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KALOTI CASE LIFTS CURTAIN ON DUBAI GOLD TRADE

Dubai has long had a reputation as a destination for African gold tainted by conflict and a hub for smuggling through the Middle East and Asia. A report by Global Witness provides a rare glimpse into how the city's bustling gold trade works – and how local regulators and auditors allegedly tried to cover up at least one instance where supply-chain due diligence was lacking.

At the centre of the report, based on documents handed to Global Witness by an Ernst & Young whistleblower, lies a gold refiner called Kaloti Jewellery Group. The company is run by the Jordanian Kaloti family, who have a refinery near Dubai and are building another capable of processing up to 2,000 tons of gold and silver a year, making it the largest such facility in the world.

Kaloti hired Ernst & Young last February to check its compliance with rules set by the Dubai Multi Commodities Centre, a free zone where the company is incorporated, the report says. Kaloti also wanted a clean bill of health under London Bullion Market Association rules.

In the course of its audit, however, an E&Y team in Dubai led by whistleblower Amjad Rihan found that Kaloti imported as much as four tons of gold from Morocco in 2012 that was coated in silver, apparently in an attempt to disguise its identity from Moroccan authorities and evade export restrictions. In addition, the auditors found a major portion of Kaloti's transactions were done in cash – about $5.2 billion worth in 2012 – raising concerns that the company hadn't properly documented the provenance of the metal it was refining. There was no due diligence done on more than 1,000 of those cash transactions, the report says.

Kaloti responded in the report by saying it was in full compliance with DMCC regulations. On November 27, 2013 Kaloti posted two reports - DMCC Responsible Sourcing of Precious Metals Guidance Compliance Report and EY Independent Reasonable Assurance Report on Kaloti Jewellers Factory Ltd's Refiner's Compliance - on its website when it declared that it has not been part of DFSA's investigation of Deutsche Bank. The DFSA - the regulator that oversees Dubai's main financial free zone - had sued Deutsche Bank, claiming that the German lender unlawfully refused to provide it with information as part of an investigation into suspected breaches of its rules.

Kaloti claims that it complies with due diligence standards "following the implementation of our corrective action plan," and has installed a new compliance system. The company said in a statement that no evidence of money laundering was uncovered.

Kaloti said the initial non-compliance had nothing to do with conflict gold being found in the supply chain, and indeed, Global Witness said there was "no evidence" that Kaloti bought conflict gold from Congo, where armed groups have raked in millions of dollars extracting metals out of small mines. E&Y found, however, that Kaloti was in some cases classifying newly mined gold as scrap gold, which Global Witness said was a concern because conflict metals can be disguised as scrap.

Global Witness also found fault with the DMCC in its report, pointing to an apparent conflict of interest between its role as a regulator of companies within the free zone and as a promoter of the zone as a place to do business. It also said the DMCC changed its audit guidance last year in such a way that E&Y's report on Kaloti's non-compliance was not required to be made public. The DMCC responded by saying the changes were made in line with global standards, and that it did not interfere with the Kaloti audit.

Global Witness said E&Y was also to blame in the Kaloti case for being "reluctant to rock the boat" and bring concerns about Kaloti to higher authorities. The company continued to work for Kaloti despite what it found, it said, and did not raise the serious breaches to the London Bullion Market Association, of which Kaloti is an associate member.

"EY Dubai refutes entirely the suggestion that we did anything but highly professional work in relation to our compliance engagement with Kaloti," the company said in an emailed statement. "It was the work of EY Dubai that first brought to light that there was non-compliance with the applicable regulations. The instances of non-compliance we found were fully reported by EY Dubai to the client and separately to the regulator."

While the Kaloti case may raise questions about oversight, it also highlights how Dubai's long-established gold traders and refiners are coming under increasing pressure to modernize. Hundreds of companies operate in the gold souk in Dubai's Deira area, trading millions of dollars of gold for cash every day to customers from the Indian subcontinent, the Arab world and Africa, often with little or no documentation to show where it came from.

A focus internationally on combating money laundering, conflict minerals and terrorist financing, combined with the growth of Dubai's gold-trading companies, figures to draw additional scrutiny to this informal way of doing business. In its compliance report, Kaloti admitted that it had "deviations" in 2012 in its risk-assessment procedures in which it "did not identify risks in cash settlement transactions which was the typical modus operandi in the Dubai wholesale gold market." The company has since taken steps to move away from cash settlement, it said, and was now fully compliant.

Gold trading and refining seem to pose a high money laundering risk. On November 4, 2013 a Swiss gold refiner was accused of money laundering

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