Corruption Watch (RF) NPC
Reg. No. K2011/118829/08
8th Floor Heerengracht Building, 87 De Korte Street
Braamfontein 2001 Johannesburg
P O Box 30630 Braamfontein 2017
T +27 (0)11 242 3900 F (0)11 403 2392
info@corruptionwatch.org.za www.corruptionwatch.org.za

Submissions by Corruption Watch: Financial Intelligence Amendment Bill [B33B – 2015]

Introduction

1. Corruption Watch is a non-profit civil society organisation. It is independent, and it has no political or business alignment. Corruption Watch intends to ensure that the custodians of public resources act responsibly to advance the interests of the public. Its ultimate objectives include fighting the rising tide of corruption and the abuse of public funds in South Africa, and promoting transparency and accountability to protect the beneficiaries of public goods and services.

2. Corruption Watch has a vision of a corruption free South Africa, one in which educated and informed citizens are able to recognise and report corruption without fear, in which incidents of corruption and maladministration are addressed without favour or prejudice and importantly where public and private individuals are held accountable for the abuse of public power and resources.

3. Corruption Watch submitted written submissions on the Draft Financial Intelligence Centre Amendment Bill ("the Bill") on 1 June 2015 and made oral submissions before the Standing Committee on Finance on 2 February 2016. We were subsequently requested to file supplementary written submissions which were submitted on 12 February 2016. We also made comments in respect of the Issue paper on Guidance required to Implement the FIC Amendment Act on 26 September 2016.

4. We now make submissions on section 45B(1C) which deals warrantless searches in clause 32 of the Bill.

Delays in the finalisation of the FIC Amendment Bill

5. We note the reservations which the President has about the constitutionality of the Bill which prompted him to refer the Bill back to the National Assembly for reconsideration. We are concerned about the delay which the referral has brought about especially in light of the impending FATF review in February 2017, which review will have regard for our failure to finalise the Bill and view this as being detrimental to South Africa's ability to effectively and efficiently deal with money laundering, terrorist financing and illicit financial flows more generally. In this regard, the delay seriously impacts on compliance with our own constitutional obligations and the realisation of FATF recommendations and has immense implications on the ability of South Africa to address financial crime and corruption.

6. In addition to being on the Targeted watch list by FATF and being required to report to FATF in February on the implementation of the FIC Amendment Act and its regulations, there are already a number of negative findings on South Africa's non-compliance with the FATF recommendations and failures to deal appropriately with financial crime. These need to be carefully considered in determining and following time frames for the finalisation of the Bill.

7. Firstly, South Africa has been found to be a Jurisdiction of Concern by the US Department of State 2016 International Narcotics Control Strategy Report ("INCSR"), thus highlighting the need for us to improve our financial regulatory system and introduce a risk based approach aimed at detecting and preventing illicit financial flows and other forms of corruption.[1] On page 411, it was found that:

> *"South Africa's position as the major financial center in the region, its sophisticated banking and financial sector, and its large, cash-based market may make it a target for transnational and domestic crime syndicates. The proceeds of the narcotics trade constitute the largest source of laundered funds in the country. Fraud (advance fee scams, beneficiary maintenance fraud, and deposit refund scams), theft, racketeering, corruption, currency speculation, credit card skimming, wildlife poaching, theft of precious metals and minerals, human trafficking, stolen cars, and the smuggling of goods are also sources of laundered funds. Many criminal organizations also are involved in legitimate business operations. In addition to criminal activity by South African nationals, observers note criminal activity by Nigerian, Pakistani, Andean, and Indian drug traffickers; Chinese triads; Taiwanese groups; Bulgarian credit card skimmers; Lebanese trading*

[1] United States Department of State Bureau for International Narcotics and Law Enforcement Affairs Money Laundering and Financial Crimes, Country Database, June 2016 at 411 .
http://www.state.gov/documents/organization/258726.pdf

syndicates; and the Russian mafia. Some foreign nationals are using South African nationals, mostly women, to help them send money obtained from illegal activities out of the country. Investment clubs, known as stokvels, have been used as cover for pyramid schemes. In some instances, nominee structures have been exploited by criminals who intend to launder illicit funds by mixing those funds with legitimate assets held on someone else's behalf. There is a significant black market for smuggled and stolen goods."

8. Secondly, in the most recent Mutual Evaluation Report on South Africa on Anti-Money Laundering and Combatting the Financing of Terrorism,[2] in February 2009, South Africa was found to be *partially compliant* with 14 of the 40 FATF recommendations and 5 of the 9 FATF special recommendations. We were found to be *non-compliant* with 7 of the 40 FATF recommendations. In recommending actions to be taken to address the deficiencies, the need to quickly bring into effect the FIC Amendment Act was identified, already as far back as 2009.

9. In the IMF's March 2015 report on South Africa,[3] one of the key recommendations for South Africa, in relation to finalising legislation related to beneficial ownership, were as follows:

"As a matter of priority, financial institutions including banks should be required by law to identify and verify the identity of beneficial owners of customers or assets held. The authorities are recommended to accelerate the legislative process and bring the legal framework for preventative measures, including those concerning the identification and verification of beneficial ownership, in line with the FATF standard. Upon the enactment of an appropriate legal framework, the FIC and supervisory bodies including the BSD should work together to develop and provide more guidance to the private sector with respect to the identification and verification of beneficial owners of legal persons to improve banks' ability to know their customers and detect suspicious transactions."

10. The above findings, together with being on FATF's targeted watch list and having to submit a report to FATF on progress made on the FIC Amendment Act and its regulations in a months' time, raise significant concern about South Africa's ability to manage financial crime effectively as well as its continued participation and acceptance in the global financial community. We should aspire to the highest standards of compliance and accountability not only because we are bound by FAFT recommendations but because it is in our best interests

[2] Mutual Evaluation Report, Anti-Money Laundering and Combating the Financing of Terrorism, 26 February 2009 at 215 – 230.
[3] International Monetary Fund, Technical Note on Anti-Money Laundering and Combatting and Financing of Terrorism (AML/CFT) on South Africa (IMF Country Report No.15/51) March 2015.

to ensure that we have the best possible legal and regulatory framework to combat illicit financial flows, terrorist financing and corruption in general.

11. Ultimately, we hope that the Act becomes fully operational as soon as possible in order to avoid further negative findings by other nation states and international oversight bodies. The Bill introduces a definition for beneficial ownership and a risk based approach to combatting money laundering, all essential for improving the ability of the FIC and other law enforcement agencies to combat corruption. The delay caused by the referral, especially in respect of an issue which does not amount to substantive defect of the Bill is potentially harmful to the financial regulatory system as well as anti-corruption and anti-money laundering activities, all risks which need to be considered in urgently finalising the legislation. We hope that our brief submissions on the constitutionality of section 45B(1C) will assist the committee in deciding whether or not to amend the section in light of the President's concerns.

The Constitutionality of section 45B(1C)

12. The President's reservations relate to the proposed section 45B(1C) which provides for warrantless searches. We understand that reservations to relate to the potential for privacy rights to be infringed and the possibility of criminal prosecutions arising out of the search conducted by inspectors. Section 45B(1C) reads as follows:

> "(1C) An inspector otherwise required to obtain a warrant under subsection (1B) may enter any premises without a warrant –
>
> (a) With the consent of the owner or person apparently in physical control of the premises after that owner or person was informed that he or she is under no obligation to admit the inspector in the absence of a warrant; or
>
> (b) If the inspector on reasonable grounds believes that –
>
> (i) a warrant will be issued under subsection (1B) if the inspector applied for it; and
>
> (ii) the delay in obtaining the warrant is likely to defeat the purpose for which the inspector seeks to enter the premises.

The circumscribed nature of warrantless searches

13. Firstly, it is important to note that only an inspector appointed in terms of section 45A of the Act may enter a premises for purposes of determining compliance with the Act. Non-compliance[4] may result in administrative sanctions being meted out against the non-compliant institution. These administrative sanctions are set out in section 45C (1) – (11) and do not relate to any criminal prosecutions or referrals for criminal prosecutions.

14. The non-compliant institution must also be given notice by the FIC before a sanction is imposed and be afforded an opportunity to make representations to the FIC, which representations have to be taken into account when making a decision about the sanction. Furthermore, the FIC must provide the institution or person with reasons for the decision to impose an administrative sanction and the institution or person has a right to appeal against the sanction to the appeal board established in terms of section 45(E). It is clear then that the warrantless search procedures do not attract criminal sanctions but enable purely administrative inspections which are carefully circumscribed and which are aimed at establishing non-compliance with the Act.

15. Further to this, warrantless searches by regulatory bodies performing administrative functions are accepted and have been found to acceptable in many jurisdictions around the world. These "administrative searches" differ considerably from searches conducted for purposes of a criminal prosecution and enables the FIC to closely and strictly monitor institutions and persons suspected of non-compliance with the FIC Act in a manner which is efficient and which does not place an undue administrative burden on the FIC. An example of the acceptance of warrantless searches for administrative purposes is the United States where commentators[5] have recognised and understood the differences between administrative searches and criminal searches. It has been found that:

[4] Non-compliance in the amendment Bill is defined to mean, "any act or omission that constitutes a failure to comply with a provision of this Act or any order, determination or directive made in terms of this Act and which does not constitute an offence in terms of this Act…"

[5] John N Ferdico et al, "*Criminal Procedure for the Criminal Justice Professional*" 11th Edition at 212. Chapter 6, Administrative and Special Needs Searches.

"Certain governmental activities aimed at protecting public health, safety, and welfare have a long history of regulatory enforcement – regulatory enforcement is quite different from criminal investigation and the usual strictures of the Fourth Amendment have been modified to allow for more flexible enforcement of public safety laws…

An administrative search is a routine inspection of a home or business by governmental authorities responsible for determining compliance with various statutes and regulations and … ordinarily does not result in a criminal prosecution…

Warrantless inspections of licensed and closely regulated enterprises are reasonable if a substantial government interest supports the regulatory scheme under which the inspection is made; warrantless inspections are necessary to further the regulatory scheme; and the regulatory statute provides a constitutionally adequate substitute for a warrant by advising the owner of commercial premises that the search is being made pursuant to the law, has a properly defined scope; and limits the discretion of the inspecting officers."[6]

16. Secondly, although the inspector may enter private premises, he or she can only do so if the premises are reasonably believed to be used for a business to which the Act applies, if there are reasonable grounds to believe that a warrant would be issued if an application was made and that any delay would defeat the purpose for which the inspector seeks to enter the premises. In this regard, section 45B(1D) further circumscribes the powers of the inspector by providing that:

"(1D) Where an inspector enters a premises without a warrant, he or she must do so –

(a) at a reasonable time;
(b) on reasonable notice, where appropriate; and
(c) with strict regard to decency and good order, including a person's right to –
    (i) respect for and the protection of dignity;
    (ii) freedom and security; and

[6] Ibid at 212 – 215.

(iii) personal privacy."

17. It is therefore clear that the powers of inspectors are closely circumscribed and that warrantless searches can only be conducted in limited circumstances and always with an acute regard for FIC's obligations and responsibilities towards institutions and persons who are the subjects of searches. Furthermore, the institution or person affected by the warrantless search has the right to appeal against any administrative sanction which is imposed subsequent to a warrantless search.

18. Thirdly and in regard to the inspectors' ability to search private premises without a warrant, it is clear that such ability is the exception to the rule created in section 45B which has been amended to disallow an inspector from entering a private residence. The inspector is therefore generally prohibited from entering a private residence and when he or she sees the need to do so, such entry is carefully circumscribed as set out in paragraphs 13 to 16 above. It is clear therefore that the amendments constitute a justifiable infringement of the privacy rights of an institution or a person whose premises may be searched without a warrant in a very limited circumstances. Privacy rights are not absolute and can be limited by laws which are reasonable and justifiable and the FIC amendments are both reasonable and justifiable taking into account the purpose of the legislation and the need to ensure that non-compliance is detected, deterred and sanctioned by administrative penalties.

19. Fourthly and most importantly, the Constitutional Court recently considered the constitutionality of warrantless searches in relation to 45B of the FIC Act[7] as well as section 32A of the Estate Agency Affairs Act[8] in the matter between the Estate Agency Affairs Board and Auction Alliance.[9] The Court did not declare all warrantless searches to be unconstitutional but left it to the legislature to determine the outer limits of warrantless search provisions with due regard for constitutional rights and obligations.

20. The Court did find the previous section 45B to be constitutionally invalid but suspended the declaration of invalidity in order to allow the legislature time to cure the legislative defect.

[7] 38 of 2001.
[8] 112 of 1976.
[9] *Estate Agency Affairs Board v Auction Alliance (Pty) Ltd and Others* [2014] ZACC 3.

The court read in certain provisions into section 45B as a temporary measure while the legislation was being amended. It is of utmost importance to note that the Constitutional Court's formulation of section 45B after conducting a reading in exercise is almost identical to the current provision being challenged by the President. The relevant extract of the order reads as follows:

> "(d) An inspector otherwise required to obtain a warrant under paragraph (a) may enter and search any place without the warrant referred to in paragraph (c) if the inspector on reasonable grounds believes that—
>
> (i) a warrant would be issued in terms of paragraph (c) if the inspector applied it; and
> (ii) the delay in obtaining the warrant is likely to defeat the object of the search."

21. It is common cause that the new provision which is now being challenged by the President mirrors the Court's formulation of the section. The President is therefore challenging a section which is already constitutionally compliant and in fact, the introduction of section 45B(1D) further circumscribes the powers of the inspector and provides even more protection for those affected by warrantless searches.

22. It is clear from the above that all the President's concerns are adequately addressed, these include concerns about unjustifiable infringements of privacy, the nature and extent of inspectors' powers and the potential for information collected during warrantless searches being used for criminal prosecutions.

23. We hope that these submissions are useful to the Committee and request that we be afforded an opportunity to make oral submissions during the hearing scheduled for 25 January 2017.

Submitted by Corruption Watch on 20 January 2017
Emails: Davidl@corruptionwatch.org.za /
Leanneg@corruptionwatch.org.za