US has not halted 'laundering' of diamonds

Dec 07 2006 John Cassara

With the release of the Leonardo DiCaprio film "Blood Diamond," sectors of the international diamond industry are in a panic. The film's graphic portrayal of how diamonds have helped to fuel and to finance African conflicts may negate the most successful advertising campaign in history and tarnish the image of diamonds as the ultimate symbol of love.

It is commonly recognized that diamonds are also the most condensed form of physical wealth in the world and are widely used in global value transfer and laundering. Just like dirty money, illicit diamonds are placed, layered and integrated along the "diamond pipeline." While most of the African conflicts that initiated scrutiny of the blood diamond trade have ended, other unsavory aspects along the diamond pipeline remain.

In November 2002, the Kimberly Process certification scheme was initiated by concerned governments, non-governmental organizations and the international diamond industry. Its goal was to stem the flow of "blood" – or "conflict" – diamonds into international commerce and help curb funding for long-running African civil wars. Although a laudatory initiative, Kimberly was never designed to stop what I call the "laundering of diamonds."

Diamonds treated like dirty cash

For example, corruption is endemic in areas of Africa where diamonds are mined. Criminal organizations provide diamond diggers with working capital to procure a digging license in exchange for accepting and laundering illicit diamonds. Similar to money laundering techniques, diamond launderers mix illicitly mined stones with licit ones, creating "mixed parcels" that are almost impossible to trace. In certain areas, KP certificates are available for purchase. It may be time to rethink what a "blood" diamond is. At the other end of the pipeline, it is also time to reassess impotent countermeasures, rules and regulations increasingly imposed on dealers in precious metals and gems.

On July 29 2003, President George W. Bush signed Executive Order 13312 implementing the Clean Diamond Trade Act. The CDTA provides a statutory authority and framework to make the US a full partner in the KP. The standards, practices and procedures developed in the international KP are applied through the US's domestic implementation mechanisms.

The US Government Accountability Office recently issued a report evaluating the effectiveness of the CDTA and related diamond initiatives. Although the report chronicles some progress, there are many deficiencies, as outlined below.

Overreliance on documents

The Department of Homeland Security's Customs and Border Protection relies primarily on document review for examination of shipments. A very small percentage of rough diamond shipments are subjected to physical inspection. Since 2003, CBP has seized only seven shipments of diamonds and all are being administratively adjudicated. There are no known Immigration and Customs Enforcement investigations.

The US has delegated the responsibility for confirming diamond import receipts to importers. Despite KP reporting standards, the US has confirmed few import receipts with foreign exporting authorities. For example, the US confirmed just 2 percent of rough diamond import shipments from Belgium in 2004 and 18 percent in 2005. The US monitors the export process of diamonds using electronic data checks rather than physical inspections of rough diamond shipments.

Ineffective AML regime for diamond dealers

Separate from the CDTA, on June 3 2005, after years of delay, the US Treasury Department's Financial Crimes Enforcement Network issued the interim final rule implementing section 352 of the USA PATRIOT Act of 2001. The rule requires that dealers in precious metals, stones or jewels establish anti-money laundering programs. The rule came into force on January 1 2006. (See fincen.gov and jvclegal.org for specific definitions, exemptions and guidance.)

Yet it is becoming apparent that FinCEN's highly touted "rules-based" approach for dealers is seriously flawed. For example, the requirements imposed are minimal. Left to their own devices, dealers will do only what is absolutely necessary because of the inherent regulatory costs of implementing strong internal programs. A critical flaw is that the basic requirement to report suspicious activity is voluntary rather than obligatory. Unfortunately, experience has shown around the world that voluntary reporting programs do not work. Perhaps that is why in June 2006, the Financial Action Task Force's "mutual evaluation" of the US was critical of the country's efforts. It said that the US was "non-compliant" and

had "major shortcomings" in the category of "designated non-financial businesses and professions," of which the diamond industry is a part.

Moreover, FinCEN does not examine industry members for compliance. In the case of diamond dealers, the Internal Revenue Service is the designated federal agency. For the most part, the IRS has simply ignored the mandate.

More troublesome, even if the industry did produce suspicious activity reports, FinCEN does not have the expertise, data mining systems, management structure and relationships with law enforcement to utilize the information effectively. At the present time, reporting will simply add another layer of paperwork to a system where most of the Bank Secrecy Act reports are unread and unused. And even if the information was referred to law enforcement for investigation, with the creation of the DHS and the decimation of the legacy US Customs Service, investigating dirty diamonds is not a bureaucratic priority.

Similar to the stalled war on terrorist finance, a plethora of new reporting requirements on the industry will not solve the problem until the government gets back to the basics of enforcement and effectively analyzes the information it already collects. As New York Yankees great Yogi Berra once said, "This is like déjà vu all over again."

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