the acquisition of bulk diamonds), and they can be conducted using cash more easily. Smaller diamond dealers, retail shops and even pawn shops can sell finished pieces of jewellery or even separate diamonds with cash as the payment method. Trends point to a decrease in the use of cash, mainly due to the introduction in some countries of legislation restricting the use of cash to purchase high value goods, such as jewellery and diamonds. However, not all countries have retail outlets or pawn shops among their catalogue of reporting entities, which means that transaction reports may not be received for sales of diamonds in all cases.

Uses of "IOUs" or promissory notes - **promissory notes** are used to cover debts related to the trade of diamonds (especially in bulk) by miners, dealers, brokers, cutters and polishers. They are negotiable instruments – as opposed to IOUs, which are non-negotiable instruments – and can be treated in the same way as cash (i.e. transferrable to a third party). The free and unrecorded circulation of these mostly honoured IOUs creates an unofficial and unmonitored "banking system", that provides financing for traders, outside the official banking system. Furthermore, in most

circumstances, the circulation of the promissory notes is totally "in house" within the "guild" of diamonds. The actual financial risk of a diamond dealer is "under the radar" of the official banking creditors and regulators.

The unrecorded circulation of IOUs facilitates the transfer of high value assets, without a trace in the monitored financial system. Thus, it is possible to cause the transfer of large scale funds, just by word of mouth among two persons who are members of Diamonds exchanges in different and remote locations.

The vulnerability of these cash like mechanism lays also in that it is possible to pay for the purchase of diamonds with an IOU, even with a 3rd party IOU, with no AML/CFT duties applying since only cash transactions fall under the standard and the AML/CFT legislation in most countries. This means that through the use of an IOU it is possible to avoid KYC procedures and reporting to the FIU with no audit trail of the transaction. While cross-referencing of these negotiable instruments may be useful, it is uncertain whether or not this is common practice for notes exchanged for diamond trade. Participant countries sent limited information regarding this issue, so further research is **recommended** to better assess the extent of the use of IOUs between diamond dealers and the risks entailed by such practice.

Use of diamonds as a collateral currency - Diamonds are an attractive alternative for criminals and terrorists to transport and transfer value physically, as diamonds are relatively small in size and are high value goods. The latter has also made diamonds a feasible alternative to currency, which is used in some countries by criminal or terrorist groups to buy supplies, drugs, weapons, or pay for drug-trafficking related debts.

This is relevant considering that diamonds could be **stolen** pieces, "conflict diamonds" or diamonds used to pay for drugs or weapons. Forged Kimberley Certificates can allow them to pass as recently and legally extracted stones, those bought as investments or as used diamonds removed from pieces of jewellery.

This is particularly important to financial institution providing loans against diamonds as collateral. Without the ability to verify the source of diamonds either for rough diamonds where a KP certificate is available or for loose polished diamonds where there is no certificate, there is a risk of such loans being part of a ML/TF scheme.

Memo transactions – As mentioned, memo transactions may bear some vulnerability to misuse in terms of ML/TF. These vulnerabilities are linked to possible variation of the prices of the diamonds evaluated, over or undervalued, and to the possibility of fraud committed by the consignee. For example, a potential buyer may review a parcel of diamonds and select some of the stones while returning the unsold diamonds to the consignor. The original shipment may occur at a certain stated value while the unsold return is made at another value (potentially over or undervalued). This flexible gap of value is common and may not be considered unusual or suspicious by the financial institution. But, it may also be used for ML purposes. The difference in price also raises the question whether the stones returned were all included in the shipment in the beginning. It has to be noted that the percentage of returns of polished diamonds is high. Consignment transactions may be considered by some countries to be high-risk deals with stricter rules for financing by the banks. In certain cases that involve familiar and reliable diamond dealer account holders, some banks do transfer funds or accept funds as advance payment without any document agreement

(save for a statement by the diamond dealer account holder), and then monitor the advance payment. The bank may be limited in the ability to verify that the financial transactions correspond to the terms of the memo and the value of the diamonds. The other risk linked to memo transactions is the possibility for fraud, when the consignee does not return the diamonds consigned.

"Advance payment" – some of the accepted **financial** practices by diamond dealers may also serve as conduit to ML or TF. For one, it is an accepted practice to transfer funds as an advanced payment for the stones. These are payments conducted without sending the precious stones. In many cases the advanced payment is returned back to the customer/diamond dealer. These transactions may be used to send back money from a 3rd party.

"Return shipments" – another accepted practice which create a ML/TF vulnerability is the return of shipments (partial or hole). In transaction such as memo transactions, stones are sent to the customer for his review and in case the customer is not satisfied with the stones he will send some or all the stones back to the diamond dealer. This in many cases would be accompanied with a return of funds already paid. Banks financing the trade should be aware that the funds should be returned from the same party to which the funds were initially transferred to and also with the same value. This may also be relevant to the diamond dealer where his customer is asking to transfer or transferring such funds to a third party.

"Fork Transactions" – in general these are transactions where funds are sent/received to/from other parties than those appearing in the documents as customer/supplier. As illustrated later, several cases illustrate such transactions conducted via diamond dealers' accounts.

Date of sale vs. date of payment – while conducting a transaction, the diamond dealer and its customer (which may also be a diamond dealer) will negotiate the terms of the deal including terms of payment. In most cases the diamonds will be provided close to the date of the sale and before the payment is received. The date of payment may be upon delivery of the diamonds but may also be several month later.

According to Recommendation 22 of the FATF (customer due diligence for DNFBPs) CDD measures apply for Dealers in precious metals and dealers in precious stones: *"when they engage in any **cash** transaction with a customer equal to or above the applicable designated threshold"*.

The same applies to Recommendation 23 with regard to reporting duties of DNFBPs which states that dealers in precious metals and dealers in precious stones *"should be required to report suspicious transactions when they engage in any **cash** transaction with a customer equal to or above the applicable designated threshold"*

In many cases, the form of payment will determine the AML/CFT duties, it may be the case that the KYC and reporting duties will be conducted long after transaction took place and the diamonds have been delivered to the customer. Since, diamonds are a form of currency and may be used themselves for ML/TF purposes, this creates a vulnerability in which the ML/TF process may have taken place long before the details of the customer were verified and a report was sent to the relevant FIU.

Deficiencies in KYC / CDD procedures - In a number countries, diamond dealers and brokers are not accustomed to performing KYC or CDD procedures, as the industry is fairly closed to a limited

number of persons, involved in the business even for generations, who generally know each other. According to industry sources, it is difficult for a new and unknown individual to get involved in the trade of diamonds without being referred or introduced by an already established dealer¹¹⁵. In these cases, identification and cross-referencing of information may be used, however it is not mandatory.

The procedures to identify customers that purchase diamonds at the retail level are not the same in every jurisdiction, mainly because some countries do not consider dealers in diamonds, jewellers or retail outlets, including pawn shops, as reporting entities. Depending on the jurisdiction, sales outlets or even large-scale, wholesale transactions may be subject to reporting duties for large cash transactions or suspicious transactions.

The main difficulties to perform due diligence on customers arise from the international nature of the trade. The risk of these transactions is further increased when at least one of the parties conducts business through brokers, in which case the seller and buyer may not know each other. The trade of diamonds through the internet has become both a feasible and lucrative activity. However, the online trade in diamonds lacks sufficient – or, in some cases, any – procedures to identify customers and perform due diligence on potential buyers or sellers. This provides a level of anonymity that makes this market attractive for trade of diamonds with the purpose of concealing the illicit origin of resources or financing terrorist activities. KYC will be challenging to the banking institution receiving the payment from the buyer, since if the diamond dealer selling the diamonds does not fully know who his customer is then this is even more so for his bank.

One jurisdiction identified the lack of a central and up-to-date database with information on all registered individuals and legal entities dealing with diamonds – mining, exporting, importing, cutting, polishing or sales – worldwide as a deficiency on implementing KYC measures. This can prove helpful for assessing B2B transactions, but would still have little effect on retail level transactions, which have been linked by most countries to most risks.

The WFDB indicated that someone who is not a diamond bourse member cannot walk in to another diamond bourse and trade with the local members. It is required to present a letter from the bourse where he is a member, to the bourse where he intends to trade.

Screening of transactions - Reporting duties of transactions involving diamonds and other precious stones are, for most countries, in line with reporting duties established for other activities and businesses, both financial and non-financial, with the requirement to file reports before the relevant authorities when said transaction is above the established threshold or the characteristics of the transaction could raise suspicion.

Countries have recognised that information regarding the common practice involving transactions at various market levels is far from sufficient. Also, one of the countries reported that banks usually have limited ability to confirm that the parties to a transaction are, in fact, involved in the formal production and trade of diamonds. This may be one of the explanations for the low level of reporting as evident from statistics provided by team members.

¹¹⁵ This is sometimes required by law. In the consultation with the WFDB it was said that this is a requirement from all bourses of the WFDB.

CHAPTER 7.

RED FLAGS AND INDICATORS OF ML/TF¹¹⁶

There are many avenues in which diamond and jewellery may be bought:

- trade centres and diamond bourses;
- precious stones fairs in HK, Thailand, Switzerland and USA;
- Tenders;
- Sights;
- internet platforms;
- jewellers/jewelleries;
- Pawn shops.

Each stage of the trade may have its own red flags and indicators on top of red flags and indicators which are general and apply to all stages of the trade.

The 2008 FATF RBA guidance paper for dealers in precious metals and stones lays the foundation for an analysis of the risks which dealers in precious metals and stones, among other relevant players, are facing while conducting their business and provides the "*criteria to assess potential money laundering and terrorist financing risks*¹¹⁷". These criteria are reflected in some of the indicators below and may assist relevant players to identify specific possible ML/TF activity.

The following indicators have been identified from an analysis of the responses and cases collected by the project team. The existence of a single indicator does not necessarily indicate illicit activity, but should encourage further monitoring and examination. In most cases, it is the existence of multiple indicators which raises suspicion of potential criminal activity. These red flags and indicators may also assist in performing more general ML/TF risk-analysis in the diamond industry.

At the onset a clear distinction should be made between two different categories of red flags:

- red flags to **financial institutions**, mainly to banking corporations, referring to financial transactions carried out by entities involved in the diamond trade; and
- red flags or indicators referring to the **entities involved in the trade of diamonds** being one sector of the DNFBPs.

The first category of indicators is much more familiar and covers many indicators which would perhaps be relevant to other types of financial activities. The second category, the trade in a

¹¹⁶ The following member countries provided direct responses to the Collection Plan topic on red flags/indicators – Australia, Canada, Israel, The Netherlands and the United States. The red flags and indicators provided by the Netherlands were derived from Customs related case studies. There applicability is limited to import and export situations.

¹¹⁷ FATF (2008a).

commodity, is somewhat different and requires knowledge of the regular patterns and characteristics of the diamond trade throughout the "diamond pipeline". This second category is targeted more to diamond dealers themselves.

Further analysis of member responses identified four categories of indicators.

- a) Red flags and indicators for regulated entities
- b) Indicators related to the trade in diamonds
- c) Indicators for the diamond industry at each stage of trade
- d) Indicators specific to customs cases involving the import/export of diamonds

All categories have been included to provide the Egmont/FATF Project Team with a strong foundation to inform this chapter of the report.

Some member responses related specifically to one or some the above categories. Where possible the stage of trade is highlighted in brackets at the end of the indicator. For example:

- Israel provided indicators which are related to the trade in diamonds (category 2 above)
- The Netherlands provided customs cases from which indicators were drawn.
- Canada reported that it provides guidance to dealers in the precious metals and stones sector. This guidance includes red flags for possible suspicious transactions. Canada also reported that many indicators from diamond-related ML/TF cases were generally consistent with common ML indicators. Canada also identified red flags specific to the diamond industry at each stage of the trade.

It is also important to emphasize that while some general indicators have been identified, they are only partial and are not a replacement of general ML/TF red flags and indicators for reporting bodies.

Important remark: for the purpose of this section *only* the term Diamond Dealer will refer to all actors along the different parts of the trade from the mining sector to through dealers in rough or polished diamonds to jewellery retailers and pawn shops (unless the stage of the trade is specifically indicated).

RED FLAGS AND INDICATORS FOR REGULATED ENTITIES

The following indicators may assist regulated entities to identify potential ML/TF activity through the trade in diamonds and diamond jewellery. In most cases, these are general indicators serving to identify ML/TF activity of customers which are diamond dealers conducting their business in other

sectors than the trade in diamonds¹¹⁸. In some cases these are specific indicators relating to the trade in diamonds or diamond jewellery.

Red flags and indicators relating to trade practices

- Profit is unlikely with respect to the investment of a diamond dealer.
- Diamonds originate from a country where there is limited production or no diamond mines at all.
- Trade in large volumes conducted with countries which are not part of the "diamond pipeline".
- An increase of the volume of the activity in a diamond dealer's account despite a significant decrease in the industry-wide volume.
- Selling or buying diamonds between two local companies through an intermediary located abroad (lack of business justification, uncertainty as to actual passage of goods between the companies).
- Volume of purchases and/or imports that grossly exceed the expected sales amount
- Sale of gold bars, coins, and loose diamonds from a jewellery store (retail).
- Payments related to the appearance of rare or unique diamonds in the international market outside of known trading procedures (e.g. Argyle's rare pink diamond appearing in the international marketplace outside of the annual tender process). This to the best knowledge of the financial institution.
- A single bank account is used by multiple businesses.

Red flags and indicators related to transactions/financing of diamond trade

- Unusual *forms of payment* in the diamond trade, for example, use of travellers cheques (all stages according to the accepted forms of payments).
- *Date of payment* not customary in the trade, (e.g. receiving/sending funds for a diamond deal conducted a very long time ago (outside accepted payment terms). Or, a customer paying upfront where the customary payment date is within a 120 days term.
- *Financial activity* is inconsistent with practices in the diamond trade. For example,

¹¹⁸ This is not an exhaustive list. Red flags related to financial activity in general (e.g., structuring of transactions below the reporting threshold, transactions in high risk areas, etc.) are also applicable to the activity of diamond dealers.

- o Foreign currency deposits followed by currency conversion and cash withdrawal in local currency.
 - o Cheque deposits followed by immediate cash withdrawals in slightly lower amounts (possible use of the diamond dealer account for cheques discounting).
 - o Transfers of foreign currency and/or foreign currency cheques deposits, followed by currency conversion and immediate withdrawal from the account (possible use of the diamond dealer account for exchange services).
- No economic rationale for transactions involving an individual or company in the diamond industry.
- Deposits immediately followed by withdrawals, atypical of practices in the diamond trade, including but not limited to:
 - o Circular transaction related to import/export of diamonds.
 - o Circular transactions related to local trade (between local bank accounts).
 - o Circular financial transactions between a diamond company's account and the private account of the company's shareholder/director, without business or economic reason.
 - o High turnover of funds through an account with a low end of day balance.
- Deposits or transfers to a diamond dealer's account from foreign companies followed by immediate transfer of similar amounts to another jurisdiction.
- Immediately after a diamond dealer's related account is opened, high-volume and high-value account activity is observed.
- Transactions between accounts of different companies which are affiliated with the same customer, particularly to or from Free Trade Zones or countries with tax leniencies ¹¹⁹ (may be an indication of transfer pricing or trade mispricing).
- Open export¹²⁰ is settled by offsetting to, and receiving payment from, a third party.
- Open export is settled abroad by offset in front of the importer.
- Settling an open export invoice with unrelated companies that engage in diamonds and not through value/return from abroad or return of goods to the diamond merchant.

¹¹⁹ These transactions should be closely monitored since they may facilitate ML/TF activity and tax evasion through transfer pricing.

¹²⁰ An export of diamonds where a payment was not yet received and the sale was not cancelled.

- Details of the transaction are different from the details of the commercial invoice presented by the diamond dealer to the bank (name of importer/exporter, sum, place etc.)¹²¹.
- High-value funds deposited or transferred to an account described as short term loans with no transactions showing repayment of loans.
- Early repayment of diamond dealer's loan (a loan for 25 years is repaid after five month) with no reasonable explanation.
- Sale of diamonds and jewellery at small incremental amounts (retail).
- Multiple cheques drawn on the same diamond dealer's account on the same day.
- Origin/destination of funds is different from the destination/origin of the diamonds.
- Diamond dealer account is credited by transactions with no evidence of diamonds sales.
- Numerous returns of advanced payments.

Customer-related red flags and indicators

- Activity does not match KYC, for example:
 - Actual trade volumes are significantly larger than the expected volume.
 - Customers and/or suppliers of the customer do not correspond to the stage of the trade initially declared.
- Diamond dealer is not familiar with trade practices.
- Diamond dealer maintains high level of secrecy.
- Diamond dealer conducting activity in a branch not specializing in diamonds (where such branches exist).
- Use of a bank account in the name of a *charity*¹²² to transfer funds to/from diamond dealers.
- Frequent changes in company name and contact person for a business in the diamond industry (mainly wholesale).

¹²¹ This may indicate a false/fictitious invoice which might constitute a predicate offence.

¹²² In the particular case provided by Australia from which the indicator was derived the charity was not a registered charity, company and/or business name. This is an additional general indication not related to trade in diamonds.

Red flags and indicators related to the use of third parties

- Customer consults a third party while conducting transactions.
- Receiving/transferring funds for import/export activity to/from entities that are not known to be involved in the diamonds trade (either an individual or a legal entity).
- Return of an advanced payment from a third party.
- Receiving/transferring funds for import/export where the ordering customer/beneficiary is an MSB.
- Use of third parties to deposit funds into single or multiple diamond dealers' accounts.
- Return of an advanced payment from a third party.
- Name of sender in the payment transfer to the diamond dealer is not the importer/buyer (mainly rough and polished trade).
- Name of receiver in the payment from the diamond dealer is not the exporter/supplier.
- A single bank account with multiple deposit handlers (retail and wholesale).

Red flags and indicators relating to the use of missing/suspicious/falsified documents

- KP certificate is or seems to be forged.
- Long validity of a KP certificate¹²³.
- Transfers of funds or an attempt to transfer funds through a diamond company's account without producing appropriate documentation.
- Diamond dealer claims funds received/transferred are an advanced payment without producing any appropriate export/import invoice to support it.
- Transfers between a diamond company and a private account that are reported to the bank as diamond transactions, without presenting appropriate documentation.
- Invoice presented by the diamond dealer appears to the bank as unreliable/fake.

¹²³ The Kimberley Certificate has a maximum two month-validity: KP certificates have a maximum validity of two months following their issuance. A “good for one entry-only” policy, a unique serial certificate number, and by the mandatory “import confirmation” from the importing KP Authority to the KP Export Authority of the exporting KP is intended to create a closed loop.

- Failing to provide a customs declaration in relation to a foreign currency cash deposit resulting from selling precious stones abroad.

RED FLAGS AND INDICATORS FOR DIAMOND DEALERS

For each of the following red flags and indicators, the relevant level of trade is indicated in brackets.

Customer or supplier related red flags and indicators

- Purchases or sales which are unusual for customer or supplier (all stages of the trade).
- From what the diamond dealer knows about the customer or supplier, the transaction appears to him to be illogical from a business or economic point of view (all stages of the trade).
- Customer or supplier does not hold a position within a company they claim to represent (all stages of the trade).
- Customer or supplier is not familiar with trade practices (all stages of the trade).
- Customer or supplier maintains high level of secrecy (all stages of the trade).
- Customer or supplier known for their *involvement in trafficking conflict diamonds* (mainly rough trade. Could apply to diamond dealer who is involved in both rough trade and polished trade)
- Customer indiscriminately purchases merchandise without regard for value/price, size or colour (all stages of the trade).
- Sale of illicit goods from a jewellery store, such as counterfeit jewellery (retail and wholesale).
- Sale of gold bars, coins, and loose diamonds from a jewellery store (retail).

Red flags related to the sale or purchase of diamonds (transaction)

- Purchases or sales that are not in conformity with standard industry practice (all stages of the trade).
- Origin/destination of funds differs from the destination/origin of the diamonds (mainly rough trade and polished trade).
- Diamonds are not accompanied by a valid KP certificate¹²⁴.

¹²⁴ Every shipment of rough diamonds at import and export needs to be accompanied by a valid and validated KP Certificate. For transactions of rough diamonds within the jurisdiction of the same KP country no KP certificate is required, but the commercial invoice must contain the WDC system warranties declaring the shipment to be conflict free. This allows the overseeing authority of the KP country to follow the transactions from import to re-export.

- Diamond cutters receiving unwashed and uncut diamonds where the source of the diamonds is unknown or questionable (rough trade).
- The appearance of rare diamonds in the international market outside of known trading procedures (e.g., Argyle's rare pink diamond appearing in the international marketplace outside of the annual tender process. (rough trade, cutting and polishing).
- Selling or buying diamonds between two local companies through an intermediary located abroad (lack of business justification. uncertainty as to actual passage of goods between the companies).
- Purchase of diamonds with a credit card issued in a country which is not the buyer's country (where credit cards are used, mainly retail).
- Regular interval purchases, rather than seasonal purchases from foreign wholesaler (retail especially, less so with diamond dealers and wholesalers).
- Buying of diamonds or jewellery and reselling even at wholesale price (retail).
- Customer is known to purchase of diamonds off the street (retail).

Red flags and indicators related to the use of third parties

- Use of third parties to sell diamonds jewellery where this is not acceptable in terms of trade practices (all stages).
- Use of third parties including relatives to conduct transactions/receive payments where this is not acceptable in terms of trade practices (all stages).
- Customer or supplier consults a third party while conducting transactions (all stages of the trade).
- Purchase of diamond or jewellery from a company abroad (funds are sent to the selling company) and receiving the diamonds from a third company (rough trade, polished trade, jewellery).

Red flags and indicators relating to the use of suspected/falsified documents

- KP certificate is or seems to be forged.
- Long validity of a KP certificate

Red flags and indicators relating to the method of payment

- High-value cash purchases of diamonds particularly in non-cash jurisdiction and/or non-cash stage of trade (all stages and depending on jurisdiction).

- A customer paying for high-priced jewellery with cash only (mainly retail).
- Unusual *means of payment* in the diamond trade, for example, use of traveller's cheques, cashier's cheques or money orders. Higher risk where they are sequentially numbered (all stages of the trade).
- Customer or supplier appears to be indifferent to the *date of payment* (all stages of the trade).
- Paying for diamonds with cheque and noting on the cheque the payment is for something else (retail and wholesale).
- Customer attempt to use a third party cheque or a third party credit card.

Red flags and indicators related to geographic location/country

- The customer or supplier appears to be related to a *high-risk jurisdiction* (all stages of the trade).

RED FLAGS AND INDICATORS FOR CUSTOMS

The Netherlands provided customs-related case studies. These cases yielded indicators related to the import and export of diamonds. The following indicators were used to detect the cases highlighted in the Netherlands' response.

Red flags related to export/import (documentation and entities involved)

- Origin of diamonds seems to be fictitious.
- The long validity period of the KP Certificate opens up possibilities for reuse and setting up a carousel¹²⁵.
- Low invoice amount.
- Overvaluation of imported good.
- The consignee doesn't specify a permanent address on the airway bill but makes use of a hotel, or other temporary accommodation, to receive the shipment, complicating the audit trail.
- The consignee specified on the airway bill is a known diamond dealer, but a different delivery address is provided.
- The diamond appears to have been shipped as a form of payment.

¹²⁵ For countries participating in the Kimberley Process Certification Scheme, international shipments of rough diamonds must be accompanied by a Kimberley Process certificate to guarantee that they are conflict-free. See Kimberly Process (n.c).

CHAPTER 8.

MONEY LAUNDERING SANITISED CASES THROUGH TRADE IN DIAMONDS¹²⁶

Methodological remarks - This section of the report looks at case studies which illustrate the ML/TF methods and techniques which are used in the diamond industry throughout its various stages. All the cases were provided by countries that completed the collection plan¹²⁷ or through open source analysis. The case studies included in this chapter are real cases but in most instances the real names have been omitted. For the purpose of this analysis, clear distinction should be made between two methods of ML/TF through the trade in diamonds which were already outlined in the short overview of the international diamond trade provided in the beginning of this report.

- The first method is the conduct of ML through the use of diamonds as vehicles of intrinsic high value which may often be the proceeds of crime in cases of theft or robbery.
- The second method is the abuse of the financial trade in diamonds to launder illegally gained funds generated from other predicate offences such as drug trafficking and fraud.

Other precious stones - even though the project team decided to exclude other precious stones from the scope of this report, team members provided several cases where precious stones other than diamonds were used in money laundering schemes. This information has been provided in this report to emphasize the ML/TF vulnerability and risk that concerns precious stones and to highlight the importance of AML/CFT counter measures required to mitigate such risks. These cases also point to the need to conduct further research on the use of other precious stones for ML/TF purposes.

ML methods and techniques - The analysis of the cases collected identified seven ML method. Each method may be carried out through different techniques. Many cases entail the use of more than one method or technique of ML. The methods identified are:

- a) Use of diamonds as currency.
- b) Acquisition of diamonds with proceeds of crime as a means to store wealth.
- c) Laundering through stages of the diamonds trade (either ML of proceeds generated via offences not related to the diamond trade or laundering the proceeds of diamonds related crime such as theft or robbery of diamonds).
- d) TBML and customs infractions.
- e) Use of financial hubs and FTZs.

¹²⁶ FIU sanitized cases, Law enforcement, open source cases / investigation.

¹²⁷ Including the limited collection plan.

- f) Smuggling of diamonds and cash.
- g) Link with or use of gold and/or other precious stones trade.

The methods identified above correspond to a large extent to the vulnerabilities identified in the previous section dealing with the vulnerabilities of the diamonds trade. The previous discussion of the diamonds trade identified certain vulnerabilities, based on the unique characteristics of diamonds:

- the possibility to use the diamonds as currency and as a mean to store wealth,
- the different vulnerabilities entailed in each stage of the trade from mining to retail level,
- the vulnerability to large scale TBML (e.g. via under or over valuation),
- and a vulnerability to smuggling resulting from these characteristics.

These cases show that criminals and professional money launderers take advantage of the identified vulnerabilities.

The analysis show that the ML/TF methods are closely related to the nature of the diamond trade conducted within specific jurisdictions or to the stage of the "pipeline" each case is referring to. Thus, for example, Belgium and Israel have significant cases relating to diamond dealers and diamond trading companies, whereas the US identified as a retail market show more laundering through jewellers. Several intelligence gaps still remain due to the lack of cases from several African mining counties and financial hubs such as the United Arab Emirates. This raises questions about the actual AML/CFT investigations in the sector.

Case structure – since the project is dealing with a trade-related DNFBP, the project team found it important to indicate for each case, where information was available, the characteristics of the trade and the financial activity related to the trade. For each case, the associated predicate offences were specified and also the ML stage (*placement, layering or integration*). Since the cases show very large scale ML activity, the sum involved in the case was also specified. Finally, the source of information (country contribution, open source or both) was also indicated.

General remarks –

- a) **Large scale ML** - many cases show very large scale predicate offences or ML activity conducted through the diamond trade. One of the vulnerabilities identified was the ability to launder large sums of money, since the transaction performed in the various stages of the trade may amount to tens of millions of USD. These cases provide an indication that this vulnerability is used in ML schemes.
- b) **Common predicate offences** – the most common predicate offences identified in these cases are smuggling and tax offences, including large scale tax fraud. Tax fraud, particularly when conducted through financial hubs and trade centers such as Dubai, Switzerland, Belgium and Israel, are an indication of the use of transfer prices for the purpose of avoiding tax regimes.

- c) **Third party transactions** – one important issue which surfaced from different countries is an extensive use of the diamonds trade to transfer funds to or from entities which are not related to the diamond industry.

METHOD 1: USE OF DIAMONDS AS CURRENCY

In at least 15 cases that were provided by the countries, diamonds were used as an alternate currency. As indicated previously, criminals will often purchase diamonds as a means of laundering proceeds of crime and then sell the diamonds to obtain cash at a later date or a different location. In this case, ML is engaged in to purchase the diamonds and then the diamonds are sold to recover cash. This amounts to laundering of the proceeds of crime.

Diamonds bear features which enable their use as a form of currency. This is demonstrated perfectly by the use of diamonds to finance armed conflicts. These features of diamonds bring criminals to use diamonds in a similar way while conducting other offences. Several cases from team members and open source information show that such use of diamonds is mainly prevalent with drug traffickers in different countries around the world. The use of diamonds as currency was also discussed during the workshop held in Dakar, where it was pointed out that in South African diamonds are used as a payment means by criminal syndicates, for example as payment to rhino poachers. Cases also show that diamonds are smuggled between countries along with drugs or other commodities, probably as payment between parties.

This form of payment, just as cash payments, is untraceable and allows criminals to avoid the use of financial institutions while conducting their criminal activity thus avoiding rigorous KYC procedures put forth by banking institutions where diamond dealer's accounts are managed. This provides the criminal with security that suspicious activity reports would not be filed to the FIU. The use of diamonds as currency, and the fact that the trade in diamonds is international, opens up options for the criminal or money launderer such as smuggling the diamonds to other countries and exchanging them for other forms of payment such as cash or cheque, or laundering them through much less regulated diamond dealers locally or abroad.

TECHNIQUE: DRUGS TRAFFICKING RELATED USE OF DIAMONDS AS CURRENCY

The most noted predicate offence related to the use of diamonds as a currency is drug trafficking¹²⁸. Canada, Australia, the United Kingdom and the United States provided cases for such use. Drug traffickers/producers use these commodities for a number of reasons in support of their criminal enterprise. The drug business generates huge amounts of cash which is a well-known fact by reporting entities and law enforcement. It isn't surprising that criminal organisations that are involved in drug production and trafficking are looking for other ways of payment. Cases provided by team members have shown that diamond and jewellery are actually used by drug traffickers of different levels as a mean to finance the purchase and distribution of drugs.

¹²⁸ See Annex 2 - predicate offences.

A sophisticated scheme provided by Canada illustrated the use of diamonds as a form of payment received by street-level drug dealers and the mode in which diamonds (including jewellery) are used to finance this criminal activity throughout the drug distribution/production chain. Additional cases showed drug traffickers apprehended with drugs, cash, diamonds and jewellery in their possession and changing proceeds of crime to diamonds and jewellery, smuggling them to other countries where they are laundered through local diamonds trade industry.

Case 1: *Financing drugs trafficking with diamonds and ML through retail level*

This case involved an organised criminal group that distributed drugs and controlled several low level (street-level) drug dealers. The higher placed distributor would distribute drugs to the street-level dealer and receive *diamonds, gemstones* and *jewellery* as payment, as well as cash. Likewise, the street-level drug dealer traded drugs for diamond jewellery and then traded up to the higher placed drug dealer for more drugs and debt payments. The higher placed drug distributor would then sell the diamonds and jewellery at small incremental amounts (CAD 3 000-CAD 8 000) to the jewellery market (jewellers) and **in** return would receive payment by way of *cheque*. The drug distributor also received high end jewellery (watches) instead of payment for the illicit jewellery.

Predicate offence/s	Drug trafficking
Stage of Trade	Retail
ML/TF Stage	Placement (precious stones proceeds of crime in jewellery market)
Money/Trade flow	-
Types of financial/trade activities	Sale of diamonds and jewellery for cheques
Sums involved	-
Red flag indicators	■ Link to organised crime ■ Sale of diamonds and jewellery at small incremental amounts ■ Frequent deposits of small denomination cheques drawn on jeweller(s) where this is not typical for the customer ■ Link with other precious stones
Source	Canada (response to collection plan, 2013)

Case 2: Link between use of diamonds and drug trafficking

In October 2011 officers from the Metropolitan Police Service's Central Task Force arrested Daniel McNeill-Duncan, Aaron Howell, Karl King and James Bailey at Bailey's Neasden home. A drugs search found more than GBP 92 000 in cash, almost 2 kilos of cocaine (street value GBP 1m+). A search of King's home found large quantities of cocaine cutting agents Boric Acid, Phenacetin and Lignocaine, scales and a money counting machine. A search at Marlon Okeowo's address - Bailey's associate - found GBP 80 000 worth of *cut diamonds*. All pleaded guilty to conspiracy to supply cocaine. Sentenced on 24/04/12 : King (6 years, 9 months), Okeowo (7 years, 3 months), Howell (6 years) Bailey (6 years), McNeill-Duncan (5 years).

Predicate offence/s	Drug trafficking
Stage of Trade	Manufacturing/retail
ML/TF Stage	-
Money/Trade flow	-
Types of financial/trade activities	Diamonds as currency
Sums involved	GBP 80 000 in diamonds, GBP 92 000 in cash, GBP 1 000 000 (drugs)
Red flag indicators	-
Source	United Kingdom (response to limited collection plan, 2013)

METHOD 2: ACQUISITION OF DIAMONDS WITH PROCEEDS OF CRIME AS A MEAN TO STORE WEALTH

Prices of diamond are relatively stable and provide the security that the value invested in their purchase would not depreciate significantly over long periods of time. By changing proceeds of crime into diamonds and jewellery, criminals can:

- i. conceal proceeds of crime over long periods of time and avoid seizure and confiscation,
- ii. transfer very high value across borders while keeping their investment relatively safe,
- iii. transfer very high value across borders without a need to declare carrying value as requires by FATF standards and local legislation with regard to bearer negotiable instruments (BNIs)¹²⁹,
- iv. use as a form of payment after long periods of time, and
- v. insure the value of the diamonds in case of loss or theft.

At any level of the trade, a purchase of a large sum worth of diamonds or jewellery by a customer, whether in cash or any other means of payment, may be an attempt by a criminal to place proceeds

¹²⁹ For the FATF definition of BNIs see FATF glossary at: www.fatf-gafi.org/pages/glossary/a-c/.

of crime into diamonds as a vehicle to store wealth, making the diamond trade a target for placement and layering of criminal proceeds.

TECHNIQUE: DIAMONDS BOUGHT AND KEPT FOR A PERIOD OF TIME AND SOLD UPON THE CRIMINAL'S REQUEST

Case 3: *Placing diamonds bought with proceeds of crime in safes as a mean to store wealth*

An Austrian bank filed an STR saying that a Brazilian national conducted illogical transactions. He paid a large sum (profit from sale of real property) into an account for investment. He did not make any investment but wanted to transfer the “total amount” to the USA.

Austrian FIU conducted appropriate analyses and decided to initiate criminal police investigations. Austrian FIU filed report to the competent Public Prosecutor’s Office and discussed further steps with the bank obliged to report. During his next visit at the bank, the above mentioned national was contacted; his statements only reinforced suspicion of ML; therefore, surveillance was initiated. Surveillance revealed extremely conspicuous behaviour; he went to a different bank (vault). Another report of facts of the case was filed to the Public Prosecutor’s Office. Finally, a court order to open the bank safe was obtained. The content of the safe revealed further safe keys, which were also opened by Court order. Austrian FIU seized a large number of false passports and diamonds.

First analysis of documents seized sufficed for the issuance of an arrest warrant regarding the Brazilian national, and execution of the warrant. Interrogation revealed that he was laundering money for a large-scale fraudster from the United States. They transferred funds to accounts of offshore companies; fraudster handed funds to money launderer; he took over the funds and purchased diamonds at “jewellers”. He handed these diamonds over to middlemen who smuggled the diamonds to Austria. They placed these (precious) diamonds in safes and as the fraudster needed most of the money, he ordered for the money to be wire transferred. The money launderer sold some of the diamonds and deposited the profit into above mentioned account.

Predicate offence/s	Fraud, Smuggling of diamonds, false passport
Stage of Trade	-
ML/TF Stage	Layering
Money/Trade flow	Austria to United States (money)
Types of financial/trade activities	Use of safes, Wire transfers
Sums involved	-
Red flag indicators	■ Frequent visits to a safe. ■ Visits to a safe followed with cash deposits and a request to transfer the funds abroad
Source	Austria (2012)

Case 4: *Drug dealer Launders jewellery received as payment for drugs and buys jewellery as a mean to store wealth*

This case involved a drug dealer/producer who sold drugs and traded drugs for collectively over USD1 million in stolen and purchased jewellery. The drug dealer who had strong industry, commodity and market knowledge sold the least valuable (scrap) jewellery as scrap to jewellery stores and bullion dealers. Jewellery that had some aesthetic or residual market value above the component parts was sold as estate jewellery to jewellers. In return, the drug dealer received cash, gold and silver bars and coins and diamond jewellery. The drug dealer used some of the proceeds of crime from the sale of drugs and sale of jewellery obtained through trade for drugs to purchase specific diamond jewellery and gemstones items (jade) as a mean to store wealth. The drug dealer used appraisals to define the value of jewellery that was stored as wealth and to help negotiate fair prices for the resale of the jewellery to the market.

Predicate offence/s	Drug trafficking
Stage of Trade	Retail and wholesale
ML/TF Stage	Placement through jewellery
Money/Trade flow	-
Types of financial/trade activities	Jewellery sold for cash, Jewellery sold for gold and silver bars and coins, Jewellery sold for diamond jewellery and gemstones
Sums involved	CAD1 million
Red flag indicators	■ Frequent selling of jewellery ■ Jewellery traded for jewellery ■ Jewellery traded for gold and silver
Source	Canada (response to collection plan, 2013)

METHOD 3: LAUNDERING THROUGH STAGES OF THE DIAMOND TRADE

The "diamond pipeline" is very long and complex. Each level of the trade chain offers opportunities for those seeking to exploit the nature of the trade and the unique features of the commodity traded for the purpose of ML or TF. Cases collected show the use of all levels of the trade from mining companies, dealers in rough and loose polished diamonds through diamond wholesalers to retailers and pawn shops with little information regarding ML through the mining sector where an intelligence gap exist due to limited contributions from African mining countries.

A distinction, which was detailed in the overview section of the report, can also be seen in the cases. This distinction is between on the one hand:

- a) ML conducted through the trade in diamonds where proceeds are generated by crimes not related to the diamond trade (e.g., drug trafficking).

And on the other hand:

- b) Laundering diamonds or jewellery generated by crime (*i.e.*, theft, diamond used as payment for drugs, illegal mining) by "legitimising" these proceeds of crime through the trade.

Cases show a variety of techniques used by criminals to use different levels of the trade for ML purposes. Some techniques may be used in a similar way in different stage of the trade. An example of this may be the laundering of illegally mined rough diamonds by way of commingling through the mining sector or commingling through a rough diamond dealer. The following techniques were identified:

- a) Commingling of illegally gained diamonds through the mining sector.
- b) Laundering *illegally gained diamonds* through wholesale, retail jewelleries, pawnshops or trade shows.
- c) Laundering *proceeds of crime* through wholesale or retail jewelleries – these cases were mostly presented by large retail markets such as the US and Canada where large sums of money would be more easily placed.
- d) Using accounts of diamond dealers as a conduit to transfer funds, particularly in favour of *third parties* which are *not part of the diamond trade* – this type of ML activity was identified by several countries and is more common in trade centres such as India, Israel and Belgium. Canada and the US also identified this type of behaviour. FinCEN indicated in a SAR analysis performed by the FIU that the diamond industry entities interacted with charitable foundations, electronics manufacturers, automobile dealers, real estate businesses and unknown entities in unknown locations. Australia submitted a case where a charity interacted with diamond industry entities. This type of activity seems to be indicative of the industry in light of the pattern spanning across the globe. It seems large amounts of money are *transferred through* the diamond sector from *unrelated entities* with a purpose to hide the source of funds, the destination of funds or both.
- e) Amounts involved are high, indicating that large amounts of money are funnelled through the industry in favour of undeclared entities.

Some of the cases feature more than one technique which may result from the change of the *modus operandi*. Some cases show large scale ML activity amounting to tens and even few hundreds of millions of USD. These cases are instances of what was previously portrayed as a vulnerability, namely that since the diamond trade amounts to almost USD300 billion per annum, characterised by very large transactions, it provide an opportunity to launder very large sums.

Trade Based Money Laundering and *Smuggling* are both prevalent in the diamond industry. Since these are methods not unique to trade in diamonds and since they are not particular to a specific stage of trade, they are dealt separately.

TECHNIQUE: COMMINGLING OF SMUGGLED DIAMOND AT THE MINING LEVEL

Case 5: *Attempt of commingling illegally mined diamonds via exporting companies*

In 2005, the Guyanese government caught an attempt by a company to export 8 500 carats of rough stones with allegedly illegal origins. Given the owner's Venezuelan connections, discovered by investigators, the stones were believed to have originated in Venezuela and laundered through the company for legal export out of Georgetown.

The Guyanese government investigated in 2007 another company over a 4 000-carat batch of diamonds with nefarious origins, presumably from Venezuela, Brazil, or even West Africa, according to government documents.

Predicate offence/s	Illegal diamond trade
Stage of Trade	Rough diamond trade
ML/TF Stage	Placement and layering
Money/Trade flow	Venezuela to Guyana (suspected illegal trade)
Types of financial/trade activities	Rough diamond export
Sums involved	-
Red flag indicators	■ Lack of KP certificate for rough diamonds or certificate seems to be forged
Source	Open source: Logan, Samuel (2009)

TECHNIQUE: LAUNDERING ROUGH DIAMONDS BY CUTTING AND POLISHING

This technique provides two main benefits to the money launderer: first, once a rough diamond is cut it is almost impossible to verify the source of the stones. Second, once a diamond is cut and polished it no longer falls under the KPCS and may be exported without the controls established by the Kimberley process.

Case 6: *Illegal diamonds sent to foreign jurisdiction to be cut and polished*

A case of non-Kimberley Process rough diamonds smuggled into Canada, then the diamonds were smuggled to a foreign jurisdiction to be cut and polished (as Canada has few independent diamond cutters) and then the diamonds were sent legally back to Canada as they were now cut and polished and no longer subject to Kimberley Process protocols (this case engaged the rough diamond production and diamond cutting sector of the industry).

Predicate offence/s	Smuggling diamonds
Stage of Trade	Rough diamond production, cutting and polishing
ML/TF Stage	Laundering illegal diamonds through cutting and polishing
Money/Trade flow	-

Case 6: *Illegal diamonds sent to foreign jurisdiction to be cut and polished*

Types of financial/trade activities	Cutting and polishing
Sums involved	-
Red flag indicators	-
Source	Canada (response to collection plan, 2013)

TECHNIQUE: LAUNDERING ILLEGAL DIAMONDS THROUGH DIAMOND DEALERS

The following case concerns a technique which facilitates illegal trade in diamonds where diamonds are smuggled into Russia circumventing the KPCS. The illegal diamonds are laundered by the criminal establishing diamond companies for the purpose of selling the stones without a KP certificate.

Case 7: *Trafficking of illegal Gemstones*

Mr. M, an Israeli national, sets up a company "M" in St. Petersburg specializing in an unauthorised distribution of precious stones (diamonds). According to the documents, precious stones are supplied by five companies that are registered in Russia and founded by the same Mr. M. According to intelligence provided by law enforcement, the said companies were set up to launder precious stones that are smuggled into Russia.

Company "M" handled the smuggled stones without keeping any written records of transactions, with all deliveries being made on the basis of customers' requests. Deliveries of diamonds to the company office were made by couriers and involved no supporting documentation.

The proceeds were channelled abroad in the form of interest-bearing loans to foreign companies with bank accounts in Israel and Hong Kong, China. A criminal investigation revealed that the said foreign companies owed Company "M" a total of over USD 2 million. However, a close study of STRs revealed that more than USD 8.9 million had been credited to the accounts of these companies. Yet, the total amount of Company M's debt to the suppliers of diamonds stands at more than 90 million rubles.

Predicate offence/s	Smuggling diamonds
Stage of Trade	-
ML/TF Stage	Layering
Money/Trade flow	Israel (money Out); Hong Kong, China (money Out)
Types of financial/trade activities	Loans to foreign companies
Sums involved	USD 9 million

Case 7: Trafficking of illegal Gemstones

Red flag indicators	- Loans are provided by a diamond company to legal entities not in the diamonds industry - Loans provided by the diamond company are not repaid. - No supporting documentation to the international transactions conducted in the diamond company account
Source	Russia (response to collection plan, 2013)

TECHNIQUE: LAUNDERING ILLEGAL DIAMONDS VIA RETAIL LEVEL – JEWELLERIES, PAWN SHOPS

One of the risks identified by the team members was the risk of theft which is relevant for every stage of trade in all countries involved in diamonds trade. The jewellery market is prone for theft and is perhaps and broadly speaking the sector where the risk is the highest since in the mining sector and the trade centres control and supervision are more stringent. Retail jewellers are everywhere and constitute the largest sector of the trade in terms of entities involved and turnover per annum. These stolen items must be laundered through appropriate venues in what may be called laundering of illicit diamonds/jewellery as opposed to ML per se. The cases below present the techniques used to launder illegal diamonds or jewellery in the US.

Case 8: Theft Case Example – Operation Cut and Run

During January 2004, a handful of South American immigrants from New York City stole nearly USD 100 000 worth of Rolex watches from a jewellery store in Cranston, Rhode Island. They fled the scene in a minivan, with local police in hot pursuit. Minutes later, they slammed into a police cruiser. They jumped out of the van and fled on foot, but four were immediately caught and arrested.

This led to massive investigation (Operation Cut and Run) by the FBI, the New York City Police Department, the Bureau of Immigration and Customs Enforcement (ICE)¹³⁰, the U.S. Attorney's Office in the Southern District of New York, the Queens County District Attorney's Office, and other law enforcement partners.

In the end, this multi-agency initiative uncovered and ultimately took down a criminal enterprise that had stolen more than USD 3 million worth of high-dollar pieces of jewellery across the eastern seaboard in more than 90 separate thefts. At least 16 members of the crew have been arrested or indicted, and one has pled guilty.

This case is considered by FBI to be a 'textbook' jewellery theft case. Mainly because the thefts were orchestrated by a signature international enterprise (i.e., a SATG – South American Theft Group) that operated out of New York City, one of the common bases for jewellery theft rings. The ring was also sophisticated. For example, the thieves would enter jewellery stores in small groups, with some

¹³⁰ Now Homeland Security Investigations (HSI).

Case 8: *Theft Case Example – Operation Cut and Run*

members distracting sales and security personnel while others operated as lookouts. Once they determined it was safe to proceed, some of them would stand around a showcase to shield it from view while others used a tool to cut the silicone holding the case together and remove the goods. The group would then leave the scene and meet a waiting vehicle to escape.

The thefts in this case extended across state lines which brought in the FBI with its national and international network of agents. Like most other cases, “fences” (individuals who knowingly buys stolen property for later resale - see case 9 below) played a role in receiving and moving the stolen goods. The intelligence gained by law enforcement—including the modus operandi of the group and descriptions of suspects—was entered into a database. This information helps law enforcement partners nationwide coordinate any related investigations and better understand the jewellery and gem criminal enterprises operating in the United States.

Predicate offence/s	Theft
Stage of Trade	Retail
ML/TF Stage	-
Money/Trade flow	-
Types of financial/trade activities	-
Sums involved	USD 3 million
Red flag indicators	-
Source	United States (response to collection plan, 2013)

The case below illustrates the manner in which stolen diamonds are laundered in the United States.

Case 9: *Trafficking in Stolen Goods*

Diamonds taken from large scale robberies, thefts and burglaries are sold to “second hand” dealers to include pawn shops, estate jewellery dealers and other high-end retail outlets. Diamonds are often targeted by highly professional groups noted above and other organised crime groups from the Balkans (e.g., former Yugoslavia, Albanian, and Kosovo). Picking up on the examples described above, professional theft crews can sell stolen goods to their fences for between 20% and 30% of retail value.

Reporting by law enforcement indicates that pawn shops may also be used or operated by criminal gangs as “front companies”. Diamonds sold for cash in pawn shops are often owned by Russians affiliated with organised crime who have contracts in the Diamond District. According to the FBI it is not difficult to sell stolen property. Criminals sell stolen property at a deep discount to the pawn shops, which in turn have to negotiate with “legitimate” dealer who take stolen goods at 40% or 50% on dollar. These diamonds enter the legitimate stream of commerce in the Diamond District.

Pawn shops are required to have a license from New York to be a second hand dealer. However, the secondary market for stolen diamonds is segmented. Diamonds stolen could be “used” property or

Case 9: *Trafficking in Stolen Goods*

they may be stolen new product from wholesalers with the “tickets” still intact. Additionally, thieves can target select high-end or estate dealers as noted above.

Predicate offence/s	Diamond theft, robbery, burglary
Stage of Trade	Retail
ML/TF Stage	Placement of illegal diamonds or jewellery
Money/Trade flow	-
Types of financial/trade activities	-
Sums involved	-
Red flag indicators	■ Diamonds are sold for less (third to half) of their retail value, particularly if customer is not previously known ■ Links to organised crime groups ■ Frequent cash withdrawals from an account managed by jewellery dealer or pawn shop where this is unreasonable.
Source	United States (response to collection plan, 2013)

Case 10: *Buying diamond over the internet with stolen credit card numbers and laundering the goods via jewellery retailers*

A diamond dealer has been arrested on organised crime charges allegedly laundering more than USD 100 000 in high-quality diamonds stolen by a local ring of thieves.

According to court records, diamond and jewellery dealer Mr B purchased the diamonds from thieves who stole credit card information and bought the stones from Internet retailers across the country, according to the Dallas Morning News. Mr B could face five to 99 years in prison and a fine of up to USD 10 000. Mr B is one of eight people indicted in the identity-theft ring.

The thieves searched trash containers for credit card receipts and then used the card numbers to purchase diamonds using a prepaid mobile phone, arranging to either pick up the stones from UPS offices or intercepting the packages as they were being delivered to the homes of the people whose identity had been stolen.

Court documents charge that Mr B paid the other suspects USD 173 700 for approximately 40 stolen diamonds. The documents charge that he sold the jewellery to other retailers nationwide. It is estimated Mr B bought the stones at 50% below their real price.

Predicate offence/s	Theft, Credit card fraud
Stage of Trade	Retail
ML/TF Stage	Placement, laundering through retail
Money/Trade flow	-

Case 10: *Buying diamond over the internet with stolen credit card numbers and laundering the goods via jewellery retailers*

Types of financial/trade activities	Buying diamonds with credit card online, Selling diamonds for cash
Sums involved	More than USD 100 000
Red flag indicators	■ diamonds are sold for half their value ■ customer selling diamonds at jewellers which he has no clear link to (E.g. his home and business address are remote)
Source	Open source (USA): International Diamond Exchange (2005)

TECHNIQUE: MONEY LAUNDERING THROUGH WHOLESALE AND RETAIL JEWELLERY STORES

Several cases show that these same features of the retail market described under the previous technique (*Laundering illegal diamonds via Retail level*) are exploited for ML. Proceeds generated in other predicate offences are placed in wholesale and retail jewellery store in very large amounts. As a first step in the laundering scheme these proceeds are changing their form from financial instruments received as payment for crime (cash, money orders, cheques, etc.) to diamonds and jewellery. This is done instead of depositing the proceeds of crime at a financial institution. This first stage may then be followed by using other features of the diamonds or jewellery, some of which are represented in the following cases:

- smuggling to another jurisdiction,
- using them as means of payment,
- selling the diamonds in return for payment in cash or within a financial institution locally or abroad,
- selling the diamonds over the internet exploiting the relative anonymity of the internet payment system,
- using the diamonds as a mean to store and hide wealth for long periods of time and avoid confiscation, etc.

The first case below involves a huge amount of money. Large scale ML can go unnoticed for long periods of time. This may be attributed to low level of transparency and high secrecy of the industry and to low level of enforcement. Two cases are linked to drug trafficking as a predicate offence and in a third case the predicate offence was fraud. A link to ML through gold was found in one case which is indicative of a wider link found between ML through diamonds and ML through gold based on additional cases. In one case the internet as a trading platform for diamonds was used as part of the ML scheme to quickly move the diamonds by selling them with no mark up.

Case 11: *Laundering the proceeds of Narcotics through a jeweller (Celebrity Jeweller)*

Mr A, a New York diamond merchant, who has outfitted countless rappers and NBA players, was sentenced in 2008 to two and a half years in federal prison for lying to investigators about his part

Case 11: *Laundering the proceeds of Narcotics through a jeweller (Celebrity Jeweller)*

in a multistate drug ring. Mr A was also fined USD 50 000, and ordered to forfeit USD 2 million to the US government.

Mr Av was arrested at his Manhattan shop in 2006 and accused of being part of a conspiracy to launder about USD 270 million in drug profits. He was among 40 people indicted in the scheme orchestrated by the Black Mafia Family, which ran drugs out of Detroit beginning in the 1990s. Mr A facilitated the purchase of jewellery utilizing drug proceeds of other defendants in order to conceal the true nature, source and ownership of the funds involved in these transactions. After receiving payments in cash, money orders and cashier checks, amounting to hundreds of thousands of dollars for each payment, Mr A would fail to report these cash payments to the IRS (Form 8300) or would falsify these records. Officials dropped the money-laundering charges against the jeweller as part of his plea agreement.

Predicate offence/s	Drug Trafficking
Stage of Trade	Wholesale
ML/TF Stage	Placement through jewellery
Money/Trade flow	-
Types of financial/trade activities	Jewellery for cash, Jewellery for money orders, Jewellery for cashier's check
Sums involved	USD 270 million
Red flag indicators	■ Jewellery is paid with money orders and cashier's check ■ Jeweller Frequently deposits money orders and cashier's check (or carrying any other financial transaction with these instruments)
Source	United States (response to collection plan, 2013), Open source

Case 12: *Money Laundering Case Example – New York Diamond Dealer*

In 2005, Roman Nektalov, a jewellery district gold and diamond dealer, was sentenced to 10 months imprisonment for ML. The prosecution of Nektalov was part of “Operation Meltdown,” an undercover investigation targeting narcotics ML activities in the 47th Street jewellery district in Manhattan.

Operation Meltdown targeted a ML method commonly used by Colombian drug traffickers. Under this method, drug traffickers and money brokers who provide laundering services to the drug traffickers employ couriers to pick up cash at designated locations and deliver the cash to gold jewellers and suppliers. The jewellers or suppliers then exchange the cash for gold, diamonds or other precious commodities, which are then smuggled to Colombia, either via couriers or hidden in cargo. Once the diamond and gold arrives in Colombia, it is sold for Colombian pesos, which are then ultimately delivered to the narcotics traffickers.

Roman Nektalov, an owner of Roman Jewellers, operated a scheme to launder what he believed to be narcotics proceeds. Cooperating Witnesses (CW) and Under Cover (UC) law enforcement agents

Case 12: Money Laundering Case Example – New York Diamond Dealer

indicated that they and their associates had narcotics proceeds in the New York City metropolitan area which they wanted to exchange for gold and diamonds, and then wanted to smuggle the gold and diamonds to Colombia. In particular, at trial, the Government presented testimony and audiotape recordings of meetings in which the CW, the UC known as “Angel,” and Nektalov discussed the sale by Nektalov of diamonds to the UC in exchange for cash believed by Nektalov to be drug money.

The evidence at trial showed that on 4 June 2003, Nektalov met with the CW and the UC at Roman Jewelers to exchange a large number of diamonds for USD 500 000 in cash. After the diamonds were placed on a table in a back room where the transaction was to take place, federal agents entered Roman Jewelers and arrested Nektalov seizing the diamonds.

Predicate offence/s	Drug Trafficking, Smuggling of gold, diamonds and precious commodities
Stage of Trade	Wholesale and retail
ML/TF Stage	Placement through jewellery
Money/Trade flow	United States to Colombia (smuggling)
Types of financial/trade activities	Cash payments for gold and diamonds
Sums involved	-
Red flag indicators	■ Frequent large cash purchases of diamonds ■ Link to gold
Source	United States (response to collection plan, 2013)

Case 13: Laundering proceeds of crime through purchase of diamonds and resale at wholesale prices to jewellers and to final customers via the internet

This is a case where fraud was the predicate offence. The criminals had jewellery industry contacts at the wholesale level. To launder the proceeds of crime they purchased CAD 1 000 000 + of diamonds that were then re-sold back to the jewellery market and also to the general public through the internet. They did not mark up the value of the diamonds for retail purposes instead sold them to retail customs at wholesale prices and therefore moved them quickly. The diamonds were all in a size and quality class that are the most desirable and resulted a quick turn over of the diamonds. The money received from the sale of the diamonds was wired direct to their bank from the various sales locations.

Predicate offence/s	Fraud
Stage of Trade	Retail and wholesale
ML/TF Stage	Placement and layering through trade in diamonds
Money/Trade flow	-

Case 13: *Laundering proceeds of crime through purchase of diamonds and resale at wholesale prices to jewellers and to final customers via the internet*

Types of financial/trade activities	Wire transfers
Sums involved	CAD 1 000 000
Red flag indicators	■ Diamond bought and resold quickly ■ Diamonds are sold to retail customers at wholesale prices
Source	Canada (response to collection plan, 2013)

TECHNIQUE: LAUNDERING OF SMUGGLED DIAMONDS THROUGH TRADE SHOWS.

In the following case, smuggled diamonds are laundered through a trade show. Trade shows are held in different trade centres around the world (Hong Kong, China; Switzerland; Singapore; Israel; United States, etc.) where cash is still used to a large extent. The diamond will be sold for cash without proper certification which will then be disposed of by usual means. The case presents one of the techniques by which the illegal trade is conducted. The case also exposes the lack of expertise by custom authorities to identify diamonds that are misclassified.

Case 14: *Selling Smuggled diamonds at gem shows*

Homeland Security Investigations (HSI) received information that a Guinean National was attempting to sell uncut smuggled diamonds at local area Gem Shows. HSI undercover agents (UCA) conducted surveillance at several Gem Shows and negotiated with the Guinean national the sale of rough uncut diamonds from Zimbabwe. UCAs purchased one rough uncut diamond weighing approximately seven carats for USD 15 300. The subject admitted to UCAs the diamonds were smuggled to the United States and lacked the required Kimberley Certificates.

During the UC meeting, two additional associates were present with a gem inventory that included rough-cut *diamonds*, *aquamarines*, and *tourmalines*. The Guinean National admitted that the rough cut diamonds had been smuggled and did not contain the Kimberley Process certificates. He also admitted that the organisation smuggles diamonds into the United States, or *misclassifies* them, depending on the quantity; and stated that the *US Customs authorities don't know what they are looking at*.

An expert gemmologist certified the purchased stone was a diamond. Based on this information, HSI agents obtained a search warrant, which resulted in the seizure of 11 665 carats of rough-cut diamonds, other precious and semi-precious stones and the arrest of all three subjects.

A follow-up interview was conducted with the Guinean National who admitted to have imported 12 000 carats of un-cut diamonds and *misclassified* the Customs entry paperwork as miscellaneous coloured stones. He also admitted to have purchased the diamonds from a mine in Zimbabwe from where he then flew to Thailand, then Amsterdam and arrived to the United States.

All three subjects were arrested on violation of Title 18 USC 545 Importation Contrary to Law and 19 USC 3907 violation of the Clean Diamond Trade Act. It is believed that through the smuggling of diamonds, this criminal organisation generated over USD 500 000 in illicit proceeds.

Predicate offence/s	Smuggling diamonds, misclassification of shipments in order to deceive customs authorities
Stage of Trade	Rough trading
ML/TF Stage	Layering (smuggling and moving diamonds through a number of states)
Money/Trade flow	Zimbabwe to Thailand to Netherlands to United States (illegal trade)
Types of financial/trade activities	Sale of rough stones at gem trades
Sums involved	USD 500 000
Red flag indicators	Lack of KP certificate for rough diamonds
Source	United States (response to collection plan, 2013)

TECHNIQUE: ML THROUGH DIAMOND DEALERS ACCOUNT AND USE OF A DIAMOND DEALER ACCOUNT TO TRANSFER FUNDS FOR THIRD PARTIES

Large number of cases relate to the use of diamond dealers' accounts as a conduit to transfer funds for parties not related to the diamonds trade. This technique is therefore used mainly for the

layering of funds generated in criminal activity by conducting numerous transactions between accounts to conceal their source. This is perhaps the most common activity identified in cases submitted by team members. Some of the cases show activity which may well be trade-based ML, however the information submitted refers mainly to financial transaction through the diamond dealer's account with no information as to the manner in which the trade was used to launder funds¹³¹. The fact that the transaction originated from, or destined for, real estate companies, charities, textile companies, metal trading companies, money service businesses, etc. is a clear indication that diamond dealers are used as a front for funds generated in criminal activity.

One of the interesting points is that this type of activity takes place in different jurisdictions¹³² serving as trade centres for the diamond trade. This is indicative of the global nature of the diamond trade, the connectivity between different stages of the trade cycle and the fact that diamond dealers in many cases have an international presence and are sometimes involved in more than one stage of the trade. When a diamond dealer turns to the wrong side of things this can be exploited to transfer funds between accounts held by the same entity worldwide as part of the usual business doing.

Three cases present the activity of the diamond dealers' accounts and an additional case presents the activity of a non-diamond trade entity transferring funds to and from diamond dealers in a tax fraud case through a charity submitted by Australia. Two of the cases submitted by India and Australia show large scale ML cases amounting to tens of millions of USD.

¹³¹ TBML is dealt with as a separate method which entails use of the diamond dealer's account.

¹³² Australia, Belgium, India, Israel. Canada also indicated in the response to the collection plan that based on the SAR analysis, one of the red flags identified was transactions of entities not involved in the diamond trade such as construction and renovation, and the food industry.

Case 15: *Sanitised STRs relating to diamond trade Inputs from Financial Intelligence Unit*

ABC is a company represented by its directors Mr. XXX and Mr. YYY. The company opened a bank account in June 2011. The aggregate turnover in the account from April 2012 to July 2012 was INR 321 million. The total turnover in the account from July 2011 to May 2012 was INR 687 million and the average balance in the account during the period was INR 0.5 million. This triggered the suspicion that the account was being used only for *layering* of funds. The funds were received in this account through Real Time Gross Settlements (RTGS)/clearing and by transfer from other firms whose activities consisted of *real estate, metal trading, textiles, exporters/importers, diamond trade and steel & alloys*.

The funds were transferred to different entities whose activities were related to diamond trade. The company had also sent foreign outward remittances of INR 5.6 million to Hong Kong, China ostensibly for the purpose of import of *polished diamonds* during the period July 2011 to May 2012. The transactions happened between ABC and other diamond traders but the funds never stayed in the account of ABC except on few occasions when the funds were kept just for a day.

Mr. XXX and Mr. YYY also have their personal savings account with the same bank. An analysis of the transaction activities in this account revealed that the company used to transfer funds through RTGS to *real estate* companies and *stock-trading* firms as well. These transactions raised doubts that the company, being active in the diamond trade, may be facilitating the integration of funds received from diamond merchants in favour of real estate/share trading companies. During enhanced due diligence carried out by the bank, the directors were not forthcoming in explaining the genuineness of the transactions and as to why the fund transfers happen on the same day. The very high turnover followed by low end of day balances in the account shows that the customer was using the banking system only for fund collection and transfers.

The main points of suspicion were: 1. The operation of the account by the customer, the layering of transactions carried out by them and their business activity point to a suspicion that they may be acting as a *front for third parties*. 2. The company projected an annual aggregate turnover of INR 100 million in the account whereas the actual turnover was six times higher. 3. The fund transfers through several layers gave rise to a suspicion that the funds were transferred on behalf of certain persons to certain beneficiaries who may not have relationship with one another.

Analysis of FIU-IND's revealed heavy cash transactions in several other bank accounts of the main company and the accounts of related entities.

Predicate offence/s	-
Stage of Trade	Polished diamond trade
ML/TF Stage	Layering
Money/Trade flow	India to Hong Kong, China (money)
Types of financial/trade activities	International transfers
Sums involved	INR 687 million
Red flag indicators	-

Case 15: *Sanitised STRs relating to diamond trade Inputs from Financial Intelligence Unit*

Source	India (response to collection plan, 2013)
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The following case also demonstrates the importance of international cooperation between FIUs. This enables to confirm ML suspicions while respecting the confidentiality of the exchanged financial intelligence. After highlighting the serious ML indications, the relevant information was structured and promptly forwarded to the judicial authorities.

Case 16: *Commingling proceeds of theft in an account of a diamond trade company*

CTIF-CFI received a disclosure from an Asian counterpart. An investigation conducted in this Asian country revealed that the main figure, of Asian origin, had deposited a large amount in cash on his account with a bank in Asia. Shortly afterwards he had these funds transferred to an account in Belgium held by a Belgian company.

Based on the financial documents provided by the Asian FIU, the Belgian FIU, CTIF-CFI, was able to obtain more details on the transactions conducted in Belgium. CTIF-CFI also detected a large number of transactions that were not previously known.

It became clear that the company traded in diamonds. It held an account with a bank in Belgium, on which the transfer from the country in Asia took place. The manager, of Asian origin and residing in Belgium, held power of attorney.

CTIF-CFI's analysis showed that numerous transactions took place on the account: many international transfers debited and credited the account. The money he transferred from Asia to the diamond company in Belgium was clearly a layering transaction. He was suspected of ML linked to theft with violence in Asia and seemed to have used the diamond company as a cover to purchase diamonds with proceeds of this crime. Mixing funds of illicit origin with proceeds of business activities is typical of ML.

The Asian FIU granted CTIF-CFI permission to use the intelligence in the request and the file was reported to the Belgian judicial authorities for theft.

Predicate offence/s	Theft
Stage of Trade	Wholesale
ML/TF Stage	Layering
Money/Trade flow	Asian country to Belgium (Money)
Types of financial/trade activities	Cash deposits (in Asia), International transfers
Sums involved	■ Large cash deposits followed by international transactions ■ Frequent international transactions in a diamond company account (both credit and debit) without logical explanation
Red flag indicators	Belgium (response to collection plan, 2013)
Source	Theft

Case 17: *Activity in the Designated Diamond Account Deviates From Normal Practices of the Diamond Trade*

The Israel Money Laundering Prohibition Authority (IMPA) received Unusual Activity Reports (UARs) regarding person X. Analysis of the information about X revealed he held 50% of the shares of company B, operating in the diamond trade.

According to the UARs, W transferred tens of thousands of dollars to beneficiaries abroad, which did not seem to be related to the diamond trade in their countries. X transferred money to beneficiaries abroad, while the true name of the beneficiary in his order of transfer was different from the actual beneficiary stated in the Diamonds Importer Declaration form, made by him according to the AML/CFT banking order.

Moreover, X made a deposit of travellers' cheques in an amount exceeding USD 100 000 that was stated as "diamonds export return", traveller cheques as a form of payment for export return is highly irregular.

At the time, information had already been received indicating a suspicion that X had a connection to organised crime groups. The connection of X to the head of a criminal organisation raised the supposition that X assisted the criminal organisation to transfer money for its illegal operations and launder funds by giving guise of precious stones deals to the fund transfers. The information of this case was subsequently forwarded to law enforcement.

Predicate offence/s	Link to organised crime
Stage of Trade	Rough diamond trade
ML/TF Stage	Layering
Money/Trade flow	-
Types of financial/trade activities	International transfer (out), Deposit of travellers cheques
Sums involved	Over USD 100 000
Red flag indicators	■ Transfers to entities which seems to be unrelated to the diamonds trade ■ Discrepancies between names of foreign beneficiaries of the transactions in the bank account with the names of suppliers indicated on the importer declaration form ■ Unusual form of Payment in the diamond trade (use of travellers cheques) ■ link to organised crime
Source	Israel (response to collection plan, 2013)

Case 18: *Laundering of tax fraud proceeds through the diamond industry*

Over a seven-year period suspect A and his family members operated a complex ML scheme in which approximately AUD 42 million was transferred from Australia to Israel. The services provided by suspect A and his family involved the laundering of undeclared and untaxed cash from business earnings of various clients.

Suspect A opened an account in the name of a non-existent charity, a fictitious entity with no legal basis. The charity was not an incorporated company and it did not have a registered business name.

The account was used to deposit, move and launder undeclared earnings from business activities of clients of suspect A. The cash deposits made by suspect A and his family members were subsequently transferred to Israel. The funds were transferred through the bank under the guise of charitable donations. Clients used the services of suspect A specifically to launder funds with the intention of not declaring income and to avoid tax.

Suspect A also used the diamond industry to launder funds. Over a three-month period law enforcement officers observed suspect A travel from an Australian-based airport to the offices of two diamond dealers. On each occasion, suspect A left the diamond dealers' offices in possession of a plastic shopping bag which he had not taken into the dealers' offices. The following day, suspect A deposited a large amount of cash into the account of the charity and transferred the funds to Israel.

Authorities alleged that most of the money laundered by suspect A came from the cash sale of diamonds which had been imported illegally into Australia. Following the cash sale of the diamonds, the proceeds were collected by suspect A and deposited into the account of the charity. The funds were then transferred back to the overseas-based diamond suppliers under the guise of charitable donations. This method facilitated the avoidance of sales tax on the sale of the diamonds and the payment of income tax on the profits from the sale.

Enquiries identified that three bank accounts in Israel and one in Sweden received funds sent by suspect A and his family. A further two overseas-based accounts were identified. These accounts also received funds and both accounts were associated with diamond merchants in Israel and Belgium. These diamond merchants supplied wholesale diamonds to Australia.

Suspect A was convicted of conspiracy to defraud the Commonwealth and sentenced to five years imprisonment.

Suspect A's family members were convicted of conspiracy to defraud the Commonwealth and sentenced to periods of imprisonment ranging from nine months to 15 months, suspended for periods ranging from three years to five years during which, the family members are to be of good behaviour.

Predicate offence/s	Tax offences, illegal import of diamonds
Stage of Trade	Wholesale?
ML/TF Stage	placement, layering
Money/Trade flow	Belgium and Israel to Australia (trade), Australia to Israel & Sweden (money)

Case 18: <i>Laundering of tax fraud proceeds through the diamond industry</i>	
Types of financial/trade activities	Cash deposits, International transfers
Sums involved	AUD 42 Million
Red flag indicators	■ Use of account of a non-existing charity ■ Purpose of transaction (charity donation) does not correspond the activity of the account (diamond dealer) ■ Use of diamond dealer's family members to transfer funds
Source	Australia (response to collection plan, 2013)

METHOD 4: TRADE-BASED MONEY LAUNDERING AND CUSTOMS INFRACTIONS

Dealers in precious metals and precious stones are perhaps the only sector covered by the FATF 40 Recommendations in which all its activity is trade-related. By definition, almost all cases involving the use of diamonds relate to trade. Almost, since smuggling is an illegal activity outside the normal or routine trade and not part of it. Diamonds are a commodity traded worldwide through different distribution channels. This also applies to cases presented under the various methods and techniques presented in this part of the report. However, the cases presented under this method refer to specific techniques used to transfer funds through the financial system as part of a ML scheme under the guise of trade-related activity. These cases are less indicative of the characteristics of the diamonds as a commodity (diamonds as currency) or where diamonds are themselves the proceeds of crime as in the cases of theft and robbery) or where the account was just used to as a conduit to transfer funds without any reference to actual trade practices.

Some of the techniques produced by team members are known TBML techniques, such as overvaluation of the price of the traded goods as in the case provided by India, or misrepresentation of transactions as in the case provided by Israel where an "underground bank" activity was carried out under the guise of transactions misrepresented as import and export of diamonds. Where the ML activity in these two cases is conducted through trade centres and cutting and polishing centres, an additional case submitted by Sierra Leone illustrates the use of TBML in the mining sector.

As in previous cases presented, the amounts laundered in TBML cases can be huge and ML activity spans over a long period of time. In one of the cases submitted by Israel, the amounts laundered reach hundreds of millions of USD. The case presented by India exposes how through overvaluation diamonds were shipped at a value that was tens of millions of USD higher than the real value. This kind of overvaluation cannot be done in goods with a fixed or even relatively fixed price.

TECHNIQUE: ML THROUGH OVERVALUATION OF DIAMONDS

The case below submitted by India is a case of overvaluation the diamonds are exported at an extremely higher value than their real or market value. In the case of most products exported or imported, such gross overvaluation would not be possible. This kind of overvaluation cannot be done in goods with a fixed or even relatively fixed price. When the price or value of the goods shipped is more apparent, gross overvaluation may be more easily detected by customs authorities.

This case shows the level of manipulation which may be conducted through the diamond trade due to the specific characteristics of diamonds such as the very high value of the commodity and the lack of known and stable prices for diamonds which allows for the manipulation of price.

Case 19: *Overvaluation of Imports and Round-Tripping of Diamonds*¹³³

Four importers of diamonds located in Surat and Mumbai imported 28 packages of rough diamonds, falling under Chapter 710231.00 of the Indian Customs Tariff Headings, from four Hong Kong, China-based suppliers. On investigation, these importers were found to have been involved in fraudulent imports by grossly overvaluing these goods to USD 544.8631 per carat, apparently with a view to transfer huge amounts of foreign exchange outside India. The goods were also not accompanied by valid Kimberley Process (KP) certificate, which is required under various regulations of the Government of India.

The consignments consisting of 28 packages of rough diamonds imported by India based importers with a declared value of **USD 98 951 493 (INR 4 880 million)** were placed under detention by Customs authorities. Subsequently, the Hong Kong, China-based exporting firms approached the Indian Customs to amend the declared value to **USD 353 328.45** (INR 17.4 million) which was not allowed by the Customs, as it appeared to be an afterthought in the light of the detention already made by the Customs. As per investigations conducted, there appears to be gross overvaluation of approximately Indian Rupees 4 860 million (USD 98.5 million) by the said companies.

All the four Hong Kong, China-based exporting firms appear to be registered in the name of the same proprietor who is an Indian national, and managed by another Hong Kong, China-based Indian national.

The table below shows the values declared before the Indian Customs and the value which was sought to be amended after detention of the goods by Indian Customs, as follows:

Name of Exporter	Original declared value (in USD) in Invoice	Value (in USD) as per revised invoice after the goods in question were detained by DRI	Difference in value (in USD)
A	24 489 997	84 787.36	24 405 209.64
B	24 585 844	90 090.07	24 495 753.93
C	21 282 561	72 906.30	21 209 654.70
D	28 593 090	104 544.75	28 488 545.25
	4538	2678.48	3857.52

Investigations have revealed that the 28 packages exported from Hong Kong, China appear to have been originally imported into Hong Kong, China from India at much lower value in the name of different Hong Kong, China-based firms. This suggests that the same diamonds have been round-tripped and brought back in India at an exorbitantly inflated price.

Further, the same four Hong Kong, China exporters have also exported 15 packages of rough diamonds at a declared value of INR 2 600 million (USD 47 million) to the same four importing firms earlier, which was cleared from Customs a week before the consignments of 28 packages were

¹³³ Further discussion on round tripping in India was published by Chaim Even-Zohar in Evan-Zohar (2013). It was stated by Even-Zohar that a duty of 2% was put on polished diamonds import which significantly reduced this activity.

Case 19: *Overvaluation of Imports and Round-Tripping of Diamonds*¹³³

detained. The earlier consignments also appear to have been grossly overvalued and the same are also looked into by the Indian Customs.

Mr. XXX who is an authorised representative of all the four exporting companies in Hong Kong, China has earlier also come to the adverse notice of the Indian Customs in similar cases of overvaluation and circular trading of diamonds.

The investigation in this case is still going on and if the charges are proved, the offences are punishable with long imprisonment and fines.

Predicate offence/s	Fraudulent diamond import
Stage of Trade	Polished diamond trade
ML/TF Stage	-
Money/Trade flow	India to Hong Kong, China (trade) Hong Kong, China to India (Money)
Types of financial/trade activities	International transfers Export/import of polished diamonds
Sums involved	USD 98.5 million
Red flag indicators	■ Diamonds are grossly overvalued ■ Lack of valid KP certificates ■ Circular trading of diamonds ■ Proprietor and managers of foreign counterparts Are both nationals ■ Average price per carat does not correspond to trade practices ■ Numerous counterparts are affiliated
Source	India (response to collection plan, 2013)

TECHNIQUE: PROVIDING MONEY SERVICES IN THE GUISE OF DIAMOND TRADE/USE OF FALSE INVOICES

The case below details the activity of an "underground bank" managed by a diamond dealer facilitating the transfer of large amounts of money to locations abroad to the request of the "bank's" customers. The activity is conducted by use of the diamond dealer's accounts and is declared by him to the customs and to the bank as an import and export activity, although no diamonds are being sent. In fact, these funds were received by him in cash which were then sent through his account abroad. In this manner, the diamond trade was used as a mean to transfer funds internationally through accounts of a diamond dealer. In many cases this was undeclared cash that was sent abroad so as to avoid paying tax.

Case 20: *"Underground Bank" in the guise of diamond trade*

Mr. A is a licensed diamond dealer and the owner of a designated diamonds account in a bank branch designated to serve the diamonds trade sector. In order to create import of diamonds documentation, required by the bank to conduct payment transactions, Mr. A entered Israel numerous times. He went through the customs "red Lane" and declared that he was importing diamonds purchased abroad ("by passenger" import), while actually carrying a parcel that contained low value, but good quality gems.

Later, every such shipment was presented by Mr. A in the designated customs station, operated by the Inspector of Diamonds in the Diamonds Exchange complex, for clearance. This was done after real diamonds were inserted in the shipment. There Mr. A claimed that the value of such a shipment exceeded several millions USD. Thus, A obtained a validated official importation statement from the customs which he used later at the bank to facilitate transactions abroad.

Mr. A presented the documents to his Bank together with fake invoices, to enable him to perform international foreign currency transfers to entities abroad in the guise of payment for the imported goods. Actually, these transfers did not represent any real high value acquisition of diamonds by A. The fake import was only done in order to produce the documents required by the bank to authorize the international transactions. These transactions were made to other countries for himself and other diamonds dealers wanting to receive funds abroad while avoiding questions by the bank and reports to IMPA concealing revenues and avoiding tax. Fictitious invoices were also issued to diamond dealers for the purpose of avoiding tax. In this manner Mr. A was providing money services for others of transferring funds abroad through his account in the pretence of a diamond import transaction, providing loans, discounting foreign currency checks and conversion of foreign currency.

According to open source information, indictments will be served against the entities involved, pending a hearing on suspicion of fictitious import, fictitious invoicing, tax offences and ML in amounts of many hundreds of millions of NIS (several hundred million USD).

Predicate offence/s	Smuggling/fictitious import, fictitious invoicing, unregistered MSB
Stage of Trade	Rough and polished trade
ML/TF Stage	Placement, layering
Money/Trade flow	-
Types of financial/trade activities	■ International transfers (out) ■ Physical transfer of diamonds/gems
Sums involved	Several hundred million USD
Red flag indicators	■ Frequent deposits of large FC cheques to a diamond dealer's account, particularly followed by large cash withdrawals ■ Unreasonable turnover for the diamond dealer ■ International transactions to entities not involved in the diamond trade ■ Use of fictitious documents
Source	Israel (response to collection plan, 2013)

TECHNIQUE: USE OF KP CERTIFICATE TO CONCEAL SOURCE OF ILLEGAL DIAMOND OR FOR ML PURPOSES

Case 21: *Illegal Trafficking in diamonds*

A shipment of rough diamonds arrived at Amsterdam Airport Schiphol (the Netherlands) from Dar Es Salaam, Tanzania. The airway bill indicated Brussels, Belgium, as the destination. The 2012 Kimberley Certificate (KC) specified Tanzania as the origin of the diamonds. A forensic investigation was carried out after shipment had passed and showed poorly legible stamps dating from 2007. The address of destination on the airway bill differed from the diamond dealer's official address. It is not known whether the diamonds reached their final destination. If the KC was false, it is not possible to establish where the diamonds are coming from.

Predicate offence/s	Illegal trafficking in diamonds
Stage of Trade	Rough trade
ML/TF Stage	-
Money/Trade flow	Tanzania to Netherland (trade), Netherland to Belgium (trade)
Types of financial/trade activities	-
Sums involved	-
Red flag indicators	■ Shipment is not sent directly to destination ■ Forged KP certificate ■ Low invoice amount (possible undervaluation) ■ Fictitious legitimate origin ■ Address of destination on the airway bill differs from the Diamond dealer's official address.
Source	Netherlands

Case 22: *Operation Carbon' - Diamond fraud*

A report published by Partnership Africa Canada (PAC) in 2006 revealed a suspicion of "massive diamond fraud" in which almost half of Brazil's diamond export was fraudulent. According to PAC, the police raided three Brazilian cities in February 2006, resulting in the arrest of ten people – diamond miners, diamond dealers and money changers. Suspicions of fraud, tax evasion and ML were raised.

The case involved Mr A, a diamond dealer from Africa. Mr A was one of those arrested and was responsible for more than half of Brazil's diamond exports in 2004 (Ahmad's business exported some 54% of all Brazilian diamonds registered that year, according to Brazilian Federal Police documents). In 2005 PAC detailed a series of frauds involving one of his government-certified exports to Dubai. Mr A claimed to have purchased the diamonds from a company that in reality deals only in mineral pigments. Mr A further claimed that the diamonds had been mined in the space of seven days, from untouched ground – by a dead man (the report indicated that the sixth largest

Case 22: Operation Carbon' - Diamond fraud

producer in Brazil was already dead and the fourth largest was a homeless). On top of all that, the diamonds were *undervalued* by more than USD million.

Mr A's diamond smuggling operation, working under the legal cover of a company known as "Primeira Gema", used falsified documents to obtain legitimate Kimberley Certificates to obscure, or launder, the origin of his rough stones.

The production statistics, the export numbers, and PAC's research all point to one conclusion: 50% of Brazil's diamond production and export was fraudulent or from highly suspect sources¹³⁴.

Predicate offence/s	Smuggling diamonds, forgery of documents,
Stage of Trade	rough diamond trade
ML/TF Stage	-
Money/Trade flow	Brazil to Dubai (trade)
Types of financial/trade activities	-
Sums involved	-
Red flag indicators	-
Source	Open source: Partnership Africa Canada (2006a and 2006b)

TECHNIQUE: TBML THROUGH BUYING COMPANY AT THE MINING LEVEL**Case 23: Laundering of drug trafficking proceeds through mining/buying company**

A Foreign national registered a series of corporate vehicles including a diamond mining/ buying agency to facilitate the laundering of proceeds from alleged drug trafficking. The Law enforcement agency received a tip-off from Interpol of a possible drug trafficking ring involving the subject. Investigation revealed that the subject has received huge wire transfers of about USD 500 000 from a European country and there was no apparent justification for such proceeds. The diamond and other string of businesses were used as a cover-up to engage in more dubious business activities.

Predicate offence/s	Drug trafficking
Stage of Trade	Mining
ML/TF Stage	Layering
Money/Trade flow	Europe (Money in)
Types of financial/trade activities	International transfers
Sums involved	USD 500 000

¹³⁴ At the time Brazil suspended itself from the KPCS.

Case 23: *Laundering of drug trafficking proceeds through mining/buying company***Red flag indicators**

Large international transfers with no apparent justification
Foreign national registering numerous corporate vehicles

Source

Sierra Leone

METHOD 5: USE OF FINANCIAL HUBS AND FTZS

As mentioned at the start of this chapter, the cases that are presented here usually display more than one ML method or technique. Several cases already presented in previous chapters introduced the use of trade centres and financial hubs to launder illegally gained funds or diamonds. At the very least they presented some involvement or link to financial or trade hubs.

A significant feature of the cases below is the huge amounts of money or huge value of the diamonds laundered. The cases presented, mainly from open source information, show ML schemes amounting to **billions** of USD/EUROs, where the trade was conducted through trade centres such as the United Arab Emirates, Switzerland, Israel, Belgium and Panama. These cases also show additional offences committed such as smuggling, falsifying documents including invoices and large scale tax fraud. The cases show instances where the use of FTZs like Dubai or Geneva helps to lower tax payments and tax fraud, by registering the profit in the FTZ where tax levels are low.

One of the cases below (case no. 26) gives an example of the possible use of *courier services*, which form part of the industry providing services of secure transport of diamonds between different locations around the globe but also provide services as a customs agent sending and releasing diamond shipments from the customs authorities. These services were abused according to the case for smuggling, tax-evasion and ML. In another case Panama was used on the one hand as an emerging trade centre for diamonds linking the US where drug proceeds were generated and Colombia where the drug traffickers were located and as a FTZ on the other hand for the laundering of drug trafficking proceeds.

Case number 25 also illustrates a method in which the Kimberley process is circumvented by sending the diamond through the United Arab Emirates and then resending them with a certificate indicating an origin of multiple mining countries to facilitate the laundering of offences conducted in Belgium.

Case 24: *Diamonds trader involved in corruption, drugs and arms trafficking*

In 2011, a financial intermediary submitted an STR to Money Laundering Reporting Office Switzerland (MROS) concerning his client X who had made his fortune in the trade with diamonds and precious metals in Africa for counter-parts in the Middle East and the European Union. Initially, the assets were held in accounts of various branches of European banks in Switzerland. In 2004, X forwarded these assets to another foreign bank in Switzerland – which had filed the report to MROS.

Conducting research on the external database, the bank discovered that X and his company Y were subject to sanctions issued by the US authorities (OFAC Specially Designated Narcotics Trafficker Kingpin) for trafficking of weapons and drugs. X was also believed to be a member of a criminal organisation. A press article also suggested that X was involved in a case of arms trafficking,

Case 24: *Diamonds trader involved in corruption, drugs and arms trafficking*

corruption of judges and ML in a country in South America - where he was known as a property developer.

Analysis of MROS confirmed the suspicion of the financial intermediary and highlighted also other elements. Very important information was further obtained from the FIUs of other countries that have given the permission to transmit this information to the Swiss competent prosecution authorities.

Predicate offence/s	Arms trafficking, Drug trafficking, Corruption
Stage of Trade	Rough trade (trade with diamonds in Africa)
ML/TF Stage	Layering
Money/Trade flow	-
Types of financial/trade activities	National transfers
Sums involved	-
Red flag indicators	■ Link to criminal organisations ■ Money transfer from various accounts to another account managed in foreign banks
Source	Switzerland (response to limited collection plan, 2013)

Case 25: *Laundering illegal diamonds through smuggling and financial hubs*

Police in Antwerp investigated a massive diamond fraud in which a family smuggled diamonds worth an estimated EUR 1.3 billion over the course of several years. The family has not been named, and most of the income from the scheme is thought to have been exported to Lebanon.

The investigation started with a warning from the state security service that the family had connections with known dealers in illegal diamonds. The diamonds were allegedly brought into Antwerp and the takings then exported, both undocumented, to evade huge sums in tax. The illegal diamonds, including stones originating from conflict zones (possible conflict diamonds) were mixed with legal diamonds and the whole shipment KPC indicated that the origin of the diamonds was from multiple mining countries. . The family managed to get around the Kimberley system by passing the stones through the United Arab Emirates and Switzerland before bringing them into Belgium. Meanwhile, the profits were laundered by means of false invoices and fake bookkeeping.

Predicate offence/s	Smuggling diamonds, Tax evasion/Tax fraud, false invoices, fake bookkeeping
Stage of Trade	Rough trade
ML/TF Stage	-
Money/Trade flow	Lebanon (money in), Belgium (commodity in), United Arab Emirates (commodity in/out), Switzerland (commodity in/out)

Case 25: *Laundering illegal diamonds through smuggling and financial hubs*

Types of financial/trade activities	
Sums involved	EUR 1.3 billion
Red flag indicators	■ Connections with known dealers in illegal diamonds ■ Documents seems to be forged
Source	Open source: Flanders today (2012)

Case 26: *Use of Companies in a FTZ - Diamond fraud*

This case involves a large scale fraud which targeted 220 suspects. According to open source the fraud was estimated at EUR 800 million. The investigation concerned 220 individuals, including 107 diamond traders and companies charged with falsifying documents, ML and criminal conspiracy.

The case centres on Company A, which once held a quasi-monopoly on diamond delivery, but which was closed down by authorities in 2005 after a courier was stopped with a huge sum of cash.

Investigation suggested the company was using the *free trade zone* in Geneva, which is intended to simplify customs restrictions, to smuggle diamonds and escape tax. Swiss authorities cooperated and turned over more than 35 000 seized Company A shipping dossiers, which showed that diamonds supposedly for export, were instead rerouted to Antwerp to be sold on the black market.

The 220 suspects have been identified from four fraud circuits used by Company A to launder money and avoid tax.

In 2012, the case came to court. The prosecution charged 36 diamond companies and 96 people on various counts, main case being fraud. Eleven of Monstrey's employees were charged with running a courier service that transferred diamonds and jewellery without proper legal disclosure. The case presented to the court discusses EUR 66.7 million.

Predicate offence/s	Tax fraud, forgery of documents, smuggling
Stage of Trade	Rough and polished trade
ML/TF Stage	-
Money/Trade flow	-
Types of financial/trade activities	-
Sums involved	EUR 66.7 million
Red flag indicators	Documents seems to be forged
Source	Open source: Flanders today (2013), International Diamond Exchange (2012)

Case 27: Tax fraud and ML through financial/trade hubs

Company D, a major market maker, came under investigation, and its executives fled Belgium, when an employee of the company revealed in 2006 how Company D had traded diamonds out of Africa for years, avoiding taxes by transacting deals through Dubai, Tel Aviv and Geneva, then moving the profits back to Belgium. The former employee is a native of Belgium with Israeli citizenship who has also spent years in Africa and Southeast Asia.

The charges allege that Company D traded diamonds out of Angola and Congo over a period of years, avoiding tax by moving the transactions through Dubai, Switzerland and Israel. Representatives from the company allegedly earned billions of Euros by buying diamonds cheaply on the black market in Angola and the Democratic Republic of the Congo. They then traded the stones to companies in Dubai, Tel Aviv and Geneva for profit and laundered the proceeds. Later they sold the diamonds to companies in Belgium, in price only slightly larger than they paid in Dubai and Geneva – so they paid tax in Belgium only on the gap between these rates were systematically neglected.

Officials who investigated the case believe that Company D did not declare considerable amounts of its profits and moved cash overseas. It is believed to have laundered money through a complex scheme of around two dozen firms and banks around the world managed by family members of the two key suspects.

Early This year it was published that in a settlement between Company D and the Belgian authorities Company D has agreed to pay a sum of EUR 150 million.

Predicate offence/s	Fraud, Tax evasion/Tax fraud
Stage of Trade	Rough diamond trade
ML/TF Stage	-
Money/Trade flow	■ Angola (commodity out), Congo (commodity out), Dubai (commodity in/out), Tel Aviv (commodity in/out), Geneva (commodity in/out), Belgium (commodity in/out) ■ Dubai (money in/out), Tel Aviv (money in/out), Geneva (money in/out), Belgium (money in)
Types of financial/trade activities	International transfers
Sums involved	EUR 2 – EUR 3 billion
Red flag indicators	Many firms and bank accounts are opened by family members
Source	Open source

Case 28: *Laundering drug proceeds through a wholesale jeweler located abroad*

More than USD 40 million worth of gold, silver and jewellery forfeited in international ML case.

US indictment of an offshore business engaged in the illicit black market peso exchange, an ML operation through which narcotics proceeds earned in the United States are exchanged for Colombian pesos and then used to purchase goods in the *Colon Free Zone in Colon, Panama*. During the course of the investigation, two natural persons were identified as major money launderers based in Panama. The two used a wholesale jewellery business, engaged in the sale of gold and silver jewellery and precious metals to many retail and wholesale customers throughout Central and South America and in Europe and the Middle East, and a related company to facilitate their illegal ML activities.

Based on a joint investigation conducted by the US and Panama, the natural persons and the related companies were charged with laundering millions of dollars in narcotics proceeds through the said companies in Panama.

According to evidence presented in the case, drug proceeds from the United States were sent to Panama through cash pick-ups, wire transfers, cashier's checks and third party bank checks. Through the companies, which together did more than USD 100 million in business annually, the two natural entities knew that the primarily South American-based customers were laundering millions of dollars in drug money from the United States through bulk purchases of jewellery. According to court documents, the companies were heavily involved in the black market peso exchange.

On 17 May 2006, a US District Court Judge signed a final order of forfeiture directing that the government of Panama transfer custody of the assets seized in Panama to the government of the United States. The assets transferred to the United States include approximately 468 boxes of gold and silver jewellery, as well as gemstones and watches, weighing ten tons, seized from the wholesale jewellery company.

From the judgment:

"A primary modus was to sell jewellery to drug lords, knowing that it was being paid for with drug money, thus allowing them to convert dirty money into glistening clean jewellery."

Predicate offence/s	Drug trafficking
Stage of Trade	Wholesale
ML/TF Stage	Placement and layering
Money/Trade flow	■ United States to Panama (Money) ■ Panama to Colombia (Jewellery)
Types of financial/trade activities	■ Cross-border cash pick-ups, wire transfers, cashiers checks and third party bank checks ■ USD exchanged to Colombian pesos
Sums involved	USD 40 million worth of jewellery forfeited

Case 28: *Laundering drug proceeds through a wholesale jeweler located abroad*

Red flag indicators	■ Use of cashier's checks and third party bank checks to purchase jewellery ■ Deposit of cashier's checks and third party bank checks to an account managed by a wholesale/retail jeweler. ■ Unusual international transaction/checks in large sums transferred/ deposited to a wholesale/retail jeweler ■ Funds are transferred from a different country than the commodity is sent to
Source	Open Source: US Department of Justice (2013), US District Court (nc)

METHOD 6: SMUGGLING OF DIAMONDS AND CASH

Diamonds are smuggled into jurisdiction for several purposes:

- a) Sale of illegally gained diamonds or jewellery, either by illegal mining, by theft or robbery or by criminals accepting diamonds as forms of payment and laundering them through smuggling abroad.
- b) Hide value and store wealth in another jurisdiction thus avoiding confiscation.
- c) As part of a ML scheme to sell diamonds and jewellery bought with proceeds of crime.
- d) As part of a TF scheme where diamonds are bought with clean money with a purpose to finance terrorist organisations.

Cases regarding smuggling of diamonds were provided by a majority of team members: Australia, Austria, Belgium, Canada, Israel, the Netherlands, Russia, Sierra Leone, South Africa and the United States. Open source information provides additional examples of instances where smuggling of diamonds occurred in Brazil, South Africa and Israel. These cases provide a clear indication that the illegal trade exists. Within the framework of this report it is not possible and outside the scope of this project to establish the extent of the illegal trade. However cases provided by team members, discussions held at team meetings and open source information indicate that illegal trade is a significant problem. Illegal trade may facilitate all the purposes detailed above.

Two cases also show the smuggling of cash by diamond dealers. Cash transactions are part of the diamond trade. In instances where the trade is used to launder illegally gained funds, cash transactions may also be used. Smuggling of cash may be part of a ML scheme, or may also be done as part of a scheme to avoid tax payments.

Case 29: *Trafficking of illegal diamonds and jewellery*

Mr. N, an Indian national who arrived on a flight from Dubai, was stopped for customs inspections by officials at a Moscow airport while attempting to pass through the Green Corridor for passengers who have nothing to declare. The ensuing luggage inspection and body search produced several pieces of jewellery (pendant and earrings) and a total of 30 401 natural diamonds valued at RUB 4 691 047, all of which were confiscated.

Case 29: *Trafficking of illegal diamonds and jewellery*

Predicate offence/s	Smuggling diamonds
Stage of Trade	Illegal rough trade, illegal jewellery trade
ML/TF Stage	-
Money/Trade flow	United Arab Emirates to Russia
Types of financial/trade activities	Physical transfer of diamonds
Sums involved	RUB 4 691 047
Red flag indicators	-
Source	Russia (response to collection plan, 2013)

Case 30: *Smuggling polished diamonds*

South African police have arrested a man who they say swallowed 220 polished diamonds in an attempt to smuggle them out of the country.

The man was arrested as he waited to board a plane at Johannesburg airport.

Officials said a scan of his body revealed the diamonds he had ingested, worth USD 2.3 million (GBP 1.4 million; EUR 1.8 million). The man was travelling to Dubai.

According to the information, authorities believe the man belongs to a smuggling ring. Another man was arrested in March also attempting to smuggle diamonds out the country in a similar way.

Predicate offence/s	Diamond smuggling
Stage of Trade	-
ML/TF Stage	-
Money/Trade flow	South Africa – Commodity Out Dubai – Commodity In
Types of financial/trade activities	-
Sums involved	USD 2.3 million
Red flag indicators	-
Source	South Africa (response to collection plan, 2013) Open Source: BBC (2012)

Case 31: *Trade in illegal diamonds*

A Diamond Exchange has blown the whistle on one dealer who seems to be actively engaged in trading with Venezuela. The dealer, who was claiming to represent the diamond exchange, said that he was a member of the another Diamond Exchange and the WFDB. It was said that he had even submitted a request, in the name of the diamond exchange, for the government of Panama to declare his business premises as a 'Free Zone'.

In the absence of official Kimberley Certification, Venezuelan rough diamonds sold by the dealer in the diamond exchange are illegal.

Predicate offence/s	Smuggling diamonds, forgery of documents
Stage of Trade	Rough diamond trade
ML/TF Stage	-
Money/Trade flow	Venezuela to Panama (suspected smuggling)
Types of financial/trade activities	-
Sums involved	-
Red flag indicators	lack of KP certificate for rough diamonds or indication that the certificate is forged
Source	Open source: Tacy Ltd (2008)

Case 32: *Diamond smuggling network*

An investigation of a suspected tax evasion case of a woman who operated a small kindergarten led to the discovery of a diamond smuggling network. According to the tax authorities the network operated in Israel, Belgium and Russia.

During the kindergarten inquiry, investigators found that the owner's husband had travelled abroad 245 times in the past eight years, on trips that usually lasted just two days.

During the investigation, 15 men and women were arrested, all suspected of being involved in the smuggling ring. The suspects were relatives who have allegedly carried out more than 500 such diamond operations in a value of hundreds of thousands of USD and were paid USD 600 per trip plus travel expenses. Among the suspects are hi-tech executives and an education advisor. The report adds that the diamonds were hidden inside "private" body parts.

Predicate offence/s	Smuggling
Stage of Trade	-
ML/TF Stage	-
Money/Trade flow	■ Russia to Israel, Belgium to Israel (illegal trade) ■ Israel to Belgium, Israel to Russia (illegal trade)
Types of financial/trade activities	-

Case 32: *Diamond smuggling network*

Sums involved	Hundreds of thousands of dollars
Red flag indicators	■ Family members involved ■ Frequent travels abroad
Source	Open source: Haaretz (2008)

TECHNIQUE: CASH SMUGGLING BY DIAMOND DEALER**Case 33: *Cash smuggling by an employee of a diamond company***

An employee of a Diamond company was found in possession of large amount of cash on the way from South Africa. The cash was found hidden. The suspect failed to satisfactorily explain the source of the cash. The cash was confiscated and the suspect was charged with contravening the Prevention of Organized Crime Act, 2004 (Act No. 29 of 2004). Further net worth analysis is being conducted on the suspect.

Predicate offence/s	Customs infractions
Stage of Trade	-
ML/TF Stage	-
Money/Trade flow	South Africa to Namibia (money)
Types of financial/trade activities	Physical transfer of cash
Sums involved	-
Red flag indicators	Cash transactions conducted by an employee of a diamond company
Source	Namibia (response to collection plan, 2013)

Case 34: *Smuggling of cash by a diamond dealer and international transfers from entities not related to the diamond trade through a Diamond Dealer account*

Person A was caught by customs upon leaving the country, carrying cash in an amount higher than the amount he actually declared.

Further inquiries made by the Israel Money Laundering Prohibition Authority (IMPA) revealed many UARs according to which person A was involved in several companies operating in the diamond trade. The inquiries also revealed that person A made thirteen customs declaration with reference to trans-border foreign currency transfers made by him between the years 2003-2008. The declarations showed discrepancies and errors in the data provided by person A in the declaration forms e.g., omission of letters from his name, misrepresentation of his ID number, illegible data, insertion of his passport number in place of ID number, in a manner that render the relevant data almost impossible for collation and retrieval.

Person A's bank transactions were matched with dates of his exits and entries from\to the country.

Case 34: *Smuggling of cash by a diamond dealer and international transfers from entities not related to the diamond trade through a Diamond Dealer account*

This showed additional instances where a few days after his arrival to the country a foreign currency deposit in a sum higher than the declaration threshold was made to his bank account without person A submitting a currency declaration to the customs during his entry to the country.

Moreover, STRs regarding Designated Diamonds Accounts of companies that A was connected to showed that the banks reported the transfers of value for exports from a foreign entity that was not known to be a trader in diamonds. The name of the entity was similar to names of an MSB. IMPA submitted a request for information to another FIU that confirmed the suspicion that the creditor company was known as a money services bureau.

This affirmed the suspicion that A used his Designated Diamonds Accounts as a "pipeline" to perform large foreign currency transfers, posturing as payments related to diamonds export / import activity.

Person A was brought before a sanctions committee which decided on imposing a financial sanction of ILS 80 000. After an appeal the amount was reduced to ILS 7 500.

Predicate offence/s	Cash smuggling
Stage of Trade	-
ML/TF Stage	Placement and layering
Money/Trade flow	-
Types of financial/trade activities	Cash deposit, International transfers
Sums involved	-
Red flag indicators	■ Discrepancies and errors in provided data (customs declaration) ■ Proximity between entering to the country and deposits of foreign currency to the account ■ Deposits of foreign currency to a diamond dealer's account without customs declaration about entering money to the country ■ Transactions in a diamond account to/from money service business
Source	Israel (response to collection plan, 2013)

METHOD 7: LINK WITH OR USE OF GOLD AND/OR OTHER PRECIOUS STONES TRADE

Several cases presented above display a link between ML through diamond and ML through other precious stones and/or gold. Since the project initially focused on both diamond and other precious stones, relevant cases were provided before the scope of the project was narrowed down to diamonds only. Few additional cases display similar links. This is just an initial indication that gold and/or other precious stones are used in ML schemes. Further research is required to understand

the characteristics of the trade in these commodities and to establish their vulnerabilities to ML and TF and the extent they are used in practice for ML and TF purposes.

Case 35: *Link between proceeds of drug trafficking and diamond jewellery used as currency*

This case involves a drug courier/trafficker who was found carrying CAD 40 000 worth of drug money. The courier's cash bag also contained a quantity of *diamond* jewellery and loose *sapphire gemstones* that collectively were valued at CAD 60 000. The jewellery had been appraised by a third party. The appraisal value listed the jewellery for its cash value if it were sold as wholesale (just below wholesale). (Aside for the appraisal obtained, the jewellery trade is not as yet being engaged in this case as the diamonds/gemstones is being used between criminals as an alternate currency).

Predicate offence/s	Drug trafficking
Stage of Trade	Appraisal
ML/TF Stage	-
Money/Trade flow	-
Types of financial/trade activities	Physical transfer of cash Physical transfer of diamond jewellery
Sums involved	CAD 60 000
Red flag indicators	■ Request for an appraisal for high value jewellery where source of stones is not clear ■ A customer (not a diamond dealer or a jeweller) requests wholesale price on jewellery he tries to sell.
Source	Canada (response to collection plan, 2013)

CHAPTER 9.

TERRORIST FINANCING THROUGH TRADE IN DIAMONDS¹³⁵

Only a few cases were provided by team members with regard to TF related to the trade in diamonds. Additional information based on SAR analysis was provided by Canada and the United States. The SARs and one of the cases provided by the United States are related to the Lebanese-Canadian bank (see case 37 below). While indications of involvement of terrorist organisation in the diamonds trade may be traced in open source information¹³⁶ such indication are at this point limited to the cases received from team members¹³⁷.

TECHNIQUE: CAPITAL INCREASE TO SUPPORT A TERRORIST NETWORK

Case 36: *Capital increase to finance terrorism*

The Belgian FIU CTIF-CFI, received a disclosure from an auditor regarding company A. He noticed that Mr. X, manager of company A, carried out a capital increase of several million EUR. The auditor found it suspicious that the origin of the funds was unknown. Moreover, company A appeared to be a dormant company.

Apart from a disclosure by the auditor, the notary executing the deed and the bank holding company A's account also disclosed these facts to CTIF-CFI. Through the capital increase by means of a contribution in kind Mr. X obtained a majority interest in company A.

Mr. X was a candidate refugee from the Middle East. Company A was a night shop, which is considered to be a sensitive business with regard to TF. Multiple cash deposits were carried out on company A's account. Mr. X was known to the police for ties with a terrorist organisation. He was suspected of employing illegal foreigners and using the night shop's profits to finance terrorist activities. Part of the night shop's profits was sent to the Middle East to support a terrorist network.

Furthermore, certain elements revealed a link between the invested funds and conflict diamonds of terrorist groups. This reinforced the serious indications of TF.

Predicate offence/s

Terrorist Financing, trade in conflict diamonds

¹³⁵ FIU sanitized cases, Law enforcement, open source cases / investigation.

¹³⁶ In April 2003 global witness published a report claiming to present "evidence that confirms that Al-Qaeda has been involved in the rough diamond trade since the 1990s. Firstly in Kenya and Tanzania and then in Sierra Leone and Liberia, where they began to show an interest in diamond trading in 1998, following the crackdown on their financial activities in the wake of the US embassy bombings in Kenya and Tanzania." See Global Witness (2003).
Additional information was published in: Republic Of Liberia Truth And Reconciliation Commission (2009), pp. 30.
See also Farah, Douglas (2005): "Diamonds have also been used extensively by Hezbollah and other terrorist groups in the Middle East that have a long tradition of access to diamonds in West Africa".

¹³⁷ Two cases were also provided in FATF (2003) typologies report which included a section on diamonds.

Case 36: <i>Capital increase to finance terrorism</i>	
Stage of Trade	Wholesale
ML/TF Stage	-
Money/Trade flow	Europe to the Middle East (Money)
Types of financial/trade activities	Cash deposits, capital increase
Sums involved	Millions of EUR
Red flag indicators	■ Unknown origin of funds ■ Use of a dormant company ■ Use of sensitive business (night shop) ■ Multiple cash deposits followed by international transfers ■ Link with terrorist organisation
Source	Belgium (response to collection plan, 2013)

TECHNIQUE: USE OF LEGITIMATE BUSINESSES

Similar to regular ML cases, legitimate businesses are often used as a cover to funnel funds to terrorist organisations. The involved entities are also using money coming from diamonds smuggling or drug trafficking to support these organisations.

Case 38 is an open source case and therefore has few indicators on the *modus operandi*. Although there were indications of terrorist support in the United States, the main subject wasn't convicted for this in Belgium.

Case 37: *Car businesses to transport value*

An investigation by the Drug Enforcement Administration (DEA) and other federal law enforcement agencies discovered a scheme to launder money through the United States financial system and the United States used car market. As part of the scheme, funds are transferred from Lebanon to the United States in order to purchase used cars, which were then shipped to West Africa and sold for cash. Cash proceeds of these car sales are then transferred, along with the proceeds of narcotics trafficking and other crimes, to Lebanon. The cash is often moved through bulk cash smuggling. In 2012, the US District Court-Southern District of New York (SDNY) issued a civil ML complaint and "in rem" forfeiture action involving a number of Lebanese financial institutions and exchange houses.

The SDNY civil complaint stated that prior to being identified as an entity of primary ML concern by FinCEN in a Section 311 (of the U.S.A. Patriot Act) Action, Lebanese Canadian Bank (LCB) had poor anti-ML controls and, indeed, knowingly conducted business with Hizballah-controlled entities and individuals and entities linked to, among others, African diamond smuggling, ML, and narcotics trafficking. The SDNY civil complaint also mentioned that the LCB maintained a banking relationship with individuals and entities involved in the African diamond smuggling trade.

In all, hundreds of millions of USD a year went through the accounts, held mainly by Shiite Muslim

Case 37: *Car businesses to transport value*

businessmen in West Africa, many of them known Hezbollah supporters, trading in everything from **rough-cut diamonds** to cosmetics and frozen chicken, according to people with knowledge of the matter in the United States and Europe. The companies appeared to be serving as fronts for Hezbollah to move all sorts of dubious funds, on its own behalf or for others.

The system allowed Hezbollah to hide not only the sources of its wealth, but also its involvement in a range of business enterprises.

Predicate offence/s	Diamond smuggling and drug trafficking
Stage of Trade	
ML/TF Stage	
Money/Trade flow	■ Lebanon (Money IN) ■ West Africa (Cars OUT) ■ Lebanon (Money OUT)
Types of financial/trade activities	
Sums involved	
Red flag indicators	■ Use of legitimate business ■ Goods used to transfer money ■ Link with terrorist organisation ■ Bulk cash smuggling
Source	The United States (response to collection plan, 2013) Open source: The New York Times (2011)

Case 38: *Cover companies to transfer money*

The U.S. Department of the Treasury designated Kassim Tajideen and Abd Al Menhem Qubaysi, two Africa-based supporters of the Hezbollah terrorist organisation. Under E.O. 13224. E.O. 13224 targets terrorists and those providing support to terrorists or acts of terrorism by freezing any assets the designees have under US jurisdiction and prohibiting U.S. persons from engaging in any transactions with them.

Kassim Tajideen is said to be a financial contributor to Hezbollah who operated a network of businesses in Lebanon and Africa. He has contributed *tens of millions of dollars* to Hezbollah and has sent funds to Hezbollah through his brother, a Hezbollah commander. In addition, Kassim Tajideen and his brothers run cover companies for Hezbollah in Africa. In 2003, Tajideen was arrested in Belgium in connection with fraud, ML, and diamond smuggling.

Abd Al Menhem Qubaysi was a Cote d'Ivoire-based Hezbollah supporter and was the personal representative of Hezbollah Secretary-General Hassan Nasrallah. Qubaysi communicated with Hezbollah leaders and has hosted senior Hezbollah officials traveling to Cote d'Ivoire and other parts of Africa to raise money for Hezbollah. Qubaysi played a visible role in Hezbollah activities in

Case 38: *Cover companies to transfer money*

Cote d'Ivoire, including speaking at Hezbollah fundraising events and sponsoring meetings with high-ranking members of the terrorist organisation.

Predicate offence/s	Terrorist financing, fraud, ML and diamond smuggling
Stage of Trade	
ML/TF Stage	
Money/commodity flow	Open source: US Department of Treasury (2009)
Source	Terrorist financing, fraud, ML and diamond smuggling

Canada submitted three cases which were linked to a listed terrorist organisation in Canada. The first case involved several jewellery businesses, some of which were suspected of sending funds to the terrorist organisation. Some of the jewellery businesses were located in Canada, as well as in two foreign jurisdictions (hereafter referred to as Country A and Country B).

The similarity of the business names, and the fact that many were registered and operating at the same address, made it challenging to follow the flow of funds. Some of the businesses ordered funds to the benefit of other jewellery businesses located in Country A and two other jurisdictions.

Another case involved an STR that was reported on a jewellery business that is believed to support a listed terrorist organisation in Canada. Again, this case involved similar jewellery business names registered and operating from the same address. The jewellery business ordered funds from Canada to the benefit of other jewellery entities in Country B.

One final case connecting the diamond industry to potential terrorist financing activities is that of an individual who was intercepted by foreign authorities with diamonds. According to the case, it was suspected that the individual was acting on behalf of a terrorist organisation.

In the framework of a SAR analysis, the United States also submitted several SARs that reported suspected terrorist financing activities, including overall transactions totalling over **USD 3 billion**. The SARs appear to report newly identified transactions involving activities that occurred as long as 10 years ago involving individuals who have since been designated as terrorists by the US Department of the Treasury, Office of Foreign Assets Control (OFAC). Others reported newly identified transactions involving now-closed Lebanese banks that enabled Hezbollah fundraising transactions.

CHAPTER 10.

MONEY FLOWS RELATING TO SUSPECTED ML/TF RELATED TO THE DIAMONDS INDUSTRY

Some limited information was collected for the study on money flows pertaining to suspected ML/TF, as they relate to the diamond industry. Information is particularly scarce with regard to TF, where flows are typically quite small. Many countries noted that they have reported very few suspicious transactions to their FIUs involving the trade of diamonds and other precious stones.

Some overall trends can be noted, however, and in some countries, typical financial flows can be discerned through sanitised cases and reports from FIUs.

Generally, there has been a trend away from purely cash transactions, likely due to ML/TF requirements in the precious stones sector introduced several years ago. The most commonly used methods of payment by precious stones dealers are cash deposits and national and international transfers. Many countries noted funds transfers to high-risk countries, including those where a significant diamond trade does not exist. Multiple cross-border transfers enable layering of transactions to take place.

Where countries provided information on money flows pertaining to suspected ML/TF as they relate to the diamond industry, it is included below.

Australia did not provide aggregate information on suspected illicit financial flows; however, its case studies included an example whereby funds (primarily resulting from undeclared and untaxed cash from business earnings) were transferred from Australia to Israel under the guise of charitable donations. The transfers also involved the proceeds from the cash sale of diamonds to bank accounts in Israel and Sweden; the accounts were linked to merchants in Israel and Belgium. Another example cited by Australia involved financial flows relating to a money exchange business operating in South-East Asia.

Belgium provided significant analysis on money flows related to ML. A trend was noted whereby diamonds and funds formerly flowed from Africa directly to Antwerp; however, more recently both diamonds and funds transit through the United Arab Emirates. Financial flows in 105 disclosures of cross-border cash movements involving diamonds show that the majority of the funds were physically transported to Belgium from Congo (DRC); Hong Kong, China; Japan; and Thailand. The main countries of destination were France; Guinea; Hong Kong, China; Italy and South Africa. With regard to suspected trafficking of diamond cases in 2011-2012, the majority of funds were transferred internationally to Belgium from accounts from Hong Kong, China; India; Israel; the United Arab Emirates and the United States. Nearly 60% of funds were transferred to United Arab Emirates and Switzerland from Belgium. In other cases of suspected ML related to diamonds (predicate offences besides illicit trafficking of diamonds), the financial flows were mostly transfers in USD sent from India, Israel and Switzerland to the United Arab Emirates. Belgium also noted the

use of numbered¹³⁸ accounts in foreign countries (Liechtenstein and Switzerland) to conceal transactions. A major problem is the identification of the actual/principal beneficiary of incoming or outgoing international transfers on the account of diamond companies.

In Canada, diamond money-laundering schemes appear to frequently relate to drug trafficking. Illicit financial flows are most often between Canada and the United States. Other countries include Belgium, Cambodia, China, Israel, Panama and Switzerland.

India reported a relatively large number of sanitised cases (12) in which suspicious transaction reports were received. In these specific cases, Hong Kong, China is a destination for illicit cash flows related to the diamond trade.

Israel reported that international bank transfers were the most common method of payment used. In the case of unusual activity reports (UARs), major financial transfers occurred from Switzerland (28% of the total amount), Cyprus (15%) and Hong Kong, China (13%). Some of the countries sourcing funds (*i.e.*, Cyprus, Panama) do not appear in the customs export data. This means that funds are coming from countries to which diamonds are not exported. According to reports disseminated to law enforcement, major amounts come from Belgium (52%), United States (28%) and Great Britain (15%). Among the reported countries of destination, major amounts are going to China (30%); United States (26%); Hong Kong, China (20%); and Switzerland (10%).

Namibia identified South Africa and ZAR currency transactions as being the most commonly used.

The Netherlands noted that it is a transit country for diamonds into and out of the European Union, because diamonds are transported by airplane and Schiphol airport offers a wider range of destinations. Nonetheless, it had very few cross-border transactions relating to diamonds reported as suspicious.

The Russian Federation only cited examples where the predicate offence involved the smuggling of diamonds, notably from Dubai and Thailand. However, one case pertained to a company specializing in the unauthorised distribution of diamonds, the proceeds of which were transferred to the bank accounts of foreign companies in Israel and Hong Kong, China.

In the United States, diamond money laundering schemes appear to frequently relate to the trafficking of drugs and stolen goods. The United States noted that, based on their SAR analysis, no significant specific trends or patterns appeared to be particularly unique to diamond trading. The examined SARs revealed patterns of incoming and outgoing wire transfers involving multiple and regionally diverse countries that often appeared as points of transaction origin, destination, transit, a suspect's domicile, and/or location of foreign-based financial institution accounts. These include:

- Angola
- Austria
- Botswana

¹³⁸ A numbered bank account is a type of bank account where the name of the account holder is kept confidential, and they identify themselves to the bank by means of a code word known only by the account holder and a restricted number of bank employees, thus providing accountholders with a degree of bank privacy in their financial transactions.

- Belgium
- Brazil
- British Virgin Islands
- Canada
- Czech Republic
- China
- India
- Israel
- Latvia
- Lebanon
- Liechtenstein
- Mauritius
- Panama
- Peru
- Portugal
- Russia
- Sierra Leone
- St Vincent and the Grenadines
- Switzerland
- The United Arab Emirates
- The United Kingdom
- The United States

In the United States, diamond money-laundering schemes appear to frequently relate to the trafficking of drugs and stolen goods.

CHAPTER 11.

MAIN FINDINGS

Diamond trade, as an international phenomenon, needed a complete and global analysis to understand and determine ML and TF threats and vulnerabilities related to this unique trade. This report has aimed not only to provide a general overview of the diamond trade with its specific business practices, funding methods and risks, but also seeks to highlight a number of significant issues that require further consideration. The report has identified different issues that require consideration as to the sufficiency of the current measures mitigating new risks (see next chapter for issues for consideration).

In the process of this project, a sample of 17 countries submitted contributions. All contributions have been relevant to the project and have helped to address the questions that were raised at the beginning of this project.

TRADE PRACTICES AND FIGURES

344. Some important changes within the trade practices were identified such as a reduced use of cash, the appearance of new trade centres like China, India and the United Arab Emirates, Botswana becoming a trade centre due to the move of De Beers from London to Gaborone, De Beers no longer being an all-inclusive monopoly opening the diamond industry to more trade actors, an increase in interest from several diamond producing countries in diamond beneficiation, the emergence of synthetic diamonds and the Internet as a new trade platform for diamonds.

345. KP public statistics and other open sources provided a general overview of the trade in rough and polished diamonds. These figures show that almost 80% of the mining activity is concentrated in the Botswana, Canada, Democratic Republic of Congo, Russian Federation, Zimbabwe and that China, after India, is becoming a major cutting and polishing centre. In 2012, Belgium, Israel, Switzerland and the United Arab Emirates were the main trade centres for rough diamonds and the United States had the largest consumer market for polished diamonds (jewellery). What stands out from the figures is the change in the role played by the United Arab Emirates, and its significance in terms of the worldwide rough diamond trade and indications on the role it might have on ML/TF activity.

LEGISLATION AND REGULATION

Diamonds have been recognised by the FATF as vehicles for laundering the proceeds of crime and therefore diamond dealers were included in the definition of Designated Non-Financial Business and Profession (DNFBP). Specific attention goes out to the fact that Recommendation 22 on customer due diligence for DNFBPs and Recommendation 23 on other measures for DNFBPs are only based on cash transactions. All other transactions in which diamond dealers are or could be engaged in are not covered. With regard to Recommendation 32 it can be stated that diamonds are not included in the definition of currency or bearer negotiable instruments. Therefore, countries are not required to have measures in place to detect the physical cross-border transportation of

diamonds through a declaration/disclosure system, even though cases show considerable use of cross-border value transfer via the use of diamonds.

Although specific FATF Recommendations are applicable to diamond dealers, several countries have not yet implemented these in their national AML/CFT legislation. In those countries that do have national AML/CFT regulation on diamond dealers, the overall compliance of the sector is assessed to be medium. Only in a few countries are licences and registration required for business activity in the diamond trade. Although there are supervisory authorities, no sanctions were imposed in the last two years, an indication of the low level of enforcement in the sector.

348. Cross-border transportation of diamonds falls under customs control. There are some major differences between countries, especially on polished stones. In most of the countries there are no specific import export controls on diamonds and none of them have specific AML/CFT requirements where one has to declare diamonds when entering/leaving the country.

FUNDING OF THE TRADE

The trade is primarily funded by financial institutions such as banks. Several countries have specialised diamond banks or designated divisions or branches that diamond dealers must use for doing business and/or that provide financial services to them. In most countries, the banks and credit institutions do not apply special “know your customer” or due diligence procedures to diamond dealers. The main methods of payment used by diamond dealers are wire transfers or electronic funds transfer. The use of cash is still a common method of payment in the diamond business in countries where cash is widely used such as in mining centres like some African and Latin American countries, or in trade centres like Hong Kong, China.

THREATS, VULNERABILITIES AND RISKS

The different and unique characteristics of diamonds and the diamond trade make the industry vulnerable to ML and TF. The diamond supply chain in all of its stages, from production to consumption, can be the gateway to profitability, for laundering proceeds of crime, for ML and for moving proceeds of crime into the financial system. It is important to keep in mind that the complexity of the international diamond trade means that the ML and TF vulnerabilities and risks may differ from one segment of the “pipeline” to another and from one jurisdiction to another. For example whereas mining countries are facing the threat of illegal mining, trade centres are more vulnerable to transfer pricing. Cutting and polishing centres have to be more aware of the fact that diamonds become untraceable. Retailers are faced with other criminals that use their business to launder their proceeds of crime. Nonetheless theft, commingling and smuggling of diamonds can occur at all stages of the trade.

Diamonds can be used to earn, gain or store value, and are easily moved or smuggled. Their low weight, very high value, high durability, exchangeability for other commodities, ability to remain undetected, changeability, unsteady price and the ease in which they can be traded outside the formal banking system are just some of the characteristics that make them vulnerable to ML/TF and other crimes such as theft.

The fact that diamonds are used as an alternative currency by criminals who use them to acquire other goods (such as tobacco, guns, and drugs) is important to note, since diamonds are not included in the concept of cash/currency or a bearer negotiable instrument (FATF Recommendation 32). The emphasis on cash transactions (Recommendation 22) only and the fact that several countries have not yet subjected diamond dealers to AML/CFT legislation causes major vulnerability in international and national legislation. Cases show that criminals are taking advantage of this vulnerability. Few compliance assessments on diamond dealers have been carried out, no fines have been issued and no other AML/CFT civil enforcement actions have taken place in the last two years. Enforcement of the diamond sector is also exposed to a degree of vulnerability due to limited awareness of the sector, lack of evidence to collect and difficult international police cooperation. The low number of successful cases that were reported to judicial authorities or brought before court can be seen as a major vulnerability in the prevention of ML/TF. All these figures show low levels of enforcement which may be the outcome of the complexity of the industry, traditional ethics of trust of within the sector and the lack of sufficient expertise of relevant regulating and law enforcement bodies.

The concerns related to KP certificates are the fact that current enforcement efforts related to diamonds are directed more at ensuring compliance with the KPCS rather than preventing smuggling, fraud, or ML; there is no transparency for controlling officers at the border; the ease with which new KP certificates can be issued by authorities and the requirement of KP certificates only for import and export of rough diamonds alone. In this respect the KP certificate might also serve unintentionally as a ML tool since the existence of the certificate may signify that the source is legitimate overlooking ML/TF considerations. It should be considered that the localization of the beneficiation process may be a possible way to circumvent the purpose of the KP since exports will turn to be more of polished diamonds where KP certificates is not required.

In earlier studies, diamonds were also identified as goods that are more susceptible to TBML due to the difficulty in identifying the true value of the goods. The diamond industry is tremendously vulnerable to TBML primarily because of the high subjectivity in the valuation of diamonds, the ability of diamonds to change their form, the trade-based and global nature of the diamond market, the high value of the product which may facilitate large scale ML/TF and the long production chain involving many actors. In some countries the tariff for customs declarations is based only on carat, which creates a gap within the export/import systems which may be easily exploited for over/under valuation while making it hard to establish whether there is an infringement of customs laws and regulation.

The Internet, being a relatively new trade platform, not only entails vulnerabilities that may be applicable to all sales and purchases on the Internet (fraud with online rough diamond sale) but also create specific vulnerabilities related to KYC/CDD measures. Not only the increased anonymity of the customer but also the fact that almost all payments are facilitated through banking and credit institutions or Internet payment means (which are not covered by FATF Recommendation 22) make it harder to conduct and enforce proper KYC/CDD procedures and conduct investigations if such a case arise. Another upcoming technique is the laundering of stolen diamonds via the 'Darknet', where jewellery with diamonds is sold on the 'silk road' using e-currency such as 'bitcoin'.

With regard to the financing of the trade, several vulnerabilities and risks appear. Advance payments, return shipments, fork transactions, deficiencies in the KYC procedure, the use of cash, consignment agreements and promissory notes create opportunity for ML/TF.

Although cash is diminishing for large-scale business to business (B2B), cash usage still poses a risk for ML/TF in the diamond trade. At retail level, where cash is a frequent means of payment, not all countries have proper AML/CFT legislation to report cash transactions above a specific threshold. Vulnerabilities also arise when diamond trade credit is extended at concessionary terms, thus making it more attractive in comparison to rates of credits in other sectors.

The free and unrecorded circulation of promissory notes, which may take a bearer negotiable instrument form, creates an unofficial and unmonitored "banking system" which provides financing for traders, outside the official banking system, facilitates the transfer of high value assets and makes it possible to avoid KYC procedures and reporting to the FIU with no audit trail of the transaction. Although consignment agreements are a very common trade method, especially in international trade, they may bear some ML/TF risks. These risks are linked to the potential variation of the prices of the diamonds evaluated (over or understated), and to the possibility of fraud committed by the consignee.

RED FLAG & INDICATORS

This report provides red flags and indicators to identify potential ML/TF activity through the trade in diamonds, which are divided into several categories. The first category of indicators is intended for regulated entities and covers many indicators which would perhaps be relevant to other types of financial activities but that should be addressed from a diamond trade perspective and requires a good understanding of the diamonds trade practices. They are related to trade practices, to transactions/financing of the diamond trade, customer profile, use of third parties and the use of missing/suspected/falsified documents. The second category of red flags and indicators is targeted at diamond dealers and jewellers themselves and refers to the sale/purchase of diamonds or jewellery, the customer/supplier, use of third parties and the use of missing/suspected/falsified documents. The last category is aimed at customs officials and gives indicators related to the export and import of diamonds.

CASE STUDIES

The case studies illustrate the ML/TF methods and techniques used in the diamond industry in its various stages. Besides the more conventional cases of ML, this report also provided several sanitised cases where diamonds are used as an alternative currency (for asset movement, storage and protection) and a few cases related to TF. What is of importance is the fact that many cases illustrate that criminals are taking advantage of the vulnerabilities entailed in the trade, many of these vulnerabilities were identified in the relevant sections of this report. It is not possible to ascertain, within the scope of this research, the level of risk posed by the diamonds trade, but the cases presented are an indication of such risk, which may be seen for example in the large volumes of ML the cases present.

In total, 64 cases were received from team members or located in open source analysis conducted as part of the information collection process. An analysis of the means of payment revealed:¹³⁹

- a) In 30 cases non-cash payment means were used.
- b) In 19 cases cash was used as payment method.
- c) In 30 cases there is no indication as to the payment method (many cases involve smuggling and/or the use of diamond as currency).
- d) In only 6 cases the only method of payment used was cash.

The cases collected show very large scale money laundering, which spread across jurisdictions involving different trade centres and may even amount to few billions of dollars. One case of "round tripping" shows overvaluation where by the diamonds are imported at a much higher value than their market value and the value in which they were exported. This is one example showing the level in which the price of the diamond might be manipulated in a TBML case. Other cases show large scale smuggling and very large tax fraud and money laundering cases.

Finally, it was noted that in most large scale theft or robbery cases, which may amount to many tens of millions of dollars, the diamonds are almost never found. This shows the ease in which illicit diamonds can be laundered through the diamond trade but also the possible ease in which money may be turned into diamonds and laundered in the same way.

CONNECTION TO TF

Based on the information that was received from all countries involved in the project, experts in the diamond trade and literature review, no hard evidence was found that proved a strong link between the diamond trade and terrorist financing activities. Some indications were found but the risk of misuse of the sector for TF purposes does not seem higher than in other sectors.

MONEY FLOWS

The last section of the report looked at money flows pertaining to suspected ML/TF, as they relate to the diamond industry. Although information was scarce, some trends were noted. There has been a trend away from pure cash transactions and many countries noted funds transfers to high-risk countries, including those where a significant diamond trade does not exist.

¹³⁹ Some cases feature more than one payment method.

CHAPTER 12.

ISSUES FOR CONSIDERATION – SUGGESTED WAYS TO MITIGATE RISKS TO THE DIAMONDS TRADE

There appear to be a number of issues that could be considered to improve the capacity to mitigate the ML/TF risks associated with the trade in diamonds.

Building a better awareness: Criminals use creative schemes to exploit the diamond sector. Lack of awareness of ML and TF risks associated with diamonds and the trade in diamonds could contribute to the risks of ML/TF posed by the abuse of the trade. This lack of awareness amongst key players about their role in the process of fighting illicit activities is a significant vulnerability, particularly since certain expertise is required to improve understanding and awareness. Understanding the ML/TF risks associated with the trade in diamonds by government bodies and the private sector, including financial institutions, would assist in addressing this vulnerability and taking any needed steps to mitigate the risks. Awareness-raising may prove to be very useful by enhancing enforcement of existing regulation. This would require resources for outreach, training or other cooperative activities, and may result in enhanced information exchange.

FATF Recommendation 22 and 23 are only based on cash transactions. The findings of the reports point to issues that may be considered by the FATF with respect to the extent cash is used in the trade and the risks identified in the research, which are not related to the use of cash.

Some jurisdictions as well as private sector response stated that almost no cash is used, particularly not in international trade. On the one hand this reduces the risk of laundering cash proceeds of crime. On the other hand, since the FATF diamond dealer definition covers only cash-based transactions when a diamond dealer¹⁴⁰ is engaging in a transaction with a customer, then most of the trade in terms of volume (carat) and value (tens or even hundreds of billions of USD) is not covered by AML/CFT requirements. However, the report notes that these parts of the trade are still vulnerable to ML/TF, while the current FATF Recommendations applicable to diamond dealers do not directly address such risks.

AML/CFT duties are dependent on the form of payment which in many cases is not known until a substantial period of time has passed from the day in which the diamonds were sold. Since diamonds themselves can be used in ML and TF schemes, the transaction and the laundering process may be completed with no requirement for CDD or suspicious activity reporting at the time of the transaction.

Consideration should be given by the FATF to broadening AML/CFT duties to non-cash payment means.

FATF Recommendation 32: Countries are currently not required to have measures in place to detect the physical cross-border transportation of diamonds through a declaration/disclosure system. The report noted that diamonds were often moved across borders as part of ML/TF

¹⁴⁰ As previously indicated the FATF recommendations applies to DPMS which include diamond dealers.

schemes allowing for the cross-border transfer of very high value. The report also showed the use of diamonds as currency by criminals. While a person who would transfer cash or other negotiable bonds would be required to declare the amounts he is carrying, when transferring the same value by using diamonds he is not required to declare. The FATF may wish to consider including diamonds in a similar manner as cash/currency or as bearer negotiable instrument.

Definition of a diamond dealer: There is no definition given by FATF of a dealer in precious stones (which includes a diamond dealer). This results in different national legislation and interpretation of diamond dealers. Pawn shops and retailers are often not seen as diamond dealers and therefore not under any national AML/CFT legislation and regulation. Consideration should be given to defining a dealer in precious stones including a diamond dealer, which could mitigate the risk of ML/TF.

Enhancing transparency through cooperation with the private sector: Although the sector is specialised and there are barriers to entry, engagement with the private sector during this project has indicated that they are not unwilling or reluctant to cooperate. In general, AML/CFT authorities need a better understanding of legitimate commercial practices for diamonds (including KPCS functions) as well as what they perceive as suspicious, and the measures taken to mitigate the risk.

TBML: A significant risk as shown by some of the cases is large scale TBML through the trade in diamonds. Countries do not always have experts or risk-based control on diamonds import and export. More inspection by expert gemmologists working within or on behalf of customs may mitigate the risks for TBML and narrow the room for price manipulation through international trade.

Availability of information: Information on the diamonds trade was assessed low to medium by the jurisdictions who participated in the project. Most information collected for the project came from FIUs, law enforcement and private sector along with information through investigational analysis by way of statistical accounts. The collection and availability of more complete information by all AML/CFT stakeholders involved in the trade in diamonds would support a more accurate and complete understanding of the ML/TF risks associated with the diamonds trade.

International co-operation: Difficulties in the international exchange of information and the use of tax havens are major obstacles in the detection and prosecution of ML through the trade in diamonds. Since the trade is multi-jurisdictional, involving several countries from mine to market, a multi-jurisdictional cooperation is required to investigate ML/TF cases. International co-operation and information-sharing are key factors in the fight against ML given the international dimension of the market. Countries need to work cooperatively to identify and combat the use of diamonds for ML/TF purposes.

Regulatory level playing field: Given the international character of the trade in diamonds, it is important to encourage a level playing field for AML/CFT regulation. Where there are major discrepancies between jurisdictions, this may attract criminals to conduct their transactions in jurisdictions with low or no AML/CFT regulation on the diamonds trade. For a sector which is mainly based on trust and long-lasting partnerships, the application and enforcement of the AML/CFT legislation and the obligation of diamond dealers to collect identification documents from each client and report suspicious transactions, has a large impact on the competitiveness vis-à-vis diamond dealers in other countries who are not subject to similar obligations. This may have the

adverse effect of diverting the diamonds trade to less regulated jurisdictions, generating higher levels of ML/TF risks associated with the diamonds trade. When analysing the over-all level of risk associated with a particular jurisdiction the FATF may consider the level of risk posed by the local diamond industry.

National risk assessment- With respect to jurisdictions where diamonds trade is a significant part of the economy or where trade volumes are high, relevant national authorities should incorporate the diamonds trade as part of their national risk assessment and impose proportionate AML/CFT measures.

ANNEX 1 – GLOSSARY OF TERMS

Alluvial mine – mines in which diamonds are recovered from deposits such as river bed and ocean floor contrary to a kimberlitic hard rock mine. These are considered to be secondary deposits, *i.e.*, that diamonds from primary kimberlitic mines were washed away. Alluvial mines may spread over huge geographical areas.

Business to Business (B2B) - commerce transactions between businesses, such as between a manufacturer and a wholesaler, or between a wholesaler and a retailer.

Broker – a person mediating between a seller and a buyer, usually for a commission. The level of involvement of the broker may vary between one who only mediates between a buyer and a seller to a broker who perform the sale, receives payment from the buyer and transfers the funds to the seller.

Conflict diamonds – according to the Kimberley process web site a "*conflict diamonds, also known as 'blood' diamonds, are rough diamonds used by rebel movements or their allies to finance armed conflicts aimed at undermining legitimate governments*"¹⁴¹.

Diamond Bourse – a bourse is the diamond industry term for a diamond exchange centre, located in large cities and providing secure trading environments for diamond dealers. Bourses are self-governing, setting sales standards and arbitration provisions. There are 28 diamond bourses members in the WFDB. In a way, the bourses have developed some “universal diamond trading laws”. Disciplinary action in one bourse, which may include membership suspension or even expulsion, will automatically apply in every single diamond bourse in the world. Therefore members of the diamond bourses prefer trading among themselves, as they have comfort in verbal agreements. WFDB commented that the strength of this legal framework also means that the bourses can compel members to, for example, adhere to the Kimberley Process, refrain from mixing natural and synthetic diamonds, enforce the writing of warranties on invoices, etc. Dispute resolution, sometimes involving millions of dollars, is immediate – without a need for court actions. WFDB commented that in virtually every diamond trading country, arbitration decisions by WFDB affiliated bourses are generally automatically confirmed by courts.

Diamond dealer – since the scope was narrowed to diamonds excluding other precious stones the report will in many cases address diamond dealers only. The term refers to a person dealing in rough or polished loose diamonds (unless otherwise specified).

"Diamond pipeline" – a term refers to the whole diamond trade chain from mining to retail level where the diamonds reach the final customer.

Harmonized Commodity Description and Coding System (HS) - An internationally standardised system of names and numbers for classifying traded products. The system was developed and is maintained by the World Customs Organization.

¹⁴¹ See FAQ on the KP web site - www.kimberleyprocess.com/en/faq.

Kimberlitic Mine – named after Kimberley, South Africa where a hard rock pipe was first found. These are hard rock mines where diamonds are located. The diamonds were brought to the surface by magma flowing from deep within the earth¹⁴².

Kimberley Process (KP) – *"The Kimberley Process is an international certification scheme that regulates trade in rough diamonds. It aims to prevent the flow of conflict diamonds, while helping to protect legitimate trade in rough diamonds"*¹⁴³.

Kimberley Process certification scheme (KPCS) – an international initiative aimed at preventing conflict diamonds from entering legitimate trade. It seeks to ensure that diamond purchases are not used to finance violence by rebel movements seeking to undermine legitimate governments. The KPCS imposes extensive requirements on its members to certify shipments of rough diamonds as 'conflict-free'. The KPSC also bans trade in rough diamonds with non-participants to reduce the illicit trade in conflict diamonds.

Polished Diamond – a diamond which has been cut and polished from a rough diamond to gain its final shape which will then be used in diamond jewellery.

Loose diamond – cut and polished diamonds which have not yet been set in jewellery.

Mounted diamond – a polished diamond which was set in jewellery such as ring, watch necklace, etc.

Rough Diamond – a diamond in its rough form before being cut and polished.

Synthetic diamonds – man made diamonds which are manufactured by artificial means.

Other precious stones – the term refers to all precious stones apart from diamonds.

Beneficiation – The term has been used to describe the process whereby more stages of the "pipeline" mainly but not limited to cutting and polishing are conducted in the mining country generating additional economic benefits to the mining country¹⁴⁴.

¹⁴² See <http://science.howstuffworks.com/environmental/earth/geology/diamond1.htm>.

¹⁴³ See FAQ on the KP web site - www.kimberleyprocess.com/en/faq.

¹⁴⁴ See for example www.israelidiamond.co.il/english/news.aspx?boneid=741&objid=3138. See De Beers policy for beneficiation www.debeersgroup.com/Operations/Sales/About-Beneficiation/

ANNEX 2 – PREDICATE OFFENCES RELATED TO THE DIAMOND TRADE

	Australia	Belgium	Canada	India	Israel	Namibia	Netherlands	Russian Federation	Sierra Leone	South Africa	United Kingdom	United States
Fraud	+	+	+		+			+	+		+	+
Theft/robbery	+		+							+	+	+
Drugs trafficking		+	+						+		+	+
Cigarette trafficking		+										
Trade in Conflict Diamonds		+	+									+
Trade in/possession of illegal diamonds						+		+				
Link to Criminal Organisations		+	+									+
Tax/Customs offences		+			+		+					+

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