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An evaluation of the AUSTRAC enforcement mechanism in regards to non-compliance with reporting obligations

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Faculty of Law

Centre for Transnational Crime Prevention (CTCP)

**AN EVALUATION OF THE AUSTRAC ENFORCEMENT
MECHANISM IN REGARDS TO NON-COMPLIANCE
WITH REPORTING OBLIGATIONS**

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**This thesis is presented as part of the requirements for the
award of the Degree of Doctor of Philosophy
from the University of Wollongong**

January 2012

THESIS CERTIFICATION

I, Mohammad Abdallah A Fattah AlRashdan, declare that this thesis, submitted in partial fulfilment of the requirements for the award of Doctor of Philosophy in Law, at the Centre for Transnational Crime Prevention, Faculty of Law, University of Wollongong, is wholly my own work unless otherwise referenced or acknowledged. The document has not been submitted for qualification at any other academic institution.

Mohammad AlRashdan

January 2012

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LIST OF ACRONYMS

ABA	Australian Bankers Association
ACAMS	Association of Certified Anti-Money Laundering Specialists
ACBPS	Australian Customs and Border Protection Service
ACC	Australian Crime Commission
ACCC	Australian Competition and Consumer Commission
ACL	Australian Consumer Law
AFP	Australian Federal Police
ALRC	Australian Law Reform Commission
AML	Anti Money Laundering
AML Act	<i>Anti-Money Laundering and Counter-Terrorism Financing Act 2006</i> (Cth)
APG	Asia Pacific Group on Money Laundering
APRA	Australian Prudential Regulation Authority
APSC	Australian Payments System Council
ASC	Australian Securities Commission
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
AUD	Australian Dollar
AUSTRAC	Australian Transaction Reports and Analysis Centre
BOOM	Prosecution Service Criminal Assets Deprivation Bureau (the Netherlands)
CCA	<i>Competition and Consumer Act 2010</i> (Cth)
CDD	Customer Due Diligence
CDPP	Office of the Commonwealth Director of Public Prosecutions
CEO	Chief Executive Officer
CFATF	Caribbean Financial Action Task Force

CPA	Certified Practising Accountants
CTF	Counter Terrorism Financing
CTH	Commonwealth
CTR	Cash Transaction Report
DFAT	Department of Foreign Affairs and Trade
DNFBP	Designated Non-Financial Businesses and Professions
ESAAMLG	Eastern and South African Anti Money Laundering Group
EU	European Union
EXCOM	Executive Committee
FATF	Financial Action Task Force
FinCEN	US financial Intelligence Unit
FIU	Financial Intelligence Unit
FIU-NL	Financial Intelligence Unit - Netherlands
FTRA	<i>Financial Transaction Reports Act 1988 (Cth)</i>
G8	Group for the Governments of Eight Major Economies (Canada, France, Germany, Italy, Japan, United Kingdom, United States and Russia)
GAFISUD	Financial Action Task Force on Money Laundering in South America
GFC	Global Financial Crisis
GIABA	Inter-Governmental Action Group against Money Laundering in West Africa
GPML	Global Programme against Money Laundering
HMT	Her Majesty's Treasury
IBAC	International Business Aviation Council
ICAC	Independent Commission against Corruption (NSW)
ICASA	South African Independent Communications Authority
IFTI	International Funds Transfer Instruction Report
IIC	International Institute of Communications

IMF	International Monetary Fund
INCB	International Narcotics Control Board
INTERPOL	International Criminal Police Organisation
ISC	Insurance and Superannuation Commission
ITU	International Telecommunications Union
JAFIO	Japan Financial Intelligence Office
KLPD	Netherlands National Police
KYC	Know Your Customer
ML	Money Laundering
MLCA	<i>US Money Laundering Control Act 1986</i>
MOT	Act on Reporting Unusual Transactions of 1993 (<i>The Netherlands</i>)
MOU	Memorandum of Understanding
NSW	New South Wales
OCDD	Ongoing Customer Due Diligence
OECD	Organisation for Economic Co-operation and Development
OFAC	US Office of Foreign Asset Control
PEP	Politically Exposed Person
POCA	<i>Proceeds of Crime Act 1987</i> (Cth)
PSA	Prices Surveillance Authority
RBA	Risk Based Approach
SAR	Suspicious Activity Report
SMR	Suspicious Matter Report
SMSF	Self Managed Superannuation Funds
SOCA	UK Serious Organised Crime Agency
STR	Suspicious Transaction Report
SUSTR	Suspect Transaction Report
SVCs	Stored Value Cards

TF	Terrorism Financing
TPA	<i>Trade and Practices Act 1974</i> (Cth)
TPC	Trade Practices Commission
TRASA	Telecommunication Regulatory Association of Southern Africa
TTR	Threshold Transaction Report
UK	United Kingdom of Great Britain and Northern Ireland
UN	United Nations
US	United States of America
USD	United States Dollar
US DOS	United States Department of State
UTR	Unusual Transaction Report
WID	Act on Identification for Financial Services of 1993 (<i>The Netherlands</i>)[<i>Wet identificatiebijfinanciële dienstverlening</i> (WID)]
WWFT	Prevention of Money Laundering and Financing of Terrorism Act of 2008 (<i>The Netherlands</i>) [<i>Wet ter voorkoming van witwassen en financieren van terrorisme</i> (WWFT)]

ABSTRACT

Australia is one of the countries that have been active in criminalising money laundering (ML) activities, particularly when it passed the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act), and when it established AUSTRAC (the Australian Transaction Reports and Analysis Centre) as the financial intelligence unit (FIU) and the regulator of the Australian AML system in 1989. The Financial Action Task Force (FATF) evaluated the Australian AML system in October 2005 (before passage of the *AML Act* in 2006) and found a considerable number of shortcomings, one of those being that Australia was partially compliant (PC) with a number of important aspects in regard to its AML regime. This includes AUSTRAC's inability to enforce compliance. It noted that even where AUSTRAC had limited powers to enforce compliance these have been utilised very infrequently. This thesis assesses the operational capacity of AUSTRAC's enforcement mechanism in regard to non-compliance with reporting obligations.

This thesis contextualises the review process of activities that have been undertaken in Australia (after issuing the *AML/CTF Act of 2006*) to enhance the ability of AUSTRAC to apply the most effective enforcement powers regarding compliance with reporting obligations. These activities failed to address a number of major shortcomings that have, nevertheless, been explored by FATF in its mutual evaluation reports. This thesis further notes that, while the Australian AML system has shortcomings, there exist a number of factors (some more amenable to change than others) that will make it more difficult for Australia to comply with existing and future FATF Recommendations if the scenario remains largely the same. These factors include: the struggle of various entities to understand and apply the risk based approach (RBA), the limitations of the AML

training programs for reporting entities, and the disconnection in the relationship between AUSTRAC and its partner agencies.

This thesis will consider the benefits that AUSTRAC's enforcement mechanism could gain — in terms of increasing its level of effectiveness — from examining the enforcement mechanisms of other countries' FIUs as well as the enforcement mechanisms of other Australian regulatory agencies in regard to non-compliance behaviour.

Finally, this thesis suggests that while a number of recommendations and practical solutions for AUSTRAC, its partner agencies and reporting entities can be reliable options to achieve increased effectiveness for the Australian AML system, any such initiative is more likely to deliver sustainable positive outcomes when it contributes to enhancing this system in general and the AUSTRAC enforcement mechanism in particular.

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1 INTRODUCTION

1.1 Preface

1.1.1 Background

Several features of financial institutions make them particularly attractive to money launderers. First, organised crime generates proceeds generally in the form of cash; second, the sheer volume of cash handled by financial institutions makes it possible to channel huge amounts of money through financial institutions without arousing their suspicions; third, the financial system is highly internationalised, making it very easy to transfer proceeds from one jurisdiction to another; and, fourth, financial institutions are often surrounded by a cloak of secrecy.¹ Due to these vulnerabilities financial institutions are often subject to regular surveillance by a government's financial intelligence unit (FIU).

The global anti money laundering (AML) regime has, through the Financial Action Task Force (FATF), established a number of obligations for financial institutions so that they can prevent themselves from being used for the purpose of money laundering (ML), and so uphold the reputation of their businesses, and also assist government efforts against ML. One of these obligations is that of reporting certain unusual suspicious transactions or matters to an appropriate authority in a way prescribed by the government.

Under the national legislation of various countries, the reporting obligations are very strict since this is one of the most important pillars of the AML regime.² In the early

¹ Guy Stessens, *Money Laundering, A New International Law Enforcement Model*: Cambridge Studies in International and Comparative Law (Cambridge University Press, 2000) 134.

² Tatsuo Ueda, 'The Suspicious Transaction Reporting System and its Effective Use' (2001) *UNAFEI 117th International Seminar, Current Situation and Counter Measures Against Money Laundering* 411, 411.

period of reporting, administrative or regulatory penalties were imposed on non-complying institutions; today this is rarely the case. Now, it is not uncommon for a failure to report to be a criminal offence.³ Governments take enforcement measures regarding reporting obligation non-compliance very seriously, and often a series of actions is available against non-complying financial institutions.

Although regulatory authorities have the choice of several disciplinary alternatives available when a particular non-compliance situation requires a response, in practice responses are generally only expressed through a number of relatively ‘softer’ measures, for example, persuasion, warning letters and so on. As Broome (2005) observes, prosecutions for failure to report remain rare and finding such an instance is difficult unless there is some reason for regulators to focus on particular transactions.⁴

There could be several explanations for this leniency on the part of regulators (in AML fields, the regulator is often the FIU but in many cases the role is performed by a number of sectorial regulators) toward financial institutions (the ‘reporting institutions’ in AML). Broome (2005) notes that governments are probably not yet experienced enough in the application of harsher punishment for non-compliance.⁵ Consequently, more serious action has occurred over the last seven years and may be seen more frequently in future as the pressure for full-compliance increases.

³ John Broome, *Anti-Money Laundering, International Practice and Policies* (Sweet and Maxwell, 2005) 292.

⁴ Ibid 293.

⁵ In this thesis, harsh(er) regulatory sanctions and/or penalties means the sanctions/penalties which have more intrusive regulatory aspects, with consequently higher levels of intervention and compliance costs, while references to soft(er) regulatory sanctions/penalties means the use of sanctions/penalties with less regulatory intrusive, lower levels of intervention and compliance costs. For example, warning letters or requests for changes in procedures are less intrusive than mandated changes in processes. The level of intrusion increases with changing sanctions such as requirements for corrective advertising and the payment of refunds, requirements to terminate relationships with other entities (such as service providers) and the suspension or cancellation of licenses.

Regulators also may decide not to apply severe penalties due to the impossibility of knowing what the results would be in terms of a cost-benefit analysis of such an action. Financial institutions are pillars of a country's economic infrastructure; therefore, a decision to revoke the licence of an institution for reporting obligation non-compliance may not be easy to take. However, a reporting entity's 'blindness' to a known criminal activity in an account may be considered to have fulfilled the *mens rea* (guilty mind) requirement and the institution may be prosecuted accordingly, as was held in the case of *United States v Bank of New England*.⁶

Discussion of enforcement actions where reporting obligation non-compliance is detected is relevant: reporting is the foundation of any AML regime. If there is no strong enforcement mechanism to ensure compliance, the reporting system will fail, causing the entire AML regime to ultimately fail. Therefore, it is necessary to assess the FIU's enforcement mechanism to identify its strengths and weaknesses.

In this thesis, the researcher is going to appraise the enforcement mechanism available to the Australian FIU (the Australian Transaction Reports and Analysis Centre (AUSTRAC)) regarding non-compliance with reporting obligations under Australian AML legislation.

1.1.2 The Problem: AUSTRAC and its Enforcement Mechanism

AUSTRAC was established in 1989 under the *Financial Transaction Reports Act 1988* (Cth) (*FTR Act*) and continues its work under the *Anti-Money Laundering and Counter Terrorism Financing Act 2006* (Cth) (*AML/CTF Act*). It is a financial intelligence unit and regulator that works alongside Australian reporting entities in their compliance with

⁶ Matthew R Hall, 'An Emerging Duty to Report Criminal Conduct: Banks, Money Laundering, and the Suspicious Activity Report' (1995-1996) 84 *Kentucky Law Journal* 669.

legislation to combat ML crimes. AUSTRAC fulfils an investigative role, and assists law enforcement bodies and partner agencies by passing relevant information to them in order to prevent financial crimes and facilitate the prosecution of criminals in Australia and beyond.⁷

The *FTR Act* required ‘cash dealers’ to report to the CEO of AUSTRAC⁸ regarding international funds transfer instructions (IFTIs), significant cash transactions and suspect transactions. Lawyers were then only required to report significant cash transactions.

Under the *AML/CTF Act 2006*, ‘reporting entities’ were required to first undertake their reporting obligations (these are the same obligations under the *FTR Act 1988*) by 12 December 2008. Reporting entities can be individuals, companies or other entities that provide a ‘designated service’ as defined in the *AML Act*, including banks, non-bank financial services, remittance (money transfer) service-providers, bullion dealers and gambling businesses,⁹ accountants, lawyers and real estate agents.

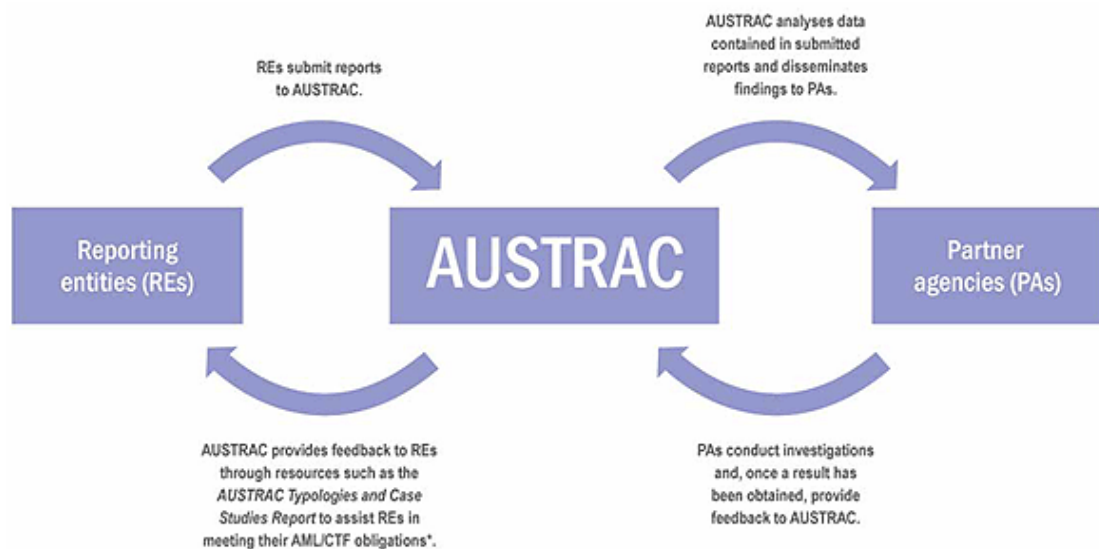
In order to assist reporting entities to comply with their reporting obligations, AUSTRAC released a reporting implementation policy on 19 September 2008. According to this policy, entities were required to report suspicious matters and, if applicable, threshold transactions and IFTIs to AUSTRAC.¹⁰ Figure 1 below represents the AUSTRAC reporting system.

⁷ Jackie Johnson, ‘Australia: Working within the Law – The Attitudes of Reporting Officers to the Financial Transaction Reports Act 1988’ (2000) 8(2) *Journal of Financial Crime* 162.

⁸ Ibid.

⁹ AUSTRAC, *AML/CTF Act – Reporting Requirements* (December 2008)1.<http://www.austrac.gov.au/files/mfs_requirements.pdf> at 28 May 2011.

¹⁰ AUSTRAC, *AML/CTF Act – Reporting Implementation Policy v.1* (September 2008) 1–2.<http://www.austrac.gov.au/files/amlctfact_reporting_implementation_policy.pdf> at 28 May 2011; AUSTRAC, *Overview of the AML/CTF Act 1*.<http://www.austrac.gov.au/elearning/pdf/intro_amlctf_overview_amlctf_act.pdf>at 28 May 2011.



* Obligations under the AML/CTF Act include implementing an AML/CTF program, conducting risk assessments, identifying and verifying customers, conducting ongoing customer due diligence and submitting AML/CTF Act reports to AUSTRAC. Obligations under the FTR Act include submitting transaction reports to AUSTRAC.

Figure 1: The AUSTRAC Reporting System

Source: AUSTRAC website

The *AML Act* has addressed several areas and includes a ‘tipping off’ offence, strengthening the reporting system.¹¹ Strict obligations regarding record-keeping requirements are also imposed.¹²

The enactment of AML legislation using a risk-based approach (RBA) makes reporting obligations more important. For example, RBA can enhance the AML reporting system by requiring every entity that may be considered to pose a ML risk to submit suspicious matter reports (SMRs). Customers considered to pose a higher ML risk would need to provide additional information and be placed under stricter supervision. Thus, reporting obligation compliance should be strategically targeted by AUSTRAC.

¹¹ *AML Act 2006* s 123 prohibits a reporting entity that has provided information or a document to a person (under subsection 49(1)) from disclosing that material to anyone else.

¹² The *AML Act 2006 (Cth)* as amended up to and including Act No 8 of 2010 (this compilation having been prepared 22 March 2010), pt 10, and pt 11 div 3. See <[http://www.comlaw.gov.au/ComLaw/Legislation/ActCompilation1.nsf/0/21AC5D1801F8FC5DCA2576EF001E3EC2/\\$file/AntiMoneyLaundCountTerrFin2006.pdf](http://www.comlaw.gov.au/ComLaw/Legislation/ActCompilation1.nsf/0/21AC5D1801F8FC5DCA2576EF001E3EC2/$file/AntiMoneyLaundCountTerrFin2006.pdf)> at 28 May 2011.

In fact, AUSTRAC believes that reporting obligation compliance is essential for a successful AML regime. In instances of non-compliance, AUSTRAC is, therefore, ready to take appropriate action to guarantee compliance and rectify the situation — the *AML/CTF Act* equips it with a wide range of enforcement powers to be used in cases of non-compliance with the Act.¹³

AUSTRAC has issued a number of circulars that explain and justify its use of the enforcement mechanism. Documents include AUSTRAC's Enforcement Policy, the guiding principles within its Supervisory Framework Policy, and the Enforcement Manual. AUSTRAC is to use its enforcement powers where non-compliance has been identified. According to its Enforcement Policy, '[W]here cooperation and negotiation have demonstrably failed, AUSTRAC will not hesitate to take measured but firm enforcement action for the purpose of securing compliance and rectification'.¹⁴

For the enforcement options available to AUSTRAC (as per its enforcement policy), see Figure 2 below.

¹³ AUSTRAC, *AUSTRAC Annual Report 2007–08* (2008) 39. See <http://www.austrac.gov.au/files/austrac_annual_report_2007-08.pdf> at 28 May 2011.

¹⁴ AUSTRAC, *AUSTRAC Enforcement Policy* (pdf file undated, e-version last modified 3 March 2010) 1. See <http://www.austrac.gov.au/enforcement_policy.html> at 25 May 2011.



Figure 2: AUSTRAC Enforcement Mechanism

However, the 2005 FATF mutual evaluation report on Australia found AUSTRAC to be only partly compliant in its application of sanctions where non-compliance was detected. (See, for example, the Report’s recommendations 17, 35 and 40, below). AUSTRAC’s actions demonstrate that it does not routinely apply formal sanctions in such instances.

Recommendation 17 notes:

The penalty regime in the FTR Act provides for criminal sanctions or civil injunction power under section 32 (Part V), where AUSTRAC may also seek to

restrain unlawful conduct by application to Court for injunction relief under section 32 of the FTR Act. However, statistics reveal that this power is used by AUSTRAC in limited circumstances. Criminal sanctions are also available in the Criminal Code or the Crimes Act 1914. The lack of administrative sanctions means in practice that formal sanctions are generally not applied. However, Australia notes that agreed remedial action with the cash dealer, while not a formal sanction, successfully encourages improvements.¹⁵

Recommendation 35 reiterates much of the above but adds that '[t]he regulatory sanctions available in the broader Australian financial supervisory and regulatory environment include criminal, civil and administrative mechanisms.'¹⁶

Recommendation 40 clearly states a number of AUSTRAC shortcomings in its approach, including an over-reliance on 'education' and a lack of compliance inspections (in terms of frequency, type and range of target institutions), and a need to introduce a 'comprehensive administrative penalty regime' and 'specific measures' for licence revocation and other matters. It is worth reproducing here in full:

AUSTRAC's on-site supervision activities do not cover the full range of compliance tools available to it under the FTR Act. AUSTRAC currently focuses on education visits and has conducted only two compliance inspections of banks in the last two years. ... educational visits include inspections of records to ascertain whether an entity is a cash dealer, and if so, whether they have reporting obligations and whether they are complying with them. Australia also notes that education visits can result in agreed remedial action with the cash dealer which, while not a formal sanction, successfully encourages improvements. Nevertheless, the Australian government needs to develop an on-going and comprehensive system of on-site AML/CFT compliance inspections across the full range of financial institutions. There should also be specific measures that enable the regulator to disqualify management or directors or revoke a licence to operate for specific AML/CFT failings. There is also a need to introduce a comprehensive administrative penalty regime for AML/CFT failings.¹⁷

Even today, some five years later, under the latest AML Act which enhanced AUSTRAC's power in applying both civil and criminal penalties (especially after the *Policy (Civil Penalty Orders) Principles 2006*), the reader of the AUSTRAC annual

¹⁵ FATF, Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism/Australia (FATF, 2005) 99.

¹⁶ Ibid 10.

¹⁷ Ibid.

reports will not find much difference in the way AUSTRAC deals with non-compliance. (The only exception is that there are some improvements in the level of persuasion.) According to the retired AUSTRAC CEO, Neil Jensen, AUSTRAC has not enforced civil penalties.¹⁸ In its 2008/09 annual report, AUSTRAC states that it had ‘investigated a number of financial institutions and other regulated entities regarding breaches of the FTR Act and AML/CTF Act’ and ‘received a legally enforceable undertaking from one institution to rectify breaches and comply with its AML/CTF obligations’.¹⁹

AUSTRAC has not applied civil or criminal penalties for non-compliance; rather it has limited its action to a number of soft enforcement actions, such as accepting enforceable undertakings from a number of non-compliant entities that had been found to have a number of deficiencies and been in breach (including in regards to their reporting obligations) of Australia’s AML/CTF laws.²⁰ This reveals shortfalls in AUSTRAC’s current response to reporting entity non-compliance.

Accordingly, an attempt to identify and examine the reasons for AUSTRAC not pursuing civil and criminal penalties against non-compliant reporting institutions — and determine whether it had any impact on the level of reporting compliance — is justified.

¹⁸ Marsha Jacobs, ‘Money-Laundering Regulator to Get Tough’ *Australian Financial Review*, 1 April 2009, 9.

¹⁹ AUSTRAC, *AUSTRAC Annual Report 2008-09* (2009) 37. See <<http://www.austrac.gov.au/files/ar0809.pdf>> at 10 May 2011.

²⁰ AUSTRAC, ‘AUSTRAC Accepts Enforceable Undertaking from Mega International Commercial Bank’ Media Release, 1 July 2009 <<http://www.austrac.gov.au/1jul09.html>> at 6 June 2011; AUSTRAC, ‘AUSTRAC Accepts Enforceable Undertaking from Barclays Bank, Media Release, 1 July 2009 <http://www.austrac.gov.au/1jul09_2.html> at 6 June 2011; AUSTRAC, ‘AUSTRAC Accepts Enforceable Undertaking from George Thomas Hotels Pty Ltd, Media Release, 31 December 2010; AUSTRAC, ‘AUSTRAC Accepts Enforceable Undertaking from Argos Investments Pty Ltd, Media Release, 9 December 2010. For texts of the enforceable undertakings see AUSTRAC website: <http://www.austrac.gov.au/enforceable_undertakings.html> at 6 June 2011.

1.2 Scope

First, the thesis will be limited to the issues of AML and not extend to cover CTF related issues. Thus, it will be confined to the legislative and strategic aspects of improving AUSTRAC's enforcement mechanism regarding non-compliance with reporting obligations, an element crucial to the strength of the Australian AML system. Cultural, technical and practical matters do impact on enforcement mechanisms, which could make measuring its effectiveness difficult.

Factors affecting the AML system in Australia (as elsewhere) include the regulatory culture, corporate culture and the different interests of those who are part of the AML system, political perceptions, and the nature of AML activities which continuously change as criminals utilise new methods and types of operations. This last factor inevitably leads to underestimations of criminal activity (due to the lag between identification of a new type of activity, formulation of appropriate legislation, subsequent detection, much less the imposition of appropriate sanctions). The level of confidentiality to be observed and a lack of information available as to why AUSTRAC has refrained from using its enforcement powers — and as to whether or how regulated entities react to this lack of enforcement — further complicate matters.

Second, the AUSTRAC enforcement mechanism's strengths and weaknesses regarding reporting obligation noncompliance will be evaluated using what information is available (taking into consideration the aspects mentioned above), and by doing field research and collecting empirical data. The thesis findings will provide material from which a better understanding of the actual reasons for the situation can be derived. AUSTRAC's enforcement mechanism will be examined in order to identify, and critically evaluate, the factors that impact upon AUSTRAC's enforcement decisions

(particularly in relation to its enforcement mechanism). Data obtained will also be examined in order to understand reporting entity perceptions of AUSTRAC's enforcement regime.

The following must be taken into consideration when evaluating AUSTRAC's enforcement mechanism regarding reporting entity non-compliance:

- 1 The regulatory and corporate cultures, including any political influences playing a role in the way that AUSTRAC deals with non-compliance.
- 2 The different nature of the reporting entities, including the type of work undertaken, organisational size, history of compliance and regulatory 'capture', and how this affects the role of AUSTRAC when it applies sanctions on a non-compliant entity.
- 3 AUSTRAC's self-regulation, including staff training, budget, information technology system and relations with reporting entities and partner agencies.

When discussing enforcement powers, a comparison can be made between AUSTRAC and other countries' FIUs and their enforcement mechanisms, such as those of the USA, the Netherlands. Comparisons can be drawn between AUSTRAC and other regulatory agencies such as the Australian Securities and Investments Commission (ASIC) and the Australian Competition and Consumer Commission (ACCC) and their experiences with enforcement compliance in the Australian context. These can inform evaluation of AUSTRAC's enforcement mechanism.

1.3 Significance

This thesis reports an important and original study, because of the lack of sources in this field. By evaluating AUSTRAC's enforcement mechanism, the thesis is able to make theoretical and practical contributions to the field of combating ML crimes at national and international levels.

This thesis represents the first intensive research into the AUSTRAC's enforcement mechanism and its implications for the AML system. It will enhance the literature in this area by providing comprehensive knowledge and original data. This thesis will also play a vital role in drawing attention to, and increasing the understanding of, the Australian regime's achievements and any inadequacies with respect to preventing ML activities. Its findings should subsequently provide valuable conclusions for the Australian AML regulatory model in its enforcement in relation to the non-compliance issue, and ultimately contribute to the reduction of ML crimes.

On the international level, this thesis will provide valuable information to governments, so they can benefit from the successes of the Australian regulatory experience, and avoid its shortcomings.

1.4 The Research Question

The research question is:

What are the strengths and weaknesses of AUSTRAC's enforcement mechanism with regard to non-compliance with reporting obligations under the AML Act?

1.5 Overview of the Thesis

After discussing the thesis problem in Chapter 1, the next step in this chapter is to undertake a review of the literature in the area of FIU enforcement mechanisms, in terms of their descriptions or views on how to achieve the most effective enforcement mechanism for these agencies so as to guarantee the highest level of compliance by the reporting entities with the AML reporting obligations. The thesis methodology including the data analysis is then provided, and the building of the theoretical framework to be able to answer the research question.

Chapter 2 provides the required knowledge to identify and clarify ML crimes, and reflects upon the international initiatives and conventions against such harmful illegal activities, taking into especial consideration the FATF Recommendations as a benchmark. The chapter then provides an historical overview of the Australian experience in the AML domain.

Chapter 3 highlights the reporting obligations under the FATF Recommendations, and reflects on the need for the compliance with these obligations, particularly in light of the Mutual Evaluation of the FATF to Australia (before enacting the *AML Act 2006*) and the US Department of State report 2008–2010 (after enacting the *AML Act 2006*). This chapter reflects upon the need for clearer recommendations from FATF, the need for Australia to comply with the reporting obligations, and also the need for more effective AUSTRAC and AML system in the Australian jurisdiction.

Chapter 4 emphasises the need for this agency to consider the most effective enforcement mechanism in order to achieve an effective enforcement profile, and suggests four attributes and requirements (that have been found through the analysis of the theoretical and practical approaches of the reporting entities interviewed) in

designing and adopting such a mechanism. These attributes are essential to any regulators when enforcing compliance and not only for AUSTRAC. This chapter also highlights the experiences of other countries' FIUs (notably those of the United States and The Netherlands) in enforcing compliance with reporting obligations and demonstrates that a country's regulatory culture and the pre-existing legal system can play a vital role in the formulation and operation of a country's regulatory system and its regulator's enforcement mechanisms. The Chapter also examines the experiences of other Australian regulatory agencies (namely ASIC, the ACCC and APRA) and their enforcement mechanisms. The experiences of the selected FIUs and those of other Australian regulatory bodies are compared and contrasted to those of AUSTRAC with the aim of discerning ways in which the local regulator's performance could be improved.

In Chapter 5, a number of AUSTRAC publications are discussed, including its strategies, annual reports, surveys, and typologies and case studies. Even though AUSTRAC has tried in these publications to reflect its role as an effective regulator and its great achievements in the AML system, an analysis of these publications reveals differences between 'what AUSTRAC says' and what actually occurs in regards to non compliance with reporting obligations.

Given the facts and outcomes reported in the previous chapter, Chapter 6 came to highlight a number of factors that are affecting AUSTRAC's enforcement mechanism for reporting obligation non compliance. An analysis of the responses obtained in a number of interviews pointed to a number of these factors, including AUSTRAC's lack of experience and capacity, disengagement in the relationship between AML parties, and AUSTRAC's underachievement of its Guiding Principles.

The final chapter, Chapter 7, presents the overall findings of the thesis, and reflects on the current enforcement mechanism scenario of AUSTRAC in regards to non compliance with reporting obligations in light of the four attributes and recommendations that the thesis encourages AUSTRAC to consider when improving its enforcement profile. Unless its enforcement operation and capacity improve, AUSTRAC and the society it serves will continue to suffer from its weak decisions and enforcement profile.

1. 6 Literature Review

AML systems rely on the power of their reporting regimes; therefore, the level of compliance determines a regime's strength. Regulators are always looking for compliant entities; however, in the presence of non-compliance although regulators may have sanctions at their disposal, their use of such sanctions appears uncertain, and often limited. Some studies have discussed FIU enforcement mechanisms generally but, to the best of our knowledge, AUSTRAC's enforcement mechanism is yet to be externally or independently researched and evaluated.

When studying any country's AML system, it needs to be borne in mind that while ML cannot be entirely eradicated, efforts can be made to regulate it. What countries should be calling for is the best possible regulation, regulation that is able to reduce, even minimise ML.

However, a number of factors (other than the FIU enforcement mechanism) challenge an AML system's regulatory processes. The literature on this area mentions, for example, basic cultural issues, compliance costs, different interests of the various AML system parties, and privacy costs. Influences usually extend to include political, practical, economic and technical influences and so on.

1.6.1 Cultural Costs and the AML System

In the process of regulating the economic sector, many influences can play a vital role in justifying a country's regulatory system. Levi (1997) discussed 'regulatory compliance culture' and its influences on the establishment of an effective AML regime. He argues that various countries have different levels of willingness to control and regulate their systems. Countries establish their regulatory systems to ensure the stability and the efficiency of their economy. Alongside increased security and savings, a major role of regulatory bodies is protecting the national financial system from illicit approaches and misuse. However, the different approaches that countries adopt to regulate their systems differ in their operations and reveal different priorities in combating ML crimes. Many factors affect the way different countries respond in their efforts to combat such crimes.²¹ In her article, Gilboy (1998) states that such factors must be taken into account when looking to regulate any system, as it is shaped by the country's cultural forces, which have social, professional, organisational and work-group impacts.²²

1.6.1.1 Cost of Compliance

The regulatory compliance culture in the field of AML reflects the different interests and priorities for the AML system parties within that country and even between countries. Those parties are the reporting entities, FIU, law enforcement bodies, and other partner agencies.

Masciandro and Filotto (2007) note that as profit is the main goal of financial institutions, any regulatory decision militating against this interest would not be very welcome. Compliance costs are one of the factors that could affect the formulation and

²¹ Michael Levi, 'Money Laundering and Regulatory Policies' in Ernesto U Savona (ed), *Responding to Money Laundering: International Perspectives* (Harwood Academic, 1997) 259, 260–1.

²² Janet A Gilboy, 'Third-party Participation in the Regulatory Process: Legal Duties, Culture, and Noncompliance' 1998) 20(2) *Law and Policy* 135, 151.

operation of the AML system, because '[a]s the cost of regulation rises, the level of its acceptability to intermediaries declines'. This, in turn, affects the level of the effectiveness of any AML regime by prompting those institutions whose operations are proposed to be affected to actively oppose the introduction of the measure, and ultimately affect the nature of the measure finally adopted. The 'bottom line' for a regulatory system to be effective is, according to Masciandro and Filotto, that 'it must possess a sufficient level of acceptability to the regulated intermediaries'.²³

Braithwaite (1993), however, indicates that the effects of compliance costs do not stop at the reporting entities stage, but also extend to the regulatory and government agencies' enforcement costs, including the 'enforcement bureaucracies, prisons, courts ... involved in ML enforcement and ... tax revenue forgone when criminal organizations are prevented from laundering their money into legitimate businesses that pay taxes and create honest jobs'.²⁴

As the regulatory compliance culture is affected by the compliance cost, if the cost of compliance with the AML system is high, then the level of the compliance will most likely decrease.

There are other factors. Verhage (2009) explains that the reporting entities also have a reputational interest to guard, to prevent any association with criminal attitudes and activities, protect their reputation, and avoid regulatory sanctions for non-compliance or loss of confidence or trust from other reporting entities. The FIU and law enforcement bodies, too, are looking to combat ML crime, and protect their reputation as successful

²³ Donato Masciandro and Umberto Filotto, 'Money Laundering Regulation and Bank Compliance Cost: What Do Your Customers Know? Economics and the Italian Experience' (2007) 5(2) *Journal of Money Laundering Control* 133, 133.

²⁴ John Braithwaite, 'Following the Money Trail to What Destination? An Introduction to the Symposium' (1993) 44(3) *Alabama Law Review* 657, 658.

authorities inside and outside the country. Other partner agencies care about keeping the financial system's integrity safe-guarded, and maintaining a healthy economic regime.²⁵ It can be added that ML can affect reporting entity reputation in the eyes of customers or regulatory agencies; however, the level of reputational harm for any given event varies from entity to entity and from one matter to another. For example, if ML activity has occurred, the effect may vary with the size of the entity (having a disproportionate effect on smaller entities) but also between similar sized entities. Therefore, the influence of ML on reporting entity reputation is highly subjective, and should be taken into consideration when examining their AML compliance. Also important is the high reputation of the FIU, as a strong, active FIU inspires confidence and cooperation from enforcement authorities and partner agencies.

Broome (2005), and Grabosky and Braithwaite (1993), however, draw attention to the conflicting interests of regulators, customers and suppliers; the various regulatory typologies; and the level of financial institutions' compliance and implementation. According to Broome, regulator, customer, and supplier all seek to serve their own interests or concerns: the regulator to regulate the financial system, customers to buy goods at the lowest possible price, and suppliers to achieve the highest price for their goods. The interplay between these sometimes mutually exclusive benefits plays a vital role in building regulatory model.²⁶

The nature of FIUs differs. Grabosky and Braithwaite clarified the typologies factor. They observed that (i) some rejected law enforcement powers and concentrated on bringing conflicting parties together to resolve disputes; (ii) some held powers to

²⁵ Antoinette Verhage, 'The Anti Money Laundering Complex: Power Pantomime or Potential Payoff?' in Joanna Shapland and Paul Ponsaers (eds), *The Informal Economy and Connections with Organized Crime: The Impact of National Social and Economic Policies* (BJu Legal, 2009) 81.

²⁶ Broome, above n 3, 321–2.

enforce but rarely used them; and (iii) others prosecuted offending financial institutions in terms allowed by their regulatory process.²⁷

Entity compliance with the relevant regulatory regime also varies, reflecting and affecting a country's regulatory culture in a complex interaction.

Each in this chain is engaging in this preventive process from its own standpoint, looking to fulfil its own purposes.²⁸

1.6.1.2 Cost of Secrecy

'Privacy cost' is another example that demonstrates the regulatory culture issue and the different interests at play in combating ML crimes. According to Masciandro (1999), reporting entities would always prefer to avoid problems with regulatory agencies in the combating of ML crimes and would like to comply with their regulation. Yet they are aware of misusing their customer information during the process, which could affect the level of their customer trust in their institution.²⁹ The FIUs, law enforcement bodies and other partner agencies need to obtain as much information as they require without (or with limited) privacy obligations to effectively combat ML. Publication of data on their databases for access by different entities and agencies may also be viewed as highly desirable by agencies;³⁰ but however secure their databases, reporting entities or customers may not view their use of 'private' data so calmly.

²⁷ Peter Grabosky and John Braithwaite, 'Australian Regulatory Enforcement in Comparative Perspective' in Peter Grabosky and John Braithwaite (eds), *Business Regulation and Australia's Future* (Australian Institute of Criminology, 1993) 10–11.

²⁸ Verhage, above n 25, 81.

²⁹ Donato Masciandro, 'Money Laundering: the Economics of Regulation' (1999) 7 *European Journal of Law and Economics* 225, 237.

³⁰ Australian Privacy Foundation, *Submission to Attorney-General's Department and AUSTRAC* (April 2006) 'Anti-Money Laundering/Counter-Terrorism Financing Legislation Senate Legal and Constitutional Committee, Inquiry into Exposure Draft Bill, Rules and Guidelines (Submission)' (2006) 3. See <<http://www.privacy.org.au/Papers/AGs-AUSTRAC-AML-CTF-0604.rtf>> at 6 June 2011.

In addition to the privacy issue and its influence on the level of the reporting entities' compliance (referred to by Masciandro), it is important to add that reporting entities do not immediately prefer to deal with law enforcement bodies in ML matters, because these bodies always need information to pursue their investigations and prosecutions, and such activities could harm the reporting entities and their clients' privacy. Some would argue that there is a need for the FIU to act as a filter for information in such cases and take appropriate action before it becomes necessary for such material to go to the enforcement authorities.

The multiple parties involved in the AML processes, and the differences in their interests, make the creation of one single, operationally identical, effective global system to combat such crimes unviable, and highlight the importance of the need to identify and prioritise the conflicting interests. FATF with its 'Forty Recommendations' attempted to provide solutions for countries worldwide.

1.6.2 The Need for FATF

The Financial Action Task Force (FATF) — the inter-governmental body whose purpose is the development and promotion of national and international policies to combat ML and terrorism financing (TF) — issued its Forty Recommendations to provide a complete set of countermeasures against ML. They covered the criminal justice system law enforcement, the financial system and its regulation, and international cooperation. With these recommendations FATF adopted principles for action and gave member countries a measure of flexibility in implementing these

principles according to their constitutional frameworks, their financial system and legal culture.³¹

1.6.2.1 FATF and the Obligation to Report

A number of important aspects have been covered by these international standards. One of the most important, core requirements was the obligation for reporting entities to report suspicious transactions. Recommendation 13 states:

If a financial institution suspects or has reasonable grounds to suspect that funds are the proceeds of a criminal activity, or are related to terrorist financing, it should be required, directly by law or regulation, to report promptly its suspicions to the financial intelligence unit (FIU).

According to Ping (2005), the STR obligation is a very important tool in combating ML crimes, and the most effective measure to accomplish cooperation between reporting entities and government authorities. Ping also states that the concept of ‘suspicious transaction’ is not defined in the international documents.³² However, he did not posit the possible reasons for this, such as the different financial and legal cultures of various countries.

1.6.2.2 FATF and the FIUs

Recommendation 13 of FATF’s Forty Recommendations makes clear the reporting entity’s obligation to report to the relevant FIU. On the issue of FIUs, an important contribution to this thesis has been the analyses by Reuter and Truman (2004) and Broome (2005). They point out that the local AML regime is dominated by the influx of

³¹ See FATF, *About the FATF* <<http://www.fatf-gafi.org/>> at 4 August 2011.

The Recommendations were created in 1991 and first revised in 1996 to take into account changes in ML trends and to anticipate potential future threats. In 2001, a second revision expanded the mandate of the ‘40 Recommendations’ to include the TF issue. More recently (2003), FATF completed a thorough review and update of the 40 Recommendations.

³² He Ping, ‘The Suspicious Transactions Reporting System’ (2005) 8(3) *Journal of Money Laundering Control* 252.

international AML standards. They note that the FATF Recommendations were the fundamental base for enhancing countries' compliance with its standards and starting the AML regulating process with the establishment of FIUs with respect to recommendations 26 to 32.³³

According to Ueda (2001), the FIU is a very important body in any AML regime, with its role seen as a bridge between the reporting entities and law enforcement authorities.³⁴

Ping (2005) similarly notes that in the STR system the FIU is the centre for information and plays a vital role in the cooperation between the financial institutions and governmental authorities by providing the possibility of information exchange and information sharing.³⁵(See Figure 3)

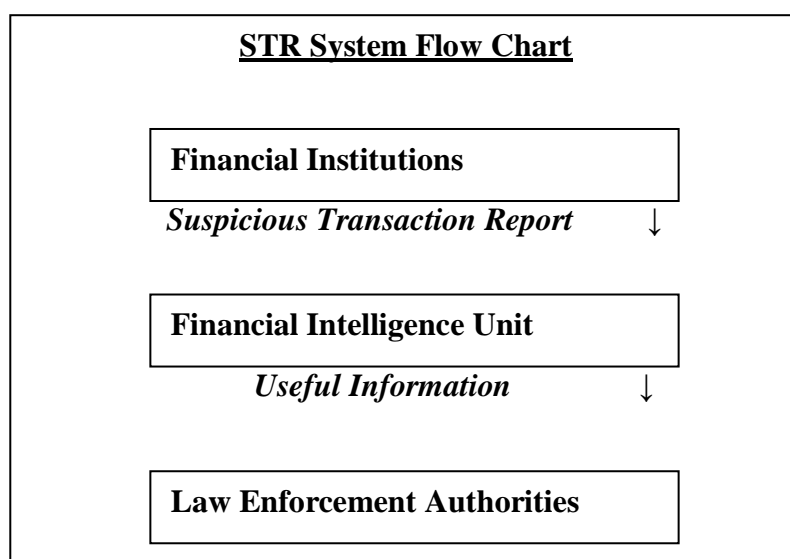


Figure 3: STR System Flow Chart

Adapted from Tatsuo Ueda, 'The Suspicious Transaction Reporting System and its Effective Use'.³⁶

³³ Broome, above n 3, 31–2; Peter Reuter and Edwin M Truman, *Chasing Dirty Money* (Institute for International Economics, 2004) 81–2.

³⁴ Ueda, above n 2, 413.

³⁵ Ping, above n 32, 256.

³⁶ Ueda, above n 2, 411.

However, none of the above authors (with the exception of Broome (2005)) discussed one very important issue: the different FIU models, and their roles and obligations in the STR system.

Okogbule (2007) and Broome (2005) clarify the availability of different FIU models. Okogbule (2007) argues the importance of such units, which by their role provide the required focus, increase effectiveness, and lead to better law enforcement.³⁷ Significantly, Broome (2005) details different jurisdictions' experiences of establishing FIUs, and distinguishes the structure of various models. Although all play a vital role in the relationship between the AML system parties of their countries, they do so somewhat differently, illustrating cultural, technical and situational differences and variations.³⁸

Some FIUs have the right to collect and analyse information obtained from financial institutions before passing it to other regulatory agencies and law enforcement bodies (the 'Administrative Model'). In this model the relationship between the FIU and other authorities indicates a strong, interactive relationship, and most countries have adopted it (for example, the United States of America, Monaco, Slovenia, France, and Australia among others).

In contrast, the 'Investigative Model' carries out the investigative role in relation to ML activities either alone or with other regulatory agencies and law enforcement bodies. This reflects a direct relationship between the FIU, other authorities and the courts.

³⁷ Nlerum S Okogbule, 'Regulation of Money Laundering in Africa: The Nigerian and Zambian Approaches' (2007) 10(4) *Journal of Money Laundering Control* 449.

³⁸ Broome, above n 3, 307–15.

In the third model, the ‘Judicial Model’ (adopted in Portugal and Luxemburg), the FIU is a part of the judicial sector, or reports directly to the judicial authorities after collecting and analysing information.

On the other hand, a fourth important model identified in Broome’s study is the ‘Law Enforcement Model’. Here the FIU is a part of the police agency. This gives this unit the opportunity to benefit from intelligence offered by law enforcement agencies and other regulatory bodies. However, this last model (adopted by the New Zealand and UK jurisdictions)³⁹ makes financial institutions feel uncomfortable as they deal with an FIU which has a power of law enforcement.

Therefore, most countries, including Australia, follow the administrative model. According to Thony (1996), Australia established its AUSTRAC in accordance with this model. By law, it has the authority to supervise and regulate the reporting entities’ compliance with legal provisions on ML. AUSTRAC has created its own system of automatic reporting for cash transactions and reporting of suspicious activities and transactions. Such information is electronically transmitted from the reporting entities to AUSTRAC databases, where it is then accessible by partner agencies, law enforcement bodies and also foreign institutions that have agreements with AUSTRAC to do so.⁴⁰

While a number of scholars mention that the choice of a particular FIU model depends on the regulatory culture of the country, the administrative model is an effective model for FIUs, especially in relation to STRs. However, it is not comprehensive.

In his study, Ueda (2001) argues that the model chosen can play an important role in justifying an FIU’s abilities and powers generally, such as in dealing with the AML

³⁹ Ibid 307–17.

⁴⁰ Jean-François Thony, ‘Processing Financial Information in Money Laundering Matters: The Financial Intelligence Units’ (1996) 3 *European Journal of Crime, Criminal Law and Criminal Justice* 257, 270.

process, and, more specifically, by enforcing compliance with the STR obligation. Ueda notes that the administrative model can have some problems. The *Japan* Financial Intelligence Office (JAFIO), for example, follows the administrative model but has limited powers to analyse STRs because it cannot carry out criminal investigations nor access the necessary criminal database. As a solution, Ueda suggests that JAFIO acquire investigative powers. These would enhance its enforcement mechanism by giving it the ability to obtain the necessary crime-related information from the reporting entities and law enforcement bodies. It would then be able to carry out high-quality analysis of the STRs and provide law enforcement bodies with high quality information for their investigations.⁴¹ Although Ueda's suggestion involves enhancing JAFIO's enforcement mechanism, it should be clear that it would still differ significantly from the law enforcement model. It would remain an example of the administrative model, but one enhanced by some additional power which would increase its effectiveness and its ability to analyse.

The FIU models can help increase understanding as to how these agencies operate, how they work in supervising compliance, how they relate to other agencies, entities and institutions, and the availability of the enforcement powers according to each model's style. One of the FIU's main reasons for being, however, is the availability of an active policy and utilisation of its enforcement mechanism, whether the FIU is operating according to the administrative or another model. The level of understanding shown by the reporting entities in regard to their obligations, especially reporting obligations, and the degree of their compliance with those obligations is partly fashioned by FIU policies and expectations as well as local factors.

⁴¹ Ueda, above n 2, 415–16.

1.6.3 FIU's Enforcement Mechanism and Reporting Obligations

Most of the above authors note that high compliance with a reporting system is not easy to achieve but systems can move closer to the ideal by improving the cooperation between the AML reporting system parties (especially between reporting entities and FIU), and their responses to this system, and by taking into consideration the various interests and cultural influences operating.

However, the success of any AML reporting system relies on the success of the authority that is supervising this system, and its use of its powers where needed. Thus, FIUs (or the relevant regulator where this role is not given to the FIU) have an obligation to enforce compliance where non-compliance is detected.

But the question remains, how should an FIU deal with non-compliant reporting entities regarding their non-compliance so as to achieve the highest level of compliance?

1.6.3.1 Enforcement Power and Regulation

Generally, the 'regulatory approach' is related to the form of law and enforcement that has developed in areas of social regulation over a long period. Criminal law is often considered essential to guard the public from threats from which they could not protect themselves, with criminal sanctions defined as tools for prevention.⁴² In terms of the economy, one of the main purposes of the law is to protect and sustain high levels of industry performance, ensuring conduct conducive to this goal, and through the law's most effective enforcement ensures a suitable balance between the differing interests of trade parties and public protection.

⁴² Mohammad AlRashdan, جرائم غسيل الاموال وموقف التشريع الاردني منها (trans *Jordanian Legislation's Perspective of Money Laundering Crimes*) [Arabic] (دار قنديل للنشر والتوزيع) 2007) 36-7.

A number of enforcement strategies can be adopted. According to Croall (2003), the last resort in enforcement is the use of criminal prosecution. A regulatory approach is associated with compliance and linked with a minimal use of criminal sanctions.⁴³ It is essential to note that this often emerges from lengthy negotiations between industry groups, regulators and governments. Hutter (1997) notes that regulatory enforcement usually relies on the adoption of cooperative compliance strategies, including persuasion and education; nevertheless, regulators adopt a range of administrative sanctions, including providing restrictions, imposing fines, and suspending or revoking licences, which can affect the survival of a business. These play a vital role in regulatory enforcement.⁴⁴

1.6.3.2 Strategic Regulation Theory

Regulators adopt an approach to enforce compliance that varies according to the nature and type of sanctions that are applied when non-compliance with the law and regulations is detected.

Braithwaite's theory, embodied in his *Enforcement Pyramid*, clarifies the regulatory power; how it works, and how it should work, not only for business compliance, but also in relation to a number of other areas. This theory is employed widely by researchers in fields as diverse as environmental regulation (Hawkins

⁴³ Hazel Croall, 'Combating Financial Crime: Regulatory Versus Crime Control Approaches' (2003) 11(1) *Journal of Financial Crime* 45.

⁴⁴ Bridget M Hutter, *Compliance: Regulation and Environment* (Oxford University Press, 1997) 14.

1984),⁴⁵ occupational health and safety (Gunningham and Johnstone 1999),⁴⁶ and ML (Fisse 1997).⁴⁷

This theory provides a ‘macro perspective’ on the role of enforcement sanctions in protecting regulatory compliance. It advocates regulatory compliance as best secured by persuasion rather than legal enforcement. For persuasion to be effective, generally a threat of punishment must lie behind the regulator’s appeasing actions. The threat of punishment should take the form of a set of sanctions, which the regulator can threaten to use where breaches occur. The sanctions should escalate in severity of response to more serious breaches of the law, until the top of the enforcement pyramid is reached. (See Figure 4)

⁴⁵ Keith Hawkins, *Environment and Enforcement: Regulation and the Social Definition of Pollution* (Oxford University Press, 1984).

⁴⁶ Neil Gunningham and Richard Johnstone, *Regulating Workplace Safety: Systems and Sanctions* (Oxford University Press, 1999).

⁴⁷ Brent Fisse, ‘Regulatory Strategy and International Corporate Controls’ in Ernesto U Savona (ed), *Responding to Money Laundering International Perspectives* (Harwood Academic, 1997).

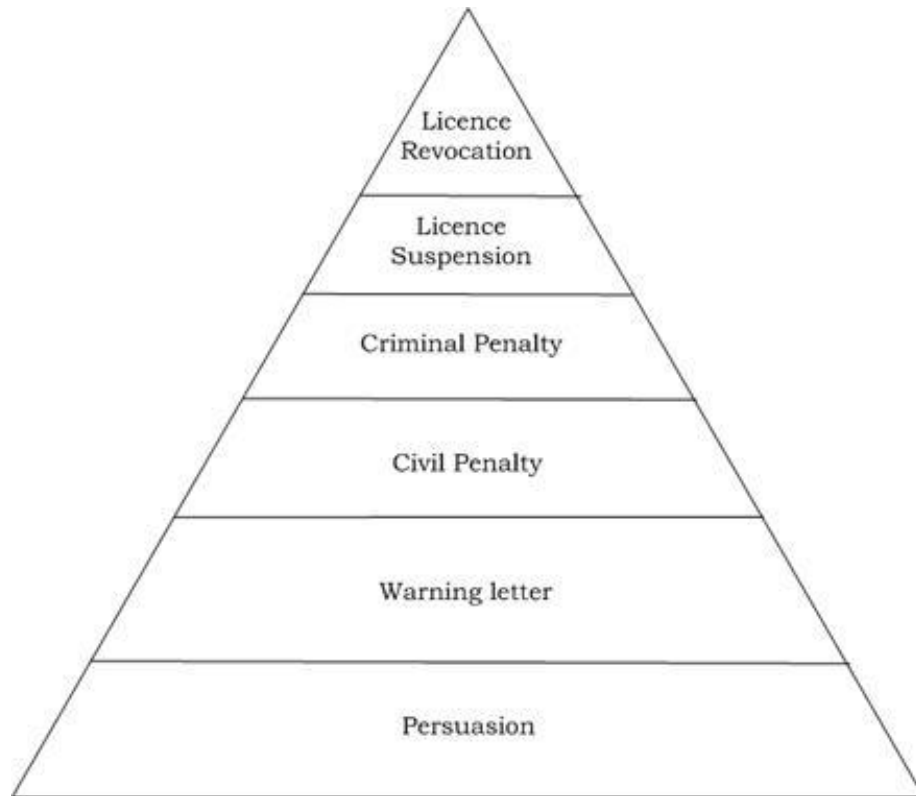


Figure 4: Enforcement Pyramid

Adapted from Ian Ayres and John Braithwaite, *Responsive Regulation, Transcending the Deregulation Debate* (Oxford University Press, 1992) 35.

Many researchers argue that its purpose is to motivate the highest levels of regulatory compliance. The rationale of this strategic regulation theory and its pyramid model is that those regulated ‘will comply sooner or later’ through a combination of normative aspiration and instrumental prevention.⁴⁸

However, Baldwin and Black (2007) indicated that this theory does not provide guidance on what the regulator should do to detect non-compliance activities. Both scholars explained that *the Enforcement Pyramid* is a limited theory mainly focusing on how to punish non-compliant entities in order to achieve the aim of securing compliance. They also pointed out that this theory does not help the regulator to insure

⁴⁸ George Gilligan, Helen Bird and Ian Ramsay, ‘Civil Penalties and Enforcement of Directors’ Duties’ (1999) 3 *University of New South Wales Law Journal* 417, 426.

it selects the inspection strategies which will lead to superior enforcement outcomes. In addition, this theory does not tackle essential regulatory aspects when enforcing compliance such as unclear objectives, changes in the regulatory environment, conflicting institutional pressures and how the regulatory agency should evaluate the effectiveness of its enforcement strategies and applications.⁴⁹

Nevertheless, Freiberg (2010) pointed out that the influence of the *Enforcement Pyramid* in the regulatory arena has been profound and fruitful. The *Enforcement Pyramid* has flourished to the level that a large number of regulators have developed some variant upon this highly respected theory. Thus, he believes that this theoretical accuracy has definitely enhanced the quality of regulation at both state and federal levels in Australia. As a result, the Australian regulatory frameworks faced the challenge of the global financial crisis (GFC) effectively.⁵⁰

Indeed, the *Enforcement Pyramid* is a rich source of information and applicable theory for regulatory agencies and enforcers in different areas including AML. Through their theory, Braithwaite and Ayres have identified regulatory compliance as a good governance issue, and if a country has a high level of governance it will have an improved regulatory framework. In the Australian AML context, AUSTRAC needs to effectively adopt this kind of approach by giving the businesses it deals with a greater interest in achieving compliance with the lowest level of regulatory intervention.

⁴⁹ Robert Baldwin and Julia Black, 'Really Responsive Regulation' LSE Law, Society and Economy Working Papers 15/2007, London School of Economic and Political Science (2007) 3.

⁵⁰ Arie Freiberg, 'Re-Stocking the Regulatory Tool-Kit' Paper presented to *The European Consortium for Political Research (ECPR) Standing Group on Regulatory Governance* [University College, Dublin] *Third Biennial Conference 'Regulation in An Age of Crisis'* Dublin, 17–19 June 2010, 1.

Braithwaite (2002) declares that regulation works best with an image of punishment in the background. If persuasion alone is to provide a more effective ‘ground level entry’ to the enforcement pyramid, then agencies should treat it as a real area of activity and not leave a situation until there is no choice but to move to the top of the pyramid. Early intervention is recommended to maximise the effectiveness of persuasion. Agencies that speak or act softly and delicately must at the same time carry ‘very big sticks’ (‘the Benign Big Guns’).⁵¹ Non-compliant or potentially non-compliant entities must be made aware of this ‘threat’ that may be activated should compliance not occur. Sooner, in this situation, is better (and more cost-effective) than later. Consequently, the base of the pyramid is illustrated as being wide, signifying the larger number of matters involving many entities whose activities become compliant relatively easily, using less force. Continuing non-compliance results in an escalation up the pyramid, towards ever harsher penalties. The model illustrates the progressively fewer cases being addressed by increasingly harsher measures. Persuasion should first be utilised, then a warning letter when dialogue fails, progressing to civil penalties, then criminal penalties, then licence suspension and finally, when all else fails, permanent revocation of the relevant licence.⁵²

Thus, the regulatory agency has options, and can determine when and how to respond where the level of regulatory intervention can be lesser or greater and where the costs to both the regulator and the regulated effectively increase the further the regulator move up to the top of the pyramid.

In other words, the real choices for the regulator are whether to be ‘soft’ by adopting a lower cost, lower levels of intervention and lower compliance costs approach for the

⁵¹ John Braithwaite, *Restorative Justice and Responsive Regulation* (Oxford University Press, 2002) 35.

⁵² John Braithwaite, *Regulatory Capitalism, How it Works, Ideas for Making it Work Better* (Edward Elgar, 2008) 88–9.

reporting entities, or to be ‘harsh’ by adopting a higher cost and higher level of intervention approach.

According to Ayres and Braithwaite (1992), clear interaction (in cases of deterrence) between the regulatory agencies and industry in accordance with the pyramid increases the likelihood and extent of compliance and lowers the level of interventionism. Where there is a lack of clear communication, escalation to the enforcement level and above more frequently results.⁵³

In conclusion, according to Braithwaite’s theory, the responsive regulatory approach relies on how well people self-regulate, how they react when detected for breaches and how effective the regulator’s disciplinary reaction is where and when required.

It is clear from the above discussion that sanctions which could be applied for non-compliance are diverse, and escalate in severity. However, the question in the area of ML crimes prevention is which sanctions better achieve the purpose — is it better for the regulator to take ‘measured but firm enforcement action for the purpose of securing compliance and rectification in regard to the reporting obligations’?

1.6.3.2.1 Soft Sanctions

According to Tsingou (2005), FIUs always have one goal: compliance, and this is most likely achieved through persuasion, cooperation, self-regulation, risk-based discretion and, sometimes, ‘private remedies’.⁵⁴ Thus, he recommends ‘soft’ rather than harsh sanctions to ensure enforcement.

⁵³ Ian Ayres and John Braithwaite, *Responsive Regulation, Transcending the Deregulation Debate* (Oxford University Press, 1992) 38–9.

⁵⁴ Eleni Tsingou, ‘Global Governance and Transnational Financial Crime: Opportunities and Tensions in the Global Anti-Money Laundering Regime’ CSGR Working Paper No 161/05 (2005) 12.

Unger and van Waarden (2009) also support this argument, giving the example of the Dutch legal culture which relies on persuasion, advice, provision of more information, and education of potential transgressors in enforcement compliance.⁵⁵

What are the reasons behind applying the soft sanctions?

A number of reasons can convince an FIU to apply soft rather than harsh sanctions on non-compliant reporting entities, especially initially:

- 1 Risk based approach (RBA): The AML policy has switched from the ‘rule based’ to RBA in a number of countries (including Australia). RBA entails a reporting entity managing and mitigating their own risks, including the risk of suspicious transactions, while the rule based approach involves a monitoring system designed to detect certain laundering behaviours rather than suspicious transactions.

According to Unger and van Waarden (2009), shifting from the rule based approach to RBA aims to achieve the best level of compliance through avoiding over-reporting by the reporting entities. The new approach led to a large range of definitions and perceptions of ‘suspicious transactions’. Reporting entities have the right to determine the suspicious behaviour that they need to report, making it more difficult for FIUs to impose sanctions for wrongful reporting. In some jurisdictions, paradoxically, RBA led to a flood of reports (see further below).

- 2 Regulatory Capture and Lack of Ascendancy: While RBA imposes self-regulation on the reporting entities, it is also recognised that danger potentially exists if regulators are drawn from the industry to be regulated. In this instance, the FIUs

⁵⁵ Brigitte Unger and Frans van Waarden, ‘How to Dodge Drowning in Data? Rule and Risk-based Anti Money Laundering Policies Compared’ (2009) 5(2) *Review of Law and Economics* 973.

may be more ‘flexible’ in dealing with non-compliant entities, and the soft sanctions may be the only powers used to enforce compliance. According to Clarke (2000), a related issue is the extent to which a regulator can achieve ‘ascendancy’ (the opposite of capture). Indeed,

a lack of superiority [of the regulator’s power] and the truculence of major companies were partly responsible for the difficulties faced by regulators in the pensions “mis-selling” cases in which, despite regulatory action and attempts at “naming and shaming”, major household names persistently denied any misconduct.⁵⁶

Etzioni (2009) makes a significant point when he illustrates how regulatory capture weakens the enforcement of existing regulations and the regulator’s enforcement mechanism. For example, in USA the US Sentencing Commission implemented sentencing guidelines in 1989 and introduced large fines of up to USD364 million for criminal activities. These guidelines faced opposition from powerful interests — major trade associations and corporations — who used their influence to have the fines reduced. As a result of pressure from such powerful lobbies, the Commission reduced the penalties by as much as 97 per cent and, not only that, allowed offending corporations in particular circumstances to reduce the remaining penalties to a small amount, if not nil.⁵⁷ Thus, regulatory capture can constitute a problem in some instances in the design of an enforcement mechanism and in the use of applicable sanctions.

- 3 Pre-existing legal institutional framework: Legal systems are the product of decades of development of public policy regulation and case law. Thus the adoption of an AML compliance system predicated on applying soft sanctions rather than harsh penalties where the jurisdiction generally embodies a harsher

⁵⁶ Michael Clarke, *Regulation: The Social Control of Business between Law and Politics* (St Martin’s Press, 2000) 249.

⁵⁷ Amitai Etzioni, ‘The Capture Theory of Regulations – Revisited’ (2009) 46 *Society* 319, 320.

approach may not be a policy option readily acceptable to the entities in that jurisdiction nor may the adoption of a harsher approach be welcomed in a jurisdiction where generally a softer approach is used elsewhere in that jurisdiction. According to Schäfer (2002), the pre-existing legal context is very important in determining the actual enforcement mechanism and its acceptability in any country, especially when countries vary from developing to developed, and have different legal traditions in dealing with non-compliance. An external source (FATF) for seemingly arbitrary alterations to an AML regime (rules or sanctions) may not be an option as the current regime is part and parcel of an entire existing legal system.⁵⁸ Hence the variety encountered even between developed jurisdictions (such as the USA and the Netherlands, further below). Unger and van Waarden (2009) indicate that while the ‘soft’ Dutch legal framework invokes criminal law; its sanctions are not harsh nor instantly imposed, without respect for the person.⁵⁹

However, will relying on soft sanctions help an FIU guarantee compliance in all cases? From the above, it is clear that the use of the soft sanctions as the only sanctions to enforce compliance may be preferable in many circumstances and jurisdictions, but not all. It depends on the country’s political and legal systems. Nor are soft sanctions the adequate way to deal with non-compliance in every instance. According to Croall (2003), the use of soft sanctions to enforce compliance could encourage the ‘capture’ of the enforcing agency as sympathy develops between regulators and the regulated when they operate in a cooperative style.⁶⁰ In other instances (as outlined earlier), the existence of soft regulation or use of soft enforcement and light penalties, despite the

⁵⁸ Hans-Bernd Schäfer, ‘Legal Rules and Standards’ *German Working Papers in Law and Economics* [2002] article 2.

⁵⁹ Unger and van Waarden, above n 55, 973.

⁶⁰ Croall, above n 43, 47.

availability of harsh sanctions, may be a symptom of such capture. The continual application of soft sanctions could also reflect an FIU's lack of experience, which makes it impose 'immature'⁶¹ and disproportionately low sanctions on non-compliant entities.

According to the FATF *Methodology for Assessing Compliance with the FATF 40 Recommendations and the FATF 9 Special Recommendations*, an FIU should have adequate and effective powers of enforcement and sanctions against the reporting entities, and their directors or senior management for failure to implement or properly implement requirements to prevent ML, consistent with the FATF Recommendations.⁶²

1.6.3.2.2 Harsh Sanctions

In some jurisdictions (such as the USA), harsh sanctions are used to enforce reporting obligation compliance. According to Hall (1996), the US financial intelligence unit (FinCEN) utilises strict enforcement sanctions, including harsh fines and criminal sanctions.⁶³ Sanctions have significantly increased since the enactment of the *Patriot Act* after the events of 11 September 2001. These included fines of USD25 million for Riggs Bank in 2004 (for failure to report suspicious transactions), USD24 million for Arab Bank PLC in 2005, and USD50 million for AmSouth Bank.⁶⁴

What are the reasons behind applying harsh sanctions?

- 1 Ingrained Cultural Values. One active, ingrained US cultural value is that reporting entities are independent in their work but still responsible for their

⁶¹ The term of 'immature sanctions' in this thesis means: the improper sanctions that have been imposed by the FIU because of its lack of experience and weak enforcement decisions.

⁶² FATF, *Methodology for Assessing Compliance with the FATF 40 Recommendations and the FATF 9 Special Recommendations*, 27 February 2004 (updates as of February 2009), 38. See <<http://www.fatf-gafi.org/dataoecd/16/54/40339628.pdf>> at 17 September 2011.

⁶³ Hall, above n 6,668.

⁶⁴ Unger and van Waarden, above n 55, 972.

actions and deserve to be prosecuted if they behave badly. Unger and van Waarden (2009) have pointed out that the basic US industry / regulatory body relationship is one of distrust, so when entities misbehave an agency is more likely to favour harsh sanctions over persuasion and education as the way to guarantee compliance.⁶⁵

- 2 The Cost-benefit Analysis. Broome (2005) states that regulators may decide not to apply harsh penalties if it is difficult for them to know the cost-benefit analysis of such an action, but they will use them if they do know.⁶⁶ Unger and van Waarden (2009) also note that government, especially in the US, believes strongly that harsh sanctions have the ability to correct actions, so the importance of an FIU's experiences in dealing with non-compliance must be considered. Broome maintains that government will use its powers and apply harsher punishment for non-compliance if it is experienced in this area of law. As a consequence, more serious action may be seen in future as the pressure for full compliance increases.⁶⁷

What are the problems of applying harsh sanctions?

A number of scholars have mentioned some problems that could occur when applying harsh sanctions to the reporting entities when they fail to implement or properly implement requirements to prevent ML.

- 1 Crying Wolf. Hall (1996) explains that banks in the US carry different liabilities in relation to the reporting system, including their liability to customers for filing the reports and for terminating accounts after filing the reports, in addition to their

⁶⁵ Ibid 974.

⁶⁶ Broome, above n 3,293.

⁶⁷ Ibid.

liabilities to government for failure to file such reports, and for the bank's participation in the conduct described in the reports. These liabilities will push banks to apply 'safe harbour' provisions, by reporting to the FUI as many as they can of the transactions that they believe have clear indicators or even doubtful indicators of their being suspiciousness transactions, just to 'be on the safe side', leaving the analysis and investigative role to the regulator. This phenomenon is called the 'Crying Wolf'.⁶⁸

Therefore, excessive sanctions force reporting entities to report transactions which are less suspicious, especially if the AML system relies on the RBA and identifying the suspiciousness is a matter left to the reporting entities to specify. Levi (1997) mentions that financial institutions sometimes struggle to identify suspicious transactions as it is complicated to prove the actual level of trade that corresponds to the currency deposits of customers.⁶⁹ Beare (2002) supports this argument, arguing that suspicion is most likely generated in an area of uncertainty and anxiety, where financial institutions cannot tell if they are facing professional launderers, who are disguising the typical features of suspicious transactions.⁷⁰

AUSTRAC's public legal interpretation series provides a description of 'to suspect'. An SMR obligation arises when reporting entities suspect 'on reasonable grounds' any of the matters specified as reportable under the AML Act, and this suspicion is based on evidence that supports the truth of the suspicion.⁷¹ This should be helpful to the

⁶⁸ From the traditional tale of the boy who cried 'wolf' so often when no wolf was near that when there was a wolf, no one came to his aid and the sheep were lost: see Hall, above n 6, 665.

⁶⁹ Michel Levi, 'Money Laundering and Counter-Measures' in Adam Graycar and Peter Grabosky (eds), *Money Laundering in the 21st Century: Risks and Countermeasures* (Australian Institute of Criminology, 1996) 6.

⁷⁰ Margaret E Beare, 'Searching for Wayward Dollars: Money Laundering or Tax Evasion Which Dollars are We Really After?' (2002) 9(3) *Journal of Financial Crime* 260.

⁷¹ AUSTRAC, Public Legal Interpretation Series No 6 of 2008 – Suspicious Matter and Suspect Transaction Reports (2008), esp 6 [21] ff.

reporting entities, enabling them to determine a suspicious transaction and report it. If they fail to do so, the regulator must utilise the appropriate enforcement power to guarantee compliance.

Takats (2009) argues that harsh sanctions are not the tool to use to enforce compliance, and banks should not be regarded as criminals but as honest informants. He recommends that to encourage them to comply with reporting obligations, the regulator needs to decrease the sanctions for negative false reports but introduce reporting fees to discourage false positive reports.⁷²

Banks and other reporting entities are trying to do their jobs, fulfilling their obligations to depositors, customers/clients and shareholders as well as helping the FIU combat ML which also threatens their integrity in the longer term. These reporting entities are crucial to the AML system, but decreasing sanctions may not be the best solution for non-compliance. According to Roule and Kinsell (2002), the UK is facing a major problem with non-financial services reporting entities (such as lawyers⁷³ and accountants), who filed only 180 of the 15,000 reports submitted in 2000.⁷⁴ In such a situation, it would not appear that the best way to deal with semi or non-compliance with reporting obligations would be to decrease sanctions or impose reporting fees.

⁷² Elod Takats, 'A Theory of "Crying Wolf": The Economics of Money Laundering Enforcement' (2009) 13 *Journal of Law, Economics, and Organization*, 34.

⁷³ In a meeting with Professor John Broome on the 4th of July 2012 at the University of Wollongong, he indicated that there have been a number of cases in the UK around the implementation of the AML legislation. He suggests two reasons for this: the application of the reporting regime to lawyers and greater levels of enforcement including high monetary penalties for non compliance. Lawyers run cases trying to narrow down their obligations and that is a reason why there was more case law in the UK. Unlike the UK system where the lawyers were covered under the law from the early 1990's as a result of the EU AML Directives, the general lack of coverage of lawyers in Australia and the lack of enforcement action explains why there are no legal challenges to AUSTRAC legislation. Challenges are unlikely in the absence of enforcement action.

⁷⁴ Triffin J Roule and Jeremy Kinsell, 'Legislative and Bureaucratic Impediments to Suspicious Transaction Reporting Regimes' (2002) 6(2) *Journal of Money Laundering Control* 151,152.

An interesting suggestion made by (former Northern Territory technology-based gambling regulator and consultant) Alan Pedley was that the best solution for enforcing STR compliance would be to minimise the number of these reports and achieve the reporting of genuine STRs. He argues that this will never occur without the regulator understanding all of the threats and vulnerabilities (which could be quite complex), and then treating them as required.⁷⁵

2 Low Quality Reports (Defensive Reporting). As harsh sanctions could push reporting entities to report ‘less suspicious’ transactions (and more of them) to the FIU, it could also introduce a correspondingly lower quality for these reports (reporting less important or unreliable information) — an activity that called ‘defensive reporting’. According to Carrington and Shams (2006), defensive reporting is a product of the difficulty of finding the right balance between reporting entities meeting their reporting obligations and being a trustworthy partner by providing the FIU with reliable and high quality data on which to undertake its analysis.⁷⁶ Verhage (2009) indicates that banks should not be blamed for the large number of STRs they send or for their poor quality. Rather blame should attach to the FIU if (i) it fails to provide enough assistance to these entities to clarify the suspicious transactions for them, thus enabling them to clearly identify them; or (ii) the FIU utilises tough enforcement powers and harsh

⁷⁵ Lori Tripoli, ‘How Vigilant Should We Be Against Money Laundering?’ (2009) 13(4) *Gaming Law Review and Economics* 278, 279. Given the highly computerised nature of many on-line and other gambling transactions, he highly recommends sophisticated computerised monitoring of transactions for ST detection: at 285.

⁷⁶ Ian Carrington and Heba Shams, ‘Elements of an Effective AML/CFT Framework: Legal, Regulatory, and Best Institutional Practices to Prevent Threats to Financial Stability and Integrity’ (2006) (Paper presented at the Seminar on Current Development in Monetary and Financial Law, Washington, DC, 23–27 October 2006) 25. See <http://www.imf.org/external/np/seminars/eng/2006/mfl/cs.pdf> 25 September 2011.

sanctions for non-compliant reporting entities, thus making them fear error and so ‘over-report’.⁷⁷

However, instead of attempting to attribute blame, it would be better to take an appropriate regulatory initiative to solve the problem. Of particular interest is how to make the FIU more active in its relationship with reporting entities. By forming a close and strong relationship, the FIU can have greater opportunity to approach these entities and understand their workings, supervise them from a near distance and apply the most effective enforcement powers on non-compliant behaviour. Effective relationships could be formed in many ways (for example, building bridges between the FIU and the reporting entities through presenting awards to the best reporting entities of the year).

The responsibility for compliance with reporting obligations in the AML system is not only the responsibility of the reporting entities; it is also that of the FIU, which should ensure compliance by using the right tools where non-compliance arises. The reporting entities differ in size, history, type of work and culture; all of these factors should affect the way in which the FIU deals with semi or non-compliance. In this context, it is probably difficult to apply a high level of sanctions (such as licence revocation) on a non-compliant entity, especially if it is large because such an action may affect the economy by rendering many people unemployed and decreasing the value of investments in this business. That does not mean that the offending entity should go unpunished; several civil and criminal punishments could still be applied.

Thus, this thesis, from a review of the literature and available research, has come to observe that the FIU should not concentrate on adopting a purely cooperative style (in terms of soft sanctions) or take the opposite approach and be a tough regulator

⁷⁷ Verhage, above n 25, 108.

(applying harsh sanctions on non-compliant reporting entities). Rather, a more qualitative approach should be adopted, individually tailoring the approach on the basis of an examination of the FIU's findings on entity non-compliance, and how it can best operate its mechanism so as to ensure those entities comply effectively with their reporting obligations.

1.6.3.3 Obligations for AUSTRAC and the Current Enforcement Mechanism

By enacting the *Australian Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth)* (AML/CTF Act) (and its amendment in 2007), Australia has taken a step forward in the process of meeting international standards, including the standards set by the Financial Action Task Force (FATF). According to part 15 of this Act, the AUSTRAC CEO and AUSTRAC obligations to supervise the AML system entail (i) the requirement to monitor compliance by reporting entities with their obligations under this Act, the regulations and the AML/CTF Rules; and (ii) the responsibility to enforce compliance by prosecuting offences and seeking civil and criminal penalties, issuing remedial directions for reporting entities that have contravened civil penalty provisions, seeking injunctions, exercising powers of questioning, issuing notices to reporting entities, and accepting enforceable undertakings.⁷⁸

AUSTRAC clarified this in its enforcement policy, specifying its monitoring and compliance enforcement role. Persuasion and education are followed by several enforcement actions, including the prosecution of criminal offences, imposition of civil penalties, issuing of infringement notices, remedial directions, injunctions, accepting

⁷⁸ *Anti Money Laundering and Counter Terrorism Financing Act 2006 (Cth)* pt 15, divs 1–9. For text, see Australian Government, 'ComLaw' website.

enforceable undertakings, notices to take ML and TF assessment, and notices to undertake external audits and compliance monitoring.⁷⁹

As AML and the Financial Action Task Force (FATF) are two faces of the same coin, one of FATF's concerns is the evaluation of the AML systems of member countries, including Australia. When FATF examined AUSTRAC in its 2005 Mutual Evaluation report, AUSTRAC's enforcement mechanism was an aspect that attracted criticism. The Report identified Australia as partially compliant with recommendation 29, noting that 'AUSTRAC's powers of enforcement and AML/CTF sanctions exist but are limited to criminal sanctions and hence rarely applied; there is a need to institute a regime of administrative penalties'.⁸⁰ Recommendation 29 makes it clear that the FIU should apply adequate enforcement powers for non-compliant behaviour:

Supervisors should have adequate powers to monitor and ensure compliance by financial institutions with requirements to combat money laundering and terrorist financing, including the authority to conduct inspections. They should be authorised to compel production of any information from financial institutions that is relevant to monitoring such compliance, and to impose adequate administrative sanctions for failure to comply with such requirements.⁸¹

In fact, AUSTRAC's enforcement mechanism relies on persuasion, education and on-site visits. This is clear in the annual reports that it has issued from the year it was established (1989) until its most recent annual report (2010/11). The content of the FATF recommendation (above) and the application of Braithwaite's theory to the use of AUSTRAC's enforcement mechanism reveals that AUSTRAC is not using its enforcement powers as it should. (See Figure 5, below.)

⁷⁹ AUSTRAC, *AUSTRAC Enforcement Policy*, above n 14, 4.

⁸⁰ FATF, Third Mutual Evaluation Report, above n 15.

⁸¹ *Ibid.*

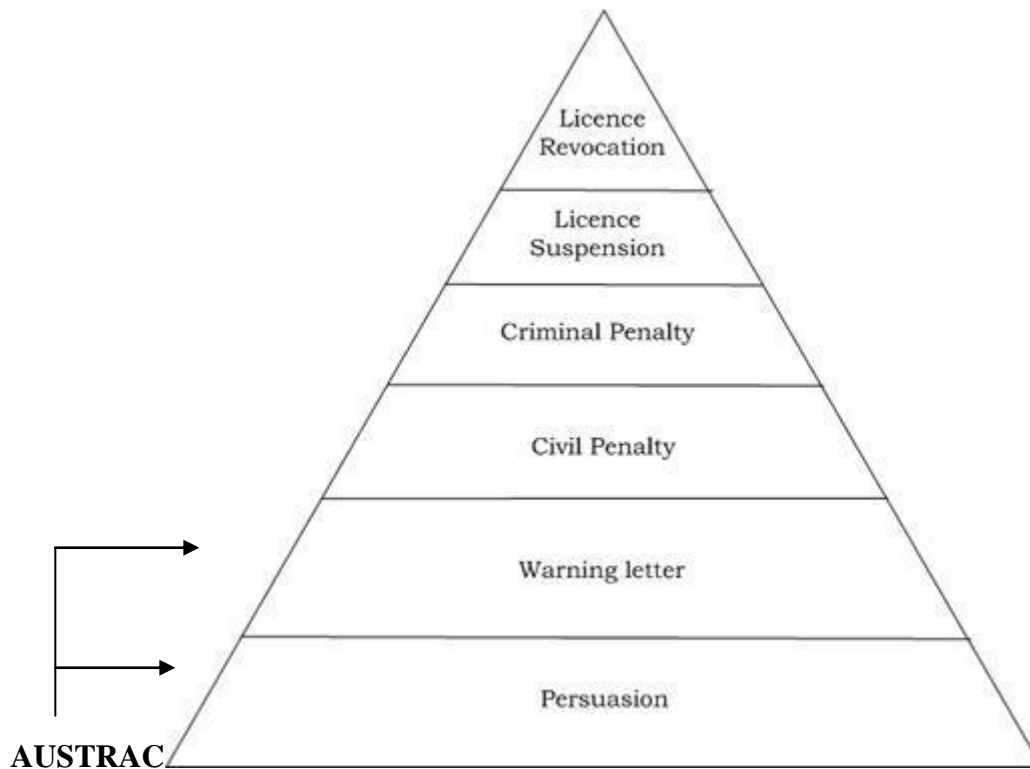


Figure 5: AUSTRAC's Limited Use of Braithwaite's 'Enforcement Pyramid'

Looking at AUSTRAC's enforcement policy, or the theory of Braithwaite or any other theorist who is concerned with enhancing the system to achieve the goal of strategic regulation, it is there recommended that enforcement tools be adequate and proportionate to the breach that has occurred. When the regulatory agency does not adequately fulfil this obligation, then there is a problem that needs to be addressed.

Yet examining the diagram above, which illustrates AUSTRAC's partial use of the Braithwaite enforcement pyramid and therefore limited use of the tools at its disposal, it can be seen that AUSTRAC is applying a cooperative system in dealing with non-compliance and has chosen soft sanctions even in the longer term. Indeed, AUSTRAC's approach is based on acceptance of the view that it is better for both the regulator and regulated to start at relatively low intensity interventions with relatively low costs.

Crucial questions arise:

- (i) Why does AUSTRAC not use its available enforcement powers as it could? There might be a number of reasons, including RBA, regulatory capture, pre-existing legal and political institutional framework, and avoiding the problem of reporting entities ‘crying wolf’ and defensive reporting.
- (ii) How does AUSTRAC perceive its approach to enforcement and the methods it uses to ensure compliance?
- (iii) How does AUSTRAC deal with non-compliant entities, and how do these entities perceive AUSTRAC’s enforcement mechanism?

1.6.3.4 Most Effective and Adequate Enforcement Mechanism Will Lead to a Strong Reporting System

In earlier debate, scholars put forward a number of ideas about the affects of the FIU enforcement mechanism on the AML reporting system, and the challenges that face the use of the FIU’s enforcement powers on non-compliant reporting entities. However, there is no indication in the literature as to how the Australian FIU, AUSTRAC, could or indeed should improve its enforcement mechanism for reporting obligation non-compliance. The thesis will focus on and explore this area. As explained earlier, there are no fixed standards for enforcing compliance; each country follows its own system in regard to its FIU’s application of its enforcement powers, with some of them applying soft sanctions and following a cooperative system, and others applying harsh sanctions. However, a strong reporting system will never be instituted without the most effective and adequate enforcement mechanism being in place in accordance with a country’s

enforcement policy. AUSTRAC has its own enforcement policy which provides AUSTRAC with the ability to apply soft and harsh sanctions.

The literature review has identified a few common enforcement/compliance issues regarding AML reporting obligations; they could be a primary means of assessing the enforcement mechanism when we look for ‘most effective and adequate enforcement powers’ in relation to reporting obligation non-compliance. But the key issue is to identify the ideal set of attributes that will prescribe the enforcement mechanism in the AUSTRAC context, and this is what this thesis will do. However, should Braithwaite’s theory be a benchmark, given that in the AML field it is not adequate in every respect? Should AUSTRAC then examine the best practice of other countries’ FIUs and that of other local partner agencies to learn from their experiences in enforcing compliance before adopting an amended regime? If so, which countries and local agencies should be examined? Australia has its own AML system. Although other countries’ different political and economic systems will affect the way they deal with compliance issues, a comparison could prove valuable. And while the nature of AUSTRAC’s type of work differs from that of its partner agencies, making it difficult to judge how AUSTRAC should utilise its enforcement powers, nevertheless consideration of all the above aspects is important to gain an understanding of the strength and weaknesses of the AUSTRAC enforcement mechanism, and how it should be constructed to best deal with non-compliance regarding reporting obligations.

Therefore, this thesis will consider the previously reviewed literature that indicates that AUSTRAC should adopt a more qualitative approach when it establishes its findings on non-compliance by the different reporting entities (reporting entities are various and have different sizes, natures and type of businesses they provide). In considering all the

above, this thesis will clarify the theory that will reflect the core and sub-core problems that will be built on the outcome of the research conducted using qualitative methodology. This will identify the ideal set of attributes that will prescribe the enforcement mechanism in the AUSTRAC context, an enforcement mechanism that will ensure that those entities make their best efforts to comply effectively with their reporting obligations.

1.7 The Methodology

The thesis will discuss AUSTRAC's enforcement mechanism and critically evaluate the factors that influence its enforcement decisions that stem from that mechanism. A theoretical approach is needed to evaluate AUSTRAC's strengths and weaknesses in dealing with enforcing compliance. A number of AUSTRAC publications, including annual reports, typologies and case studies reports, and its surveys series will be analysed for relevant statistical data and to determine entity self-perceptions.

After building the theoretical framework, the thesis will take a practical approach through the collection of empirical data (via interviews) with staff from a number of reporting entities, whose contributions would be helpful in this stage.

It will then analyse the findings and compare these with the outcomes of the examination of the AUSTRAC publications. This will determine if there is a contrast between 'what AUSTRAC says' (that is, its operations in theory) and 'what AUSTRAC does' (its operations in practice), or not. This thesis will then conclude by making what the researcher hopes will be some useful recommendations.

1.7.1 The Approach: Development of a Theoretical Framework

Firstly, the thesis will develop a theoretical framework. This will be divided into two main areas. In the first part, it will examine the FIUs of other countries and the application of their enforcement mechanism in regard to non-compliance with AML reporting obligations. Also examined will be the enforcement mechanisms of other Australian regulatory agencies' (partner agencies to AUSTRAC in combating ML crimes) and the use of these mechanisms against non-compliant behaviour. The countries selected for comparison purposes are the United States and the Netherlands, and the partner agencies selected are the Australian Securities and Investments Commission (ASIC), the Australian Competition and Consumer Commission (ACCC) and the Australian Prudential Regulation Authority (APRA). The thesis will particularly scrutinise their use of enforcement powers. These international and national comparisons will serve to highlight a number of aspects of the topic and reveal factors that could affect the strength and weaknesses of their mechanisms. Their experiences can be compared to that of AUSTRAC. The discussion of other Australian partner agencies' enforcement mechanisms will be underpinned by the *Enforcement Pyramid* theory of John Braithwaite and Ian Ayres.

The thesis will clarify the concept of the enforcement pyramid, and seek to determine whether it really provides a model solution to the non-compliance problem or whether it is a part of the problem. What it is clear from previous discussion is that the enforcement pyramid theory does not explain why AUSTRAC does not take further action in enforcing compliance. Therefore, the thesis will test, amongst other things, whether the use of the enforcement mechanism by AUSTRAC is consistent with its desired regulatory outcomes. The thesis will examine whether the enforcement pyramid

theory of Braithwaite is a useful basis for measuring how well AUSTRAC operates in enforcing compliance.

After establishing the theoretical framework, the thesis will develop the concept by analysing a case study. The thesis will select one enforcement sanction, the civil penalty that AUSTRAC could apply in non-compliance area to determine the response of AUSTRAC in applying such sanctions.

In this regard, the experience of other partner agencies that apply the same sanction and deal with it more commonly than AUSTRAC will be closely examined. By comparing the AUSTRAC experience in this domain with that of other partner agencies, the case study will help to illustrate successful regulatory approaches in applying the enforcement mechanism on non-compliant actions and enable some identification and evaluation of the reasons for regulatory strengths and weaknesses in this field.

The main criteria for the selection of the civil penalties as a case study were:

- AUSTRAC has the right to apply this sanction as do other partner agencies on entities for non-compliant activities.
- Partner agencies — including ASIC, ACCC — have used this type of sanction in their enforcement powers. However, they have yet to apply it for AML failings as they would say they have no role. According to the FATF Mutual Evaluation Report (2005):

APRA and ASIC have wide-ranging powers to remedy breaches of their relevant legislation, which apply to entities as well as their directors and officers (e.g. senior management). Powers include the ability to compel specific remedial actions, disqualify persons for management or directorship functions, and revoke a license or authorisation to operate. Australia notes that these powers would apply for non-compliance with the *FTR Act* if the breach created risks or breaches relevant to APRA's and ASIC's legislation. However, it was unclear to the evaluation team

how these would be applied in practice, as there are no express powers to remove management or revoke a license for a breach of AML/CFT requirements. No sanctions have yet been applied by APRA or ASIC for AML/CFT failings.⁸²

- Information should be available from a number of studies to illustrate the experience of other agencies in this area, and on the websites of the respective agencies as well as that of AUSTRAC.

Secondly, the thesis will look at AUSTRAC's enforcement mechanism in depth and address the role and function of AUSTRAC, and how AUSTRAC says it measures its effectiveness in the field of the enforcement mechanism through its publications.

1.7.2 Data Resources

The data resources of this thesis will take into consideration primary and secondary resources:

1.7.2.1 Primary Materials

In order to answer the thesis question, and to obtain the data that are needed, a number of different resources are required, particularly resources that can inform and inspire the qualitative research thesis. Thus, primary resources and secondary resources are necessary to construct the practical approach of the thesis.

Primary Material A:

For the purpose of this thesis, interviews have been used as a first main methodology to collect this thesis's primary data. Recordings have been made and transcripts prepared

⁸² FATF, Third Mutual Evaluation Report, above n 15, 10.

and saved on a secure computer during the data analysis process, in accordance with the rules of the ethics committee at the University of Wollongong.⁸³

Initially the researcher planned to interview (face to face or via telephone) a number of staff from both reporting entities and AUSTRAC and its partner agencies. However, this proved impossible as a number of partner agencies and law enforcement bodies (including the Australian Federal Police (AFP), the Independent Commission Against Corruption (ICAC), the Australian Taxation Office (ATO), and the Australian Crime Commission (ACC)) refused to participate due to claimed privacy issues and other concerns.

The researcher also tried repeatedly and over a prolonged period (four months from June to October 2010) to convince AUSTRAC to participate in the interview process. Both the researcher, and his main supervisor Professor Broome, contacted AUSTRAC a number of times via email in an attempt to secure their cooperation. After some delay, they decided not to accept the invitation to participate in the interview process due to privacy issues and concerns. Thus, the researcher relied on their publications (frequently available online) as a source of information regarding their activities and their perceptions regarding their operations and to compare these with the responses obtained from reporting entities' interviews.

The interviews conducted therefore targeted reporting entities from different categories:

⁸³ To facilitate this matter and meet Australian requirements in relation to research involving participants, the researcher undertakes to adhere to the rules of the University of Wollongong by making an application to the relevant accredited Human Research Ethics Committee, in regard to the conduct of interviews, supplying questions and other documentation as required (eg, participant information and consent forms) in order to obtain the approval to carry out the necessary interviews (either face to face wherever practicable, or by telephone if this is not possible). I undertook to follow guidelines for this process which are available at the UOW website:<<http://www.uow.edu.au/research/rso/ethics/human/index.html>>.

- A number of small, medium and large financial institutions in Australia, with interviews conducted with a number of managers and employees from the Risk Management Compliance Departments of these institutions
- A number of managers of legal firms (lawyers), licensed accountants and licensed real estate agents.

Primary Material B:

The second main reliable methodology adopted to enable the researcher to add to the above data was his attendance of workshops and seminars that highlighted AML issues and AUSTRAC performance in this domain. This was to help (to some extent) offset the researcher's inability to interview personnel from AUSTRAC or its partner agencies and enforcement bodies.

The researcher is also a regular visitor to the Forensic Accounting Committee at the Certified Practicing Accountants (CPA) Australia⁸⁴ and has a close relationship with its members, and is a member of the Association of Certified Anti-Money Laundering Specialists⁸⁵ (ACAMS) Australasian Chapter and CPA Australia. Members of these committees were happy to help the researcher with the data collection process, either by

⁸⁴ CPA Australia is one of the world's largest accounting bodies with a membership of more than 129,000 finance, accounting and business professionals across the globe, and it works together with the regulators, industries, academia and the general public. Although dating back to the 19th Century, the current name of the organisation, CPA Australia dates from April 2000. For the approximately 10 years prior, the society had been known as the Australian Society of Certified Practising Accountants: see CPA Australia website <<http://www.cpaaustralia.com.au/cps/rde/xchg/cpa-site/hs.xsl/about-organisation-history.html>> at 5 October 2011.

⁸⁵ See ACAMS at <<http://www.acams.org/ACAMS/ACAMS/About/AboutACAMS/Default.aspx>> at 5 October 2011. ACAMS is the leading organisation for AML professionals and the 'provider of the Certified Anti-Money Laundering Specialist® (CAMS) credential – the most respected certification in the industry'. ACAMS mission is: 'to advance the professional knowledge, skills and experience of those dedicated to the detection and prevention of [ML] around the world, and to promote the development and implementation of sound [AML] policies and procedures ... through: Promoting international standards for [ML and TF] detection and prevention ...; [e]ducating professionals in private and government organizations about these standards and the strategies and practices required to meet them; [c]ertifying the achievements of its members;[and] [p]roviding networking platforms through which AML/CTF professionals collaborate with their peers throughout the world.'

introducing the researcher to the reporting entities to facilitate interviews, or by inviting the researcher to workshops and seminars that proved to be fruitful sources of data. Using reliable institutional sources like the CPA and ACAMS as a source of data in this field gives credibility to the data obtained and a status and value to this material which helped to achieve the aim of this thesis.

1.7.2.2 Secondary Materials

Secondary data resources used in this thesis are diverse. They included:

- a) Books, journals, articles, academic reports, conferences papers
- b) Relevant Australian legislation and regulations, and some related legislation and regulations for some other countries, such as the USA and UK.
- c) FATF documents and the FTAF website; websites of Australian government and regulatory agencies, including AUSTRAC, ASIC, APRA and ACCC; and the websites of international firms, and convention websites.
- d) Official reports of the regulatory agencies; such as their annual reports, policies and Memoranda of Understanding; the financial institution policies and plans.

1.7.3 Data Analysis

This thesis relied on the Constant Comparative Method, also known as ‘Grounded Theory’ and aimed to secure reliable results and outcomes from the collected information.

What is Grounded Theory and how does it work?

Grounded Theory is a research technique that starts from a very indistinct preliminary question/s and allows the theory to come from the data. Therefore, this approach is not

about identifying and examining hypotheses; rather, it is more about the analysis of responses elicited from interviewees or other data and ‘reading between the lines’ of the phenomena to discover and generate a theory that is grounded in the data.⁸⁶

The process begins with data collection, which is achieved through a range of methods (for example, interviews or surveys). In terms of interviews: interviews are recorded, and the recordings then transcribed. This is a preliminary to the first step. The main ideas in the transcripts are then highlighted using a number of main *codes* which will themselves emerge from the transcripts. ‘Open Coding’ is the initial stage of coding when the researcher codes all information collected during fieldwork, through interviewing and literature review. The researcher constantly compares incident to incident in order to assist emergence of concept, and when a concept emerges then it is compared incident to concept, and categories are thereby generated.⁸⁷ The Open Coding stage will arrive at codes that will fit into similar *concepts* in order to make them more practicable. This is the ‘Axial Coding’ stage. The collected concepts then go through another filtering process to *categories*. These then go through ‘Selective Coding’, where a core category is established and other categories related to it. These categories form the source of the establishment of a *theory* for the thesis.⁸⁸

⁸⁶ Anselm Strauss and Juliet Corbin, *Basics of Qualitative Research: Techniques and Procedures for Developing Grounded Theory* (Sage, 3rd ed, 2008) 23.

⁸⁷ Barney G. Glaser, *Basics of Grounded Theory Analysis* (Sociology Press, 1992) 38–9.

⁸⁸ George Allan, ‘A Critique of Using Grounded Theory as a Research Method’ (2003) 2(1) *Electronic Journal of Business Research Methods* 1. See also Strauss and Corbin, n 83 above, 102–103.

Is 'grounded theory' a reliable source and approach?

Grounded theory is now by far the most common and popular analytic technique for qualitative research and has become extremely popular in a number of academic research fields, including law and legal studies.⁸⁹

Grounded theory has long been used. Its roots can be found in the work of Charles Cooley and George Herbert Mead between 1863 and 1931.⁹⁰ However, more systematic procedures for grounded theory were provided by Glaser and Strauss in 1967. Grounded theory then became more common and two variations developed:⁹¹

- 1 The first was Strauss and Corbin's grounded theory in *the Basics of Qualitative Research* (Strauss and Corbin 1990). In this version the grounded theory method has been reworked to incorporate a strict and complex process of systematic coding.
- 2 The second was Glaser's grounded theory in *The Discovery of the Grounded Theory* (Glaser and Strauss 1967). He argued that the theory should clarify the phenomena.

These two variations differ in many respects:⁹²

- 1 In the research questions: While Strauss and Corbin rely on a statement that identifies the phenomenon to be studied, Glaser relies on two main questions: What are the main problems/concerns that citizens are facing in the area of the thesis, and what category does the concern point to?

⁸⁹ Ibid 1.

⁹⁰ Christina Goulding, 'Grounded Theory: Some Reflections on Paradigm. Procedures and Misconceptions' (Working Paper No WP06/99, University of Wolverhampton, 1999) 5–6.

⁹¹ Ibid 7.

⁹² Helen Health and Sarah Cowley, 'Developing a Grounded Theory Approach: A Comparison of Glaser and Strauss' (2004) *International Journal of Nursing Studies* 41, 145–9.

- 2 In processes: While the Strauss and Corbin's methodological process is easy to apply, Glaser's is more difficult.
- 3 In how concepts are generated: While generating the concepts after Strauss and Corbin will reflect a phenomenon that will lead with its concepts to the theory, generating the concepts after Glaser is more complicated as it links the concepts according to their relationships with each other to clarify and interpret the differences in the outcome in the area of the thesis.
- 4 In producing the theory: While Strauss and Corbin keep the testing and examination of the concepts and their relationship with each other as a key element to establish and produce the theory, Glaser's methodology is more about establishing a verity of theoretical hypotheses without making any effort to test the concepts.

Strauss and Corbin's version is becoming the most popular and widely used method, and this thesis follows their perspective.

In order to examine the actual scenario of the AUSTRAC enforcement mechanism, the interview questions were designed to examine the Australian AML system and to evaluate AUSTRAC's enforcement mechanism regarding non-compliance with reporting obligations. A total of nine respondents were interviewed: five representing four groups of reporting entities (including major banks, trustees and executor services institutions, investment and superannuation institutions, and bookmaker and betting institutions); and four representing two non-reporting institutions (including accountants and real estate agents who will be obliged under the second tranche of the AML Act to carry out the reporting obligations).

The structured interviews were conducted over a flexible period of time for each interview, ranging from 25 to 90 minutes, with an average length of 50 minutes. All were conducted in or from Sydney (Australia) in 2010 and comprised three telephone interviews (two entities from Melbourne, one from the Northern Territory) and six face-to-face interviews.

The interviews began with more general questions to gauge the interviewees' behaviours regarding AML policies and practices, then moved to more relevant questions which became the basis for more specific questions that did not need to be prepared in advance. These questions covered the reporting entities' understanding of their role under the AML Act and Rules, including customer identification and verification as well as customer due diligence (CDD). The questions then turned to the RBA and the AML training and the reporting entities' viewpoints on these issues, followed by questions about the transaction monitoring processes and the reporting obligations of these entities. The questions were designed to discover the feasibility of the AML Act and Rules as well as these entities' behaviours in regard to their reporting obligations and AUSTRAC feedback on these reports. The questions then centred on AUSTRAC's enforcement powers and its mechanism regarding this issue and AUSTRAC's operational transparency, as well as the reporting entities' experiences in this domain. Finally, the interviewees were asked to supply suggestions and advice to AUSTRAC with the aim of eliciting and coming to an understanding of their deep reactions and the overall viewpoint of these entities about the AML system in general and AUSTRAC's work and enforcement mechanism in particular.

Among the advantages offered by interviews and the use of Grounded Theory include the wealth of information able to be obtained and the opportunity for contributions from

participants in response to open-ended questions. In some instances this may lead to unanticipated avenues of research or theorising that may arise organically from the data rather than from the presuppositions of a researcher. Patterns of key words give rise to concepts which can coalesce to form one or more primary concerns and associated repeated observations. This in turn can give rise to a theory that reflects the patterns observed in the phenomena being examined.

Answers to interview questions go through the three levels of analysis in accordance with constant comparative method of ‘grounded theory’ outlined above, namely:

- 1 Open coding.
- 2 Axial coding.
- 3 Selective coding.

After the open coding and axial coding process are applied to the data collection, selective coding is used to identify the core categories. The core problematic area arises from those categories. Selective coding means ceasing other forms of coding that came prior to this stage and delimits coding to variables closely related to the core category.⁹³

After the selective coding a core category or categories emerge through data analysis.

In terms of this thesis, these core categories revealed the core problematic area which is that: ‘AUSTAC is facing challenges in applying most effective enforcement mechanism’. These challenges (as manifested in the interviewee responses) are related to AUSTAC’s incapability of applying the most effective enforcement mechanism on entities that are non-compliant in regard to their reporting obligations. The thesis has

⁹³ Glaser, above n 87, 75.

observed the core categories that revealed the core problem area (as discussed in Chapter 6 of the thesis), including:

- 1 AUSTRAC's lack of experience and capacity.
- 2 Australia's AML system was not ready for the risk-based approach, and AUSTRAC is struggling to apply the risk-based approach to regulated entities.
- 3 Lack of efficiency in AML training for both reporting entities and AUSTRAC employers.
- 4 Disengagement in the relationship between AML parties.
- 5 AUSTRAC enforcement powers are still to fully mature.
- 6 AUSTRAC: Underachievement of its Guiding Principles which leads it to appear to be subject to influence during the Global Financial Crisis.



Figure 6: The Core and Sub-core Problematic Areas (the Outcome of the Selective Coding Stage)

From these analysed concepts, this thesis was able to derive its theory which requires finding the main attributes that AUSTRAAC needs to consider as solutions that will help it to achieve an active, adequate and most effective enforcement mechanism on non compliant reporting entities, namely:

- 1 There should be different and actively used sanctions in place to be applied in response to non-compliance.
- 2 There should be concord and agreement between the main regulator of the field and its partner regulatory agencies, and also between the regulators and the regulated entities to comply with the regulation.

- 3 There should be unquestioned legislation and regulation essential for a successful enforcement mechanism.
- 4 The regulatory agency must avoid regulatory capture, and not draw away from its responsibilities due to political pressure or economic problems.

This thesis will work to reflect the Australian AML's experience and AUSTRAC operations and enforcement mechanism in relation to this theory to find out to what extent it succeeds in considering and addressing the above attributes, to be able to answer the main question of this thesis which is:

What are the strengths and weaknesses of AUSTRAC's enforcement mechanism with regard to non-compliance with reporting obligations under AML Act?

2 CLARIFICATION OF MONEY LAUNDERING

2.1 Introduction

Money laundering (ML) is one of the most serious crimes involving financial systems worldwide. Although no-one has been able to determine exactly when this criminal practice began, it is clear that ML was used by the Mafia in the United States, Italy and Russia during the 20th century, and was among their range of illegal activities, such as drug trafficking, gambling, prostitution, ‘protection’ rackets and similar profitable criminal activities. The traditional way to ‘clean’ the mafia’s ‘dirty’ money was by buying apparently legitimate businesses and mixing the money derived from criminal activities with the legitimate earnings from new businesses.⁹⁴

Most countries started to deal with ML crime in the late 1980s, making every effort to curb this offence, and curtail the sources of illegitimate earnings (such as drug trafficking, human trafficking, political corruption, and fraud) and interrupt terrorism financing (TF).⁹⁵ The goal was the prevention of the laundering of huge amounts of ‘dirty’ money — indeed some estimate that the industry involves about USD1 trillion annually around the world.⁹⁶

ML has a multiplicity of harmful influences on the world. It impairs a State’s economy and sovereignty, diffusing through the economy under the cover of financial institutions’ legitimate activities. Today the use of sophisticated technology in banking

⁹⁴ Joseph D Serio, 'Fueling Global Crime: The Mechanics of Money Laundering' (2004) 18(3) *International Review of Law Computers & Technology* 435–4. In the 1920s and 1930s, Al Capone and other Chicago gangsters evaded taxes by failing to declare income from illicit sources as a way to launder their illicit gains, and they were prosecuted for doing so.

⁹⁵ Laura S Newland, 'Money Laundering' (2008) 45(2) *American Criminal Law Review* 741.

⁹⁶ J D Agarwal and Aman Agarwal, 'International Money Laundering in the Banking Sector' (2004) 18(2) *Finance India* 767.

provides additional ML opportunities. Electronic banking and associated cards, for example, are an extra source of risk in relation to the laundering of illicit gains.⁹⁷

Money launderers have directed their activities at financial institutions as the most important channel for their operations. Such institutions are utilised for transferring the funds to be laundered from one place to another, both within countries and across the world. Therefore, money launderers depend on being able to take advantage of the development of financial institutions and regulations. International money markets also provide a further avenue for exploitation.

This chapter identifies ML crimes and highlights the international achievements in combating such harmful illicit activities.

2.1.1 Money Laundering: The Definition

Obviously, there is no one simple way to identify and thereby characterise and define ML activities. Efforts have been made by scholars and governments to ensure that there is an appropriate definition. Scholars in their research and governments in the formulation of their policies and laws have become increasingly more able to describe ML accurately.

Large numbers of old as well as more recent empirical studies have shown considerable variation in the development of a comprehensive definition of ML activities. For example, a number of scholars (such as Savona (1997)) define ML as an activity undertaken to conceal the illicit source of money.⁹⁸ Reuter and Truman (2004) similarly define it as a method used to convert criminal proceeds into assets, the origins of which

⁹⁷ Mohammad AlRashdan, above n 42, 10.

⁹⁸ Ernesto U Savona (ed), *Responding to Money Laundering: International Perspectives* (Harwood Academic, 1997) 3.

cannot later be traced.⁹⁹ Hopton (2006) also points out that any ML activity is a process to hide the original proceeds of criminal activities.¹⁰⁰ Newland (2008) identifies ML as a process to conceal the existence of unlawful funds, or unlawful application of income, and disguising that income to make it appear lawful.¹⁰¹

Many jurisdictions have sought to identify and thus define ML activities. For instance, the US *Money Laundering Control Act 1986* (MLCA), reflects a belief that ML activity has two elements: financial transactions, and specified unlawful activities. According to this Act, an ML activity is an illegal practice to conceal the identity, source, or destination of the illicit gains (Madinger 2006).¹⁰² On the other hand, in the United Kingdom jurisdiction,¹⁰³ particularly under the *Proceeds of Crime Act 2002* (UK), ML is defined in such a way that it involves not only traditional ML by third parties on the behalf of the offender, but also the possession by criminals of their own proceeds of criminal activity.¹⁰⁴ Thus, in the UK, ML is an action involving property in any form

⁹⁹ Reuter and Truman, above n 33, 1.

¹⁰⁰ Doug Hopton, *Money Laundering: A Concise Guide for All Business* (Ashgate, 2006), 1.

¹⁰¹ Newland, above n 95, 741.

¹⁰² John Madinger, *Money Laundering: A Guide for Criminal Investigators* (Taylor and Francis, 2nd ed, 2006) 20. According to the *Money Laundering Act of 1986*, Title 18, Part I, Chapter 95 §1956. Laundering of monetary instruments (a):

(1) Whoever, knowing that the property involved in a financial transaction represents the proceeds of some form of unlawful activity, conducts or attempts to conduct such a financial transaction which in fact involves the proceeds of specified unlawful activity

(A)(i) with the intent to promote the carrying on of specified unlawful activity; or

(ii) with intent to engage in conduct constituting a violation of section 7201 or 7206 of the Internal Revenue Code of 1986; or

(B) knowing that the transaction is designed in whole or in part

(i) to conceal or disguise the nature, the location, the source, the ownership, or the control of the proceeds of specified unlawful activity; or

(ii) to avoid a transaction reporting requirement under State or Federal law, shall be sentenced to a fine of not more than \$500,000 or twice the value of the property involved in the transaction, whichever is greater, or imprisonment for not more than twenty years, or both.'

¹⁰³ Money laundering legislation in the UK is governed by:

(a) Three Acts of primary legislation:-

(i) Terrorism Act 2000

(ii) Anti-Terrorist Crime and Security Act 2001

(iii) Proceeds of Crime Act 2002

(b) Secondary regulation provided by the Money Laundering Regulations 2003 and those of 2007.

¹⁰⁴ Peter Alan Sproat, 'An Evaluation of the UK's Anti-money Laundering and Asset Recovery Regime' (2007) 47(3) *Crime Law Social Change* 169.

(money, property, goods, and so forth), which is either wholly or in part the proceeds of a crime. This reflects the reality of the various uses of funds that are originally criminal proceeds.

However, the Australian jurisdiction has another approach to identifying ML activities. The *Anti Money Laundering and Counter Terrorism Finance Act 2006* (Cth) has adopted the meaning of ML appearing in the *Criminal Code Act 1995* (Cth).¹⁰⁵ Thus, ML has been defined as a criminal activity occurring when money or property that are the proceeds of crime are used or when there is a risk that money or property will become an instrument of crime.¹⁰⁶

Therefore, a number of objectives for money launderers can be found in most definitions of ML activities:¹⁰⁷

- a) Money launderers are always attempting to disguise their true identity.
- b) Money launderers disguise property ownership.
- c) Money launderers are attempting to distance themselves from the property they are about to launder.

¹⁰⁵ According to the introduction of the *Australian Anti Money Laundering and Counter Terrorism Financing Act 2006*, pt 5: Definitions, money laundering is defined as:

‘...conduct that amounts to:

- (a) an offence against Division 400 of the Criminal Code; or
- (b) an offence against a law of a State or Territory that corresponds to an offence referred to in paragraph (a); or
- (c) an offence against a law of a foreign country or of a part of a foreign country that corresponds to an offence referred to in paragraph (a).’

¹⁰⁶ Through the *Criminal Code Act 1995* (Cth), and especially in Division 400 section 2, money laundering has been defined as a crime:

‘(1) For the purposes of this Division, a person deals with money or other property if:

- (a) the person does any of the following:
 - (i) receives, possesses, conceals or disposes of money or other property;
 - (ii) imports money or other property into, or exports money or other property from, Australia;
 - (iii) engages in a banking transaction relating to money or other property; and
- (b) the money or other property is proceeds of crime, or could become an instrument of crime, in relation to an offence that is a Commonwealth indictable offence or a foreign indictable offence.’

¹⁰⁷ Kenneth Kaoma Mwenda, *Combating Financial Crime: The Legal, Regulatory, and Institutional Frameworks* (2006) 32.

Thus ML is disguising the true nature of the illegal funds or other property (its source, identity, the destination and/or application of income) which has been obtained from criminal activities, by hiding the actual source of the economic goods and making it appear legitimate fund. It is important to understand that ‘dirty money’ after laundering looks ‘clean’, but it will never be so, whatever processing it undergoes or whatever form it adopts. Moreover, it must be strongly emphasised that such activities are crimes and need to be prevented. Most importantly it should be known that such activities are being prosecuted under the criminal law in most jurisdictions with criminal proceeds also available post-conviction. In some jurisdictions, the criminal proceeds are subject to confiscation under civil law using a system of ‘civil recovery’ where illicit gains are confiscated without the need for a criminal conviction.¹⁰⁸

2.1.2 Money Laundering: The Cycle

It has been clear that ML activity takes some time and involves a number of procedures to complete the process. Indeed, the ML process may take several stages. Most scholars, though not all, characterise ML as being comprised of three stages:¹⁰⁹

- 1 Placement: money or other economic goods obtained from illegal activities are initially placed into the financial sector and its systems (for instance, by opening a new bank account).
- 2 Layering: monies obtained from criminal activities are separated from the true ‘dirty’ sources and the disguising process is begun by creating complex layers of

¹⁰⁸ See, eg, Crown Office and Procurator Fiscal Service, ‘Proceeds of Crime Recovers Record Amount’ (Media Release, 27 June 2011) <<http://www.copfs.gov.uk/News/Releases/2011/06/Proceeds-Crime-recovers-record-amount>>. Where reference is made to over GBP 9 million recovered by the Civil Recovery Unit (no criminal conviction required). GBP 16.5 million was also recovered from those criminally convicted.

¹⁰⁹ Savona, above n 98, 23–7.

financial transactions designed to disguise or obscure the audit trail and provide anonymity.

- 3 Integration: money is combined into the financial system and integrated with other assets in the system. By this stage, it is extremely difficult to differentiate between legal and illegal assets. For example, the transfer of money through an electronic funds transaction to a lawful bank from a bank owned by the launderers. ('Shelf banks' are purchased without any trouble in many tax havens.)

Thus, according to these scholars, ML needs to go through a cycle of three stages. Moreover, these stages complement each other and occur in sequence.

Some scholars, however, have an expanded view of the stages of ML. According to Broome (2005), such activities are more sophisticated than previously thought. He argues that in addition to the three stages commonly described above, there are three more stages crucial to the description of the whole ML process. The six stages he believes are: 'Creation', 'Consolidation', 'Placement', 'Layering', 'Integration', and 'Realisation'.¹¹⁰

In the 'Creation' stage, ML activity originates in criminal activity (such as drug trafficking) that produces the 'dirty' profits. 'Consolidation' follows, where criminals combine illicit proceeds obtained from different criminal sources in such a way that the criminals are safe from (or at least at reduced risk of) arrest and prosecution. 'Placement' follows where the 'dirty' profits are placed in the financial system (for example, in newly-opened accounts). The next stage is 'Layering' and involves using the 'dirty' profits from sources, and includes the purchase and sale of investment

¹¹⁰ Broome, above n 3, 168–71.

instruments, where the initial investment of illicit proceeds had been placed. Moving on to the 'Integration' stage, the money which has been laundered, is inserted for a second time into the financial system as a lawful income. Finally, the 'Realisation' stage is the invariable outcome; money that was unlawfully produced now permeates the financial system and flourishes.

Such a comprehensive analysis of the money-laundering process (dividing and categorising the ML process) has three notable results:

- 1 Greater descriptive capacity: especially when the full length and breadth of the trail of the criminal process is covered, from the originating criminal activity or 'mother crime' to the final goal of the launderer receiving the benefits of the criminal proceeds.
- 2 Greater importance placed on description: by including the crime that created the original 'dirty' profits, not just the ML process.
- 3 More realistic representation: by reflecting the real nature of ML and the funds laundered both at origin and process end (that is, the status of criminal activity adheres to funds and other property even after the ML process is completed).

In conclusion, ML activities are associated with highly organised criminal behaviour, and involve six complicated stages. They are generally hard to trace. Every effort needs to be made to raise awareness of this crime, and to combat, to curb and finally to eliminate it. This involves both national and international efforts at a number of levels, including that of government.

2.2 Global Conventions and Initiatives against Money Laundering

Most countries have taken steps to combat ML through their participation in a number of well-designed international measures designed to prevent these activities.

2.2.1 United Nations Initiatives

UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances – the Vienna Convention (1988)

In 1988, the UN Conference for the Adoption of a Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances was held in Vienna.¹¹¹ It produced one of the most important UN conventions in terms of its inclusion of ML.¹¹² The Convention addresses the issue of proceeds of crime, making ML a transnational crime, and encouraging international efforts to combat it.¹¹³

The Convention came to effect in 1990 and has been ratified by a number of countries including the 13 member countries¹¹⁴ of the International Narcotics Control Board (INCB).¹¹⁵ The INCB was calling for comprehensive international cooperation, regulation and law enforcement to combat drug trafficking as well as ML crimes. It

¹¹¹ *United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances* opened for signature 20 December 1988, E/CONF 82/15, (entered into force on 11 November 1990) ('Vienna Convention' (1988)). The Vienna Convention is one of three basic drug control conventions currently in force. The remaining two are the *Single Convention on Narcotic Drugs* (1961) and *Convention on Psychotropic Substances* (1971). For full text of the Vienna Convention, see UNODC website <http://www.unodc.org/pdf/convention_1988_en.pdf> at 10 October 2011.

¹¹² In addition, the UN has expanded its efforts after the Vienna Convention, by creating the *Global Programme against Money Laundering 1997* (GPML) to help State parties to UN conventions comply with AML provisions. GPML offers technical assistance (eg, for monitoring problems), specific initiatives for increasing AML awareness, and policy development. For further information, see the website of the United Nations Office on Drugs and Crime, <www.unodc.org> at 10 October 2011.

¹¹³ Toby Graham, Evan Bell and Nicholas Elliott, *Money Laundering* (Elsevier, 2003) 28–9.

¹¹⁴ The INCB is comprised of Ghana, Turkey, India, Brazil, Russian Federation, Nigeria, Italy, Iran, Austria, Colombia, Netherlands, USA, and Australia.

¹¹⁵ The Vienna-based Board is an autonomous body founded by the 1961 *Single Convention on Narcotic Drugs* to monitor governments' compliance with the international drug control treaties. The three treaties are the 1961 *Single Convention on Narcotic Drugs*, the 1971 *Convention on Psychotropic Substances* and the 1988 *United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances*.

cooperates with other international bodies,¹¹⁶ and other related UN expert agencies,¹¹⁷ but also with bodies outside the UN, especially the International Criminal Police Organisation (INTERPOL) and the Customs Co-operation Council.¹¹⁸

UN Convention against Transnational Organized Crime – Palermo Convention (2000)

The UN held a series of meetings in Palermo (Italy) in 2000 leading to the agreement on the *Convention against Transnational Organized Crime*.¹¹⁹ This represents a further expansion of UN efforts to combat the highly organised illegal activities (such as ML) by their prevention and investigation, and the prosecution of relevant offences.¹²⁰ In addition, a number of protocols to the Convention were subsequently issued, specifically addressing the prevention of the harmful influences of organised crime.¹²¹ However, their provisions only apply to States that are parties to the Convention.¹²² Under this convention, corrupt activities and ML are to be prevented, investigated, and prosecuted. This is provided in Articles 7 and 8 of the Convention:

Article 7: Measures to combat money-laundering

(1) Each State Party: (a) Shall institute a comprehensive domestic regulatory and supervisory regime for banks and non-bank financial institutions and, where appropriate, other bodies particularly susceptible to money-laundering, within its

¹¹⁶ For further information on the UN Commission on Narcotic Drugs, see UNODC website <<http://www.unodc.org/unodc/en/commissions/CND/>> at 10 October 2011.

¹¹⁷ Such as the World Health Organisation (WHO). See <http://www.who.int/medicines/areas/quality_safety/Framework_ACMP_withcover.pdf> at 10 October 2011.

¹¹⁸ For more, see the International Narcotics Control Board (INCB), *The Role of the International Narcotics Control Board* (2004) <http://www.incb.org/pdf/e/tr/pre/2004/precursors_incb.pdf> at 10 October 2011.

¹¹⁹ For full text, see UNCJIN website, <http://www.uncjin.org/Documents/Conventions/dcatoc/final_documents_2/convention_eng.pdf> at 10 October 2011.

¹²⁰ See text of Convention and associated protocols at: United Nations (UN), *United Nations Convention against Transnational Organized Crime and its Protocols* (2000) <<http://www.unodc.org/unodc/en/treaties/CTOC/index.html>> at 11 October 2011. Many details regarding measures to be taken (and others to be considered) in relation to the prevention of ML activities and those applicable in relation to the criminalisation of corruption are outlined in Articles 7 and 8 of the Convention. See text overleaf.

¹²¹ Three Protocols have been issued to target specific areas of organised crime:

1. The Protocol to Prevent, Suppress and Punish Trafficking in Persons, Especially Women and Children;
2. The Protocol against the Smuggling of Migrants by Land, Sea and Air; and
3. The Protocol against the Illicit Manufacturing of and Trafficking in Firearms, their Parts and Components and Ammunition.

¹²² Graham, Bell and Elliott, above n 113, 34.

competence, in order to deter and detect all forms of money-laundering, which regime shall emphasize requirements for customer identification, record-keeping and the reporting of suspicious transactions;(b) Shall, without prejudice to articles 18 and 27 of this Convention, ensure that administrative, regulatory, law enforcement and other authorities dedicated to combating money-laundering (including, where appropriate under domestic law, judicial authorities) have the ability to cooperate and exchange information at the national and international levels within the conditions prescribed by its domestic law and, to that end, shall consider the establishment of a financial intelligence unit to serve as a national centre for the collection, analysis and dissemination of information regarding potential money-laundering.

(2) States Parties shall consider implementing feasible measures to detect and monitor the movement of cash and appropriate negotiable instruments across their borders, subject to safeguards to ensure proper use of information and without impeding in any way the movement of legitimate capital. Such measures may include a requirement that individuals and businesses report the cross-border transfer of substantial quantities of cash and appropriate negotiable instruments.

(3) In establishing a domestic regulatory and supervisory regime under the terms of this article, and without prejudice to any other article of this Convention, States Parties are called upon to use as a guideline the relevant initiatives of regional, interregional and multilateral organizations against money-laundering.

(4) States Parties shall endeavour to develop and promote global, regional, subregional and bilateral cooperation among judicial, law enforcement and financial regulatory authorities in order to combat money-laundering.

Article 8: Criminalization of corruption

1 Each State Party shall adopt such legislative and other measures as may be necessary to establish as criminal offences, when committed intentionally:

(a) The promise, offering or giving to a public official, directly or indirectly, of an undue advantage, for the official himself or herself or another person or entity, in order that the official act or refrain from acting in the exercise of his or her official duties;

(b) The solicitation or acceptance by a public official, directly or indirectly, of an undue advantage, for the official himself or herself or another person or entity, in order that the official act or refrain from acting in the exercise of his or her official duties.

(2) Each State Party shall consider adopting such legislative and other measures as may be necessary to establish as criminal offences conduct referred to in paragraph 1 of this article involving a foreign public official or international civil servant. Likewise, each State Party shall consider establishing as criminal offences other forms of corruption.

(3) Each State Party shall also adopt such measures as may be necessary to establish as a criminal offence participation as an accomplice in an offence established in accordance with this article.

(4) For the purposes of paragraph 1 of this article and article 9 of this Convention, "public official" shall mean a public official or a person who provides a public service as defined in the domestic law and as applied in the criminal law of the State Party in which the person in question performs that function.'

UN International Convention for the Suppression of the Financing of Terrorism (1999)

The escalation of acts of terrorism across the world (and especially the example of 11 September 2001) encouraged countries to sign the *UN International Convention for the Suppression of the Financing of Terrorism* which had been adopted in 1999.¹²³ According to the Financial Action Task Force (FATF), members must respect the anti-terrorism measures that have been adopted by the Convention. The Convention clarified that TF, including the intention to use funds in a terrorist act, is a crime.¹²⁴

UN Convention against Corruption (2003)

The UN adopted its *Convention against Corruption* in October 2003, in order to combat corruption activities in general, such as bribery and embezzlement, and those are particularly linked to the ML process.¹²⁵ Thus, the Convention lists a variety measures that accord with the obligation of States parties to strengthen international efforts to prevent corruption and ML in Article 14.¹²⁶

¹²³ The *International Convention for the Suppression of the Financing of Terrorism* opened for signature 10 January 2000 GA Res 109, UN GAOR 54thSess, Supp No 49 UN Doc A/54/49 (vol 1) (1999) (entered into force 10 April 2002) The objective of this convention is to improve the international collaboration in developing and adopting effective methods for the prevention, investigation, and punishment of the financing of terrorism. See <<http://www.unodc.org/documents/treaties/Special/1999%20International%20Convention%20for%20the%20Suppression%20of%20the%20Financing%20of%20Terrorism.pdf>> at 10 October 2011. (This document also details reservations of individual parties.)

¹²⁴ Alison Deitz and John Buttle, *Anti-Money Laundering Handbook* (2008) 9–10.

¹²⁵ Abdullahi Y Shehu, 'International Initiatives Against Corruption and Money Laundering: An Overview' (2005) 12(3)*Journal of Financial Crime* 221.

¹²⁶ Those negotiating the text of the United Nations *Convention against Corruption* (2000) met between 21 January 2002 and 1 October 2003. The text approved by the Ad Hoc Committee was adopted by the General Assembly by its resolution 58/4 of 31 October 2003 (entered into force 14 December 2005). See <<http://www.unodc.org/unodc/en/treaties/CAC/index.html>> at 12 October 2011.

Article 14: 'Measures to prevent money-laundering' states

1. Each State Party shall:

(a) Institute a comprehensive domestic regulatory and supervisory regime for banks and non-bank financial institutions, including natural or legal persons that provide formal or informal services for the transmission of money or value and, where appropriate, other bodies particularly susceptible to money-laundering, within its competence, in order to deter and detect all forms of money-laundering, which regime shall emphasize requirements for customer and, where appropriate, beneficial owner identification, record-keeping and the reporting of suspicious transactions;

The Convention also outlines the preventive measures that states must undertake, including the adoption of anti-corruption policies and practices, and the use of a proper body (or bodies) to ensure compliance and implementation of those policies and practices.¹²⁷

2.2.2 The Financial Action Task Force (FATF)

By 1989, and through the Paris Economic Summit, the (at the time) Group of Seven¹²⁸ founded the Financial Action Task Force (FATF) whose goal is the development and

(b) Without prejudice to article 46 of this Convention, ensure that administrative, regulatory, law enforcement and other authorities dedicated to combating money-laundering (including, where appropriate under domestic law, judicial authorities) have the ability to cooperate and exchange information at the national and international levels within the conditions prescribed by its domestic law and, to that end, shall consider the establishment of a financial intelligence unit to serve as a national centre for the collection, analysis and dissemination of information regarding potential money-laundering.

2. States Parties shall consider implementing feasible measures to detect and monitor the movement of cash and appropriate negotiable instruments across their borders, subject to safeguards to ensure proper use of information and without impeding in any way the movement of legitimate capital. Such measures may include a requirement that individuals and businesses report the cross-border transfer of substantial quantities of cash and appropriate negotiable instruments.

3. States Parties shall consider implementing appropriate and feasible measures to require financial institutions, including money remitters:

- (a) To include on forms for the electronic transfer of funds and related messages accurate and meaningful information on the originator;
- (b) To maintain such information throughout the payment chain; and
- (c) To apply enhanced scrutiny to transfers of funds that do not contain complete information on the originator.

4. In establishing a domestic regulatory and supervisory regime under the terms of this article, and without prejudice to any other article of this Convention, States Parties are called upon to use as a guideline the relevant initiatives of regional, interregional and multilateral organizations against money-laundering.

5. States Parties shall endeavour to develop and promote global, regional, subregional and bilateral cooperation among judicial, law enforcement and financial regulatory authorities in order to combat money-laundering.'

¹²⁷ Sean D Murphy, 'Adoption of UN Convention Against Corruption' (2004) 98(1) *American Journal of International Law* 182.

¹²⁸ The Group of Seven (G-7), now the Group of Eight (G-8) and originally the G-6. The UK, USA, Japan, Italy, France, and Germany comprised the G-6 until Canada joined in 1976 to form the G-7. When Russia joined, the G-7 became known as G-8. Thus, G-8 is a forum that includes eight large countries: UK, USA, Japan, Canada, Italy, France, Germany, and Russia. It meets once a year to discuss critical policy issues.

encouragement of national and international policies to fight ML and TF activities.¹²⁹

Activities against such crimes inevitably involve the prevention of ML activity.¹³⁰

FATF is an independent body, with a steering community chaired for each single year term by a president who is a senior government official selected from amongst FATF member countries. In addition, a specialist secretariat office based in the Organisation for Economic Co-operation and Development (OECD) offers support to its president and steering community in their work, especially in relation to combating ML.¹³¹

FATF began with 28 member countries.¹³² Member countries have a number of obligations in relation to the creation of comprehensive international standards to combat ML, enhancing non-member countries' compliance with these standards,¹³³ improving regional AML bodies, and working in conjunction with other international organisations. Countermeasures are outlined that will apply to countries that fail to apply, or who inappropriately apply, the FATF guidelines.¹³⁴

FATF began by issuing its Forty Recommendations in 1990 as a useful tool for originating cohesive policy and a framework to prevent ML. Although such recommendations have no legal effect, the recommendations relating to the legislative

¹²⁹ FATF, FATF 40 Recommendations (FATF-GATI, 2004) <<http://www.fatf-gafi.org/dataoecd/7/40/34849567.PDF>> at 14 October 2011. Note: there have been various versions with updates on FATF Recommendations, but this thesis is referring to the (2003) iteration. In fact, after the research had been completed and the thesis written and submitted, FATF issued revised Recommendations which consolidated the 40+9 and made some changes of substance. However, while some of these changes dealt with issues that the thesis discusses (eg, identification of beneficial ownership) the changes do not fundamentally change this thesis conclusions and the basis for criticism which has been made about these provisions. For more information about the FATF Recommendations, please see the list of the old and new Recommendation numbers at Appendix A.

¹³⁰ Reuter and Truman, above n 33, 81.

¹³¹ Hopton, above n 100, 17.

¹³² FATF membership now includes 34 country members. For further information, see the website of The Financial Action Task Force (FATF), *FATF Members and Observers* <http://www.fatf-gafi.org/document/52/0,3343,en_32250379_32237295_34027188_1_1_1_1,00.html> at 15 October 2011.

¹³³ Savona, above n 98, 39–40.

¹³⁴ Robin Sykes, 'Some Questions on the FATF 40+9 and the Methodology for Assessing Compliance with the FATF 40+9 Recommendations' (2007) 8(3) *Journal of Banking Regulation* 236.

requirements, the supervision of financial institutions and law enforcement activities are a valuable resource for those wishing to implement effective policies and practices.¹³⁵ Over time they have become quasi legislative rules in ways never originally envisaged.

The Forty Recommendations identify several areas of concern and supply AML measures, as follows.¹³⁶

- 1 Recommendations 1 and 2 outline the possibilities of applying the criminal offences of ML to all legal persons who have the intention to commit and/or knowledge of the intention to commit offences — including ML.
- 2 Recommendation 3 notes that countries ought to adopt measures to stop the use of illicit gains (that is, the proceeds of crime).
- 3 Recommendation 4 notes that bank secrecy law must not conflict with the obligation of complying with FATF Recommendations.
- 4 Recommendations 5 to 12 clarify the obligations regarding CDD and record keeping. According to these recommendations, financial institutions must have comprehensively identified their customers, keep records for five years at least, and also must adopt the principle of due diligence, especially in relation to complex transactions which may include ML activities.
- 5 Recommendations 13 to 16 cover the issue of the reporting of suspicious transactions and compliance issues in depth, and point out that financial institutions must follow their legal obligations in this regard, and encourage them to improve their AML systems and staff training programs.

¹³⁵ Broome, above n 3, 34–5.

¹³⁶ FATF, *FATF 40 Recommendations*, above n 129.

- 6 Recommendations 17 to 22 list the necessary requirements for countries regarding combatting ‘shell’ banks and reporting of the cash transactions over a threshold amount. These recommendations call for solutions to be found to prevent non-complying countries from facilitating ML and TF. They also call for financial institutions to be enhanced so that they are able to detect and report any transactions from those non-complying countries.
- 7 Recommendations 23 to 25 encourage countries to ensure that their financial institutions and non-financial businesses fully comply with regulatory and supervisory measures adopted (such as licensing requirements for casinos).
- 8 Recommendations 26 to 32 reflect the need of countries to establish financial intelligence units for their financial systems, and encourage them to do so.
- 9 Recommendations 33 to 34 mention that countries must have sufficient data about the customers (both individual and corporate) so that they would be able to assist the relevant bodies in their investigation and prosecution.
- 10 Recommendations 35 to 40 cover the requirement for countries to ratify a number of important conventions, such as the *Vienna Convention*, *Palermo Convention*, and the *International Convention for the Suppression of the Financing of Terrorism*. In addition, an obligation has been set for countries to provide a variety of mutual legal assistance.

It is clear that the Forty Recommendations cover several areas, such as law enforcement powers, the financial institutions and internal regulations, the criminal justice system, and countries' collaboration in terms of AML.¹³⁷

Another Nine Special Recommendations were put into place after the crisis of 11 September 2001 in the USA. One of the main reasons behind issuing these recommendations was to cover the TF and ML in an inclusive regulation to combat such illegal activities.¹³⁸

Consequently, these additional recommendations define TF as a crime, and recommend the implementation of UN efforts regarding freezing and confiscation of terrorist assets. Moreover, these recommendations reflect the necessity of supervising funds transfer by implementing measures to detect and regulate the international transactions, and reporting suspicious deals that are related to terrorist groups. In addition, they reflect effective worldwide cooperation in respect of the prevention of TF, and to combat the abuse of non-profit organisation status by terrorists.¹³⁹

In conclusion, FATF has covered a number of major issues, and its recommendations are considered great resources in the search for an ideal AML regime for countries and organisations worldwide. The guidance FATF has provided on implementing risk-based

¹³⁷ Deitz and Buttle, above n 124, 12.

¹³⁸ Fergus O'Donnell, 'The International Response to the Need for Proceeds of Crime Legislation' in Robert Hubbard et al (eds), *Money Laundering and Proceeds of Crime* (Irwin Law, 2004) 78.

¹³⁹ Dayanath Jayasuriya, 'Money Laundering and Terrorism Financing: The Role of Capital Market Regulators' (2002) 10(1) *Journal of Financial Crime* 30-36. For the 9 special recommendations, see Financial Action Task Force (FATF), *9 Special Recommendations on Terrorist Financing* (2004) <http://www.fatf-gafi.org/document/9/0,3343,en_32250379_32236920_34032073_1_1_1_1,00.html> at 15 October 2011.

approach in 2007 is one of its most recent achievements and reflects its continuing important role.¹⁴⁰

2.2.3 Asia Pacific Group on Money Laundering (APG)

APG is an international body established in 1997, with 13 member countries¹⁴¹ working to combat ML activities. APG works in conjunction with FATF, using its style, mechanism, and 40+9 Recommendations as standards in the prevention of ML and TF.¹⁴²

APG has a number of goals which reflect its role as a regional organisation concerned with AML measures. Roles include evaluating the level of members' compliance with international standards on curbing ML and increasing cooperation between members, and their cooperation with other global organisations. APG researches and analyses the nature of ML, the risk of it occurring, methods adopted by money launderers, and its use in TF. Moreover, it seeks to improve global policy and standards in combating ML by actively participating as an associate member in FATF.¹⁴³

¹⁴⁰ The FATF principles embody an RBA using three criteria: country risk, customer risk, and product or process risk, which will be discussed on Chapter 3 of this thesis. For further information about the FATF Guidelines RBA, see The Financial Action Task Force (FATF), *Guidance on the Risk-Based Approach to Combating Money Laundering and Terrorist Financing (High Level Principles and Procedures)* (2007) <<http://www.fatf-gafi.org/dataoecd/43/46/38960576.pdf>> at 15 October 2011.

¹⁴¹ APG member countries now number 40; Australia is one of the founding members, and currently is the permanent Co-Chair of the APG: as of 16 May 2010. See APGML website, <<http://www.apgml.org/apg-members/default.aspx?JurisdictionID=1>> at 20 October 2011.

¹⁴² Deitz and Buttle, above n 124, 15–16.

¹⁴³ For more about the role of the APG, see their website: The Asia/Pacific Group on Money Laundering (APG), *History and Background* (1997) <<http://www.apgml.org/about/history.aspx>> at 25 October 2011.

2.2.4 The World Bank and the International Monetary Fund (IMF)

The World Bank and the International Monetary Fund (IMF) are two separate organisations, and while each has a slightly different aim, they collaborate with each other¹⁴⁴ in AML efforts.

The World Bank was established in 1944 to help fund the re-building of Japan and Europe in the aftermath of the Second World War. It is not an actual ‘bank’ doing financial services for customers, but a global development organisation. Its development obligations have expanded to encompass several fields, such as education, health, finance, nutrition, justice, law, and environmental concerns.¹⁴⁵ The IMF was also established in 1944, its foundation also prompted by the same concern for rebuilding countries damaged by the Second World War. However, the IMF concentrates on economic issues, such as international trade policy and exchange rates, while the World Bank is interested in a country’s structure.¹⁴⁶

Both organisations have made significant contributions with respect to combating ML activities, by providing technical assistance to member countries and instituting and maintaining adequate surveillance of members’ economic systems.¹⁴⁷ By 2001 both had encouraged beneficiaries of their financial assistance programs to include in their financial systems impressive AML and counter terrorism measures, and to fully

¹⁴⁴ Joseph Stiglitz and Robert M Pike, 'Globalization and its Discontents' (2004) 29 *Canadian Journal of Sociology* 321.

¹⁴⁵ The World Bank began with 38 member countries. Membership has now reached more than 180 member countries: at 26October 2011. For more information, see its website: The World Bank, *About the World Bank* <<http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/0,,pagePK:50004410~piPK:36602~theSitePK:29708,00.html>> at 26October 2011.

¹⁴⁶ Deitz and Buttle, above n 124; Stiglitz and Pike, above n 144, 321.

¹⁴⁷ For further information, see The International Monetary Fund (IMF), *The IMF and the Fight against Money Laundering and the Financing Of Terrorism* (2008) <<http://www.imf.org/external/np/exr/facts/aml.htm>> at 27October 2011.

implement a regime involving the relevant UN conventions.¹⁴⁸ Moreover, in 2003 the World Bank introduced a Global Dialogue Series to enhance expertise and encourage the exchange of knowledge and information between experts and senior government officials, in terms of AML and CTF. In the same year, the World Bank and IMF instituted and participated in training programmes for other FATF style regional bodies, such as the Eastern and South African Anti Money Laundering Group (ESAAMLG), the Caribbean Financial Action Task Force (CFATF), the APG, the Financial Action Task Force on Money Laundering in South America (*Grupo de Acción Financiera de Sudamérica* (GAFISUD)), and the Inter-Governmental Action Group against Money Laundering (*Groupe Intergouvernement d'Action contre le Blanchiment d'Argent en Afrique de l'Ouest* (GIABA)).¹⁴⁹

In 2004, the World Bank and IMF adopted the 40+9 FATF Recommendations as comprehensive global standards for preventing ML and TF in member countries.¹⁵⁰

2.2.5 European Directives on ML

The issue of the prevention of the use of the financial system for ML purposes was important to the European Union (EU). Therefore, the European parliament and council adopted three directives relating to combating ML through the financial institutions. These are called the 'European Directives on ML'.

¹⁴⁸ Deitz and Buttle, above n 124, 16.

¹⁴⁹ Shehu, above n 125, 221. All are FATF style regional bodies, and have the same values in combating ML activities.

¹⁵⁰ Hopton, above n 100, 13.

The First EU Directive on ML

In 1991, the EU issued the First Directive regarding ML, and required member states to fully implement its provisions which involve an improved and comprehensive regime and legislation to combat such activities in their financial systems.¹⁵¹

The Second EU Directive on ML

The Second Directive was issued in 2001, and extended the compass of the First Directive to include non-financial services, such as lawyers, accountants, real estate agencies, and casinos. This directive also extends its overview, categorising tax evasion with drug trafficking as a dangerous crime, which needs to be reported and prevented.¹⁵²

The Third EU Directive on ML

The EU's third and (thus far) final Directive was issued in 2005. According to the Third Directive, TF is a serious crime and may be separate to ML. Furthermore, it directed that currency exchange offices and casinos need to be licensed before they start to provide services; that an FIU be established to detect ML activities and other financial crimes; that RBA principles be applied to the financial framework; and CDD requirements must be met. Addressing these issues in the Third Directive has resulted in an extension of the scope of the First and the Second directives of the EU in terms of AML.¹⁵³

¹⁵¹ Savona, above n 98, 42. The first European Directive has exclusive elements to prevent ML through the financial system, such as customer identification obligations, record keeping obligations, requirement to monitor suspicious transactions, obligation to train staff, and criminalisation of ML activities.

¹⁵² Hopton, above n 100, 26–7.

¹⁵³ Deitz and Buttle, above n 124, 20–1. For further Information, see European Commission, *The EU Single Market* <http://ec.europa.eu/internal_market/company/financial-crime/index_en.htm#money_laundering> at 29 October 2011.

2.2.6 Basel Committee on Banking Regulations and Supervision

In 1988, the Basel Committee on Banking Regulations and Supervision¹⁵⁴ adopted a Statement of Principles, which is concerned about maintaining bank stability and combatting criminal behaviour (such as ML activities)¹⁵⁵ in the financial sector. The Committee has also pointed out a number of important issues, such as the bank's obligation for adequate customer identification, and the implementation of adequate protection for banks themselves against customers who are linked to ML through suspicious transactions.¹⁵⁶ The Committee is concerned with developing responses to the ML issue, the implementation of sufficient regulatory standards, and the formation of a comprehensive AML regime.¹⁵⁷

The Committee has issued several papers regarding AML crime, which have reflected on some critical issues, for example, the basic difficulties for financial institutions when they are not fully protected against ML risk, and the risk of fraud in dealings with criminal customers. They are:¹⁵⁸

- 1 1988: The Prevention of Criminal Use of the Banking System for the Purchase of Money Laundering.
- 2 1997: The Core Principles for Effective Banking Supervision.

¹⁵⁴ Basel Committee on Banking Supervision was established by the central-bank Governors of the Group of 10 countries in late 1974. It is a committee of central banks and bank supervisors and regulators from major industrialised countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States). The Committee provides a forum for regular co-operation on banking supervisory activities and is concerned with the stability of the global financial system, seeking to protect it from criminal activities, such as corruption, fraud, ML, etc. The original Committee's countries has expanded to include Luxemburg, India, Brazil, China, Mexico, Russia, Korea, and Australia.

¹⁵⁵ Graham, Bell and Elliott, above n 113, 29.

¹⁵⁶ Savona, above n 98, 40–1.

¹⁵⁷ Broome, above n 3, 103.

¹⁵⁸ For more details about Basel Committee and its papers, see its website: The Basel Committee, *About The Basel Committee* <<http://www.bis.org/bcbs/index.htm>> at 29 October 2011.

- 3 1999: The Core Principles Methodology.
- 4 2001: Customer Due Diligence for Banks.
- 5 2002: The Report on Sharing of Information between Jurisdictions in Connection with the Fight against Terrorism.
- 6 2003: Consolidated 'Know Your Customer' Risk Management.

2.2.7 Egmont Group

After decades of fighting ML activities, countries began dealing with this issue positively. Important units have been created to supervise countries' financial systems, and combat organised crimes such as ML. Such units are known as FIUs.

By 1995, a number of the FIUs of FATF member countries met at the Egmont Arenberg Palace in Brussels on the need for a cooperative intelligence unit network to facilitate sharing of information, expertise and training. Its focus includes ML prevention, and more recently TF. The network of the FIUs and the Egmont body are determined to collaborate in regards to combating ML. Meetings are held regularly to find the best way to create an effective synergy, especially regarding training and sharing of expertise. Indeed, the Egmont Group became another significant mechanism in the AML structure, and Australia contributes to it through the work of AUSTRAC. AUSTRAC was a founding member of the Egmont Group and senior AUSTRAC staff have consistently taken part in working groups and the leadership of Egmont. However,

what began as a loose network of like-minded FIUs has become a more formal organisation with entry criteria.¹⁵⁹

A fundamental role of the FIUs is to analyse suspicious transactions in regional financial institutions. In fact, most of the FIUs have no jurisdiction outside their domestic focus although they will look at any transaction originating in or coming into its jurisdiction. Thus, there can also be a very fruitful exchange of information between FIUs. A MoU has been issued to group members, with an aim to share data and help provide financial institutions, law enforcement authorities, and regulatory agencies, with important information within and between countries, in order to curb ML and highly organised crimes.¹⁶⁰

In conclusion, many initiatives and achievements have been taken to prevent ML, and many countries — among them Australia — have been involved in these efforts. Nevertheless, the question remains, are these achievements quite enough to curb the laundering of illicit gains? What has Australia done to combat ML?

2.3 Historical Overview - The Australian AML perspective

Since the late 1980s, Australia (like many countries) has made a number of significant improvements to its AML regime, especially when the then G7 (now G8)¹⁶¹ decided that ML has a dangerous impact on financial systems and should be curbed.¹⁶² As mentioned above, the *Vienna Convention* was the first international move to enhance countries' ability to combat such a crime. Australia was one of those countries that sought to do

¹⁵⁹ Hopton, above n 100, 14–15. For more information about Egmont Group, see The Egmont Group, *Egmont Group Procedure* <<http://www.egmontgroup.org/membership/procedure>> at 3 November 2011.

¹⁶⁰ Graham, Bell and Elliott, above n 113, 33.

¹⁶¹ The G8 is a group for the governments of eight major economies in the world (G8: Japan, United States, Germany, United Kingdom, Italy, France, Canada, and Russia). See <http://www.g8italia2009.it/G8/Home/Summit/Partecipanti/G8-G8_Layout_locale-1199882116809_Paesig8.htm>.

¹⁶² Broome, above n 3, 28–9.

so; it took many steps until it had created its own AML regime, and built a high reputation for preventing such crimes.

The first Australian step in combating ML activities was the amendment of the *Customs Act 1901* (Cth) in 1977 to include the power to arrest criminals and confiscate their proceeds from drug trafficking crimes.¹⁶³

The Australian Attorney-General's Department then developed a policy and drafted a Bill that became the *Proceeds of Crime Act 1987* (Cth) (POCA 1987).¹⁶⁴ This plays a vital role in controlling criminal assets while criminal proceedings are taking place, combating the hiding of assets that might be subject to confiscation.¹⁶⁵ Thus, the Australian regime against organised crime has developed from concerns not just about drug trafficking proceeds, but also about the proceeds from other criminal activities (such as 'protection', prostitution and fraud) and their potential for use for further criminal activities (such as funding terrorism).¹⁶⁶

The Act was amended in 2002. The main difference between the 1987 and 2002 Acts was the lack of civil forfeiture provisions in POCA 1987.¹⁶⁷

¹⁶³ See the Australian Institute of Criminology, *Confiscation of the Proceeds of Crime: Federal Overview* (2008) 2 <<http://www.aic.gov.au/documents/5/7/5/%7B575861BD-8901-4BAE-A7DB-B61DEFEEED3AD%7Dtcb001.pdf>> at 4 November 2011. 'The *Customs Act 1901* (Cth) (Customs Act) provided the first avenue for the confiscation of criminal assets in Australia prior to amendments in 1979, which allowed for civil pecuniary penalties for dealing in narcotics. The Act only allows the confiscation of assets in relation to activities associated with prescribed narcotics that are in contravention to the Act.'

¹⁶⁴ The Proceed of Crime Act 1988 (Cth) (POCA), the Financial Transaction Reports Act 1988 (Cth) (FTRA), and Anti Money-Laundering and Counter Terrorism Financing Act 2006 (Cth) will be further discussed in Chapter 3.

¹⁶⁵ Clayton UTZ, *The Essential Guide To Australian Anti-Money Laundering Reforms* (2006) 12.

¹⁶⁶ Australian Institute of Criminology, *Confiscation of the Proceeds of Crime: Federal Overview* (2008), above n 163.

¹⁶⁷ Ibid 1–2: 'The *Proceeds of Crime Act 2002* (Cth) (POCA 2002) came into force on 1 January 2003 and is the instrument used to recover the largest proportion of criminal assets associated with federal crimes. The Act was the result of a review, which found that the inclusion of civil forfeiture at a federal level would vastly extend the capacity to recover funds from breaches of federal law (ALRC 1999). Once confiscated, assets are paid into an account and can be shared with those jurisdictions and foreign countries that made a significant contribution to the recovery under the equitable sharing program. The

Another important amendment was to sections 81 and 82 of the Act by the *Criminal Code Act 1995* (Cth), when the Government inserted Division 400 into the Criminal Code in 2002, replacing the ML offences in sections 81 and 82 of the POCA. The new version was added to reflect the reality of ML and to apply recommendations contained in the Australian Law Reform Commission Report, *Confiscation that Counts*.¹⁶⁸

The initial Bill for *Cash Transaction Reports* was drafted in 1987 to supervise the widespread use of facilities provided by financial institutions, as well as tax evasion and ML activities.¹⁶⁹ This Bill became the *Financial Transaction Reports Act 1988* (Cth) (FTRA), and was a step to monitor financial transactions. Rather than simply supervising cash flows through financial institutions, it enhanced their ability and obligation to detect and report any suspicious transactions that may be involved in ML activities.¹⁷⁰

Therefore, Australia — through several Acts and their amendment — has tried to create a comprehensive AML regime to effectively combat ML crimes in Australia.

At the same time, Australia has participated in international moves to thwart ML. It adopted the relevant international conventions and participates in global efforts to curb

total amount of money recovered using the *Proceeds of Crime Act 2002* (Cth), between January 2003 and 30 June 2007, was \$41,377,790.’

¹⁶⁸ For Division 400 of the *Australian Criminal Act 1995*, see: The Australian Government, *Criminal Code Act 1995 Division 400-Money Laundering* (1995) <<http://www.comlaw.gov.au/ComLaw/Legislation/ActCompilation1.nsf/bodylodgmentattachments/5A22EA6D7A20887ECA256F71004F4B19?OpenDocument#TOC104>>at 3November 2011. Also, see the website of Australian Government’s Attorney-General’s Department: the Attorney-General’s Department- Criminal Justice Division, *Proposal For Amendments to the Money Laundering Provisions in Division 400 of the Criminal Code Act 1995* (2008) <[http://www.ag.gov.au/www/agd/rwpattach.nsf/VAP/\(CFD7369FCAE9B8F32F341DBE097801FF\)~c_Discussion+Paper++Division+400+-+money+laundrying+proposals.pdf/\\$file/c_Discussion+Paper+-+Division+400+-+money+laundrying+proposals.pdf](http://www.ag.gov.au/www/agd/rwpattach.nsf/VAP/(CFD7369FCAE9B8F32F341DBE097801FF)~c_Discussion+Paper++Division+400+-+money+laundrying+proposals.pdf/$file/c_Discussion+Paper+-+Division+400+-+money+laundrying+proposals.pdf)>at 5November 2011.

¹⁶⁹ Caslon Analytics, *FTR and 100 Points ID* <<http://www.caslon.com.au/100pointsnote.htm>>at 5November 2011.

¹⁷⁰ Joo-Cheong Tham, ‘A Risk-Based Analysis of Australia’s Counterterrorism Financing Regime’ (2007) 34(2) *Social Justice* 138.

ML activities. Thus, Australia was a founding member of FATF in 1989,¹⁷¹ and took into consideration the FATF Recommendations as a fundamental umbrella to improve countries' ability to create an effective AML system and one that complies with international moves in this direction (for instance, FATF Recommendation 3, which reflects the need to adopt measures similar to those adopted by the *Vienna Convention*, and the *Palermo Convention* and its protocols).¹⁷² Australia therefore ratified a number of important international conventions and is involved in significant global organisations whose goals include the ML prevention. The relevant Conventions and bodies include those listed below.

- 1 Ratified the United Nations *Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Vienna Convention)* in 1992¹⁷³
- 2 Ratified the United Nations *International Convention for the Suppression of the Financing of Terrorism* in 2002¹⁷⁴
- 3 Ratified the United Nations *Convention against Transnational Organised Crime and its Protocols (Palermo Convention)* in 2004¹⁷⁵

¹⁷¹ Attorney General's Department, *The FATF Mutual Evaluation of Australia* <http://www.ag.gov.au/www/agd/agd.nsf/Page/Anti-moneylaundering_TheFATFsmutualevaluationofAustralia> at 5 November 2011.

¹⁷² Australian Institute of Criminology, *Confiscation of the Proceeds of Crime: Federal Overview* (2008), above n 163.

¹⁷³ *United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances* opened for signature 20 December 1988 (entered into force on 11 November 1990) in accordance with art. 29(1) <<http://www.unhcr.org/refworld/category,LEGAL,ECOSOC,,,49997af90,0.html>>. Australia ratified the convention in 1992. See <<http://www.aic.gov.au/publications/current%20series/tcb/1-20/tcb001.aspx>> at 7 November 2011.

¹⁷⁴ *United Nations International Convention for the Suppression of the Financing of Terrorism* opened for signature 10 January 2000 (entered into force 10 April 2002). Australia ratified the convention in October 2002. See <http://www.ag.gov.au/www/agd/agd.nsf/Page/Nationalsecurity_Counter-terrorism_Internationalcounter-terrorismmeasures> at 5 November 2011.

¹⁷⁵ *United Nations Convention against Transnational Organized Crime and its Protocols* opened for signature 12–15 December 2000 (entered into force 29 September 2003). See <<http://www.unodc.org/unodc/en/treaties/CTOC/index.html>> at 5 November 2011. Australia ratified the convention in 2004, see <<http://www.aic.gov.au/publications/current%20series/tcb/1-20/tcb001.aspx>> at 7 November 2011.

- 4 Ratified the United Nations *Convention against Corruption* in 2005¹⁷⁶
- 5 Membership of International Monetary Fund (IMF) Development Committee in 1947¹⁷⁷
- 6 Founding Member of the Egmont Group in 1995¹⁷⁸
- 7 Founding Member of APG on Money Laundering in 1997¹⁷⁹

Nevertheless, Australian achievements regarding combating ML did not cease there. Australia had been one of a few countries sharing the honour of legislatively criminalising ML activities, which it initially did with the insertion in January 2003 of Division 40 in the Commonwealth *Criminal Code Act 1995* under the *Proceeds of Crime Act 2002*(Cth).¹⁸⁰ Other such efforts include the US *Money Laundering Control Act 1956* (MLCA), the Italian *Anti Money Laundering Act 1991*, and the French *Anti Money Laundering Act Number (96-392)* among others.¹⁸¹ In December 2003 the Australian government reconsidered the idea of adopting an Anti Money Laundering and Counter Terrorist Financing system (AML/CTF) as a further step to improve the

¹⁷⁶ *United Nations Convention against Corruption* opened for signature on 9–11 December 2003 (entered into force 14 December 2005), see <<http://www.unodc.org/unodc/en/treaties/CAC/index.html>> at 7 November 2011. Australia ratified the convention in 2005. See <<http://www.aic.gov.au/publications/current%20series/tcb/1-20/tcb001.aspx>> at 8 November 2011.

¹⁷⁷ See IMF, *A Guide to Committees, Groups and Clubs*, <<http://www.imf.org/external/np/exr/facts/groups.htm>> at 10 November 2011.

¹⁷⁸ See AUSTRAC, *Multilateral Engagement*, <http://www.austrac.gov.au/multilateral_engagement.html> at 13 November 2011.

¹⁷⁹ Ibid.

¹⁸⁰ Australian Institute of Criminology, *Charges and Offences of Money Laundering: Transnational Crime Brief No 4* (2008) <http://www.aic.gov.au/publications/current_series/tcb/1-20/tcb004.aspx> at 13 November 2011.

¹⁸¹ Wouter H Muller, Christian H Kalin and John G Goldsmith, *Anti-money Laundering: International Law and Practice* (Wiley, 2007).

level of implementation and bring it into line with the international standards issued by FATF.¹⁸²

By 2005, an exposure draft of the Anti Money Laundering and Counter Terrorism Financing Bill had been prepared and was widely circulated to receive comments from the financial institutions, and government bodies and agencies. Such consultative processes have the goal of enabling the government to enact the most appropriate legislation and to enshrine international best practice so as to combat ML effectively.¹⁸³ After an extensive consultation process, the *Anti Money Laundering and Counter Terrorism Financing Act 2006* (Cth) was passed, and replaced the existing *Financial Transaction Reports Act 1988* (Cth) (FTRA).¹⁸⁴

In 2007, the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) (AML Act) was amended. This Act, together with the second tranche¹⁸⁵ of legislation that continues to be developed, will ensure that Australia complies with the FATF recommendations on AML and their special recommendation TF.¹⁸⁶

In 1989 the Australian government created an FIU, the Australian Transaction Report and Analysis Centre (AUSTRAC) under the *FTR Act 1988* which continued to work in conjunction with the AML Act as a regulator and monitoring authority, and to assist reporting entities meet their obligations under the AML/CTF Rules and non-binding

¹⁸² See The Financial Action Task Force (FATF), *The FATF* <http://www.fatf-gafi.org/pages/0,3417,en_32250379_32235720_1_1_1_1_1,00.htm> at 14 November 2011.

¹⁸³ Tham, above n 170, 138–52.

¹⁸⁴ Ibid.

¹⁸⁵ The first tranche covers the reporting entities who are providing ‘financial services’, such as gambling, cash dealers, brokers, insurance sellers and others. The second tranche extends the coverage of the current AML/CTF package to lawyers, real states agents, jewellers, accountants when they provide ‘non financial services’.

¹⁸⁶ Clayton UTZ, above n 165, 15.

guidelines that AUSTRAC has issued.¹⁸⁷ The AML/CTF Rules set out specific requirements on matters such as customer identification, ongoing customer due diligence (OCDD), reporting of suspicious matters and AML/CTF programs.¹⁸⁸

AUSTRAC has a high standard organisational structure that sustains a number of internal committees to provide the required support for corporate governance throughout the agency. These include the Enforcement Committee, the Intelligence Oversight Committee, the Audit Committee and the Finance Committee, the Supervisory Oversight Committee, and the Program Management Governance Committee.¹⁸⁹

AUSTRAC also has its Executive Committee (ExCom), comprising the AUSTRAC CEO, the Executive General Manager Intelligence, the Executive General Manager Supervision, the six general managers, the Chief Information Officer and the General Counsel. ExCom is in charge of setting AUSTRAC's strategic direction and providing administrative supervision of the delivery of the agency mandate. ExCom has a monthly meeting to examine the agency's performance regarding a number of key performance indicators and provides an advisory service for the AUSTRAC CEO on main management, and strategic and organisational aspects.¹⁹⁰

However, AUSTRAC is not the only authority working in Australia to combat ML activities, there are also a number of regulators and law enforcement authorities who should work with AUSTRAC to stop such activities. For example, in 1997 the Wallis

¹⁸⁷ The full text of the Rules are available on AUSTRAC's website at: <www.austrac.gov.au> at 20 October 2011.

¹⁸⁸ Deitz and Buttle, above n 124, 22.

¹⁸⁹ AUSTRAC, *AUSTRAC Annual Report 2009–10*, 14 <http://www.austrac.gov.au/files/annual_report_2009_10.pdf> at 13 March 2011.

¹⁹⁰ Ibid.

Committee¹⁹¹ made numerous recommendations, including the establishment of the new Australian financial sector framework in a ‘twin peaks’ model.¹⁹²

- 1 APRA: the Australian Prudential Regulation Authority was established to carry out prudential regulation of deposit taking institutions, life and general insurance and superannuation.
- 2 ASIC: the Australian Securities and Investments Commission was established for consumer protection in the financial sector in respect of securities, futures, life insurance and general insurance, superannuation, retirement savings accounts, and deposit taking activities (other than credit).

One of the main issues in relation to these authorities’ work is the extent to which they cooperate with AUSTRAC, and the necessity for them to have an inclusive relationship with each other so they collaborate when necessary to combat laundering of illicit gains.

However, this design of the regulatory agencies was achieved only after decades of experience with financial matters in order to attempt to develop a better regulatory model to guard against financial problems.

¹⁹¹ In 1996, the Commonwealth Government of Australia commissioned a committee of industry and regulatory experts to examine financial services and regulation. The Committee was named after its chair, Stan Wallis. It published its report in 1977. It had been charged with various tasks such as:

- Reviewing financial and technological improvements;
- Considering the elements likely to bring further change; and
- Making recommendations for possible further developments to the regulatory framework.

¹⁹² Sheelagh McCracken and Anna Everett, *Banking and Financial Institutions Law* (Lawbook, 7th ed, 2009) 12–13. Before 1997, the Australian framework had a system of four regulators:

- the Australian Securities Commission,
- the Consumer Protection Regulation Functions of the Insurance and Superannuation Commission
- the Australian Payments System Council, and
- the Reserve Bank of Australia.

The first three regulators were replaced by ASIC, and then the government established APRA. The Reserve Bank Australia continued to hold the key responsibilities of monetary policy and system stability and the regulation of the payments system under its Payments Systems Board. It works alongside APRA and ASIC.

Even so, according to the latest estimates (published in 2004), the amount of laundered money in and through Australian financial system, is approximately AUD4.5 billion per year.¹⁹³ In other words, real risks persist in the Australian financial system. Far higher levels of awareness are needed of the Australian government's policies and regulatory frameworks, and greater compliance to prevent the continuing occurrence of ML crimes.

2.4 Conclusion

In recent years, ML has posed a serious risk to the financial system of every country, and there is an increasing panic that undetected ML activities will bring problems to the financial system and facilitate an increase in a diversity of predicate offences. The maxim, 'opportunity causes crimes',¹⁹⁴ applies in the area of ML crimes; countries know that if there is a possibility of disguising and hiding proceeds of crime, then this will motivate illicit activities. The AML system has evolved over time and become increasingly comprehensive, with a number of international Conventions having been agreed upon, ML activities criminalised, international and regional bodies having worked towards producing clear guidelines, new or improved supervisory bodies have been established at national and international levels, and a global AML regime having opened a new horizon for countries worldwide to benefit from these achievements.

¹⁹³ John Walker and John Stamp, 'Money Laundering in and through Australia, 2004' Trends and Issues in Crime and Criminal Justice No 342 (Australian Institute of Criminology, 2007)12–13 <<http://www.aic.gov.au/documents/6/4/2/%7B6427C6F9-BDE8-462E-A3AC-F68DB2C6505D%7Dand%7Di342.pdf>> at 17 April 2009, 5. Both authors, John Stamp as an AUSTRAC employee and John Walker as a consultant criminologist, have admitted in their article that measuring money laundering accurately is a challenge and not easily or conveniently capable of being done. They have estimated the cost of the money laundering activities to the economy as a way to focus on the danger of such activities, based on surveys, interviews and empirical data.

¹⁹⁴ Marcus Felson and Ronald V Clarke, *Opportunity Makes the Thief, Practical theory for crime prevention* (1998) 9.

Australia has commenced a sequence of actions to minimise ML risks. Australia is a foundation member of FATF in 1989, the APG in 1997, and the Egmont Group in 1995, Australia has also ratified a number of relevant UN conventions.

The criminalising of ML activities was secured through a number of new pieces of legislation and amendments, the last and the most important was the *Anti Money Laundering and Counter Terrorism Financing Act 2006* (Cth), which obliged the reporting entities to adopt AML measures and submit various types of reports to AUSTRAC, which is the FIU and regulator for the Australian AML system and has the power to receive and analyse the reports and disseminate them to partner agencies, such as ASIC, APRA, law enforcement bodies and others.

While Australia appears to be one of the leading countries (not only in terms of combating ML and proceeds of crimes but also in covering new arrangements for extradition), the FATF evaluation of 2005 found fault with the Australian AML system, and one of the matters critically evaluated was the reporting system (see below).

3 COMPLIANCE WITH REPORTING OBLIGATIONS

3.1 Introduction

As has been shown previously in Chapter Two, countries began working seriously against ML activities after the Financial Action Task Force (FATF) was founded in 1989. FATF has put in place AML rules or standards that countries worldwide have adopted. These are its Forty Recommendations on AML (and more recently the additional Nine Special Recommendations on Terrorist Financing).

FATF is today the main global policy maker in the field of AML activities. Thus, it is essential to examine its recommendations, discern the reporting obligations suggested by FATF and reflect on the Australian AML regime in relation to those obligations. An assessment of the FATF Recommendations will show that there are inherent AML reporting obligations, but the task will be to find how many of these obligations are actually contained in the Australian reporting mechanism.

In this thesis, 'reporting obligations' means reporting that includes all forms of reports such as the Suspicious Transaction Report (STR), Suspicious Activity Report (SAR), Suspicious Matter Report (SMR), Suspect Transaction Report (SUSTR), the Cash Transaction Report (CTR) and International Funds Transfer Instruction (IFTI) as well as the annual compliance report.

This chapter will consider compliance with the reporting obligations as a basic element in strengthening the Australian AML system, and will also consider the level of compliance of the Australian AML system with FATF Recommendations.

3.2 Reporting Obligations and FATF

The FATF Recommendations are regarded as a benchmark that countries should follow in preventing ML activities.¹⁹⁵ They represent a ‘one-size-fits-all’ approach that has been adopted as suitable for all countries, but the question must be asked whether this is possible?

The FATF Recommendations cover activities starting from initial customer identification and verification by reporting entities, and their fulfilment of their obligation to report relevant transactions to the FIU; and the FIU report analyses and their subsequent circulation to law enforcement bodies if required.

In Recommendations 5–12, FATF outlines the measures that a reporting entity needs to take (and what must be taken into consideration) when starting a relationship with its customers. These provide a solid basis on which reporting entities can rely when carrying out their reporting obligations. These identifying and verifying measures include CDD and Record Keeping. Under Recommendations 13–16, reporting entities are required to report suspicious transactions to the FIU. Reporting entities are encouraged to comply with this requirement because it is an important pillar for any AML system. The FIU then undertakes its analysis of these reports in accordance with Recommendation 26, and then finally circulates the outcome of these reports to the appropriate law enforcement bodies as per Recommendation 26.¹⁹⁶

¹⁹⁵ FATF, *What is the FATF?* <http://www.fatf-gafi.org/document/57/0,3343,en_32250379_32235720_34432121_1_1_1_1,00.html> at 20 November 2011.

¹⁹⁶ For the text of the FATF Recommendations, please see FATF, above n 129.

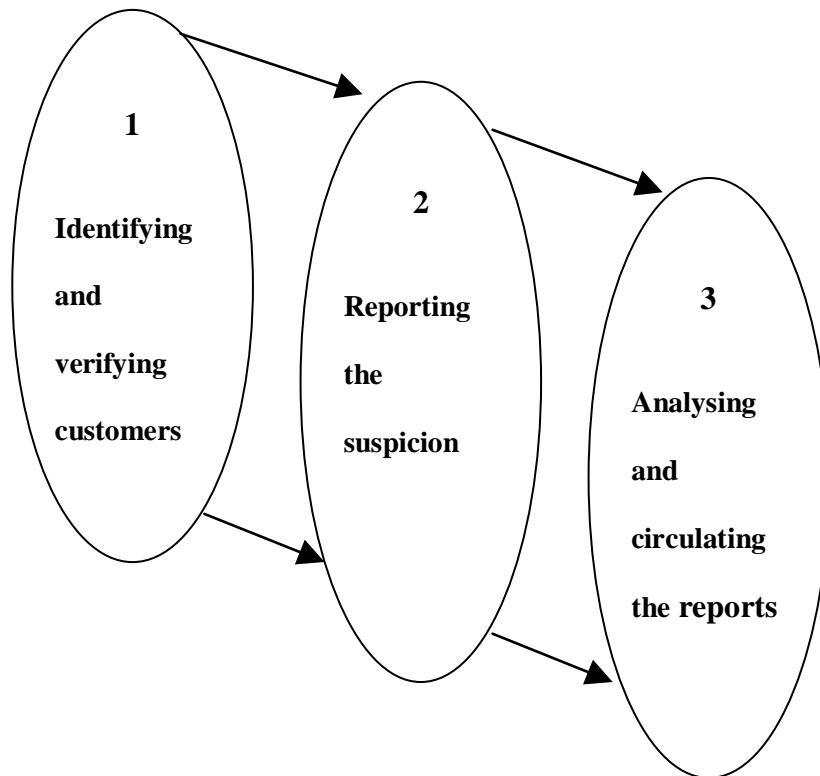


Figure 7: FATF Reporting Obligations

This chapter will consider the reporting obligations to be undertaken in accordance with the FATF scenario and then reflect on the Australian reporting obligations for the purpose of combating ML activities.

3.2.1 Identifying and Verifying Customers

To fulfil the required reporting obligations, accurate information on customers is very important. Reporting entities should undertake CDD¹⁹⁷ in accordance with Recommendations 5 to 12, which include identifying and verifying the identity of new and existing customers.

¹⁹⁷ Customer Due Diligence (CDD) is one of the most effective measures that reporting entities could take to protect their institutions from any threat of ML activities. The process is also known as 'Know Your Customer' (KYC) and it is included in the customer identification and ongoing customer due diligence (OCDD) processes. It is worth mentioning that CDD is a basic element in the reporting system because the information that have been collected within this process will be transferred to the report when it is needed. See Debra Geister, *Concepts in Customer Due Diligence: Meeting the Challenge of Regulatory Expectations* (LexisNexis Information & analytics Group, 2008) 1.

3.2.1.1 Customer Due Diligence

These recommendations should be clear enough to the financial institutions that are providing the designated services and those who are designated non-financial businesses and services (such as casinos, gold bullion merchants, real estate agents, accountants and lawyers).

This is one of the most important pillars of any AML system, particularly when the reporting entity first comes into contact with a new customer. It is at this stage — when establishing a relationship with a new customer — that it is easiest for the reporting entity to detect a possibility of ML activity before it's too late. Thus, utilising reliable documents, data and information is a major issue that any reporting entity should be concerned about.

However, FATF was not clear in illustrating the verification process. Neither the reporting entities nor the regulators could understand exactly which type of verification or method (that the FATF Recommendations have asked countries to follow for the purpose of the AML and its reporting obligations) should be used in any given instance. This ambiguity could offer the opportunity for some jurisdictions to create their own verification system with the minimum level of verification requirements (such as such as verifying customers and accepting them on the basis of appearance or behavior) which could probably bring a large number of problems to the AML reporting system and the whole AML regime.¹⁹⁸

Customer identification and verification is a serious problem, especially for those countries which are somewhat lacking in some of the online screening list services.

¹⁹⁸ T Flemming Ruud, *Auditing as Verification of Financial Information* (Norwegian University Press, 1989) 61.

FATF needs to fill this gap and identify a means of maintaining a FATF approved verification system in these circumstances as soon as possible. FATF should keep asking itself what needs to be revised to reflect experience and respond to emerging issues? And to be fair it is going through a major exercise to do this now by revising its Recommendations.

In Australia, reporting entities have been required since 12 December 2008 to identify their customers on an ongoing basis under the AML Act and its amendment. Previously, under the *Financial Transactions Reporting Act 1988* (Cth) (FTR Act), reporting entities did have to conduct customer identification and verification from the outset, but there was no obligation for entities covered by the Act¹⁹⁹ to conduct OCDD on their business relationship with customers. The 2005 FATF mutual evaluation report for Australia indicated that the Australian Transactions Reports and Analysis System (AUSTRAC) — through its Suspect Transaction Guideline²⁰⁰ — was encouraging reporting entities to adopt ‘Know Your Customer’ (KYC) in order to be aware of their customer’s business activities, but, as the Report pointed out, this guideline did not create any legally enforceable obligations.²⁰¹ The passing of the AML Act of 2006, filling this gap, is commendable.

According to the AML Act, reporting entities are required to have an AML program. ‘Part B’ of this program ought to specify the reporting entity’s ‘applicable customer identification procedures’ to verify a customer’s identity before providing a ‘designated service’ to the customer. The Act also requires a reporting entity to keep records for

¹⁹⁹ Including financial institutions, insurers, financial services licensees, unit trust managers, bullion sellers, real estate agents, and currency dealers: *Financial Transactions Reports Act 1988* (Cth) s 3.

²⁰⁰ AUSTRAC, *AUSTRAC Guideline No 1 – Financial Transaction Reports Act 1988 – Suspect Transaction Reporting* (2002) <http://www.austrac.gov.au/files/2003_guideline_1_suspect_transaction_reporting.pdf> at 28 September 2011.

²⁰¹ FATF, *Third Mutual Evaluation Report*, above n 15, 72. Also filed as IMF Country Report No 06/424 (2006). For text, see <<http://www.imf.org/external/pubs/ft/scr/2006/cr06424.pdf>> at 5 November 2011.

seven years after the end of that entity's relationship with the relevant customer. In some specific circumstances, an identification procedure may be provided after supplying a designated service.

The AML Act and Rules clarified some important issues regarding FATF, including different identification and verification requirements for different types of customers, such as individuals (including sole traders), companies (both domestic and registered foreign companies), trustees partnerships, incorporated and unincorporated associations, registered co-operatives and government bodies. The AML Rules in addition permit reporting entities to have authorised agents hold customer identification on behalf of the reporting entity.

In fact, the reporting entities interviewed for the purpose of this thesis and who have been obliged under the AML Act to identify and verify their customers were found to be screening their new customers against various lists, with most of them doing so through the Department of the Foreign Affairs and Trade (DFAT) 'LinkMatchLite' software program,²⁰² which facilitates access to a consolidated list of persons and entities on the Australian Department of Foreign Affairs and Trade (DFAT)²⁰³ and International Business Aviation Council (IBAC) websites. In the banking sector some banks were found to be also relying on some other additional lists, such as the Reserve Bank of Australia (RBA) list,²⁰⁴ and some of them extend that to include the New Zealand Police

²⁰² Australian Government, Department of Foreign Affairs and Trade, 'LinkMatchLite Software' (n d) <http://www.dfat.gov.au/icat/link_match_terms.html> at 2 October 2011.

²⁰³ Australian Government, Department of Foreign Affairs and Trade, 'Australia's Implementation of United Nations Security Council Financial Sanctions' (What is the Consolidated List?) (October 2010) <http://www.dfat.gov.au/icat/UNSC_financial_sanctions.html#section7> at 2 October 2011. List there available.

²⁰⁴ Reserve Bank of Australia, *Individuals and Entities Subject to Financial Sanctions Administered by the RBA* (August 2010) <<http://www.rba.gov.au/mkt-operations/fin-sanctions/>> at 2 October 2011.

list,²⁰⁵ and the lists of the US Office of Foreign Asset Control (OFAC),²⁰⁶ Her Majesty's Treasury (HMT) in the UK,²⁰⁷ Hong Kong Monetary Authority, Monetary Authority of Singapore, European Union²⁰⁸ and United Nations lists, as well as other lists that are mandatory in the areas in which they operate.

Even so, the verification style or method to be used still needs to be clarified, even for countries like Australia, where some still struggle with which is the best way to verify customers and cover all necessary information about them, whoever they are or wherever they are from, so as to ensure an active reporting system is in place.

3.2.1.2 Risk Based Approach

As previously identified, as a concept RBA utilised by the reporting entities aims to have them manage and mitigate the risk themselves. It can play a vital role in the reporting system if it is used the way it should be within a jurisdiction.

FATF in its recommendations considered the risk of the ML activities and included RBA in different recommendations and from different perspectives: from an industry and regulatory perspective in Recommendations 5, 6, 8, 20, 23 and 24; and from a risk management perspective in Recommendations 9 and 15.²⁰⁹ The FATF Recommendations left the door open to countries to choose the way that best suits their system to regulate the process of combating ML crimes. FATF left the decision to countries to choose their own regulatory framework, whether it came from the regulator

²⁰⁵ New Zealand Police, *Designated [Terrorist] Individuals and Organisations* (21 October 2010) avail <<http://www.police.govt.nz/service/counterterrorism/designated-terrorists.html>> at 2 October 2011.

²⁰⁶ Office of Foreign Assets Control, *Specially Designated Nationals and Blocked Persons* (3 November 2010) <<http://www.ustreas.gov/offices/enforcement/ofac/sdn/t11sdn.pdf>> at 2 October 2011.

²⁰⁷ HM Treasury, *Consolidated List of Financial Sanctions Targets in the UK* (28 October 2010) <<http://www.hm-treasury.gov.uk/d/sanctionsconlist.pdf>> at 2 October 2011.

²⁰⁸ European Commission, External Relations, *Electronic List of Persons and Entities Subject to Financial Sanctions on the Day 29/10/1010* <http://ec.europa.eu/external_relations/cfsp/sanctions/consolid_en.htm> at 2 October 2011.

²⁰⁹ See FATF, *FATF 40 Recommendations*, above n 129.

(known as a ‘Rule Based Approach’, or from the regulated in an ‘RBA’). These different concepts depend on the source of managing and mitigating the ML risk for a jurisdiction. Under the rule based approach a regulator assesses the risk and decides the applicable measures that the reporting entity must use in combating ML activities, and sets this out in ‘rules’. Under the RBA reporting entities carry out the obligation to manage and mitigate their risk according to the degree of risk that they face and implement their own measures applicable to preventing ML activity. The RBA involves delegation of many regulatory tasks to the entities being regulated. This has its own risks. It is relying on the quality of the reporting entities’ internal systems and these are different from entity to entity.²¹⁰

However, a number of Australian compliance managers indicated that there is no ‘pure’ RBA for the purpose of AML activities. They explained that:

...the rule based approach still has an important role in the [RBA]. In fact both approaches join together, when we are looking to the components being regulated from both approaches. By the end of the day there is no [RBA], it will turn to the rule based approach.²¹¹

This opinion did not come from ‘empty space’; it came from a few years of experience with the RBA issue and applying it at work. It also came from managers struggling with the meaning of ‘risk’ and ‘level of the risk’. This is despite AUSTRAC having provided some significant online material on risk analysis that could help these entities in their RBA. These materials warrant closer examination.

²¹⁰ Julia Black and Robert Baldwin, ‘Really Responsive Risk-Based Regulation’ (2010) *Law & Policy*, University of Denver/Colorado Seminary, 201.

²¹¹ A number of compliance managers at ACAMS workshop, *AUSTRAC Consultation: Making Your Voice Heard*, Melbourne, 7th of July 2010.

The comment above, however, indicates that some require more and more explanations ('rules') to apply to given situations, and thus (for them) RBA increasingly resembles rule-based approaches, as the source of guidance inevitably must be the regulator.

What Does 'Risk' Mean?

FATF has tried in many publications to clarify RBA. It has published a number of documents in an attempt to solve the complexity of the RBA terminology, but the question remains, 'Did it succeed?'.

The most important such document was the 2007 document, *Guidance on the Risk Based Approach in Combating Money Laundering and Terrorism Financing* (2007 RBA Guidance).²¹² FATF has also issued a number of guidance documents for particular types of businesses that it believes should be obliged by law to report any suspicions they have about customers. These documents include the *RBA Guidance for Accountants* in 2008,²¹³ *RBA Guidance for Legal Professionals* (2008),²¹⁴ *RBA Guidance for Trust and Company Service Providers* (2008),²¹⁵ *RBA Guidance for Real Estate Agents* (2008),²¹⁶ *RBA Guidance for Casinos* 2008,²¹⁷ *RBA Guidance for Dealers*

²¹² FATF, 2007 RBA Guidance, above n 140.

²¹³ Financial Action Task Force (FATF), *RBA Guidance for Accountants* (2008) <<http://www.fatf-gafi.org/dataoecd/19/40/41091859.pdf>> at 9 October 2011.

²¹⁴ Financial Action Task Force (FATF), *RBA Guidance for Legal Professionals* (2008) <<http://www.fatf-gafi.org/dataoecd/5/58/41584211.pdf>> at 9 October 2011.

²¹⁵ Financial Action Task Force (FATF), *RBA Guidance for Trust and Company Services Providers* (2008) <<http://www.fatf-gafi.org/dataoecd/19/44/41092947.pdf>> at 9 October 2011.

²¹⁶ Financial Action Task Force (FATF), *RBA Guidance for Real Estate Agents* (2008) <<http://www.fatf-gafi.org/dataoecd/18/54/41090722.pdf>> at 9 October 2011.

²¹⁷ Financial Action Task Force (FATF), *RBA Guidance for Casinos* (2008) <<http://www.fatf-gafi.org/dataoecd/5/61/41584370.pdf>> at 9 October 2011.

in Precious Metals and Stones 2008,²¹⁸ *Guidance for Money Services Businesses-Risk Based Approach (2009)*²¹⁹ and *Guidance for the Life Insurance Sector (2009)*.²²⁰

Despite all of these efforts to clarify RBA for different types and sizes of businesses, critical issues remain, one such issue being the meaning of the ‘risk’. For example, in its 2007 RBA Guidance, and particularly in the section on the purpose of RBA, FATF notes that:

Adopting a [RBA] implies the adoption of the risk management process for dealing with money laundering and terrorist financing. This process encompasses recognising the existence of the risk(s), undertaking an assessment of the risk(s) and developing strategies to manage and mitigate the identified risks.²²¹

No one can tell exactly what FATF means by ‘risk’ in that part of the 2007 guidance document, nor in other publications. FATF does not refer to the risk in regard to the amount of the money laundering in the 2007 guidance document,²²² instead the matter is left to the relevant legislature (or if a similar approach is taken by the legislature, to the entity itself to determine). The recommendations are advisory, not compulsory; even so the legislative and regulatory outcomes will necessarily vary from country to country. Later documents again contain no precise reference to threshold amounts, and instead issue cautionary warnings about the need for thresholds and awareness of the danger posed by split or multiple transactions.²²³ Yet in at least one exception, a 2009 guidance document, two clear recommended thresholds are indicated for particular

²¹⁸ Financial Action Task Force (FATF), *RBA Guidance for Dealers in Precious Metals and Stones* (2008) <<http://www.fatf-gafi.org/dataoecd/19/42/41012021.pdf>> at 9 October 2011.

²¹⁹ Financial Action Task Force (FATF), *Guidance for Money Services Businesses-Risk Based Approach* (2009) <<http://www.fatf-gafi.org/dataoecd/45/1/43249256.pdf>> at 9 October 2011.

²²⁰ Financial Action Task Force (FATF), *Guidance for the Life Insurance Sector* (2009) <<http://www.fatf-gafi.org/dataoecd/0/15/43905397.pdf>> at 4 November 2011.

²²¹ FATF, *2007 RBA Guidance*, above n 140, 2.

²²² *Ibid* 9 [1.42], 27 [3.14].

²²³ See, eg, FATF, *RBA Guidance for Legal Professionals*, above n 214, 13. See also FATF, *Guidance for RBA Guidance for Accountants*, above n 213.

transactions.²²⁴ However, this is because these are dealing with cash transactions on which thresholds have been applied long before the RBA.

In regard to the entity that provides the service, again there is no indication regarding ‘risk’ in the primary 2007 guidance document.

If ‘risk’ refers to the amount of money, then it could refer to either ‘any amount’ of money that has been laundered or is suspected to have been laundered; or to a ‘particular’ amount of money that has been laundered. These are different: if it is any amount of money, then it means any level of risk, including high or low risk; but if it is a particular amount of money, then it could include the high level of risk and exclude the low level of risk — FATF did not clarify whether it meant the first (threshold-free) or the second (threshold-dependent) risk type.

On the other hand, if ‘risk’ refers to the entity that provides the services, then it could be restricted to high risk entities, excluding low risk entities; or it could include both high and low risk entities. Again FATF is unclear. However, it is more likely that FATF is referring to the risk of ML activity in general terms.

Thus it is important to address the meaning of the risk and the consequences of the various definitions so as to better clarify the concept. In relation to the risk of ML activity, there are four main areas of risk, namely the customer, the service, the delivery process or the (geographical) location.

²²⁴ FATF, *Guidance for Money Services Businesses*, above n 219, 14 [48]: ‘...the identification and verification of identity of customers are requirements which must be completed *regardless of the risk based approach* for all customers that have an account or a business relationship and when the appropriate monetary thresholds are reached (*not higher than USD/EUR 15 000 for occasional transactions or not higher than USD/EUR 1 000 for wire transfers*). This is the case for *cross-border and domestic transfers of funds between financial institutions*, including MSBs.’

This ambiguity in the meaning of risk affects the way reporting entities understand and comply with the reporting system. Entities unable to correctly ascertain the level of risk — whether it is about the quantity of money they are dealing with or the level of risk according to the type of the services that they are providing — can hardly be expected to identify accurately the risk the customer may pose and so comply with any AML system and its reporting obligations. In the absence of clear, easily comprehensible definitions, they may be unable to correctly distinguish low risk from high risk products. And, if the FIU itself does not know exactly what ‘risk’ means (or its personnel are uncertain), then how can it supervise the level of the reporting entity compliance and enforce compliance when this is needed?

The Level of the Risk

Through the FATF Recommendations and the 2007 RBA Guidance it is easy to notice that the considerable level of risk that RBA continues to pose. It calls for a high level of awareness regarding persons and activities with a higher risk, and a lesser degree of awareness regarding those posing a low risk.

If the problem of the meaning of the risk is put aside, there is still a major problem when one looks at the *level* of the risk. In its 2007 RBA Guidance, FATF noted that:

A country could decide that it will apply the full range of AML/CFT measures set out in Recommendations 5-11, 13-15, 18 and 21-22, to all types of financial institutions. However, that country may also decide to take risk into account, and may decide to limit the application of certain Recommendations provided that either of the conditions set out below are met. Where there are limitations or exemptions, this should be done on a strictly limited and justified basis:

- When a financial activity is carried out by a person or entity on an occasional or very limited basis (having regard to quantitative and absolute criteria) such that there is little risk of money laundering or terrorist financing activity occurring, a country may decide that the application of AML measures is not necessary, either fully or partially.
- In strictly limited and justified circumstances, and based on a proven low risk of money laundering or terrorist financing, a country may decide not to apply

some or all of the Forty Recommendations to some of the financial activities.²²⁵

Thus, FATF indicates that countries are able to decide not to apply the AML measures for persons or activities deemed to pose a low risk, but the actual problem is not generally associated with this scenario. The problem appears when a low risk reporting entity has high risk customers, in which instance the AML system appears inadequate to deal with such issues in accordance with the FATF standards. Another scenario where a problem exists is where a low risk reporting entity (under FATF standards) has quite large numbers of small value transactions of less than the threshold amount of AUD10,000 which nevertheless (as an aggregated amount) could reflect a considerable risk.

The freedom of countries to determine their own regulations and legislation in accordance with FATF standards may result in a lack of reference to a threshold for aggregated multiple transactions (or measures in relation to them) in national legislation. In such a situation, FIU enforcement of reporting entity compliance and insistence that they take RBA measures in relation to such transactions appears problematic. Threshold variations between jurisdictions would cause further problems in regard to consistency.

The Australian AML system follows RBA and its AML Act is built on this principle. A number of compliance managers have complained that it is the mix of risks that poses particular difficulty for them as reporting entities:

[T]he Act basically says the obligation is on the reporting entity to identify, monitor and manage their own risk by themselves. The risk posed by offering that particular product to that particular customer. So the customer could be quite low risk and the product could be quite high risk and vice versa, it could be a high risk

²²⁵ Ibid 5.

customer and it could be a very ‘vanilla’ low risk product. So they are ‘mixing their metaphors’ there to start with. Transaction activity is one thing, the risk profile of the investor or the customer it is a different category altogether.²²⁶

While some may argue that this says more about the person who made the comment that the RBA concept, it does reveal existing actual or attitudinal /perceptual difficulties of those enmeshed in administering the system, and perhaps their inability to come to grips with it. In addition, transaction activity appears to be perceived as easier to identify and monitor. The involvement of customer risk profiles adds a qualitative rather than easily quantifiable dimension, and, traditionally at least, those involved in banking and finance are more accustomed to and are more comfortable with ‘numbers based’ judgments. Various ‘lists’ may therefore be resorted to.

3.2.1.3 Beneficial Owner

One of the core matters needing to be resolved in the CDD process is identifying the ‘beneficial owner’. FATF’s Forty Recommendations mention the ‘beneficial owner’ in a number of places.²²⁷ The entire document encourages reporting entities to take CDD measures, including identifying the beneficial owner at the beginning of the relationship or thereafter, and taking necessary legal or regulatory measures to prevent money launderers from being the beneficial owners in specific circumstances (such as operating or holding a management function of a casino). It also encourages countries to have adequate, accurate and timely information about the beneficial owner to prevent the unlawful use of legal persons by money launderers.

In the Glossary to the FATF Methodology, FATF defines the ‘beneficial owner’ as:

²²⁶ A number of compliance managers: ACAMS workshop, *AUSTRAC Consultation: Making Your Voice Heard*, above n 211.

²²⁷ FATF, *The 40 Recommendations*, above n 129. See Recommendations 5, 23, 33.

The natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement.²²⁸

The risk of the ML activities will never be managed or mitigated by any reporting entity when applying the RBA without identifying the beneficial owner; therefore, it is a core matter for any AML system of any country if it is to be a successful and useful regime.

However, from the Australian regulatory viewpoint the beneficial owner is limited to including individuals but not legal persons, as is clear in Chapter 1 of the AML Rules where it defines the term ‘beneficial owner’: ‘[I]n respect of a company, [it] means any individual who owns through one or more share holdings more than 25 per cent of the issued capital in the company’.²²⁹ This restriction in identifying the beneficial owner through the Rules that have been issued by AUSTRAC to suit the AML/CFT Act makes compliance with FATF Recommendation 5 unachievable for the reporting entities when it comes to knowing what level of beneficial ownership must be identified and how, especially in regard to proprietary or private companies which are not licensed and subject to regulatory oversight by Commonwealth, State and Territory statutory regulation.²³⁰

The flaw in identifying ownership resulted in FATF indicating in its 2005 mutual evaluation that the Australian AML system is non-compliant with Recommendation 5. Since 2005 and up until the date of this thesis, FATF has insisted on Australia providing

²²⁸ FATF, Methodology for Assessing Compliance with the FATF 40+9 Recommendations, above n 62.

²²⁹ Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 (No. 1) <[http://www.comlaw.gov.au/ComLaw/Legislation/LegislativeInstrumentCompilation1.nsf/0/BF832A36C2001A90CA2577AF002209E2/\\$file/AUSTRAC_n397080_v2_AMLCTF_Rules_Compilation_up_to_2010_No.pdf](http://www.comlaw.gov.au/ComLaw/Legislation/LegislativeInstrumentCompilation1.nsf/0/BF832A36C2001A90CA2577AF002209E2/$file/AUSTRAC_n397080_v2_AMLCTF_Rules_Compilation_up_to_2010_No.pdf)> at October 2011. 8.

²³⁰ AUSTRAC, Response to Australian Bankers Association (ABA) submission to the Productivity Commission, *Annual Review of Regulatory Burdens on Business – Business and Consumer Services* (2010) <http://www.pc.gov.au/__data/assets/pdf_file/0003/99174/sub026.pdf> at 5 November 2010, 10-11.

an annual report on its AML system achievements and has refused to make reporting on a biennial basis. It is clear that FATF is dissatisfied with the Australian way of applying the RBA to CDD and the AML system.²³¹ It appears particularly dissatisfied with the Australian regime permitting ‘financial institutions to [themselves] determine whether or not to apply certain measures, including identifying and verifying beneficial owners for companies’, which AUSTRAC itself reports was ‘beyond what can be determined using a RBA as defined by the FATF Recommendations’.²³² This indicates that the bankers want even less regulation while FATF wants more regulation — so AUSTRAC is being criticised by bankers for ‘too much’ and by FATF for ‘too little’ regulation.²³³

The development of the AML Act was marked by lengthy and detailed consultation with the Australian Bankers Association (ABA), its members and other entities affected, over a period of around two years. The AML Rules were also developed in close consultation with industry, including the ABA and its members, and AUSTRAC continues this practice in developing its rules. Some might say that the weaker regime was the product of too close consultation with the industry (and perhaps even a degree of ‘regulatory capture’) though from the response to this document it is obviously that the ABA would like even less burdensome regulation and greater flexibility to determine to whom to apply the Rules.

However, the question is why are there difficulties in fully complying with FATF’s requirements in regards to beneficial ownership?

²³¹ FATF, *Annual Report 2009–2010* <<http://www.fatf-gafi.org/dataoecd/50/53/45712700.pdf>> at October 2010, 22.

²³² AUSTRAC, Response to ABA submission to the Productivity Commission, *Annual Review of Regulatory Burdens on Business – Business and Consumer Services* (2010) above n 230, 10–11.

²³³ Ibid. See also FATF, *Consultation on Proposed Changes to the FATF Standards, Compilation of Responses from the Financial Sector – Part One* (2011) 32–8.

Analysis of this issue has revealed that the cause is the difficulty in identifying the beneficial owner, which in turn is due to five important reasons:

- 1 FATF standards for identifying the beneficial owner contribute some ambiguity, as accurate information must be provided that identifies the beneficial owner. Clarification of this concept is required.
- 2 The different types of entities that are obliged under the AML Act 2006 and its amendments to carry out the reporting obligations — including those to be listed under the second tranche of the AML Act, such as lawyers, accountants, real estate agents and gold bullion sellers and buyers — contribute to the difficulty in identifying the beneficial owners. The ambiguity of the FATF Recommendation is unhelpful.
- 3 Reporting entities are not engaging with the regulator — in Australia, AUSTRAC — in identifying the beneficial owner. The informal interpretation supplied to clarify the rules is insufficient, especially when the reporting entities see themselves as ‘rule followers’ without any need to discuss the matter or be involved in any further complicated issues of the AML system.
- 4 Regulators within the same jurisdiction are working too removed from each other in terms of the AML system, even in cases where they have MoUs. In the Australian jurisdiction the role of every single authority in the AML scheme is clear — most regulators view the AML supervisory role as solely belonging to the FIU unit.
- 5 The need to fill these gaps is great, because identifying the beneficial owners means lower ML risk, and not identifying them means high ML risk.

AUSTRAC is carrying too much on its shoulders in regard to this matter. In order to improve the system to meet the FATF Recommendations as FATF requires in terms of identifying beneficial owners and other issues, AUSTRAC needs to improve many processes and procedures. This requires greater resourcing.

In fact, AUSTRAC is not the only authority in Australia that has responsibility for combating ML crimes in general and regulating beneficial ownership and other issues related to the AML system. Other government agencies also have a role in collaborating with AUSTRAC. In this regard, and particularly in identifying beneficial owners, ASIC has an important role to play. As the reporting entities are facing difficulties in identifying the beneficial ownership, and with the different standards of identification and verification, they become more reliant on ASIC working as a regulator and supervisor for the integrity of the financial sector. ASIC should have processes and procedures in place to ensure that the information gained about the reporting entities and its directors is true and not by any chance false. This is important as reporting entities and particularly the financial institutions rely on the information that they receive from ASIC about other reporting entities and their directors. AUSTRAC surely cannot be blamed for not detecting false information about a reporting entity if the accuracy of such information is an ASIC responsibility. ASIC's role in CDD needs to be clarified and its effectiveness determined. In fact, ASIC currently comes under the portfolio responsibilities of the Parliamentary Secretary to the Treasurer, which means that there are multiple portfolios involved with multiple Ministers, making coordination and cooperation less likely.

If other regulators were to work in conjunction with AUSTRAC, and the important roles that these authorities actually could play in the AML system were identified

clearly, then there is no doubt that the whole situation would be changed and a new, improved climate created to combat ML crimes more effectively. This would particularly be the case if other reasons for difficulty in identifying the beneficial were addressed. However, ASIC clearly does not see itself performing such a role.

Recently, AUSTRAC made a submission to the Productivity Commission's Annual Review of Regulatory Burdens on Business – Business and Consumer Services, and took the opportunity to respond to submissions from industry groups and others regarding the legislative regime and its impact on business. It revealed its desire to comply with the FATF requirements in regard to identifying beneficial owner and other important issues.²³⁴ It is hoped that further engagement of the reporting entities with AUSTRAC can bring the required solutions and secure the best possible regulatory system as soon as possible.

3.2.2 Reporting the Suspicion

While the FATF Recommendations are legally non-binding, a number of them are presented as if they are obligations with which a country must comply.

A number of the recommendations issued oblige reporting entities (including the financial institutions and DNFBPs) to detect and report suspicious transactions to the FIU. Recommendations 13 to 16 cover STRs that the reporting entities are required to submit when a suspicion transaction has occurred. The Recommendations require such reports not only from reporting entities who offer designated services but also from non-designated financial institutions, including accountants, gold bullion buyers and sellers, lawyers, real estate agents and so on.

²³⁴ Productivity Commission, *Annual Review of Regulatory Burdens on Business – Business and Consumer Services* (2010) <http://www.pc.gov.au/__data/assets/pdf_file/0003/99174/sub026.pdf> at 20 October 2011.

FATF has thereby tried to cover all businesses that could reliably be a source of ML activities. FATF is to be commended for taking these various types of entities into consideration when designating what entities should be obliged under a country's legislation to submit STRs to the FIUs. In Australia, as previously mentioned, the second tranche of the Act to include the non-designated financial institutions in the reporting system has not yet come into force and there is no indication of an implementation date. AUSTRAC is currently more focused on implementing a pricing regime for reporting entities for its services. The idea of a second tranche was announced by the Australian Government years ago (2005)²³⁵ in large part of it remains 'on the back burner' despite the introduction of the *AML-CTF Act 2006*.

In fact, a number of dilemmas are associated with STRs, including the uncertainty of suspicion. This issue could add to the challenges that are facing or potentially undermining the achievements of the STRs' goals including reducing and preventing crime, and also add greater difficulty to measuring the effectiveness of such types of reports and problems in separating their influence from other aspects of an AML regime.²³⁶

3.2.2.1 Uncertainty of Suspicion

Although the FATF recommendations are a benchmark in regard to reporting suspicious activities, it has yet to define what 'suspicious' or 'suspicion' means. It has been said that this is because it is a subjective rather than objective matter. The ground of suspicion that entails a reporting entity's FIU reporting obligation remains unclear to

²³⁵ Attorney General's Department, *Second Tranche of Reforms* < http://www.ag.gov.au/www/agd/agd.nsf/Page/Anti-moneylaundering_SecondTrancheofReforms> at 20 October 2011.

²³⁶ David Chaikin, 'How Effective are Suspicious Transaction Reporting Systems?' (2009) 12(3) *Journal of Money Laundering Control* 239.

the reporting entities themselves and also to the FIU. The FATF Recommendations failed to clarify ‘suspicion’ or its grounds for two reasons:

- 1 FATF issued the recommendations to suit all systems of all countries, whatever their financial or the political system.
- 2 FATF issued the recommendations to cover all types of businesses; those offering designated services and those who are designated non-financial businesses and professions. The different businesses represent different kinds of risks and suspicious activities that are conducted through their institutions.

So it was difficult for FATF to identify ‘suspicion’ as suspicion has to arise in a context. It does not matter whether the country is Australia or Jordan or Mexico. ‘What is suspicious’ must be a decision made in the context of transactions involving customers and services in a location, however, while the concept is not difficult, the problem is that FATF has not explained these basic concepts and many FIUs seem unable to deal with them either.

Clarifying ‘suspicion’ is not a simple issue at the national or entity level either. In this regard, Levi (1997) pointed out that with their varying levels of economic and social development, countries have dissimilar views about the way of controlling ML activities.²³⁷ This calls into question the suitability of the FATF Recommendations and their ‘one-size-fits-all’ approach.

Beare (2002) shares this opinion and also mentions that at a local level it is easy for the expert launderers, when dealing with the reporting entities face-to-face, to mask their

²³⁷ Levi, ‘Money Laundering and Regulatory Policies’, above n 21, 260.

deception, where the less able would betray themselves with faltering speech for example.²³⁸

This uncertainty of suspicion made many reporting entities uncomfortable in dealing with this problem, especially when FATF in Recommendation 13 indicates that:

If a financial institution suspects or has reasonable grounds to suspect that funds are the proceeds of a criminal activity, or are related to terrorist financing, it should be required, directly by law or regulation, to report promptly its suspicious to the financial intelligence unit (FIU).²³⁹

Thus, suspicion and having reasonable grounds for suspicion are different concepts for FATF, or let us to say different levels. Both levels prompt reporting. FATF appears to have failed to recognise that if it asks reporting entities to identify suspicion of criminal activity, reporting entities will rightly say that they are unable to do so. This is the wrong question and it has been the wrong question from the outset. It is the problem for R13, who should ask if the transaction is unusual or suspicious from the perspective of what is known about the customers and their businesses. It also failed to take into account the need for quality reporting. A decrease in quality is probable if reporting entities report every single suspicious transaction, whether that report is built on a ‘reasonable grounds’ or not. Low or poor quality SMRs could lead to overburdening systems with finite resources.

Consequently, it is very important for the reporting entities and the FIUs to define ‘suspicion’ (as in ‘suspicious transfer’, ‘suspect’ or ‘reasonable ground to suspect’), to be more accurate when dealing with ML activities.

²³⁸ Beare, above n 70,260.

²³⁹ FATF, *The 40 Recommendations*, above n 129, 5.

That various legislatures attempting to implement FATF compliant AML legislation enact different requirements in this regard demonstrates lack of understanding of the concept or at least its openness to interpretation.

In the case of the *Shah & Anor v HSBC Private Bank (UK) Ltd*,²⁴⁰ the High Court in England and Wales rejected the argument that an SMR must be based on 'reasonable grounds'. In this case, the claimants indicated that they suffered significant damages occurring out of delays by HSBC in completing four transfers from the claimants' account. While HSBC did not provide explanations for the delay, the fundamental reason for the delay was that HSBC suspected that the funds in the claimants' account were criminal assets.

As a result, HSBC had to make an authorised disclosure to the relevant authorities before it could proceed with each transaction and then it waited for appropriate consent under the POCA. Here the claimants indicated that the reporting obligation was not generated under the POCA unless HSBC had reasonable grounds for their suspicion. If no reporting obligation existed, HSBC could have been in breach of their contractual obligation to deal in accordance with the customers' instructions and hence liable for damages. The Court held that there was no legal basis for the requirement of 'reasonableness' in the UK legislation and that 'the issue of suspicion under POCA was purely subjective'. There was no legal requirement that reasonable grounds exist for the suspicion. Thus, it was only open to the claimants to insure that the suspicion was held fraudulently. As no such assertion was made, their damages claim could not succeed. This was the case even if the suspicion was not established on reasonable grounds.

²⁴⁰ *Shah & Anor v HSBC Private Bank (UK) Ltd* ([2009] EWHC 79 (QB)) <<http://www.bailii.org/ew/cases/EWHC/QB/2009/79.html>> at 19 July 2012.

Therefore, the court rejected the claimants' argument that the suspicion must be reasonably held indicating that 'to impose a superadded requirement of reasonableness would put a banker in an impossible position and mean that he could be in breach of duty even though he was acting as the law compelled him to. That would be neither sensible nor principled.'

However, a 'reasonable grounds' requirement is embodied in the Australian approach (see below),²⁴¹ and is reflected in at least one banking entity statement on the matter.²⁴²

AUSTRAC attempts to define 'suspicion' for AML purposes. Its *Public Legal Interpretation Number 6 of 2008, Suspect Transactions and Suspicious Matter Reports*, focussing on the fact that the ground to suspect has to be 'reasonable' and notes that:

"Reasonable ground to suspect" indicates that the test is both objective and subjective. That is, the cash dealer must have a real suspicion of the relevant matters *and* the suspicion must be based on matters or evidence that supports the truth of the suspicion.²⁴³

In its most recent survey (March 2010), AUSTRAC indicated that a large number of reporting entities did not report *any* AML matters to their boards or equivalent executive body during the previous financial year. Therefore, AUSTRAC is encouraging these reporting entities to guarantee that appropriate oversight arrangements are in place.²⁴⁴

Sir Stephen Lander (2006) discussed the role of SOCA (Serious Organised Crime Agency of UK) in the SARs' system and the skills and resources that SOCA needed to fulfil its duties and responsibilities under the AML regime. One of the essential skills

²⁴¹ AUSTRAC, 'Reporting Obligations' in *AUSTRAC Regulatory Guide* [ch 9] (as at 31 August 2009) 109–15 <http://www.austrac.gov.au/regulatory_guide.html>.

²⁴² Westpac Group, *Corporate Governance AML/CTF*(n d) <<http://www.westpac.com.au/about-westpac/the-westpac-group/corporate-governance/>> at 1 October 2011.

²⁴³ AUSTRAC, *Public Legal Interpretation Series No 6 of 2008*, above n 71, 5.

²⁴⁴ AUSTRAC, *AML/CTF Compliance Officers in Australia*, AUSTRAC Survey Series No.1 (2010) 28.

that SOCA needed was the capacity to develop effective collaboration. It also needed the resources to help the reporting entities in identifying suspicion. He indicated that the recommendations in his report were predicated on the belief that if SOCA delivered better communication and performance, that of itself should make it easier for other participants in the AML regime to deliver better outcomes, including targeting suspicious activities. He added an important qualification: ‘SOCA management is prepared to take on the responsibilities and programmes set out on that basis, but as long as there is a wider recognition that it has no power to direct other participants, and that success will depend equally on their efforts’.²⁴⁵

Thus, an effective regulatory agency with improved performance and levels of communication with the reporting entities is essential to identifying suspicion, not only for SOCA but also by any other FIU including AUSTRAC.

However, in a 2010 ACAMS workshop in Melbourne,²⁴⁶ a number of compliance managers claimed that the term ‘suspicion’ is still unclear, and asked what was meant by the phrase ‘reasonable ground’ — particularly and more specifically in regard to what decision they should make about which activities it is that their entities should investigate and which activities need a report to be sent to AUSTRAC as suspicious transactions or matters. A number of them also claimed that when they contact AUSTRAC to get some clarification about such subjects, AUSTRAC staff sometimes did not know the answers and their response was that they would ‘try to get back to you

²⁴⁵ Sir Stephen Lander, ‘Review of the Suspicious Activity Reports Regime’ (The SARs Review) (2006) *Serious Organised Crime Agency*, 47.

²⁴⁶ ACAMS workshop, *AUSTRAC Consultation: Making Your Voice Heard*, above n 211.

soon with the answer from the right people who know about this issue’, but ‘sometimes they never get back to us with the required information’.²⁴⁷

‘Suspicion’ thus remains an important issue that FATF has failed to clarify to the extent required by the reporting entities persistent ambiguities and a lack of experience in the field are still two of the main difficulties that reporting entities and AUSTRAC face.

3.2.2.2 High Value Cash Transaction Reports

The high value cash transaction reports (CTRs)²⁴⁸ which are also called threshold transaction reports (TTRs) are another important pillar for the AML reporting system, because it relies on reporting of transactions that involve the transfer of physical currency or e-currency, where the total amount transferred is not less than the specified threshold amount. According to FATF Recommendation 19:

Countries *should consider* the feasibility and utility of a system where banks and other financial institutions and intermediaries would report all domestic and international currency transactions above a fixed amount, to a national central agency with a computerised data base, available to competent authorities for use in money laundering or terrorist financing cases, subject to strict safeguards to ensure proper use of the information.²⁴⁹

In its interpretative notes to the Forty Recommendations, and particularly for Recommendations 5, 12 and 16, FATF has tried to clarify the value of the cash transaction:

The designated threshold for transactions (under Recommendations 5 and 12) are as follows:

- Financial institutions (for occasional customers under Recommendation 5) – USD/EUR 15,000.

²⁴⁷ Ibid.

²⁴⁸ A Cash Transaction Report (CTR) is a report that the reporting entities are required to file for each deposit, payment or transfer of currency, by, through, or to the reporting entity which involves a transaction in currency of more than a specific amount. A number of countries, including Australia, have specified a threshold amount of \$10,000. In this context, currency means the paper and/or coin money of any country that is designated as legal tender by the country of issuance.

²⁴⁹ FATF, *The 40 Recommendations*, above n 129, 7.

- Casinos, including internet casinos (under Recommendation 12) – USD/EUR 3000.
- For dealers in precious metals and dealers in precious stones when engaged in any cash transaction (under Recommendations 12 and 16) – USD/EUR 15.000.

Financial transactions above a designated threshold include situations where the transaction is carried out in a single operation or in several operations that appear to be linked.²⁵⁰

Although FATF has clarified the threshold values (above), the purely voluntary nature of Recommendation 19 remains a concern, as there is no obligation to follow it. Broome (2005) claims that FATF has failed to cover CTRs in the way they should be. He believes that CTRs can prove valuable instruments against ML and corruption. More specifically, he criticises FATF's 'failure to endorse high value cash transactions reporting as an essential element of an AML regime'.²⁵¹

It must be mentioned that specifying threshold amounts can help to protect the integrity of the financial system if correctly set.²⁵² When the Government decides the threshold value, it believes that this is the amount that can affect the integrity of the financial institution for that jurisdiction (that is, it believes that if ML transactions were on or above this amount, such integrity would be affected). Nevertheless, in practice the value is often set for political reasons to reduce the level of CTRs and, in some jurisdictions, to ensure free flow of large amounts of questionable funds.

A substantial problem remains, however, in regard to transactions of amounts slightly lower than the threshold value (for example, AUD9000 instead of AUD10,000). Not only does the source of the funds taint the institutions but even the lower value surely

²⁵⁰ Financial Action Task Force (FATF), *Interpretative Notes for the Forty Recommendations* (2003) <http://www.fatf-gafi.org/document/28/0,3343,en_32250379_32236930_33658140_1_1_1_1,00.html> at 10 October 2011.

²⁵¹ Broome, above n 3, 555.

²⁵² Too high and it will have little impact: Asian Development Bank, *Effective Anti-money Laundering Regime in Mongolia* (ADB, 2007) 25–6 <<http://www.adb.org/Documents/Books/anti-money-laundering/Anti-Money-Laundering.pdf>>.

affects the integrity of the financial institution, particularly where such transactions are repeated without detection.

Even amounts over a threshold that are reported may pass seemingly unnoticed, as occurred prior to 9/11.

The financing arrangements for the September 11 attacks on the US appear to have gone unnoticed by security agencies except on one occasion... the leader of the 19 hijackers, opened a bank account in southern Florida in June 2000, a wire transfer of \$69,985 from the Gulf three months later prompted 'SunTrust Bank' to make a suspicious transaction report to the US Treasury's Financial Crimes Enforcement Network. Like most of the 125,000 similar reports sent in each year, it went unremarked, until it was discovered by investigators searching for information on the people behind the hijacking of the four airplanes. The rest of the \$500,000 or so needed to finance the attacks arrived in the US through much smaller transfers or in cash or travellers cheques for amounts that rang no alarm bells with the banks.²⁵³

FATF has specified the value that needs to be reported as USD/EUR15,000 (a 'face value' of 50 per cent more than the Australian threshold of AUD10,000.²⁵⁴ The value specified by FATF appears to have been based on a parity between the Euro and the US dollar, whereas by late 2011, the US and Australian dollar regularly approach parity and the value for the Euro had fallen against both currencies, rendering comparisons more difficult in terms of intention in regards to value. However, that notwithstanding, lesser amounts are considered low risk and reporting entities can be less measured in supervising such transactions or not applying measures to them if the reporting entity believes that there is no risk involved. Yet several low transactions can affect the financial system integrity if such transactions are combined and misused by money launderers for TF (as above). Technical difficulties combine with transaction volumes to

²⁵³ John Willman, 'Trail of Terrorist Dollars That Spans the World' *Financial Times*, 29 November 2002, 1.

²⁵⁴ Such figures would have been affected by the falling value of the USD relative to both the Euro and the AUD in the wake of the 'Great Financial Crisis' which began in 2007/2008 and worsened through to 2010, so that the value would now be approximately AUD 15,000 given the current USD/AUD dollar parity Euro 1: USD 1.41; and Euro 1: AUD 1.4: Figures (corrected to 2 decimal places) from Citibank NA website at 5 November 2011.

make reliable ML/TF identification difficult in such instances. Many countries did not agree with the CTR obligation as a tool to initiate investigations, but use the threshold as a tool to identify suspicious transactions, relying on the receipt of other intelligence.²⁵⁵

In fact, the AML complex — as was shown in Chapter 1— has different members, including the regulator and law enforcement bodies, and other regulatory agencies and reporting entities. Each sees the AML system from their own perspective: the regulator and law enforcement bodies would like to combat the risk of the ML activities; other partner agencies care about keeping the financial system's integrity safe-guarded, ensuring a healthy economic regime; while reporting entities are looking to protect their reputation and avoid regulatory sanction for non-compliance or the loss of confidence or trust of other reporting entities. Thus, a reporting entity could choose not to apply AML measures on transactions below the threshold, because it does not want to risk its reputed integrity, and under the Act it has the option to choose not to apply these measures.

In its recommendations and publications, FATF provides standards to the regulator and other partner agencies in the AML system, but not to the reporting entities, who have the obligations to comply with this system and need to understand strategic risk management and apply the RBA in their operations. In regard to many issues, both regulators and partner agencies regard FATF materials as not sufficiently clear and as only adding more ambiguity to an already complex AML system.

²⁵⁵ Neil J Jensen, 'Technology and Intelligence' (2005) *Journal of Money Laundering Control* 227, 230.

3.2.3 Analysing and Circulating the Reports

Information received from reporting entities (whether STRs, SMRs, or CTRs) are analysed by the FIU.

In its analysis, the FIU test the reports, and according to the results, contact other partner agencies as well as the source reporting entity to obtain clarification and collect more data about the suspicious matter. Recommendation 29 further states that production of relevant data should be able to be compelled and sanctions available for failure to comply:

Supervisors should have adequate powers to monitor and ensure compliance by financial institutions with requirements to combat money laundering and terrorist financing, including the authority to conduct inspections. They should be authorised to compel production of any information from financial institutions that is relevant to monitoring such compliance, and to impose adequate administrative sanctions for failure to comply with such requirements.²⁵⁶

Thus, the process of analysing data actually provides the FIU with possibilities of adding more information and enhancing the value of the reports that have been sent by reporting entities.

Nevertheless, the ability of the FIU to ‘add value’ to the received reports will rely on many aspects. Factors include the regulatory culture of the regulatory agencies (which plays a vital role as specified for AML issues), the presence of well trained and committed staff for both reporting entities and regulatory agencies, adequate information security tools, dependable technology and systems, legislative support, a favorable strategic framework, the FIU budget, high levels of connectivity in the relationship between the FIU and its partner agencies, and extent of international information sharing. Countries should consider the FATF Recommendations in this

²⁵⁶ FATF, *The 40 Recommendations*, above n 129, 11.

regard and FATF should consider these challenges when it comes to evaluate a country's AML system and its FIU.

Following analysis, the FIU circulates and disseminates data collected to law enforcement bodies for them to take the appropriate action.

Law enforcement bodies are the last beneficial party of the AML reporting system. They receive the system's outcome — the reports. Improving the quality of data in a report is fundamental to making it a useful source of information to law enforcement bodies, and for the overall success of the AML system.

Another aspect could emerge from the Recommendation 26, where FATF indicates that:²⁵⁷

Countries should establish a FIU that serves as a national centre for the receiving (and, as permitted, requesting), analysis and dissemination of STR and other information regarding potential money laundering or terrorist financing. The FIU should have access, directly or indirectly, on a timely basis to the financial, administrative and law enforcement information that it requires to properly undertake its functions, including the analysis of STR.

Therefore, it is crucial for countries' AML systems in this regard to not only have MoUs between the FIU and its partner agencies (including law enforcement bodies), but to also consider the need to have an active FIU that knows how to evaluate the reports and circulate the useful ones to various law enforcement bodies, so system operations will be enhanced and optimal results achieved.

²⁵⁷ Ibid 10–11.

3.3 How FATF Sees the Australian Reporting Obligations²⁵⁸

Although Australia, like so many other countries, is attempting to comply with the FATF Recommendations, it does so in the context of its own legal and regulatory system and sets its own reporting obligations in accordance with that system. Its implementation of the FATF Recommendations is, however, subject to review by FATF.

3.3.1 Australia's Reporting Obligations

Before 2006, the Australian jurisdiction combated ML, tax evasion, and other major crimes under the *Financial Transaction Reports Act 1988* (Cth) (FTR Act). Under this Act cash dealers²⁵⁹ were obliged to submit reports of:²⁶⁰

- suspicious transactions
- cash transactions equal to or in excess of AUD10,000
- international funds transfer instruction.

²⁵⁸ It is important to understand the Australian reporting system at this stage and compare it with the FATF recommendations and how Australia is complying with these recommendations in terms of the reporting obligations. However, the Australian reporting entities' experiences in this domain will follow in Chapter Six.

²⁵⁹ Cash Dealers as defined in the FTR Act includes banks, building societies and credit unions, referred to as 'financial institutions'; insurance companies and insurance intermediaries, securities and derivatives dealers, futures brokers, cash carriers managers, trustees of unit trusts, firms that deal in travelers' money orders and like persons who collect, hold, exchange or remit currency on behalf of other persons, currency and bullion dealers, casinos and gambling houses, bookmakers and totalisator agency boards.

²⁶⁰ According to the *FTR Act 1988* (Cth) s 15 Reports in relation to transfer of currency into or out of Australia:

(1) Where:

(a) a person:

(i) transfers Australian currency or foreign currency out of Australia; or
(ii) transfers Australian currency or foreign currency into Australia; and

(b) the amount of currency involved in the transfer is not less than \$10,000 in value; and

(c) a report in respect of the transfer has not been given in accordance with this section;

the person, subject to subsections (2), (3) and (4), commits an offence against this subsection.

In addition, any person making any international cash movement of AUD10,000 (or a foreign currency equivalent) or more, into or out of Australia, whether as a passenger, in person, or by post had to report that transfer to AUSTRAC.²⁶¹

Thus Australia had reporting obligations through the FTR Act before the FATF Recommendations were first issued in 1990,²⁶² which makes the Australian AML system one of the first to take the risk of the ML activities into consideration, even if

²⁶¹ *FTR Act 1988* (Cth) s

(7) A report under this section shall:

- (a) be in the approved form;
- (b) contain the reportable details in relation to the matter being reported;
- (c) be signed by the person giving the report; and
- (d) be given to:
 - (i) if the transfer is effected by a person taking the currency out of, or bringing it into, Australia with the person – a customs officer; and
 - (ii) in any other case – the AUSTRAC CEO or a customs officer.

(7A) A report under this section, other than a report mentioned in paragraph (5)(c) or (d), must be given:

- (a) if subparagraph (7)(d)(i) applies – at the time the currency concerned is brought into, or taken out of, Australia; and
- (b) in any other case – at any time before the transfer takes place.

(7AA) For the purposes of subsection (7A), if currency is taken out of Australia by a person by consignment of the currency:

- (a) through the to a place outside Australia; or
- (b) to another person for carriage to a place outside Australia by that other person or by a third person; the time when the currency is taken out of Australia is the time when it is irrevocably committed by the first-mentioned person to the Australian Postal Corporation or to the other person, as the case may be.

(7B) For the purposes of paragraph (7A)(a), the time at which currency is brought into Australia by a person is:

- (a) if the person:
 - (i) transfers the currency into Australia when a passenger on an aircraft or ship; and
 - (ii) after disembarking, goes through an area set apart for customs officers to examine the passports and personal baggage of, and perform other duties in respect of, disembarking passengers and for such passengers to collect personal baggage; as soon as the person reaches the place in that area at which customs officers examine personal baggage or, if the person does not go to that place, when the person leaves that area; or
- (b) in any other case – the first opportunity after arrival in Australia that the person has to give the report under this section.

(7C) For the purposes of paragraph (7A)(a), the time at which currency is taken out of Australia by a person is:

- (a) if the person:
 - (i) transfers the currency out of Australia when a passenger on an aircraft or ship; and
 - (ii) before embarking, goes through an area set apart for customs officers to examine the passports of, and perform other duties in respect of, embarking passengers; when the person is at the place in that area at which customs officers examine passports; or
- (b) in any other case – as soon as the person reaches the customs officer who is to examine the person's passport in relation to the person leaving Australia or, if there is no such examination, the last opportunity before leaving Australia that the person has to give the report under this section.

²⁶² The Financial Action Task Force (FATF), *The 40 Recommendations* (1990) <<http://www.fatf-gafi.org/dataoecd/25/61/33635879.pdf>> at 15 Oct 2011.

there were shortcomings in the actual Act (or later legislation) in terms of the comprehensiveness of the reporting obligations.

In the current system, the *AML Act 2006* (Cth) under its first tranche, and particularly under Part 3,²⁶³ requires reporting entities who provide ‘financial services’ to carry out their reporting obligations and report to AUSTRAC the following types of reports:

- Suspicious matter report (SMR)²⁶⁴
- Threshold transactions report (TTR) of transactions equal to or more than AUD10,000²⁶⁵
- International funds transfer instruction report (IFTI).²⁶⁶

These types of reports are very important to the AML system, because they may prompt AUSTRAC and law enforcement bodies to take further steps in detecting, investigating and prosecuting groups and individuals involved in any ML or terrorism activities.

In addition to the required types of reports in Part 3 of the Act, Part 4 covers the two further important types of reports, those relating to:²⁶⁷

²⁶³ According to Part 3 Reporting Obligations, Division 1 Introduction, s 40 Simplified outline of the *AML/CTF Act 2006* (Cth): A reporting entity must give the AUSTRAC CEO reports about suspicious matters.

If a reporting entity provides a designated service that involves a threshold transaction, the reporting entity must give the AUSTRAC CEO a report about the transaction.

If a person sends or receives an international funds transfer instruction, the person must give the AUSTRAC CEO a report about the instruction.

A reporting entity may be required to give AML/CTF compliance reports to the AUSTRAC CEO.

²⁶⁴ *AML/CTF Act 2006* (Cth) ss 41–42. See also re SMRs, AUSTRAC, Reporting Requirements, An Introduction to the Anti-Money Laundering and Counter Terrorism Financing Act 2006 (*AML/CTF Act*) Reporting Requirements (n.d.) Doc no 140/1008/CC <http://www.austrac.gov.au/files/reporting_requirements.pdf> at 5 November 2010, 3.

²⁶⁵ *AML/CTF Act 2006* (Cth) ss 43–44. See also re TTRs, AUSTRAC, Reporting Requirements, An Introduction to the Anti-Money Laundering and Counter Terrorism Financing Act 2006 Doc no 140/1008/CC, above n 264, 3–4.

²⁶⁶ *AML/CTF Act 2006* (Cth) ss 45–46. See also re the two types of IFTI reports, AUSTRAC, Reporting Requirements, An Introduction to the Anti-Money Laundering and Counter terrorism Financing Act 2006 Doc no 140/1008/CC, above n 264, 4.

- Physical currency
- Bearer negotiable instruments.

It has been clear that the AML Act (2006) and *AML Rules* delivered a number of remarkable achievements with regards to the verification and identification of customers, and reporting of suspicions.

Ongoing Customer Due Diligence

Ongoing Customer Due Diligence (OCDD) is one of the core issues for any AML system, and Australia has been taking its importance into account since the issuing of the AML Act (2006) and AML Rules, particularly under Part 2 Division 6 of the AML Act, and Chapter 15 of the AML Rules.

Reporting entities (who provide designated services) are obliged under the system to continue to supervise customers and their transactions, utilising RBA by managing and mitigating the risk of these institutions themselves.

To achieve the required level of compliance with the OCDD obligation, the reporting entities must take into consideration three compulsory elements, stated in the Chapter 15 of the AML Rules. These include:

²⁶⁷ According to the *AML/CTF Act 2006* (Cth), Part 4 Reports about cross-border movements of physical currency and bearer negotiable instruments, Division 1 Introduction, s 54 Simplified outline:

- Cross-border movements of physical currency must be reported to the AUSTRAC CEO, a customs officer or a police officer if the total value moved is above a threshold.
- If a bearer negotiable instrument is produced to a police officer or a customer officer by a person leaving or arriving in Australia, the officer may require the person to give a report about the instrument to the AUSTRAC CEO, a customs officer or a police officer.

- 1 Collecting and verifying of any additional information for customers under the KYC principle:²⁶⁸

In this element, reporting entities in their AML programs must maintain a process of collecting information about their own customers and verifying it before providing any designated service to them. They also decide when it could be essential to obtain additional KYC information. They must also update or verify existing KYC information when needed. Therefore, OCDD is more comprehensive than CDD, because it is a continual process in relation to identifying and verifying customer information and is not simply conducted when a relationship is begun.

- 2 Having a program of transaction monitoring:²⁶⁹

According to the AML Act, reporting entities must have Part A within their AML program.²⁷⁰ This must include monitoring suspicious, complex, unusual large

²⁶⁸ According to AML/CTF Rules 2006, ch 15 OCDD, KYC information:

15.2 A reporting entity must put in place appropriate risk-based systems and controls to determine whether any further KYC information should be collected in respect of customers for ongoing customer due diligence purposes.

15.3A reporting entity must put in place appropriate risk-based systems and controls to determine whether and in what circumstances KYC information should be updated or verified in respect of its customers for ongoing customer due diligence purposes.

²⁶⁹ According to AML/CTF Rules 2006, ch 15 OCDD, Transaction Monitoring Program:

15.4 A reporting entity must include a transaction monitoring program in Part A of its AML/CTF program.

15.5 The transaction monitoring program must include appropriate risk-based systems and controls to monitor the transactions of customers.

15.6 The transaction monitoring program must have the purpose of identifying, having regard to ML/TF risk, any transaction that appears to be suspicious within the terms of section 41 of the AML/CTF Act.

15.7 The transaction monitoring program should have regard to complex, unusual large transactions and unusual patterns of transactions, which have no apparent economic or visible lawful purpose.

²⁷⁰ AUSTRAC, *AUSTRAC Regulatory Guide* <http://www.austrac.gov.au/rg_3.html> at 6 November 2011. According to AUSTRAC: 'AML/CTF programs are a new requirement introduced under the AML/CTF Act. The primary purpose of Part A of an AML/CTF program is to identify, mitigate and manage the risk that a reporting entity might knowingly, inadvertently or otherwise, facilitate money laundering or terrorism financing in the provision of designated services. **Identification:** is the assessment and recognition of ML/TF risks associated with a designated service a reporting entity provides. **Mitigation:** involves analysis of the identified ML/TF risks, prioritisation of the risks according to likelihood of occurrence and the consequences if it did, developing a strategy to prevent the risk

transactions and unusual patterns of transactions that are occurring in their systems.

Reporting entities, in accordance with their RBA, can decide which system will best monitor these transactions; whether an electronic based system using specific software for this purpose or not is up to the reporting entities to decide.

3 Having a program for enhancing customer due diligence:²⁷¹

In this element the reporting entities must utilise the best techniques to identify and verify a customer who has been found by the reporting entities to have a high level of risk. For this purpose, reporting entities must verify, analyse, clarify, re-verify, update, or analyse and monitor the customer's transactions, collect any KYC information about a customer, clarify the nature of the customer's ongoing business with the reporting entity, and/or report any suspicious matter to AUSTRAC.

occurring and implementing that strategy. Management: is monitoring and reviewing mitigation strategies'.

²⁷¹ According to *AML/CTF Rules 2006*, ch15 OCDD, Enhanced Customer Due Diligence Program:

15.8 A reporting entity must include an enhanced customer due diligence program in Part A of its AML/CTF program.

15.9 The reporting entity must apply the enhanced customer due diligence program when:

- (1) it determines under its risk-based systems and controls that the ML/TF risk is high; or
- (2) a suspicion has arisen for the purposes of section 41 of the AML/CTF Act.

15.10 The enhanced customer due diligence program must include appropriate risk-based systems and controls so that, in cases where enhanced customer due diligence is applied, a reporting entity gives consideration to whether any one or more of the following applies:

- (1) further information ought to be sought from the customer or from third party sources in order to:
 - (a) clarify or update the customer's KYC information;
 - (b) obtain any further KYC information;
 - (c) clarify the nature of the customer's ongoing business with the reporting entity;
 - (d) consider any suspicion that may have arisen for the purposes of section 41 of the AML/CTF Act;
- (2) more detailed analysis should be undertaken in respect of the customer's KYC information;
- (3) KYC information ought to be verified or re-verified in accordance with the customer identification program;
- (4) more detailed analysis and monitoring should be undertaken in respect of the customer's transactions – both past and future;
- (5) a suspicious matter report ought to be lodged in accordance with section 41 of the AML/CTF Act.

Reporting Suspicious and Unusual Matters

One of the great achievements of the Australian AML system and its AML Act is that the reporting obligation has broadened from the obligation under the FTR Act to report suspicious transactions (STRs) to reporting any suspicious matters (SMRs) including suspicious transactions.

The suspicious matters reporting obligation came into effect in December 2008.²⁷² This obligation is broader than suspicious transaction obligation under the FTR Act, and includes these types of transactions and other suspicious matters, such as prospective provision of services to a person whom the reporting entity suspects (on reasonable grounds) may be other than s/he claims, or suspects that a proposed service or transaction may be related to tax evasion, an offence against a law of the Commonwealth or of a State or Territory, TF and/or ML.²⁷³

²⁷² AUSTRAC, Reporting Requirements, An Introduction to the Anti-Money Laundering and Counter terrorism Financing Act 2006 Doc no 140/1008/CC, above n 264.

²⁷³ Section 41 of the AML/CTF Act states:

(1) A suspicious matter reporting obligation arises for a reporting entity in relation to a person (the first person) if, at a particular time (the relevant time):

(a) the reporting entity commences to provide, or proposes to provide, a designated service to the first person; or

(b) both:

(i) the first person requests the reporting entity to provide a designated service to the first person; and

(ii) the designated service is of a kind ordinarily provided by the reporting entity; or

(c) both:

(i) the first person inquires of the reporting entity whether the reporting entity would be willing or prepared to provide a designated service to the first person; and

(ii) the designated service is of a kind ordinarily provided by the reporting entity; and any of the following conditions is satisfied:

(d) at the relevant time or a later time, the reporting entity suspects on reasonable grounds that the first person is not the person the first person claims to be;

(e) at the relevant time or a later time, the reporting entity suspects on reasonable grounds that an agent of the first person who deals with the reporting entity in relation to the provision or prospective provision of the designated service is not the person the agent claims to be;

(f) at the relevant time or a later time, the reporting entity suspects on reasonable grounds that information that the reporting entity has concerning the provision, or prospective provision, of the service:

(i) may be relevant to investigation of, or prosecution of a person for, an evasion, or an attempted evasion, of a taxation law; or

In fact, the Australian AML Rules encourage reporting entities also to have a program to monitor suspicious transactions and unusual transactions. Consequently, matters may or may not eventually be determined to be ‘not suspicious’ but ‘unusual’ and would need to be reported to AUSTRAC.

AUSTRAC sees SMRs as an important source of intelligence for AUSTRAC’s law enforcement, national security, revenue collection and social justice partner agencies. SMRs are seen as a tool for investigation able to provide vital intelligence to support an existing investigation, or prompt law enforcement officers to carry out supplementary risk assessment on the area of the report,²⁷⁴ or prompt an investigation by law

(ii) may be relevant to investigation of, or prosecution of a person for, an evasion, or an attempted evasion, of a law of a State or Territory that deals with taxation; or

(iii) may be relevant to investigation of, or prosecution of a person for, an offence against a law of the Commonwealth or of a State or Territory; or

(iv) may be of assistance in the enforcement of the Proceeds of Crime Act 2002 or regulations under that Act; or

(v) may be of assistance in the enforcement of a law of a State or Territory that corresponds to the Proceeds of Crime Act 2002 or regulations under that Act;

(g) at the relevant time or a later time, the reporting entity suspects on reasonable grounds that the provision, or prospective provision, of the service is preparatory to the commission of an offence covered by paragraph (a), (b) or (c) of the definition of financing of terrorism in section 5;

(h) at the relevant time or a later time, the reporting entity suspects on reasonable grounds that information that the reporting entity has concerning the provision, or prospective provision, of the service may be relevant to the investigation of, or prosecution of a person for, an offence covered by paragraph (a), (b) or (c) of the definition of financing of terrorism in section 5;

(i) at the relevant time or a later time, the reporting entity suspects on reasonable grounds that the provision, or prospective provision, of the service is preparatory to the commission of an offence covered by paragraph (a) or (b) of the definition of money laundering in section 5;

(j) at the relevant time or a later time, the reporting entity suspects on reasonable grounds that information that the reporting entity has concerning the provision, or prospective provision, of the service may be relevant to the investigation of, or prosecution of a person for, an offence covered by paragraph (a) or (b) of the definition of money laundering in section 5.

Report

(2) If a suspicious matter reporting obligation arises for a reporting entity in relation to a person, the reporting entity must give the AUSTRAC CEO a report about the matter within:

(a) if paragraph (1)(d), (e), (f), (i) or (j) applies – 3 business days after the day on which the reporting entity forms the relevant suspicion; or

(b) if paragraph (1)(g) or (h) applies – 24 hours after the time when the reporting entity forms the relevant suspicion.

(3) A report under subsection (2) must:

(a) be in the approved form; and

(b) contain such information relating to the matter as is specified in the AML/CTF Rules; and

(c) contain a statement of the grounds on which the reporting entity holds the relevant suspicion.

²⁷⁴ AUSTRAC, *Suspicious Matter Reports* <http://www.austrac.gov.au/typ10_rep_susp_mat.html> at 28 October 2011.

enforcement or other bodies (for example, the Australian Taxation Office, the Department of Social Security and so on).

However, AUSTRAC expects reporting entities to make greater efforts in adding value to AUSTRAC's SMRs, in addition to the greater effort by AUSTRAC in supervising and enforcing compliance in dealing with this issue. AUSTRAC notes: 'In addition to the details of the actual transaction, frontline staff are encouraged to include any comments or observations in the SMR that may provide useful leads to investigating agencies.'²⁷⁵ This viewpoint was discussed by Braithwaite (1993) when he indicated that:

Indeed one of the strengths of enforced self-regulation is that it enables governments to require banks to generate evaluation research that should be generated, but that governments have been too defensive to require themselves to produce concerning their own law enforcement performance.²⁷⁶

In fact, to achieve what AUSTRAC asks the reporting entities to do regarding this issue, a balance in this obligation must be struck that will not involve these institutions (rather than the appropriate authorities) committing to investigatory work instead of adhering to their role as core elements in the economic system and the financial scheme.

3.3.2 The FATF Third Mutual Evaluation of Australia Regarding Reporting Obligations

FATF's Third Mutual Evaluation to Australia issued in 2005²⁷⁷ is the most recent evaluation by FATF of Australia, so there has been no evaluation to Australia since the enactment of the AML Act in 2006. However, the United States Department of State (US DoS) did issue a number of notices regarding the Australian AML system after

²⁷⁵ Ibid.

²⁷⁶ Braithwaite, 'Following the Money Trail', above n 24, 668.

²⁷⁷ FATF, Third Mutual Evaluation Report, above n 15.

2006, with the most recent being issued in 2010 (further below following a review of the FATF Report).

If one looks at the FATF Report, the following summary for Australia's level of compliance with the FATF Recommendations can be extracted:

Level of Compliance	Number of Recommendations
Compliant (C)	12
Largely Compliant (LC)	9
Partially Compliant (PC)	10
Not Compliant (NC)	9
Average compliance level	0.53 This makes Australia a country that is between 'Partially Compliant' and 'Largely Compliant' with FATF Recommendations

Table 1: A Summary of the FATF Evaluation of Australia's Level of Compliance with the FATF Recommendations

FATF and Australian Reporting Obligations (Before the AML Act 2006)

When FATF tried to evaluate the Australian reporting obligations in 2005, it found that Australia's preventive measures in terms of reporting entities relied on the *FTR Act 1998* which was lacking in reporting obligations when assessed against the revised FATF recommendations and found that: 'Australia's legislative framework does not distinguish between financial institutions or specify AML/CFT obligations for financial institutions on the basis of risk'.²⁷⁸ Therefore, it found the level of the compliance by Australia with the reporting obligations as follows:

²⁷⁸ FATF, Third Mutual Evaluation Report, above n 15, 7.

Measurement Category	Statement of Compliance Level
Identification and verification	Non-compliant (NC)
Reporting suspicion	Non-compliant (NC)
Analyses the Reports	Compliant (C)
Circulation	Largely Compliant (LC)

**Table 2: FATF Measures of the Level of Australia's Compliance for
Reporting Obligations**

FATF indicated that Australia is 'non-compliant' with Recommendation 5 in terms of CDD, Recommendation 6 on politically exposed persons, Recommendation 7 on correspondent banking, and Recommendation 8 concerning new technologies and non face-to-face financial relationship.²⁷⁹ The Report saw Australia as 'non-compliant' with Recommendation 5 because several weaknesses had been found including the inadequate scope of CDD obligations on cash dealers that did not provide coverage of all types of financial institutions and inadequate customer identification and verification throughout account opening, cash and non-cash transactions.²⁸⁰

Regarding Recommendations 6, 7, 8 and 9, the Report found Australia 'non-compliant' noting that the country had no precise legislative or enforceable obligations concentrating on the identification and verification of politically exposed persons (PEPs), correspondent banking, and no effective CDD measures for non-face-to-face customers or for third party referees.²⁸¹ On the other hand, the Report found Australia 'partially compliant' with Recommendations 10 and 11 on record keeping and the monitoring of unusual transactions, and 'largely compliant' with Recommendation 13

²⁷⁹ Ibid 8 [20], [21].

²⁸⁰ Ibid 8 [20].

²⁸¹ Ibid 8 [22].

regarding suspicious transaction reporting and ‘compliant’ with Recommendations 14 and 19 which are about protection and no ‘tipping-off’ and other forms of reporting.²⁸²

However, the Report mentioned two main weaknesses regarding STRs:

- Limitation on the definition of ‘cash dealer’, which does not cover all financial institutions, and
- Inadequacies in the scope of the TF offence and the impact of the limitation on the reporting requirements.²⁸³

In fact, FATF indicated that the reporting and essential STR guidelines were sufficient, but that the CDD principle, internal controls and the feedback about the STRs were not covered, so Australia did not comply with the reporting of the suspicious transactions the way that it should.²⁸⁴ Australia has worked hard since then to raise the level of compliance, with a number of improvements made through the AML Act in 2006, such as including any person who is providing designated services to a customer as a reporting entity, further broadening the reporting scope by requiring reporting of ‘suspicious matters’ (rather than simply of suspicious transactions, though these are of course included in ‘matters’), and reporting of certain transactions above a threshold as well as of international funds transfer instructions.

On the other hand, the Report found Australia ‘partially compliant’ with Recommendations 17, 23 and 29 on the subject of sanctions, regulation, supervision and monitoring of AUSTRAC on the level of compliance by the reporting entities in terms

²⁸² Ibid 147.

²⁸³ Ibid 89.

²⁸⁴ Ibid 106.

of the AML system.²⁸⁵ The Report adjudged Australia to be in the category of partially compliant with Recommendation 17 because:

- AUSTRAC was applying only criminal sanctions to non-compliance, and then only very infrequently;
- There was a lack of clarity on the powers of the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investment Commission (ASIC) to apply sanctions; and
- AUSTRAC had limited powers for enforcing compliance. It lacked the power to revoke the licence of cash dealers or to prohibit persons from being a director, manager, or employee due to serious non-compliance with the FTR Act.²⁸⁶

In terms of Recommendation 23, FATF found AUSTRAC under the FTR Act failed to provide an effective AML supervisory system.²⁸⁷

Overall, according to FATF Australia falls between ‘largely compliant’ and ‘partially compliant’, but regarding the identification and verification, and reporting suspicion, Australia was non-compliant with the recommendations concerned with these issues.

The question remains, though, what of the Australian level of compliance with these recommendations after passage of the AML Act in 2006?

²⁸⁵ Ibid.

²⁸⁶ Ibid.

²⁸⁷ Ibid.

US Department of State (DoS) and Australia's Reporting Obligations (After the AML Act 2006)

The United States Department of State (US DoS) reports from 2008–2010 highlight the improvements that have occurred in the Australian AML system after the issuing of the AML Act in 2006. These reports took into consideration the FATF Third Mutual Evaluation Report, and tried to show the difference in the level of compliance of the Australian AML system with the FATF Forty Recommendations before and after enactment of the Act.

In terms of the reporting obligations, the US DoS reports indicate that the Australian government was conscious of the shortcomings that had been mentioned in FATF evaluation report and was drafting legislation on the AML system in order to comply with FATF Recommendations following that evaluation report. Therefore, most of these shortcomings were addressed by the *AML Act 2006* (Cth). This Act has been implemented in tranches and will ultimately replace the FTR Act. The first tranche of the Act has already been implemented, covering reporting entities that provide 'designated services'. These entities include the financial sector, gambling sector, and bullion dealers. These types of reporting entities now face sterner obligations regarding CDD, reporting requirements, and record-keeping obligations than those in the FTR Act era. General improvements in CDD have been provided by the new system which is probably altering the face of the Australian AML system to one of greater compliance. However, the AML Act is still going through the process of the implementation and the FTR Act is still in force until all tranches are in force.

The US DoS reports reveal that AUSTRAC received a large number of FTRs (15,740,744) in 2006–07 with 99.7 per cent of the reports submitted electronically.

AUSTRAC received 24,440 STRs for the same period, a decline of 1.5 per cent, following a 44.1 per cent increase the previous year.²⁸⁸

Nevertheless, the Australian Institute of Criminology reported that

[b]etween January 2003, when the Criminal Code was amended, and January 2008, the Commonwealth Director of Public Prosecutions dealt with 77 charges of offences of money laundering in Australia, a substantial increase over the preceding period in prosecutions for money laundering (Commonwealth Director of Public Prosecutions n.d.). Of these, 54 (70%) were in the 18 months immediately prior to January 2008. The type of charges dealt with has also changed over the five-year period. The initial charges for offences of money laundering under the Criminal Code, dealt with in the 2003–05 period, were for summary offences (Commonwealth Director of Public Prosecutions 2004; Commonwealth Director of Public Prosecutions 2005; Commonwealth Director of Public Prosecutions 2006). Almost all of the later charges were for indictable offences. A total of 35 individuals were convicted of 46 money-laundering offences out of the 77 charges dealt with under Division 400 from January 2003 to January 2008.²⁸⁹

Thus, in the period 2006–2007 AUSTRAC received 24,440 STRs (the year before issuing the Australian Institute of Criminology’s analysis in 2008), yet between 2003 and 2008 only 77 charges of offences of ML in Australia were instituted. According to the FATF Report:

the key issue in terms of effective implementation of the money laundering offense is the low number of money laundering prosecutions at the Commonwealth level (ten dealt with summarily and three on indictment since 2003, with five convictions), indicating that the regime is not being effectively implemented.²⁹⁰

The 2010 DoS report indicated that Australia should increase its efforts to prosecute and convict money launderers, besides enhancing its focus on AML and TF deterrence.²⁹¹

Who should be blamed if the regime is not being effectively implemented? Contenders include: (i) FATF and its recommendations that contain some ambiguity in a number of

²⁸⁸ US Department of State, *Country Reports A-F* <<http://www.state.gov/p/inl/rls/nrcrpt/2008/vol2/html/100807.htm>> at 28 October 2011.

²⁸⁹ Australian Institute of Criminology, *Charges and Offences of Money Laundering*, above n 180.

²⁹⁰ FATF, Third Mutual Evaluation Report, above n 15. 6.

²⁹¹ US Department of State, *International Narcotics Control Strategy, Volume II* (2010) <<http://www.state.gov/documents/organization/137429.pdf>> at 2 November 2011.

places which some entities feel makes compliance obligations unviable; (ii) the current Australian AML system with its shortcomings in different areas; or (iii) the Authority charged with regulating the industry groups to guarantee the highest level of compliance and enforce compliance when and where it is needed; or (iv) the reporting entities who see themselves somewhat removed from the AML system and whose compliance may only be secured on the basis of a need to protect their business integrity?

The answer will be as complicated as the question. Each and every contender above has its role in the system and its obligation to bring forth a better outcome, to make a better Australian AML system.

3.4 Conclusion

FATF still regards Australia as a country that ‘needs to work harder’ in number of areas, including applying RBA and CDD. Therefore, in the FATF 2009/2010 annual report, it rejected any suggestion that Australia be removed from the list of the countries that should provide follow up reports annually rather than biennially.²⁹²

On the question of whether Australia is the only jurisdiction that partially complies with the 40+9 Recommendations with continuing FATF concerns about its CDD, the answer is negative. Most countries with which FATF mutual evaluations have been conducted have been advised that their CDD principle is not compliant or only partially compliant. Indeed not one FATF member was found to be CDD compliant. However Australia must continue to provide follow up reports annually, yet many other countries have moved, despite ongoing problems, to annual reports, so complaints of a degree of differential treatment are not unwarranted.

²⁹² FATF, *Annual Report 2009–2010*, above n 231, 22.

FATF itself is not blameless. It should fill the gaps in its Recommendations and its interpretations of these Recommendations to facilitate greater clarity and compliance.

Meanwhile those in the Australian AML system should look more seriously at the gaps in its system and compliance that have been identified by the FATF Report and work harder to fill them, especially regarding concerns about CDD, the application of the RBA, matters regarding the identification of the beneficial owner, SMRs, and so on.

AUSTRAC needs to understand the reporting obligations and industry groups more than ever before, especially when Australia is working towards issuing the second tranche of the AML Act and complying with the FATF recommendations. Thus a huge number of businesses will be obliged to submit reports to AUSTRAC in the near future. AUSTRAC needs to encourage them as to how they are to comply with their reporting obligations. More active powers to enforce compliance should be available to AUSTRAC to further motivate compliance.

If it eventuates that AUSTRAC does not enforce some of the FATF rules because it believes that these rules are ineffective or have a significant shortcomings, then AUSTRAC has a reason not to insist on the enforcement of such rules. It is not just a question of whether the reporting entities are following the rules; AUSTRAC should be ensuring that the system is effective. This might mean ignoring impractical rules. For example, how effective is the reporting of suspicious transactions? If it is not effective, then why is that? What do the reporting entities think they must do and are there problems with this requirement? The answer is complex.

AUSTRAC needs to consider these questions and when answers are found there will be important consequences for the reporting obligations and the entire Australian AML regime. An improved AML system will then be in place.

4 INTERNATIONAL AND LOCAL PRACTICES IN ENFORCING COMPLIANCE

4.1 Introduction

Despite the shortcomings of the FATF Recommendations, including uncertainty about some issues related to the AML reporting obligations, Australia can play a vital role by filling these gaps in its AML system and thus provide guidance to the international AML community. This Chapter will address a very important issue that illustrates the operation of the enforcement mechanism in the course of answering the questions posed in Chapter 1, namely:

- 1 How can this thesis identify the ideal set of attributes that could be used to prescribe the optimal enforcement mechanism in the AUSTRAC context?
- 2 Should Braithwaite's theory be a benchmark or an alternative, (given that his theory in the field of the AML is not comprehensive in every aspect, as indicated in Chapter 1)?

AUSTRAC can benefit from other countries' experiences in supervising and enforcing AML compliance, as well as from the experiences of other local agencies in relation to their policies, structures, and compliance enforcement.

The different models of the FIU can assist to define the role of the FIU and the way in which it deals with non-compliance. (Australia follows the administrative model but there are significant differences between countries which adopt this general model).

On the one hand, therefore, this chapter will highlight the experience of two FIUs that fairly closely follow the administrative model, namely the FIUs of the United States and the Netherlands. The US FIU represents an administrative model that provides an

example of an FIU that utilises a harsh enforcement mechanism. The Netherlands FIU represents a hybrid administrative and law enforcement model and provides an example of an FIU with a soft enforcement mechanism. The aim is to tease out the differences between the two systems and assess them according to the requirement for the most effective enforcement mechanism and its attributes (to be discussed below). This examination will assist analysis of the experiences of Australia and other countries in the AML field.

4.2 Minimum or Most Effective Enforcement Mechanism?

According to Carson (1979), the regulatory framework is usually linked with the form of law and enforcement. These have improved since the 19th and early 20th centuries during the development of social regulation, and both were enhanced by the consideration of criminal law as a significant element in protecting the public from danger by enabling the application of criminal sanctions as a means of deterrence.²⁹³ However, the use of the enforcement mechanism in terms of prosecution (criminal or civil), especially in a self-regulatory atmosphere, often becomes the last option to be taken when non-compliance has occurred, because

Governments are more likely to become involved in co-regulation, or to set up external regulatory and enforcement regimes if they believe the level of risk and/or the seriousness of consequences that may flow from a breach justifies the expense. In the case of AML/CTF, the perception is that the consequences of deviance are serious.²⁹⁴

So the question is what is the role of the enforcement mechanism? And what is its aim? Is it just to play the role of a ‘long stick’ that appears ‘at the ready’ to punish non-compliant entities; while the reality is that a minimum level of enforcement (in terms of

²⁹³ W G Carson, ‘The Conventionalisation of Early Factory Crime’ (1979) 7 *International Journal of the Sociology of Law* 37.

²⁹⁴ Australian Institute of Criminology, *The Regulatory Response* <<http://www.aic.gov.au/en/publications/current%20series/rpp/100-120/rpp106/07.aspx>> at 3 January 2011.

both frequency and timeliness of prosecution and the relatively low levels of any penalties ultimately imposed) is still considered acceptable? Yet the 21st century is an era of rapid and continuing technological change where, despite huge improvements in the financial system, such improvements are often equalled by the adoption of new methods and avenues by those bent on crime.

Nevertheless, in the area of 'regulation' there is a 'regulatory debate' that concerns the limit to which criminal law or regulatory approach should be used to control businesses and its activities,²⁹⁵ and that debate includes the enforcement mechanisms of regulatory agencies and their role in this domain. Different approaches in this debate that view this matter from their own perspectives make for a complex answer, including views reflecting a conservative, liberal or radical approach.²⁹⁶ One answer will reflect the conservative perspective and affirm that situation should remain the same, arguing that the enforcement mechanism need only operate at the minimum level as market forces provide adequate protection. Often the intention of this perspective's proponents is to keep compliance costs low, with the enforcement mechanism operating at the lower levels. As enforcement actions increase, regulated entity costs rise.

The proponents of the liberal perspective will provide a more diplomatic answer, arguing that enforcement is necessary but agencies should seek a balance in using this power, choosing to use it only when it is necessary to regulate the system or to impose criminal sanctions.

²⁹⁵ Croall, above n 43, 46.

²⁹⁶ According to the Oxford English Dictionary, a 'conservative' is 'an adherent of traditional values, ideas and institutions; an opponent of ... change; while a liberal '[advocates] individual rights ... and ... little state intervention' and 'unrestricted trade' [free market]; and a 'radical' is one who advocates 'far reaching political or social reform ... extreme ... revolutionary'.

Finally, a more radical perspective would call for strong and harsh enforcement mechanism as the optimal option in the face of non-compliance, as it would operate at a distance from the regulated entities' interests.

None of these perspectives can alone help to find the solution as to how to use the enforcement mechanism the way it should be used, that is, in the manner in which the best outcome is secured. When examining the enforcement mechanism and its use, its design and operation will be viewed from each perspective but decisions will be made regarding recommendations and so on not from an ideological perspective but from an outcomes based approach. Here it is essentially not about the level of the enforcement, rather it is about whether the enforcement mechanism is effective and properly suited to the task and hence achieves successful outcomes in terms of a reduction in the specific activities (in frequency and/or magnitude) for which the mechanism is designed.

4.2.1 How to Determine whether an Enforcement Mechanism is Suited to the Task at Hand

A regulatory agency should, in terms of its enforcement mechanism, assess the basic intention of the law it administers, to protect and maintain the business and the financial system. The enforcement power that it uses should guarantee a suitable balance between the interests of the financial system entities and public protection. It should also highlight prosecution and punishment, not only as a deterrent for non-compliance, but also to secure justice and protect the transparency of the financial system.

Thus, where there is non-compliance, enforcement mechanisms used by regulatory agencies generally involve first using the strategies of persuasion and education, with the threat of prosecution in the background as a second option to be used only when necessary. However, the frequency and circumstances of the use of these sanctions

should be examined. A comparison between theory and practice in this domain reveals that while harsh sanctions may be ‘on the books’, it is most likely that these are rarely used.

From a theoretical viewpoint, for example, Clarke (2000) states that persuasion and education are more effective in dealing with complex offences which involve the use or abuse of the financial system and make detection difficult and prosecution lengthy and expensive.²⁹⁷ Ayres and Braithwaite (1992) in their regulatory enforcement ‘pyramid’ illustrate their belief that the first step in enforcing compliance is persuasion and education.²⁹⁸ Its primary role in the event of non-compliance (and also to prevent potential non-compliance) is reflected in its occupation of the largest space in the enforcement pyramid, and its location at its base.²⁹⁹

The idea of the pyramid is often invoked when requiring industry groups to self-regulate. The threat of external regulation remains should self-regulation fail or prove inadequate. If self-regulation fails, the regulatory agency moves from persuasion through to warnings issued regarding the possibility of prosecution, then to prosecution involving first civil, then (higher up the scale) criminal penalties, to the upper levels where a licence (for example, to operate in whatever is the relevant field or activity) is first suspended and, if compliance is not secured, revoked.

Problems arise, however, when the regulatory agency is not activating its powers when their use is needed and is reluctant to escalate enforcement action to the level where harsher sanctions are imposed. This is the actual scenario with AUSTRAC when enforcing compliance in practice (as shown in Chapter 1).

²⁹⁷ Clarke, above n 56, 249.

²⁹⁸ Ayres and Braithwaite, above n 53, 35.

²⁹⁹ Baldwin and Black, ‘Really Responsive Regulation’, above n 49, 5.

However, the most effective enforcement mechanism is not determined by the use of softer or harsher sanctions *per se*, it is — more accurately — the use of whatever is the more effective sanction that guarantees greater compliance.³⁰⁰ This may not always be persuasion and education, especially where this leads to ‘sympathy between regulators and the regulated, as Croall (2003) indicates, and possibly ‘regulatory capture’. Here, over a period of constant exposure to the ‘mindset’ (values, aims and ambitions) of the regulated, their methods, and prolonged interaction with them, the regulator loses sight of its primary objectives as a regulator. The ‘lead’ actor becomes a ‘follower’, essentially a regulator more inclined to act in the interests of the regulated entities, and lenient in its dealings in regard to non-compliance.³⁰¹

4.2.2 What are the Ideal Attributes that Can Ensure the Regulatory Agency’s Ability to Impose the Most Effective Enforcement Mechanism?

Through the analysis of the theoretical and practical approaches of the reporting entities interviewed for the purpose of this thesis, a number of important requirements and ideal attributes were found to be effective in the context of the work of AUSTRAC and other regulators and to have positive influences on their enforcement mechanisms. Logically, these four important requirements and attributes (listed below) would be able to help the regulatory agencies to ensure compliance by utilising the most effective enforcement action. These are:

³⁰⁰ Freiberg, above n 50, 17.

³⁰¹ Croall, above n 43, 45.

- 1 *There should be different and actively used sanctions in place to be applied in response to non-compliance:*

To have available a variety of sanctions (from soft to harsh) is positive in regards to financial system regulation. While the softer options (persuasion, education, the giving of advice and the issuing of warning letter) will be used as the first steps in enforcing compliance, the option of harsher sanctions must be used when circumstances arise that prompt their use, and not just allowed to languish. Their disuse may weaken their salutary effect on behaviour. It is rather like having a stick on the shelf; if left there long enough it may no longer be feared. Overuse, however, may be counterproductive, breeding disrespect and resentment, and bringing the regulator into such disfavour that cooperation will not be willingly forthcoming. Therefore, both the soft and the harsh sanctions must be ‘in play’ and used where and when appropriate. This attribute operates using Braithwaite’s theory of the regulatory enforcement pyramid. Balance and appropriateness in using the sanctions is the key issue: too frequent use of the ‘soft’ could cause a low level of compliance; too frequent use of the ‘harsh’ could cause a culture of resistance among the regulated entities.

Braithwaite himself states that regulated entities in the financial domain must also move from having ‘mere compliance policies to substantive rules’ and adds that ‘publicly ratifying plans, and giving them the force of law are not such huge steps’.³⁰² Therefore, to achieve all the above, educated and experienced personnel in the regulatory agency and appropriately trained personnel in the regulated entities are needed as is a willingness to use all sanctions at the disposal of the regulator as and when required.

³⁰² Braithwaite, ‘Following the Money Trail’, above n 24, 667.

- 2 *There should be agreement between the main regulator of the field and its partner regulatory agencies, and also between the regulators and the regulated entities to encourage regulatory compliance:*

In order to attain the highest level of compliance, it is very important to have regulators that are committed to the objectives of regulation, and partner agencies that understand, appreciate and help fulfil its role in the regulatory framework.

Increased understanding by the regulated entities of the regulatory objectives, and close supervision by the regulatory agencies of the those entities will not only make communication between the regulatory agency and regulated entities easier but also help the latter to comply with regulation — this was one of the important requirements that the reporting entity personnel interviewed for this thesis have said they have been calling for. If this attribute (concord) is present, then it will help the regulatory agency to determine the most effective power of enforcement to use in accordance with seriousness of the reporting entity breach of the law or regulation.

- 3 *The regulatory agency must avoid regulatory capture, and not draw away from its responsibilities due to political pressure or economic problems:*

It is very important for the regulator to avoid being captured by regulated entities and so weaken its performance as a regulator and deter its full use of the enforcement mechanism at its disposal.³⁰³ It is also important for it to avoid being influenced by the existence of economic difficulties when dealing with a non-compliant reporting entity (such as during the Global Financial Crisis) and failing to impose sanctions that otherwise would have been applied. The regulator must also avoid falling prey to any

³⁰³ Etzioni, above n 57, 320.

governmental political pressure and allowing such pressure to affect how it fulfils its responsibilities and imposes its sanctions on non-compliant regulated entities. Scott (2000) indicated that independence and wisdom are required for the regulatory agency as it can be held accountable for insufficient exercise of its power.³⁰⁴

Ayogu (2007), for example, has discussed the effectiveness of the enforcement mechanism of one South African regulatory agency and showed how political influences can bring pressure to bear on the regulatory agency's work and effectively weaken its enforcement mechanism. In this instance, the regulatory authority was the South African Independent Communications Authority (ICASA),³⁰⁵ established in 2000 to regulate the telecommunication and broadcasting sectors. Pressure applied by the deregulation and economic liberalisation policies of the South African government (which also wanted greater telecommunications access distribution across the nation) weakened the agency's regulatory role. It spent more time and effort in facilitating the expanding operations of the telecommunication and broadcasting industries than being the sector's effective regulatory agency. The government's emphases are reflected by the Minister of Communication, Dr Ivy Matsepe-Casaburri, who stated:³⁰⁶

In the past 10 years we have concentrated on reducing the disparity between the rural and the urban areas of our country and eliminating the inequities of our society inherited from the apartheid era. In doing so, we have worked at increasing teledensity and growing the ICT sector of our economy through a process of managed liberalization that we provided for in the Telecommunications Act.

³⁰⁴ Colin Scott, 'Accountability in the regulatory State' (2000) *Journal of Law and Society*, 60.

³⁰⁵ ICASA, The Independent Regulatory Agency of the Republic of South Africa, ICASA— Corporate, at <<http://www.icasa.org.za/corporate/Overview/tabid/56/Default.aspx>> at 10 January 2011. 'ICASA... was established in 2000 by the ICASA Act to control and supervise two important sectors including the telecommunications and broadcasting sectors, [and now also regulates] ... ICASA [applies] its actions, policies and regulations with the framework set by international and regional bodies including the Telecommunication Regulatory Association of Southern Africa (TRASA), the International Telecommunications Union (ITU), the International Institute of Communication s (IIC) and Reseau Des Instances Africaines De Regulation De la Communication (RIARC)'.

³⁰⁶ Republic of South Africa, *Policy Announcement by the Minister of Communications, Dr Ivy Matsepe—Casaburri* (2004), at <<http://www.internet.org.za/doc-min-announce-2-sept.html>> at January 2011.

In his State of the Nation Address in May of this year, the President emphasized the need to lower the cost of doing business in South Africa. He also charged us with creating a globally competitive telecommunications sector address the challenges of the 2nd economy.

In fact, restricting ICASA's enforcement mechanism so as to maximise the value of the business was an outcome clearly desired by South African government as expressed in its policies. According to Ayogu (2007), insofar as ICASA was functioning as a regulatory agency, it was in the role of a 'fire alarm' rather than that of a 'police patrol'. Even though ICASA had a wide range of powers that could be plumbed to revoke a licence of a non-compliant entity, it could not then and would be reluctant now to impose such a harsh sanction on a large regulated entity such as Telkom (one of the largest and dominant South African telecommunication companies) for two reasons. First, because the government's policy calls for the encouragement of huge investment in the country, and implementing such a policy would be made more difficult and investors discouraged from investing by the presence of a regulator that appears 'less friendly' to business. Second, Telekom is cautious and has no confidence in its dealings with ICASA. In this instance, the position of business (and the importance accorded its aims) appears stronger than the regulator's. The pre-eminence of trade liberalisation and economic development reinforce the company's position. 'Regulatory capture' of ICASA and its lack of ascendancy will remain actual rather than perceived as long as Telkom is stronger than ICASA.³⁰⁷

The disproportionate power and position accorded the largest reporting entities renders ICASA unable to impose harsh sanctions on the huge institutions that are providing services in the strong telecommunications sector; but the authority remains able to

³⁰⁷ Melvin Ayogu, 'The Marasmus of ICASA: Political Control or Bureaucratic Laxity?', *Faculty of Commerce*, (University of Cape Town, 2007) 8–9.

impose such sanctions on small businesses that are providing broadcasting services in the smaller broadcasting sector when they are in breach of some regulatory requirement.

Overall, ICASA has been found to be a rather lenient regulatory agency; it conducted just 14 cases from the 2000 (the year of its establishment) to 2005, and all were rooted in procedural issues.³⁰⁸

In terms of avoiding regulatory capture through economic problems, the Global Financial Crisis (GFC) provides salutary examples in this domain. The period 2007–2009 brought economic difficulties for the entire world community, including governments, their agencies and the industrial community. Its legacy stretched into 2010–2011 and possibly beyond. A number of specialists and economists have estimated the GFC to be the worst financial crisis since the 1930s (the Great Depression, which preceded World War II).³⁰⁹

The ‘weak regulatory environment’ in the US clearly contributed to the development of the GFC.³¹⁰ In sum, it was initially generated when the US banking industry started to face liquidity shortfalls.³¹¹ As a result³¹² a number of large financial institutions collapsed and key businesses failed. Global stock markets slumped and countries put in place relief plans for their banks and financial system. Some entities were considered

³⁰⁸ Ibid 9.

³⁰⁹ Reuters, *Three Top Economists Agree 2009 Worst Financial Crisis Since Great Depression; Risks Increase if Right Steps are Not Taken*, 29 February 2009 <<http://www.reuters.com/article/2009/02/27/idUS193520+27-Feb-2009+BW20090227>> at 16 June 2011.

³¹⁰ Ibid 7.

³¹¹ Bob Ivry, *Paulson Seeks Mortgage Value That Eluded Bear, Lehman (Update 1)*, 24 September 2008 <http://www.bloomberg.com/apps/news?pid=newsarchive&refer=home&sid=aGT_xTYzbbQE> at 16 June 2011.

³¹² Martin Neil Bailly and Douglas J Elliott, *The Use Financial and Economic Crisis: Where Does it Stand and Where Do We Go From Here?* (2009) <http://www.brookings.edu/~media/Files/rc/papers/2009/0615_economic_crisis_bailly_elliott/0615_economic_crisis_bailly_elliott.pdf> at 16 June 2011, 2.

‘too big to fail’.³¹³ The market that free-market proponents say should function as the ‘alternative regulator’ in a lightly regulated environment was not permitted to do so in all instances (see below), but the alternative appeared socially and politically unthinkable.³¹⁴ Here again, size matters.

It had spread rapidly. From 2006, the easy credit and ‘no doc’ ‘no deposit’ ‘sub-prime’ US home loans began to collapse when borrowers/mortgagees were unable to pay. The value of securities attached to US real estate pricing then fell (as did home values, triggering more foreclosures). First subprime mortgage companies, then hedge funds failed, then, as the instruments had been sold worldwide, financial institutions, including banks, worldwide were affected to varying degrees. Some were propped up by government, often with little guarantee of amended business practices; others folded.³¹⁵

A major decrease in economic movement led to a global economic recession in 2008.

The US and other stock markets fell, many dramatically. Unemployment spiralled, and consumer wealth fell.

Credit availability contracted worldwide. Shareholder confidence in the financial system, where securities suffered large losses during 2008 and early 2009, was destroyed.³¹⁶ The view that the GFC as a global phenomenon began in late 2008 and

³¹³ The belief that some were or are ‘too big to fail’ has come in for criticism: See, eg Charles Moore, ‘The Mervyn King Interview: We Prevented a Great Depression but People Have the Right to be Angry’ *Telegraph* (UK) 4 March 2011. 9 (Charles Moore is the Governor of the Bank of England) <<http://www.telegraph.co.uk/finance/economics/8362959/Mervyn-King-interview-We-prevented-a-Great-Depression...-but-people-have-the-right-to-be-angry.html>>.

³¹⁴ Though some disagree, see Ambrose Evans-Pritchard, ‘Let Banks Fail, Says Nobel Economist Joseph Stiglitz’ *The Telegraph* (London) 2 February 2011.

³¹⁵ For a summary of the crisis, particularly in the originating country, see Council on Foreign Relations, *Timeline: Global Economy in Crisis* (2011) <<http://www.cfr.org/economics/timeline-global-financial-crisis/p18709>> at 16 June 2011.

³¹⁶ International Monetary Fund IMF, *World Economic Outlook: Crisis and Recovery*, 2009<<http://www.imf.org/external/pubs/ft/weo/2009/01/pdf/text.pdf>> at 16 June 2011, 3–4.

concluded mid-2009³¹⁷ may be premature given recently emerging problems. Investment mixes have altered and in some areas the move towards re-regulation recognises the role its lack played.

The 2008 *Declaration of the Summit on Financial Markets and the World Economy of G20*³¹⁸ shared the blame between credit rating institutions, shareholders and management, who had failed to correctly manage and mitigate the risk involved in mortgage-related financial products, and supervisors, regulators and policy makers, had not amended their regulatory practices to deal with the changing financial markets.

During a period of strong global growth, growing capital flows, and prolonged stability..., market participants sought higher yields without an adequate appreciation of the risks and failed to exercise proper due diligence. ... [W]eak underwriting standards, unsound risk management practices, increasingly complex and opaque financial products, and consequent excessive leverage combined to create vulnerabilities in the system. Policy-makers, regulators and supervisors, in some advanced countries, did not adequately appreciate and address the risks building up in financial markets, keep pace with financial innovation, or take into account the systemic ramifications of domestic regulatory actions.³¹⁹

The US Senate came to a similar viewpoint when it highlighted the causes of the GFC in the *Levin–Coburn Report*:

The crisis was not a natural disaster, but the result of high risk, complex financial products; undisclosed conflicts of interest; and the failure of regulators, the credit rating agencies, and the market itself to rein in the excesses of Wall Street.³²⁰

³¹⁷ May Peters, Mathew Shane and David Torgerson, 'What the 2008/2009 World Economic Crisis Means for Global Agricultural Trade: A Report from the Economic Research Service' *Outlook* (August 2009) US Department of Agriculture, Doc No WRA-09-05 <<http://www.ers.usda.gov/publications/wrs0905/wrs0905.pdf>> at 16 June 2011, 2–3.

³¹⁸ The White House, *Declaration of the Summit on Financial Markets and the World Economy*, 15 December 2008 <<http://georgewbush-whitehouse.archives.gov/news/releases/2008/11/20081115-1.html>> at 16 June 2011.

³¹⁹ Ibid. See also for an account of causes and proposed US reregulation / need for stronger regulators, Dick K Nanto, *The Global Financial Crisis: Analysis and Policy Implications* (CRS Report for Congress, Doc No RL34742, 2 October 2009) <<http://www.fas.org/sgp/crs/misc/RL34742.pdf>> 10ff.

³²⁰ Carl Levin and Tom Coburn, *Wall Street and the Financial Crisis: Anatomy of a Financial Collapse*, 13 April 2011, 1 <http://levin.senate.gov/imo/media/doc/supporting/2011/PSI_WallStreetCrisis_041311.pdf> at 17 June 2011.

Complex financial products, products and practices that lacked transparency, the prevalence of poor underwriting standards and risk management practices (often in institutions such as banks, which people trusted almost inherently to guard their interests), excessive leverage, undisclosed conflicts of interests led to failures that were ‘contagious’ in a globalised economy; and governmental regulatory failure. The era of a free rein for the financial sector was drawing to an end; regulation was again seen by the general population and governments as necessary.³²¹ Issues revealed by the GFC must be taken into consideration by governments, policy makers, financial institutions and regulators including AUSTRAC (and that will be discussed later in this thesis).

4 *There should be unquestioned (unambivalent) legislation and regulation essential for a successful enforcement mechanism:*

Clear, comprehensible legislation and regulations can help both regulator and regulated entities to understand their roles in the regulatory system, particularly in regard to how regulated entities are to comply with the rules. In contrast, contestable, controversial legislation and regulations will push regulated entities to resist the rules and regulations rather than comply with them and lead to questionable compliance.

Unambivalent legislation and regulation will enhance the regulated entities’ ability to apply self-regulation as well as encourage a ‘culture of compliance’ where commitment to regulatory aims is required.³²²

³²¹ Alison Elliott, ‘Congress Passes Sweeping Financial Reforms’ Foreign Policy Association website 16 July 2010 <<http://foreignpolicyblogs.com/2010/07/16/congress-passes-sweeping-financial-reforms/>>; Binyamin Appelbaum, ‘Rules Grow, Banks Stay the Same Size’ *The New York Times* (Business Day section) 23 May 2010 <<http://www.nytimes.com/2010/05/24/business/24strategy.html>>. The relationship between the now failed Enron and regulators provides an example of regulatory failure/capture in another domain.

³²² Fiona Haines and David Gurney, ‘Regulatory Conflict and Regulatory Compliance: the Problems and Possibilities in Generic Models of Regulation’ in Richard Johnstone and Rick Sarre, *Regulation:*

It is also necessary to have a regulatory agency that understands the intricacies of compliance and knows how to assess compliance, before it activates its enforcement approach,³²³ especially as regulations are subject to change over time. As most regulatory systems in the AML field currently follow an RBA approach, is essential that the regulator be involved in the construction of the regulated entities' self-evaluation model so as to be able to evaluate it and respond to it effectively, utilising the most effective enforcement power (if necessary) to ensure compliance. Companies cannot be 'left alone' to formulate and implement self-regulation. As Parker notes, such policy requires ongoing corporate commitment, appropriate skills acquisition and effective institutionalisation of compliance. This can only be achieved in an environment that involves the regulator, with appropriate penalties for failure to have policies in place or for their inadequate implementation.³²⁴ This is easier if the legislation and regulation is unquestioned, that is, not subject to dispute about its scope or nature and so forth.

Considering the four requirements and attributes (above), as manifested in international and partner agencies' efforts to enforce compliance, has several implications for AUSTRAC. First, it will provide AUSTRAC with a wide range of information sources on the successes in imposing a duty to activate or when to activate the enforcement mechanism. Second, it may offer pioneering solutions to predictable or intractable problems. Third, it may offer clues as to the future direction of AUSTRAC's enforcement mechanism.

Enforcement and Compliance, Research and Public Policy Series, No 57 (Australian Institute of Criminology, 2004) 19.

³²³ Christine Parker, 'Is there a Reliable Way to Evaluate Organisational Compliance Programs?' in Richard Johnstone and Rick Sarre, *Regulation: Enforcement and Compliance*, Research and Public Policy Series, No. 57 (Australian Institute of Criminology, 2004) 115–17.

³²⁴ Ibid.

4.3 International Practices in Enforcing Compliance Regarding Non-Compliance with Reporting Obligations

Money launderers usually move their illicit funds by utilising discrepancies among countries' laws and regulations. In some more than others, criminals can successfully launder their money as there are few restrictions; they also find gaps in the AML system and legislation of some countries that are known for strong bank secrecy and privacy laws which make law enforcement investigation difficult.³²⁵

This thesis examines developed country regulators as international best practices in this domain are better matched to the developed countries than to developing countries, as the challenges of related regulatory compliance faced by developed and developing countries, least developed or 'third world' countries are dissimilar to the developed world³²⁶

4.3.1 United States

According to Reuter and Truman (2004), a successful enforcement mechanism relies on the reports that the banks send to the regulatory agencies or law enforcement bodies.³²⁷

The US long ago started combating organised crime and its most important legislative achievement in the field of AML was the *Bank Secrecy Act 1970*,³²⁸ which enhanced the investigative process for criminal activities, such as tax evasion and ML. Bank secrecy rules have been exploited by criminals; but the reporting and record-keeping obligations have been important instruments for investigating individuals suspected of involvement

³²⁵ Jeffrey Lowell Quillen, 'The International Attack on Money Laundering: European Initiatives' (1991) *Journal of Comparative and International Law* 213, 213–14.

³²⁶ Nomzi Gwintsa, 'Challenges of Establishing Financial Intelligence Units' in Charles Goredema (ed), *Money Laundering Experiences: A Survey*, ISS Monograph No 124 (2006) 51.

³²⁷ Reuter and Truman, above n 33, 33.

³²⁸ FinCEN, 'Bank Secrecy Act' <http://www.fincen.gov/statutes_regs/bsa/> at 25 January 2011. Note: *Bank Secrecy Act* is also known as the *Currency and Foreign Transactions Reporting Act*.

in crimes involving illegal drugs in the US and elsewhere.³²⁹ These US reporting obligations rely on two types of reports, the first a rule-based report and the second a discretionary report. All banks must report cash transactions where they exceed more than USD10,000 per day, and are obliged to lodge a currency report when individuals take more than USD5,000 in cash out of the country. These are important contributors to the detection of illegal activity.³³⁰

The rule-based Cash Transaction Reports (CTRs) involve less risk of error for both private and government sectors in terms of failure to report because a clear parameter is set for the sum of daily transactions for a person or entity (that is, USD10,000). However, the risk of failing to detect ML increases when the sum of transactions involved falls below USD10,000, for example USD9900.³³¹ Such transactions can be repeated over a number of days in a single account (avoiding the CTR reporting requirement), or into a variety of accounts across a number of institutions, again failing to trigger the reporting requirement. Such structuring of transactions is known as ‘smurfing’ (though it may lack the use of ‘smurfs’ or couriers).³³² This dilemma pushed the US into creating a requirement for a ‘Suspicious Activity Report’ (SAR) (a discretionary report) in 1996. SARs oblige banks and other reporting entities to report

³²⁹ John Walker, AUSTRAC and RMIT University, ‘The Extent of Money Laundering in and Through Australia in 2004’ (Australian Institute of Criminology, 2007) 11–12 <<http://www.criminologyresearchcouncil.gov.au/reports/200304-33.pdf>> at 15 January 2011.

³³⁰ David A Andelman, ‘The Drug Money Maze’ (1994) 73(4) *Foreign Affairs* 94, 96.

³³¹ *Ibid.*

³³² Secretary of the US Department of The Treasury, A Report to the Congress in Accordance with Section 359 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA Patriot Act)’ (November 2002) 9 <http://www.fincen.gov/news_room/rp/files/hawalarptfinal11222002.pdf> at 20 February 2011. Compare AUSTRAC, *Placement Techniques* (2008) 1 <http://www.austrac.gov.au/elearning/pdf/intro_amlctf_placement_techniques.pdf> at 20 February 2011 - where it keeps its narrower meaning as involving couriers.

any activity they consider to be suspicious, whether it involves transactions over or under the threshold amount.³³³

According to Unger and Waarden (2009), the US intentionally left the concept of ‘suspicious’ vague, in the belief that this uncertainty would force banks to keep alert and ready to update their understanding of how ML activity could occur, while the ambiguity would leave money launderers puzzled about the risk of proceeding with their activity.³³⁴ The use of SARs in the US has been reported as generally restricted to transactions above USD5000.³³⁵ Patterns of deposits just under the level required to trigger a CTR may prompt the submission of an SAR by alert personnel³³⁶ and/or computer assisted transaction tracking.³³⁷

The *Bank Secrecy Act* was followed by the *Money Laundering Control Act 1986*, the *Anti-Drug Abuse Act 1988*, the *Annunzio-Wylie Money Laundering Act 1992*, the *Suppression Act 1994*, the *Money Laundering and Financial Crimes Strategy Act 1998*, and the *USA Patriot Act 2001*, and finally the *Intelligence Reform and Terrorism Prevention Act 2004*.³³⁸

The *Bank Secrecy Act* also authorises the Secretary of the Treasury to issue regulations and call for certain records or reports, where the Secretary determines these have

³³³ Takats, above n 72, 33.

³³⁴ Unger and van Waarden, above n 55, 962–3.

³³⁵ Reuter and Truman, above n 33, 207.

³³⁶ AUSTRAC, *Placement Techniques*, above n 332, 1.

³³⁷ ShijiaGao and DongmingXu, ‘Conceptual Modelling and Development of an Intelligent Agent-Assisted Decision Support System for Anti-Money Laundering’ (2009) 36(2) *Expert Systems with Applications* 1493.

³³⁸ FinCEN, ‘History of Anti Money Laundering Laws’ <http://www.fincen.gov/news_room/aml_history.html> at 20 February 2011.

a high degree of usefulness in criminal, tax or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism.³³⁹

The Act obliges a great number of financial institutions to adhere to its reporting and record keeping obligations.

These include depository institutions (e.g., banks, credit unions and thrifts); brokers or dealers in securities; insurance companies that issue or underwrite certain products; money services businesses (e.g., money transmitters; issuers, redeemers and sellers of money orders and travelers' checks; check cashers and currency exchangers); casinos and card clubs; and dealers in precious metals, stones, or jewels.³⁴⁰

The primary focus was on combatting financial crime, particularly ML, so much so that it was often referred to as the Anti-Money Laundering Act or even 'BSA/AML'.³⁴¹ Financial intelligence was being collected via the reporting mechanisms, but it was primarily related to financial crimes (such as tax evasion) and ML of the proceeds of criminal activities (such as drug trafficking)³⁴² for use in establishing a financial trail for proceeds from criminal activities that could lead to prosecution.³⁴³ ML is 'defined, in part, with respect to the proceeds of specific unlawful "predicate" activities'. The list of predicate activities (and of reporting entities) may continue to expand.³⁴⁴

³³⁹ 31 USC § 5311.

³⁴⁰ FinCEN, 'About FinCEN: What we do' <http://www.fincen.gov/about_fincen/wwd/> at 15 January 2011.

³⁴¹ FinCEN, 'Statutes and Regulations - Bank Secrecy Act' <http://www.fincen.gov/statutes_regs/bsa/> at 20 February 2011.

³⁴² The list includes robbery, arson, mail fraud, even cyber crime: see Charles Doyle, 'Criminal Money Laundering Legislation in the 109th Congress' CRS Report for Congress Order Code RS22400, 15 March 2006, 2 <<http://www.house.gov/gale/legislation/issues/crime/crimedocs/RS22400.pdf>> at 20 February 2011.

³⁴³ FinCEN, 'Law Enforcement – Overview' <http://www.fincen.gov/law_enforcement/> at 20 February 2011.

³⁴⁴ Department of the Treasury, 31 CFR Part 103, 'Financial Crimes Enforcement Network: Anti-Money Laundering Program and Suspicious Activity Report requirements for Non-Bank Residential Mortgage Lenders and Originators': RIN: 1506-AB02 [Advance Notice of Rule Making] <http://www.fincen.gov/statutes_regs/frn/pdf/ANPRM.pdf> at 20 February 2011.

Enacted in the wake of 9/11, the *Patriot Act 2001* considers TF as a predicate crime under that definition. Thus ML relates to national security.³⁴⁵ This Act expanded the scope of the *Bank Secrecy Act* increasing attention on TF and ML crimes.³⁴⁶ Reflecting the expanded responsibilities and changing emphasis, FinCEN became as a bureau within the Treasury Department with its Director reporting to the Under-Secretary of Terrorism and Financial Intelligence.

The *Patriot Act* introduces stricter SARs requirements, and FinCEN was given more powers to issue rules to the reporting entities, including rules prohibiting them from ‘establishing, maintaining, administering or managing any correspondent account in the United States for or on behalf of any foreign bank that is designated as a “primary money laundering concern”’.³⁴⁷ Banks are required to identify suspicious activities and submit reports on them.³⁴⁸ If they are detected having failed to do so, they may be fined and reported to relevant government agencies.³⁴⁹ Countries that do not mandate and implement strict SAR regulations will face countermeasures, including detailed inspections of accounts that contain funds emanating from a non-compliant country, and a decrease in mutual recognition and international aid programs.³⁵⁰

Since FinCEN became the enforcement agency, the US government has moved towards civil settlements instead of lawsuits.³⁵¹ In fact, while scholars are looking to the US in terms of general regulatory approach, one needs to know that the approach to dealing

³⁴⁵ Unger and van Waarden, above n 55, 962.

³⁴⁶ Terrorism related reports were at a fairly low level prior to 9/11: Reuter and Truman, above n 33, 106.

³⁴⁷ John Walker, AUSTRAC and RMIT, above n 329, 12.

³⁴⁸ The US AML system suffers from a mixed paper and electronic reporting system. The US has a large number of banks ranging in size from large international institutions to small local banks servicing a single town. The result is a huge disparity in the capacity, skills, knowledge and technology available to the banks. This meant that the US introduced a ‘mixed’ (paper and electronic system) and this creates large problems for the regulators in collecting and analysing the reports.

³⁴⁹ Ibid.

³⁵⁰ Roule and Kinsell, above n 74, 151.

³⁵¹ Hall, above n 6,668.

with regulatory failure in US is different from that found in Europe or Australia. The American approach tends to opt for settlements involving tens of millions dollar in penalties in exchange for decisions not to prosecute and often without the companies having to admit criminal liability.

Takats (2009) cites such examples as a fine of USD25 million for Riggs Bank in 2004,³⁵² USD50 million for AmSouth Bank in 2004,³⁵³ USD24 million for Arab Bank in 2005,³⁵⁴ USD80 million for Abn-Amro Bank in 2005,³⁵⁵ USD12 million for Israel Discount Bank in 2006,³⁵⁶ USD5 million for Doha Bank in 2009,³⁵⁷ and USD110 million for Wachovia Bank in 2010.³⁵⁸ Their failure to institute and implement adequate detection regimes, or train and supervise staff for their correct operation so as to ensure compliance and timely reporting of suspicious transactions proved costly. Large and aggressive civil penalties for such failures or for false negatives, that is for not reporting transactions which are later judged ‘suspicious’ or prosecuted as ML,³⁵⁹ encourages over-reporting. This is further encouraged by a failure to impose fines for ‘false positives’, which are often computer generated alerts that are ‘false alarms’ that needlessly add to regulator and regulated entity costs.³⁶⁰

³⁵² FinCEN, *Assessment of Civil Money Penalty— Riggs Bank, N.A.* <http://www.fincen.gov/news_room/ea/files/riggsassessment3.pdf> at 16 January 2011.

³⁵³ FinCEN, *Assessment of Civil Money Penalty— AmSouth Bank* <http://www.fincen.gov/news_room/ea/files/amsouthassessmentcivilmoney.pdf> at 16 January 2011.

³⁵⁴ FinCEN, *Assessment of Civil Money Penalty— Arab Bank PLC* <http://www.fincen.gov/news_room/ea/files/arab081705.pdf> at 16 January 2011.

³⁵⁵ FinCEN, *Assessment of Civil Money Penalty— ABN AMRO Bank* <http://www.fincen.gov/news_room/ea/files/abn_assessment.pdf> at 16 January 2011.

³⁵⁶ FinCEN, *Assessment of Civil Money Penalty— Israel Discount Bank* <http://www.fincen.gov/news_room/ea/files/fincen_assessment_of_civil_money_penalty.pdf> at 16 January 2011.

³⁵⁷ FinCEN, *Assessment of Civil Money Penalty— Doha Bank* <http://www.fincen.gov/news_room/ea/files/Doha.pdf> at 16 January 2011.

³⁵⁸ FinCEN, *Assessment of Civil Money Penalty— Wachovia Bank* <http://www.fincen.gov/news_room/ea/files/100316095447.pdf> 16 January 2011.

³⁵⁹ Takats, above n 72, 34.

³⁶⁰ Ibid.

The availability of the ‘safe harbour’ provisions³⁶¹ — that is, the ability to make a report knowing that if they do they will not be open to civil prosecution by the regulator further encourages reporting. The view may be: better to report, than fail to do so and risk prosecution. As far as vulnerability to civil suit from the transactor, ‘safe harbour’ provisions are in place to protect the reporting entity. Reporting entities will, therefore, be more willing to report transactions as suspected or possible ML, resulting inevitably in false positives, in order to eliminate their exposure to harsh penalties.³⁶² However, safe harbour provisions help generate an increased number of reports, many of low quality. FinCEN and law enforcement bodies and other regulators rely on the intelligence supplied and must analyse the reports to see if they contain useful material. Perhaps with little or no result in terms of securing a prosecution, yet as adding to regulator and enforcement agency costs. It is worth recalling that FinCEN receives more than 1,290,590 SARs per year (732,563 being for depository institutions and 537,761 being for money services businesses).³⁶³ Suspected BSA/structuring/ML accounts for 44 per cent of reported transactions for depository institutions.³⁶⁴

The threat of harsh sanctions causes banks to implement costly monitoring and reporting processes in order to avoid that possibility.³⁶⁵ This monitoring and associated training could vitally affect the reporting entities’ ability to comply.

The best outcomes occur, however, when action is taken not so much out of fear of the imposition of harsh sanctions but when compliance is viewed as obligations that must be met to achieve the best AML system. Therefore, reporting entities must fully

³⁶¹ Codified in 31 USC 5318(g)(3).

³⁶² Takats, above n 72, 34.

³⁶³ Figure for 2008 also include casinos and card clubs, securities and futures industries: see FinCEN, *The SAR Activity Review – By the Numbers* Issue 12 (June 2009) 4 <http://www.fincen.gov/news_room/rp/files/sar_by_numb_12.pdf> at 21 February 2011.

³⁶⁴ Ibid.

³⁶⁵ Takats, above n 72, 34.

appreciate their role in the field of AML and endeavour to fulfil it, as it is an important pillar of a successful AML system.

In sum, FinCEN, an administrative model FIU, applies harsh penalties (including very substantial fines) on non-compliant reporting entities. Entities report ‘less suspicious reports’ rather than only those about which they are more sure, essentially “crying wolf” (to use Takats’ expression), reporting what eventually are found to be false positives. Over-reporting reduces the average value of reports as well as the overall value of reports — with low value reports perhaps crowding out higher value reports as all require the regulator’s attention.

Another disadvantage of an administrative model-based FIU, according to Forget and Hočevár (2004), is that it is more subject to direction by political authorities.³⁶⁶ This was clear in the US experience. According to Takats (2009), fines have grown in the last 10 years, particularly after the 9/11 and the enactment of the Patriot Act in 2001. Over the same period the number of the ML prosecutions has fallen, while the number of the reports that have been submitted to FinCEN from the reporting entities since the disaster of 9/11 has increased.³⁶⁷

Yet were the harsh sanctions that have been applied by FinCEN the best solution in the face of non-compliance with the reporting obligations or have they contributed to increasing or perhaps changing the nature of the non-compliance? Reporting frequency cannot replace the value of reporting quality. One wonders whether the overall value has been diluted by the sheer number of reports, or that a non-compliant attitude survives, in one way or another, where — through ignorance or intent — personnel ‘fill

³⁶⁶ Louis Forget and Vida Šeme Hočevár, *Financial Intelligence Units: An Overview* (International Monetary Fund, 2004) 11.

³⁶⁷ Takats, above n 72, 34.

in the spaces’ on the relevant forms but little more. If so, this would be disappointing, especially when one considers that report quality is an important element in any effective AML system.

Difficult political circumstances in the wake of September 11 affected the US regulatory culture in general and the US AML system and its reporting obligations in particular, driving the enforcement mechanism of FinCEN enforcement mechanism to harsher sanctions on non-compliant entities.

4.3.2 Netherlands

This country’s AML system is actually created to work in conjunction with the three relevant EU directives which it takes into consideration³⁶⁸ and FATF-influenced policies. It has enacted the *Act on Identification for Financial Services of 1993*(WID),³⁶⁹ and the *Act on Reporting Unusual Transactions of 1993*(MOT) (often referred to as the Disclosure of Unusual Transactions Act)³⁷⁰ in order to conform with the first EU directive for ML of 1991.³⁷¹ Its AML system then became more comprehensive, particularly after 2001 when the second EU directive on ML³⁷² was taken into consideration. Those obliged lawyers, dealers in gold bullion, real estate agents, car dealers and others in addition to the financial sector to report. By 2008, the Netherlands new *Prevention of Money Laundering and Financing of Terrorism Act of 2008*

³⁶⁸ See the European Directives on ML in Chapter 2 of the thesis.

³⁶⁹ Act on Identification for Financial Services 1993 (The Netherlands) [*Wet identificatiebijfinanciële dienstverlening* (WID)].

³⁷⁰ Act on Reporting Unusual Transactions 1993 (The Netherlands) [*Wet melding ongebruikelijke transacties* (MOT)] (often referred to as the ‘Disclosure of Unusual Transactions Act’) (entry into force 1994).

³⁷¹ Council Directive 91/308/EEC of 10 June 1991 on Prevention of the Use of the Financial System for the Purpose of Money Laundering [1991] OJ L 166.

³⁷² Directive 2001/97/EC of the European Parliament and of the Council of the European Union of 4 December 2001 [2001] OJ L 344.

(WWFT)³⁷³ had been issued to align legislation with the third EU directive on ML of 2005.³⁷⁴ This extended the ML definition to include TF.

The Financial Intelligence Unit Netherlands (FIU-NL) was founded in 2006 and is located within the Service for International Police Intelligence of the Netherlands national police (*Korpslandelijke politiediensten*, KLPD).³⁷⁵ Formed by a merger of the Office for the Disclosure of Unusual Transactions and the Office of the National Public Prosecutor for Cases Involving Unusual Transactions,³⁷⁶ the FIU-NL is a hybrid FIU model which combines both the administrative and the law enforcement models.³⁷⁷ A Dutch Finance Ministry survey estimated that the total of money laundered in the Netherlands jurisdiction is EUR18.5 billion, EUR17.7 billion of which comes from crimes committed abroad, and EUR1.8 billion from domestic crimes.³⁷⁸

The Netherlands' AML system refers to 'unusual transactions' (rather than 'suspicious transactions'). This is how the matter was addressed in the country's first AML legislation, the *Disclosure of Unusual Transactions Act* of 1991.³⁷⁹ As this system also adopts the RBA, the concept of 'unusual' better suits this approach than the concept of

³⁷³ Prevention of Money Laundering and Financing of Terrorism Act 2008 (The Netherlands) [*Wet ter voorkoming van witwassen en financieren van terrorisme* (WWFT)].

³⁷⁴ Directive 2005/60/EC of the European Parliament and Council of 26 October 2005 on the Prevention and Use of the Financial System for the Purpose of Money Laundering and Terrorist Financing OJ L 309/15. See also the IBA Anti-Money Laundering Forum, 'IBA Overview of the Third EU Money Laundering Directive' <<http://www.anti-moneylaundering.org/EuropeanChart.aspx>> 22 February 2011.

³⁷⁵ FIU-Netherlands <<http://www.fiu-nederland.nl/en/organization.html>> at 16 January 2011. *Korpslandelijke politiediensten* (KLPD); *Dienst internationale politie-informatie* (Dienst-IPOL).

³⁷⁶ FIU-Netherlands, *2008 Annual Review Financial Intelligence Unit-Netherlands* (FIU-Netherlands, 2009) 13 <http://www.fiu-nederland.nl/nl/informatie/doc_download/39-fiu-netherlands-2008-annual-review.html> at 16 January 2011. FIU-Netherlands, *FIU – 2009 Annual Review Financial Intelligence Unit-Netherlands* (FIU-Netherlands, 2010) (available at FIU-Netherlands website).

³⁷⁷ According to the FIU-Netherlands, the FIU-NL has a hybrid style because it 'receives, analyses, and disseminates the unusual transaction reports (UTRs) and currency transaction reports filed by reporting entities: FIU-Netherlands, *Objective* <<http://www.fiu-nederland.nl/en/objective-.html>> at 16 January 2011. These are the roles of an FIU on an administrative model (as shown in Chapter 1 of the thesis). It also provides a police function that serves as a point of contact for law enforcement (as an FIU on a law enforcement model would (as is also shown in Chapter 1 of the thesis):

³⁷⁸ Finfacts, *Money Laundering in Netherlands Amount to €18.5 Billion Annually: Amounts to 5% of Dutch GDP*, Finfacts Ireland's Business & Financial Portal (2006) <http://www.finfacts.com/ireland/businessnews/publish/article_10004923.shtml> at 17 January 2011.

³⁷⁹ Ping, above n 32.254–5.

‘suspicious’ transactions, the concept of ‘unusual’ being more extensive than that of ‘suspicious’ in the field of reporting obligations in Netherlands AML legislation.

However, the Netherlands’ AML system has issued a list to describe the unusual transactions. The list is constructed according to three core indicators (which have been fairly stable since their last major revision in 2005):³⁸⁰

- 1 Blacklisted countries: greater vigilance is needed when dealing with transactions involving entities of the countries designated by the Minister of Finance and Minister of Justice as ‘an unacceptable risk’ for ML or TF.³⁸¹ There is a very high possibility of finding an unusual transaction where transactions are conducted with a person or entity of such countries.
- 2 Crimes that are reported to police or other judicial authorities and are to be prosecuted in regard to ML: ‘such crimes are usually linked to money laundering, and include such crimes as drug trafficking, smuggling or fraud’.³⁸² ML is criminalised under the Criminal Code.³⁸³
- 3 The type and the amount of transactions: Such that, for example, for financial, credit or investment institutions or investment companies, this involves cash

³⁸⁰ FIU-Netherlands, above n 375, 39.

³⁸¹ Objective Indicator B0510100: FIU-Netherlands, above n 375, 79.

³⁸² Objective Indicator T0510111: above n 376, 79. ‘The Netherlands has an “all offenses” regime for predicate offenses of money laundering that includes narcotics money laundering’: US Department of State, *2010 International Narcotics Strategy Report (INCSR0) Volume II: Money Laundering and Financial Crimes Country Database – Montenegro through Suriname*. Report of the Bureau of International Narcotic and Law Enforcement Affairs [The Netherlands] (2010) <<http://www.state.gov/p/inl/rls/nrcrpt/2010/database/141520.htm>> 22 February 2011.

³⁸³ US Department of State, *2010 International Narcotics Strategy Report (INCSR0 – VOL 1: Money Laundering and Financial Crimes Country Database)*.

transactions of EUR15,000 or more.³⁸⁴ Where money transfers (deposits and so on) are involved, a threshold of EUR2000 applies.³⁸⁵

Variants on the above exist for credit card companies, casinos, traders in objects of high value, life insurance companies and brokers, other traders, and independent professional groups.³⁸⁶

The characteristics that the Netherlands' AML system uses as indicators for unusual transactions are those which most countries use to identify the nature of the transactions, that is, to determine whether a transaction is suspicious or not. Thus the concept of 'unusual transactions' appears in practice to have become over time very similar if not identical to that of the 'suspicious transaction', especially as RBA applies to both.

The intention of applying the RBA in Netherlands' AML system was to reduce over-reporting, improve the quality of the information in the cases reported, and establish a more effective reporting regime; but the reality is somewhat different. RBAs can differ, for example in relation to threshold amounts that trigger a response. The Netherlands system requires reporting entities to report every 'unusual transaction' (UTRs) without focusing on the idea of the 'suspicion'. The former term ('unusual') in common speech is understood as far broader (and as a far more neutral descriptor) than the latter ('suspicious') which carries a negative connotation. On the face of it, reporting entities have the obligation to report every single 'unusual' transaction, even if it is not 'suspicious'.

³⁸⁴ Objective Indicator B0510133: above n 376, 79.

³⁸⁵ Objective Indicator TT0810141: above n 376, 79.

³⁸⁶ For details see FIU-Netherlands, above n 376, 80–1.

The problem here is twofold: first, many unusual transaction reports will eventually prove to be lawful;³⁸⁷ and secondly, because this instance involves reporting ‘unusual transactions’ then there is no requirement to report it as what elsewhere would be termed a ‘suspicious transaction’. Reporting a transaction as ‘unusual’ is deemed sufficient. This will affect the ultimate value of the reports.

The regime uses a term that, from a language perspective alone, would tend to signify the inclusion of transactions ranging from a more minor concern to a more major concern. For example, a statistical anomaly with a logical explanation, such as two highly trustworthy brothers, having sold their cars on two successive days just prior to leaving for London to commence university, deposit amounts just under or over a given threshold into their account, requiring the production of one if not two reports of an ‘unusual transaction’. Such reports will inevitably be found to have been unnecessary (particularly in terms of ML prosecution) and having prompted unnecessary expense on the part of both the reporting entity and the FIU. It could be expected that the lower the threshold (physical or psychological), the greater the number of reports will be submitted to the FIU as unusual transactions, and that is exactly what happened with the Netherlands reporting experience, especially when it applied structural changes in comparatively recent years.³⁸⁸

One of the important factors contributing to the high numbers of reports submitted was the application of the RBA in the area of AML. Reporting entities (varying markedly in size and the type of business and services provided) were obliged to manage and mitigate their own risk; then report any UTRs to FIU-NL. The FIU then examines the reports made and take into consideration any they deemed ‘suspicious’ and files the

³⁸⁷ Thony, above n 40, 272.

³⁸⁸ But prior to the GFC.

others. Another factor was obliging the two major money transfer institutions, Western Union and MoneyGram to report UTRs. After 2005, the money transfer sector was the largest contributor of UTRs. Thus the figures for UTRs overall and money transfer UTRs (in brackets) for the period 2006–2009 are: 172,873 (130,992) in 2006, rising to 214,040 (146,158) in 2007,³⁸⁹ then to 388,842 (367,370) for 2008.³⁹⁰ However a substantial fall did occur across the majority of sectors in 2009³⁹¹ (a drop of 58 per cent overall),³⁹² but this may be largely due to the GFC as UTRs may have fallen in line with decreased numbers of transactions conducted.³⁹³

Figures overall for suspicious transactions (as determined by the FIU-NL from the UTRs) also rose with money transfers featuring significantly in the period 2006–2009 (money transfer sector figures in brackets): from 34,531 (28,994) for 2006 to 45,656 (40,893) for 2007, then 54,605 (50,803) in 2008 before they too fell 41 per cent in 2009 to 32,100 (28,647),³⁹⁴ the figures somewhat in line with the UTR pattern.³⁹⁵

The total funds involved, however, in suspicious transactions rose between 2008 and 2009. Money transfers, though statistically frequent, usually involve small amounts, so while they accounted for 98 per cent of the drop in the number of UTRs, their total

³⁸⁹ Unger and van Waarden, above n 55, 967.

³⁹⁰ FIU-Netherlands, above n 376, 40 [Graph 6.1]. The 2006 figure of 181, 623 UTRs was slightly higher than that for 2005: 40 [Graph 6.1].

³⁹¹ Ibid. According to Hennie Kusters the Head of FIU Netherlands: ‘The question of how the reduction in the number of reports should be assessed is legitimate. If the Money Laundering and Terrorist Financing Act (*Wet ter voorkoming van witwassen en financieren van terrorisme*, WWFT) has a preventive effect, and reporting entities have adapted their working methods to this, the decrease can be interpreted as a positive sign. ... [ie] fewer unusual transactions are taking place in response to more honest financial markets. This would certainly be very welcome. However, if the decrease is the result of an abating watchfulness of the reporting institutions, this is a cause for concern. ... the reporting entities and the supervisory authorities themselves ... have to provide ... information to explain the reduced number of reports submitted....’

³⁹² Ibid 40 [Graph 6.1].

³⁹³ FIU-Netherlands, *FIU – 2009 Annual Review Financial Intelligence Unit-Netherlands* (2009) 39. A trend would be hard to confirm regarding overall money transfers, the government does not collect statistics on overall volume, only on UTRs: 43.

³⁹⁴ FIU-Netherlands, above n 376, 43.

³⁹⁵ Though the number for 2005 (38,481) was slightly higher than for 2006: FIU-Netherlands, above n 376, 43.

value was more than offset by a larger number of transactions deemed suspicious by the FIU-NL that involved large amounts and comprised 48 per cent of the total amount involved.³⁹⁶ These two sets of figures illustrate the impact that adding these categories made in terms of volume of UTRs.

The Netherlands regime differs in its approach to reporting entity failure to report. FIU-NL is regarded as lenient in its enforcement mechanism, having adopted a more conciliatory and inclusive approach by encouraging a high degree of self-regulation.³⁹⁷ How does it supervise such entities so as to detect their failure to report, and punish those that failed to report unusual transactions? How can it compel compliance?

Here the FIU-NL has been found wanting. The Netherlands Court of Audits in its 2008 report commented critically on a number of issues which related to the Netherlands' AML system. These included a lack of information sharing between the Ministries of Finance, Justice and Interior, the lack of use of its powers to seize assets, as well as the 'limited financial crime expertise and capacity within law enforcement, and inadequate supervision of notaries, lawyers, and accountants'.³⁹⁸ This last was addressed in the most recent (2008) Act which brought these entities as well as a number of others into the ambit of the Netherlands AML system.³⁹⁹

In relation to deprivation of criminal assets, a threshold of EUR100,000 in proceeds of crime applies before a prosecution is launched by the Prosecution Service Criminal Assets Deprivation Bureau (BOOM), an agency specialising in complex cases where it

³⁹⁶ Ibid 46.

³⁹⁷ Unger and van Waarden, above n 55, 972–3.

³⁹⁸ US Department of State (DoS), Bureau for International Narcotics and Law Enforcement Affairs, *International Narcotic Control Strategy Report – Volume II: Money Laundering and Financial Crimes* (2009) 378 <<http://www.state.gov/documents/organization/120055.pdf>> at January 2011.

³⁹⁹ Ibid.

is expected that substantial assets will be seized.⁴⁰⁰ A cooperation agreement between the FIU-NL and BOOM exists but, as the FIU-NL admits, it ‘has yet [to] produce the desired result’.⁴⁰¹

The need for greater coordination and coherency of process between the FIU-NL and its partner agencies was also highlighted in its 2009 annual report as was the need to encourage criminal investigation agencies to use the information collected by the FIU-NL ‘more frequently and effectively’.⁴⁰²

Emphasis remains on increased education of or guidance for reporting entities who remain ‘gatekeepers’ for AML law.

In the event of non-compliance, the FIU-NL has the ability to impose fines of up to EUR150,000. However, FIU-NL has taken relatively few enforcement actions against non-compliant reporting entities. Where such action does occur, few involve a fine at the highest levels. According to Unger and Waarden (2009):

Between 2002 and 2007, 371 cases of non-reporting were passed on to the public prosecutor. This is on average 75 offences per year. In three quarters of the cases the prosecutor himself set a fine between 175 Euro and 11,250 Euro. The rest of the cases were forwarded to a judge, who imposed sanctions between 150 Euro and 150,000 Euro.⁴⁰³

Therefore, in the Netherlands the style of enforcement is a more consensual style that leaves sanctions ‘in the background’ of the regulatory system.

The Netherlands, however, will not impose a harsh regime like that of the US. Nor would its softer regime work, one suspects, in Australia — a country with a different culture, a different pre-existing legal institutional framework, and financial system to

⁴⁰⁰ FIU-Netherlands, above n 376, 20.

⁴⁰¹ Ibid.

⁴⁰² Ibid 13.

⁴⁰³ Unger and van Waarden, above n 55, 973.

that of the Netherlands. This can be demonstrated by an examination of the experiences of different Australian agencies that are working to regulate the Australian financial system in different areas.

4.4 Local Practices of a Number of Partner Agencies in Enforcing Compliance in the Face of Non-compliance

It was an important milestone when Australia decided to restructure its own regulatory framework. A number of factors played a vital role in the movement for change, including the desire to control the development and vitality of financial institutions, the high number of Australian citizens active in these markets, the risks for investors, depositors and creditors, and the government's promotion of the superannuation.⁴⁰⁴

Therefore, the federal government of Australia in 1996 announced an inquiry to revise the regulation of the financial services. Mr Stan Wallis was the chairman of the committee that took responsibility for reviewing the development of the financial system, its regulation and regulatory agencies. After due consideration, and lengthy consultation, the Wallis Committee issued its report in March 1997, making a considerable number of recommendations to improve the regulatory framework as well as to protect the stability and safety of the Australian financial system.⁴⁰⁵

Among the recommendations was the restructure of the regulatory framework of the financial sector and a shift to a more flexible regulatory framework — namely a functional approach to regulation — for the agencies that supervise prudential

⁴⁰⁴ Richard Grant, *Australia's Corporate Regulators — the ACCC, ASIC and APRA*, Research Brief No 16, 2004–05 (Politics and Public Administration Section, Parliamentary Library, Parliament of Australia, 2005) <<http://www.aph.gov.au/library/pubs/rb/2004-05/05rb16.htm>> at January 2011.

⁴⁰⁵ Ian R Harper, 'The Wallis Report: An Overview' (1997) 30(3) *Australian Economic Review*, 288, 288–300.

regulation and marketplace regulation.⁴⁰⁶ The goal was to reduce regulatory costs, that could otherwise affect economic sector growth, and result in the imposition of higher taxes, and poor services to the community.⁴⁰⁷

4.4.1 An Overview of the Australian Model for Corporate Regulators

According to the Wallis Report, the Australian regulatory structure should rely on three main agencies, who would undertake the various functions:⁴⁰⁸

- 1 ASIC: the Australian Securities and Commission, whose role is to protect consumers in their financial dealings with banks and other deposits taking institutions, superannuation institutions, securities, and general insurance and life insurance institutions. Subsequently created in 1998, ASIC combines the roles of the old Australian Securities Commission (ASC), the Australian Payments System Council (APSC), and the Insurance and Superannuation Commission (ISC). The government also granted more powers to ASIC in regard to consumer protection.
- 2 APRA: the Australian Prudential Regulation Authority, which undertakes prudential regulation of banks and other deposit taking institutions, superannuation institutions, and general and life insurance institutions.
- 3 The Reserve Bank of Australia, which continues its role in regard to supervising the stability of the financial system, policy and the payments scheme.

⁴⁰⁶ Roman Tomasic, Stephen Bottomley and Rob McQueen, *Corporations Law in Australia* (Federation Press, 2nd ed, 2002) 72–3.

⁴⁰⁷ Virginia Plowman, 'Functional Regulation for Capital Market Intermediaries' *APEC Financial Regulators Training Initiative* (ASIC, 2002) 4.

⁴⁰⁸ Jeremy Cooper, 'The Integration of Financial Regulatory Authorities – the Australian Experience', Paper presented to *Comissão de Valores Mobiliários* [Securities and Exchange Commission of Brazil] 30th Anniversary Conference 'Assessing the Present, Conceiving the Future' Rio de Janeiro, Brazil, 4–6 September 2006 (Australian Securities and Investments Commission, 2006) 6.

Therefore, the new structure for the Australian regulatory framework was built on a ‘Twin Peak’ framework comprising ASIC (the corporate, market and financial services regulator)⁴⁰⁹ and APRA (as regulator of prudential institutions – deposit takers, insurance companies and superannuation funds).⁴¹⁰ The model is designed to keep the regulation of the wholesale market separate from that of the retail market, because of the increasing consolidations of firms in the same line of business, the move towards conglomeration, the emergence of new financial instruments, and increased cross border transactions.⁴¹¹

The Australian Competition and Consumer Commission (ACCC), created in 1995 when the Trade Practice Commission (TPC) and the Prices Surveillance Authority (PSA) combined, shares their duty to regulate the Australian corporate system.⁴¹²

The 2005 FATF Mutual Evaluation Report indicated that Australia had succeeded in creating an improved financial system following the Wallis Report. The regulatory agencies were working under a well-regulated financial system with a solid risk management culture to achieve a responsive, efficient, flexible and competitive financial regime.⁴¹³ Nevertheless, in addition to addressing the recommendations of the Wallis Report, these regulatory agencies also were responsible for supervising and

⁴⁰⁹ Ibid 6–7.

⁴¹⁰ Ibid 5.

⁴¹¹ Harper, above n 405, 290–2. However, there was still a degree of overlap or lack of clarity in regard to their role in relation to financial service providers that was criticised by Justice Owen who presided at the Royal Commission into the HIH collapse: Cooper, above n 408, 5. See further below.

⁴¹² ACCC, *Annual Report 1999–2000*, 19 <<http://www.accc.gov.au/content/item.phtml?itemId=302720&nodeId=9c6ddf7155bbad882c2817f8638c9034&fn=Annual+Report+99-00+part+2+Appendixes.pdf>> at 14 February 2011.

⁴¹³ International Monetary Fund (IMF), *Australia: Mutual Evaluation Report — FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism*, IMF Country Report No 06/424 (2006) 16.

implementing the recommendations of the Royal Commission (2001) that investigated the collapse of the HIH Insurance Group of companies.⁴¹⁴

The HIH Insurance Group of companies collapsed in 2001 and its demise challenged the efficacy of the Wallis regulatory framework. Economic professionals considered its collapse the worst corporate failure that Australia has ever had.

ASIC had been investigating the HIH case and issued a notice suspending trading in HIH shares because it believed that the market lacked adequate information about the company's financial position. However, HIH went into provisional liquidation without seeking to re-list its financial position, with losses estimated to be in the billions when it finally collapsed.⁴¹⁵

Much of the debate at the time questioned the performance of the regulatory agencies: on one hand, the effectiveness of the twin peaks model of Wallis Report, and, on the other, questioning APRA's role in prudential regulation, openly critical of APRA's role and expressing a belief that the regulator should have reacted quickly to the HIH situation. As a result of HIH's collapse, a number of significant changes in the insurance industry have occurred, including on matters related to solvency and capital adequacy. A number of changes are due to the recommendations of a Royal Commission that was established to examine the collapse of the HIH institution and evaluate the regulators performance.

The head of the Royal Commission, Justice Owen, concentrated on a number of issues, including the need to have trained regulated entities, actions available, well-resourced regulators with a clear mandate and an adequate enforcement mechanism, efficient

⁴¹⁴ Virginia Plowman, Australian Securities and Investments Commission (ASIC), *Functional Regulation for Capital Market Intermediaries*, APEC Financial Regulators Training Initiative (2002) 13–15.

⁴¹⁵ Ibid.

information sharing, and regulators clearly independent of any political pressure.⁴¹⁶ The recommendations of the Royal Commission match the requirements and attributes earlier discussed in this Chapter. They guarantee the most effective enforcement mechanism in place for any Australian regulatory agency, including AUSTRAC, and these regulatory agencies should be aware of this.

4.4.2 The Main Partner Agencies and the AML system

The Wallis Report gave two main reasons for deciding that two separate regulatory agencies (ASIC and APRA) were preferable to one:

- 1 The existence of the two separate regulatory authorities would decrease the risk of the retail market regulator being infected by its wholesale counterpart and vice versa.
- 2 Their existence would decrease the enormous management burden that is obligatory on a solo regulator.

However, the AUSTRAC Supervisory Framework notes:

The regulators have quite distinct roles and responsibilities, although some regulated entities have expressed the concern that the activity of the regulators has overlapped and caused a repetition of work or/and conflicting requirements. AUSTRAC acknowledges that it is part of Australia's overall regulatory framework and does not intend to work in isolation from other regulators.⁴¹⁷

Even when using the twin peaks model, overlap is one of the challenges that AUSTRAC could face in its work with regulated entities and with partner agencies in the regulatory system in the AML field.

⁴¹⁶ Ibid 15.

⁴¹⁷ AUSTRAC, *Supervisory Framework* (2010) <http://www.austrac.gov.au/supervisory_framework.html> at 14 February 2011.

On the other hand, a minimal level of cooperation and coordination between the partner agencies and AUSTRAC in the AML system adds greater difficulty in relation to obtaining a more effective regulatory framework. An ASIC employee in an informal conversation indicated that he does not see ASIC within the AML system, and no success for ASIC in this domain can be attributed to it as a partner agency except that it provides AUSTRAC on-line access to its data and vice versa.⁴¹⁸

AUSTRAC has signed a number of Memoranda of Understanding (MoUs) with regulators and law enforcement bodies — including ASIC,⁴¹⁹ APRA (2007),⁴²⁰ and ACCC (2007)⁴²¹ for information sharing and to provide each other with the cooperation required in regulation, enforcement and compliance, as well as enhance the opportunities for mutual development through training programs.⁴²² But it seems these arrangements need enormous work to be effective, especially after the FATF Mutual Evaluation Report on Australia (2005) revealed:

APRA and ASIC have wide-ranging powers to remedy breaches of their relevant legislation, which apply to entities as well as their directors and officers (e.g. senior management). Powers include the ability to compel specific remedial actions, disqualify persons for management or directorship functions, and revoke a licence or authorisation to operate. Australia notes that these powers would apply for non-compliance with the FTR Act if the breach created risks or breaches relevant to APRA's and ASIC's legislation. However, it was unclear to the evaluation team how these would be applied in practice, as there are *no express powers to remove*

⁴¹⁸ An informal discussion with X an ASIC employee and CPA member at the *CPA Australia/Forensic Group*, August 2010.

⁴¹⁹ Australian Taxation Office (ATO), *Project Wickenby - Is It Worth the Risk, Project Wickenby Terms of Reference* <<http://www.ato.gov.au/super/content.asp?doc=/content/00220075.htm&page=17>> at 29 January 2011.

⁴²⁰ For details re AUSTRAC – APRA MoU (a cooperative framework) signed 22 February 2010, see AUSTRAC, *AUSTRAC Supervisory Framework*, above n 417, 5.

⁴²¹ For details re AUSTRAC – ACCC MoU (a cooperative framework) signed 16 March 2007, see ACCC, 'ACCC and AUSTRAC sign Memorandum of Understanding' News Release # MR 072/07, 16 March 2007.

⁴²² AUSTRAC provides on-line access to its data holdings to the ATO, AFP, ACC and ASIC under the terms of the Memorandum of Understanding between AUSTRAC and these agencies. AUSTRAC has recently been funded to provide analytical support: Australian Taxation Office (ATO), *Project Wickenby* above n 419.

management or revoke a licence for a breach of AML/CFT requirements. No sanctions have yet been applied by APRA or ASIC for AML/CFT failings.⁴²³

Indeed the first remedial direction for non-compliance was only issued by AUSTRAC on 5 November 2009 (some four years after the above report was made), and its second on 9 February 2011.⁴²⁴ Both directions were issued under subsection 191(2) of the *AML Act 2006*.

According to FATF, AUSTRAC's main partner agencies (ASIC, APRA and the ACCC) have actively applied their enforcement mechanisms, using a wide range of powers and applying sanctions on non-compliant financial institutions, but not for the purpose of AML activities. These agencies were able to apply their enforcement mechanism using a variety of soft and harsh sanctions on non-compliance but AUSTRAC could not or did not appear to have the same ability to apply such a wide range of sanctions although these exist in its enforcement policy. Is this an indicator of almost universal compliance, a lack of detection of non-compliance, or a reluctance to file or a failure to do so promptly? The upcoming chapters will explore this area.

4.4.3 Partner Agencies' Enforcement Mechanisms

The nature of an agency is a significant factor affecting its enforcement mechanisms. In this regard, some agencies, such as the ACCC and ASIC, are mainly enforcement agencies. Their role is to act against non-compliance to guarantee fairness, competition and transparency in the financial system.⁴²⁵

⁴²³ FATF, *Third Mutual Evaluation Report*, above n 15, 10 [36].

⁴²⁴ AUSTRAC, 'Enforcement Actions - Remedial Directions' (2011) <http://www.austrac.gov.au/remedial_directions.html> at 22 February 2011.

⁴²⁵ ACCC, *What We Do — Role and Activities* <<http://www.accc.gov.au/content/index.phtml/itemId/54137>> at 16 February 2011; ASIC, *Our Role — What We Do* <<http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Our%20role>> at 16 February 2011.

Both agencies have legislation that calls for corrective action in the face of non-compliance. Under their respective Acts, they have also the right to inform consumers, institutions, and shareholder of their rights and duties under the relevant legislation. As prosecutors, ASIC and the ACCC rely on announcing planned and successful prosecutions not only to stimulate public confidence in their functions, but also to deter non-compliance. In this regard their role is more like that of ‘naming and shaming’ agencies; AUSTRAC shares this approach with these partner agencies. ASIC and the ACCC will have failed if companies increase their power and build their reputation in the marketplace while confusing clients or harming their interests.⁴²⁶

In contrast, APRA is mainly an administrative agency working to protect depositors; consequently its role relies on monitoring financial institutions. APRA also evaluates the risks that companies could face and the impact of their failure or collapse on the market and the whole financial system. Therefore, APRA failure is linked to company failure: if a company fails then APRA has also failed; if the company succeeds, APRA has also succeeded. However, APRA essentially avoids exposure, not only because of its secrecy obligations, but also because publicising institutions’ financial intricacies would normally undermine the Authority’s prudential aims.⁴²⁷

The different compliance strategies of the partner agencies affect the way that these agencies deal with non-compliance. However, the ultimate goal of the regulators is the same: calling for and working towards the protection of the financial system, its efficiency, maintaining the reputation of both the regulated and the regulator. In order to achieve that, their enforcement mechanisms need to be used when non-compliance

⁴²⁶ Grant, above n 404.

⁴²⁷ Ibid.

occurs, especially when their regulatory culture has been built on actively enforcing a compliance culture as these agencies' has.

4.4.4 Case Study: Civil Penalties as an Enforcement Power that could be applied by ASIC and ACCC on Non-Compliance

The importance of civil penalties comes from the role they play. Civil penalties are the solution that legislation and regulations have used to counter some actions that are not subject to criminal sanction.⁴²⁸

Civil penalties are sanctioned by the regulatory agency when it approaches a civil court to secure a penalty to be applied for entity non-compliance. They are invoked by the authority of the state, and enforced by civil proceedings that follow the measures and rules of evidence in civil cases. The nature of the civil penalty provision is that it merely involves the application of a financial penalty and does not impose any criminal conviction.⁴²⁹

Current policies and practices concerning the use of civil penalties are a response to a major analysis of civil penalties by the Australian Law Reform Commission (ALRC) through its report *Principled Regulation: Federal Civil and Administrative Penalties in Australia* (ALRC Report 95/2003). This report discussed federal regulatory and penalty schemes and the use of civil and administrative penalties. It sought to achieve greater clarity, transparency and consistency in the application of such types of penalties.

In the arena of civil penalties, the ALRC report found that civil penalties serve a number of purposes including retribution, condemnation, specific or general deterrence,

⁴²⁸ Australian Government, Australian Law Reform Commission, *Principled Regulation: Federal Civil and Administrative Penalties in Australia* (ALRC Report 95) (2003) 788 <<http://www.alrc.gov.au/sites/default/files/pdfs/publications/ALRC95.pdf>>.

⁴²⁹ Minister for Justice and Customs, *Australian Government, Guide to Framing Commonwealth Offences, Civil Penalties and Enforcement Powers* (2004) 62.

compensation, and/or protection.⁴³⁰ This type of penalty could be sought more quickly by the regulatory agency to respond to non compliant entities than a criminal prosecution.⁴³¹

Criminal prosecutions necessarily take longer than imposing administrative (and perhaps civil) penalties, but it has been argued that systemic problems with the court system should not prevent the prosecution of criminal behaviour. Officers of the DPP have argued that prosecutions remain a ‘huge deterrent’, and administrative penalties like banning orders can still be imposed before or after a criminal prosecution.

The ALRC report indicated that regulators generally refer suspected criminal breaches to the DPP, which then decides whether to pursue criminal charges. Therefore, the decision to pursue a criminal, civil or administrative penalty is often influenced by the role of the DPP.

However, it was clear from the outset that government regulation, and the penalty schemes used to reinforce it, cannot be generated from a single mould but must be adapted to meet the particular demands and communities which each scheme seeks to regulate. Therefore, regulators have developed Memorandums of Understanding (MoUs) with the DPP to detail the use of criminal and civil penalties and their relationship with referrals to the DPP. These MoUs can summarise how liaison is to occur between a regulator and the DPP and provide mechanisms for resolving any conflict between the regulator and the DPP in applying criminal or civil penalties on non compliant entities.

⁴³⁰ Australian Government, Australian Law Reform Commission, *Principled Regulation: Federal Civil and Administrative Penalties in Australia* (ALRC Report 95) (2003) *Part E — Setting Penalties, Penalty Theory and Penalty Setting* < <http://www.alrc.gov.au/sites/default/files/pdfs/publications/ALRC95.pdf> > at 7 July 2012.

⁴³¹ Australian Government, Australian Law Reform Commission, *Principled Regulation: Federal Civil and Administrative Penalties in Australia* (ALRC Report 95) (2003) *Part C — Enforcement Options, Regulators and the DPP* < <http://www.alrc.gov.au/sites/default/files/pdfs/publications/ALRC95.pdf> > at 7 July 2012.

Thus, a number of regulatory agencies have experience under their law in applying civil penalties on non compliant entities:⁴³²

Unlike the ATO, ACCC and ASIC other regulatory agencies have not been given comparable powers to conduct their own criminal prosecutions. One reason for this is the risk that regulators could become too involved in the investigation and over-prosecute. However, agencies such as ASIC, the ACCC and the Australian Customs Service (ACS) already undertake both investigation and litigation of civil penalty proceedings.

Following its extensive review of the regulatory application of the existing civil penalties scheme in 2003, the ALRC concluded that:⁴³³

The key recommendation is the enactment of a Regulatory Contraventions Statute of general application to cover various aspects of the law and procedure governing non-criminal contraventions of federal law. The Regulatory Contraventions Statute is not intended to be a comprehensive code but rather should be expressed:

1. To contain certain principles of responsibility that apply to any non-criminal breach of any law of the Commonwealth; and
2. To prevail over any inconsistent Commonwealth law to the extent of that inconsistency unless that other law expressly excludes or modifies the operation of the Regulatory Contraventions Statute by express reference to that statute (or the portion of it, the operation of which is to be excluded).

Other recommendations described the principles to be set out in the proposed Regulatory Contraventions Statute in the absence of any clear, express statutory statement to the contrary. These included:

- Contraventions for which a civil penalty may be imposed may contain fault elements as defined under the Criminal Code or as specified in a law that creates a particular contravention. If no fault element is specified, a contravention for which a civil penalty may be imposed does not contain a fault element. (ie, carries strict or absolute liability).
- Any legislation that deems an individual to be personally liable for the contravening conduct of a corporation should include a fault element that the individual knew that, or was reckless or negligent as to whether, the contravening conduct would occur.
- When the same physical elements can attract both a civil penalty and criminal liability, the physical and fault elements of both the contravention

⁴³² Ibid.

⁴³³ Australian Government, Australian Law Reform Commission, *Federal Civil and Administrative Penalties* (2003) <<http://www.alrc.gov.au/inquiries/federal-civil-and-administrative-penalties>> at 8 July 2012.

attracting a civil penalty and the criminal offence should be clearly distinguished in the legislation.

- In civil penalty schemes, an infringement notice scheme should apply only to minor contraventions in which no proof of a fault element or state of mind is required. Infringement notice schemes should follow the model to be set out in the proposed statute.
- All persons directly adversely affected by a regulator's decision to impose a quasi-penalty (such as the revocation or qualification of a licence, or a social security penalty) must be afforded procedural fairness.
- The same protections for individuals afforded by the privilege against self-incrimination in criminal matters apply in relation to actions seeking a civil or administrative penalty.
- All penalty schemes should provide avenues of internal review, external merits review and judicial review, unless one or more of these is clearly inappropriate in the circumstances.
- A court may impose a non-monetary penalty in addition to, or in substitution for, a monetary penalty for an offence or contravention. The introduction of non-monetary penalties into regulatory schemes is encouraged.
- Guidance should be provided for courts setting civil penalties, particularly when considering non-mandatory penalties.

The report has been in the basis for a number of amendments of different government documents. As a result, some legislation was amended and it influenced a number of guidance reports as well as a number of court and tribunal decisions.⁴³⁴ For example, *The Guide to Framing Commonwealth Offences, Civil Penalties and Enforcement Powers* (2004) states:

A civil penalty provision should make appropriate provision for proof of fault. The principles applicable to the choice between requiring fault and imposing strict or absolute liability to an offence should be taken into account. However, the use of strict or absolute liability is more easily justified for a higher civil penalty provision than a higher penalty criminal offence, particularly where the civil penalty provision:

- 1 - applies only to corporate or white collar wrongdoing; and
- 2 - it is reasonable to expect those subject to the civil penalty to take steps to guard against any inadvertent contravention.⁴³⁵

⁴³⁴ Ibid. For example, *the Review of Sanctions in Corporate Law, A Guide to Framing Commonwealth Offences, Civil Penalties and Enforcement Powers, Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004 (Cth), and the High Court of Australia case of Rich v The Australian Securities and Investments Commission [2004] HCA 42.*

⁴³⁵ Ibid 65.

Another example is AUSTRAC's Regulatory Guide 2006 when it reflects the ALRC report and its recommendation in regards to the application of the civil penalties scheme in the *Policy (Civil Penalty Orders) Principles 2006*. The *Guide* provides that:⁴³⁶

During the period set out in subsection (2) for a civil penalty provision, the AUSTRAC CEO may apply for a civil penalty order against a reporting entity for a contravention of the provision only if the AUSTRAC CEO is satisfied that the reporting entity has failed to take reasonable steps to comply with the provision.

However, AUSTRAC practices do not reflect the recommendations of the ALRC report in applying such penalties through its enforcement mechanism and ignore this remedy which could be an effective enforcement power at its disposal.

4.4.4.1 Civil Penalties as an Enforcement Power for ASIC

ASIC's annual report for 2002–03 referred to enforcement as a basic feature of its work in dealing with non-compliance, and indicated that the active use of the enforcement mechanism is required to achieve the best regulatory results. Enforcement is highlighted as 'an essential part of effective regulation'.⁴³⁷ The 2005 FATF Mutual Evaluation Report recognises that civil penalties is among ASIC's wide range of sanction and enforcement powers.

The Australian federal parliament introduced a civil penalty scheme in the *Corporations Act 1993* (and as amended in 2001) as an active enforcement power against non-compliance.⁴³⁸ Part 9.4B 'Civil Consequences of Contravening Civil Penalty Provisions' (sections 1317DA to 1317S) imposes a civil penalty which is allowed to stand prior to

⁴³⁶ AUSTRAC, *AUSTRAC Regulatory Guide, Appendix E, Policy (Civil Penalty Orders) Principles 2006* (2006) <http://www.austrac.gov.au/rg_app_e.html> at 10 July 2012.

⁴³⁷ Australian Securities and Investments Commission ASIC, '*ASIC Annual Report 2002-03*' (Commonwealth of Australia, 2003) <[http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/annual_report2002_03.pdf/\\$file/annual_report2002-03.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/annual_report2002_03.pdf/$file/annual_report2002-03.pdf)> at 16 February 2011.

⁴³⁸ Vicky Comino, 'ASIC and its Enforcement Record Since the Introduction of the Civil Penalties Regime in 1993' (2007) 20(2), *Australian Journal of Corporate Law* (2007) 183–5.

criminal prosecution, thus effectively providing a ‘hybrid’. Civil prosecution cannot generally occur for essentially the same behaviour after a successful criminal prosecution — they are mutually exclusive in many instances. Tomasic (1993) adopted and clarified the term, but observes that ‘sometimes the dividing line between criminal and civil provisions may not be very clear or precise’⁴³⁹. He notes that

In the Corporations Law, ‘provision is made for both civil and criminal actions to be undertaken [for] ... the same conduct’. Substantial fines may be imposed under the criminal law provisions. Indeed, ... civil penalty orders which may involve the imposition of heavy fines which parallel fines which may be imposed for a breach of a corporate criminal law provision. ... under the Corporations Law ... a civil penalty of up to \$200,000 may be imposed under s 1317EA for a breach, such as ... of the directors’ duties provisions. However, the court may impose such a civil penalty order where the case has been proved only to satisfy the civil and not the criminal standard of proof, that is, where the case is proved on the balance of probabilities and not beyond reasonable doubt.⁴⁴⁰

Schedule 3 of the *Corporations Act* includes a full list of actions which can incur either a fine or imprisonment (for example, in reference to section 184, use of position / information). The Criminal Code can be brought to bear for certain offences under the *Corporations Act*.⁴⁴¹

From a legal perspective, the *Corporations Act* has created an enforcement mechanism that could be understood similarly to Braithwaite’s regulatory enforcement pyramid, particularly if one considers a variant model specifically suggested for the Australian Corporations Act by Gilligan, Bird and Ramsay (1999) (see Figure 8 below).

At the base of the pyramid are those who comply with the law and the regulations, where ASIC provides education and gentle persuasion to assist them to maintain their

⁴³⁹ Roman Tomasic, ‘Corporate Crime and Corporations Law Enforcement Strategies in Australia’ Discussion Paper 1/1993 Centre for National Corporate Law Research (1993) 3–4 <<http://www.criminologyresearchcouncil.gov.au/reports/2-91.pdf>> at 22 February 2011.

⁴⁴⁰ *Australian Corporations Act 2001* (Cth) ss 1317DA–1317S, espss 1317M–1317P <http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/> at 16 February 2011. See also Tomasic, above n 439, 2–4.

⁴⁴¹ For example, *Corporations Act 2001* (Cth) pt 9.4.

compliance. The mid-group of enforcement powers includes negotiation, settlement, investigations, inspections, examinations, notices, letters of warning and fines. These powers are in place to discipline those who are showing attempts at non-compliance in the initial and mid stages.

Civil penalties are one of the sanctions included in the upper levels of Braithwaite's regulatory enforcement pyramid. In the variant model, remedial civil penalties are distinguished from incapacitative civil penalties, with remedial civil penalties being located in the second to highest level of the ASIC enforcement pyramid, and 'incapacitative criminal or civil penalties' or banning orders (for example, loss of opportunity to practice an occupation and so forth) at the apex.⁴⁴² The apex's lesser volume indicates the relative few that 'progress' to this stage (generally having passed through the preliminary stages). This level boasts full enforcement strength sanctions for persistent and/or egregious non-compliance.⁴⁴³ (See Figure 8 below.)

⁴⁴² George Gilligan, Helen Bird and Ian Ramsay, *The Efficacy of Civil Penalty Sanctions Under the Australian Corporations Law*, Australian Institute of Criminology (1999) 2–3.

⁴⁴³ Ibid 2.

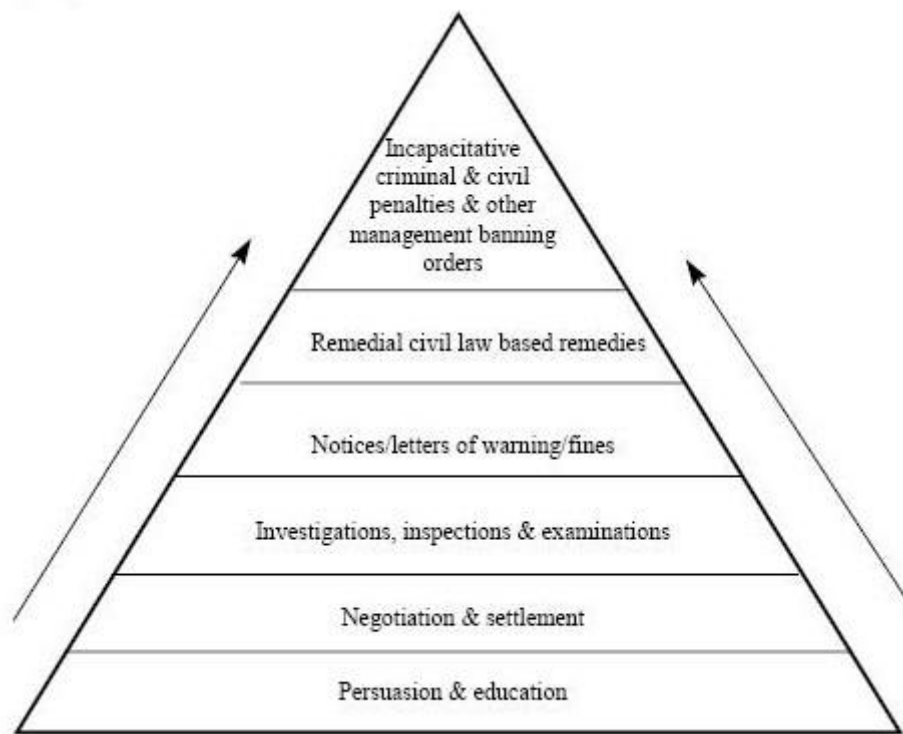


Figure 8: The Enforcement Pyramid According to the Corporations Law

Adapted from George Gilligan, Helen Bird and Ian Ramsay, ‘The Efficacy of Civil Penalty Sanctions under the Australian Corporations Law’.⁴⁴⁴

From a regulatory perspective, ASIC’s most important objective is having a successful outcome in the shortest achievable timeframe. Civil penalties are one of the powers that have been applied by ASIC on non-compliance.

Nevertheless, Gilligan, Bird and Ramsay (1999) noted that the civil penalties were not frequently applied in the six years to 1999, with just 14 instances in that period. They also indicated that the figure is low because ASIC viewed the civil penalty regime as serving a limited enforcement purpose,⁴⁴⁵ and does not indicate that this power is

⁴⁴⁴Ibid 3.

⁴⁴⁵Ibid 4.

effective in terms of discouraging non-compliance, especially given the number of factors that play a role in narrowing the scope for using civil penalties. These include:⁴⁴⁶

- 1 Challenges that could hamper the functioning of ASIC — for example, initially a number of the people who worked in the enforcement section of ASIC came from a criminal law environment and consequently they were more familiar with criminal sanctions than civil penalties. However, this has changed over time with the employment of a significant number of lawyers from civil litigation practices.⁴⁴⁷
- 2 ASIC's relationships with other regulatory agencies — for example, the relationship between ASIC and the Office of the Commonwealth Director of Public Prosecutions (CDPP) requires ASIC to liaise with the CDPP over important enforcement matters, which affects the use of civil penalties. While the role of the CDPP is to act against criminal breaches of the law, ASIC has broader obligations which include using civil remedies. These different obligations can limit the probability of civil penalties being used.
- 3 The availability of alternative sanctions, including management banning orders and injunctions. For example, section 600 of the *Corporations Act* permits ASIC to enforce a management banning order on a person in specific circumstances.
- 4 ASIC's desire to not only accomplish its enforcement objectives but also to be widely seen as doing so, which makes it difficult for ASIC to undertake enforcement activities that are more complex in nature and time-consuming and involve sanctions like civil penalties.

⁴⁴⁶ Ibid 5.

⁴⁴⁷ An informal discussion with X an ASIC employee and CPA member, above n 418.

5 Concerns about the limited usefulness of civil penalties at ASIC's disposal. Contributing factors range from unclear drafting and lack of certainty about the meaning of some provisions to civil penalties' perceived low public profile (and hence lower deterrent value).⁴⁴⁸ The uncertain nature of the civil penalty system in the *Corporations Act* and regulatory practices have added doubt about the use of these sanctions.⁴⁴⁹ Their sheer complexity make them time consuming and costly — clashing with resource constraints and making them less attractive to enforcement bodies and the public alike when compared to the 'swift, decisive and obvious' effects of alternative enforcement sanctions (such as management banning orders).⁴⁵⁰

In terms of deterrence, fines of up to AUD200,000 may be imposed under Part 9.4B of the *Corporations Act*⁴⁵¹ as either a civil or a criminal penalty.

The maximum penalty for a criminal contravention is \$200 000 or five years imprisonment or both, and a person found guilty is prohibited from managing a corporation for five years unless the leave of the court is obtained, provides for two types of penal consequences: civil penalties and criminal penalties. Two kinds of civil penalties are prescribed: a pecuniary penalty of up to \$200 000 and/or an order banning a person from managing a corporation for an unspecified period. Criminal penalties comprise a fine of up to \$200 000 or five years imprisonment or both. Criminal penalties are only imposed where a person contravenes a civil penalty provision knowingly, intentionally or recklessly and the person:

- was dishonest and intended to gain an advantage for the contravener or any other person; or
- intended to deceive or defraud someone.⁴⁵²

⁴⁴⁸ Gilligan, Bird and Ramsay, 'Civil Penalties and Enforcement' above n 48, 420.

⁴⁴⁹ Ibid.

⁴⁵⁰ Ibid 425.

⁴⁵¹ *Corporations Act* (Cth) (2001) s 1317G:

'Pecuniary penalty orders, Corporation/scheme civil penalty provisions (1) A Court may order a person to pay the Commonwealth a pecuniary penalty of up to \$200,000 if: (a) a declaration of contravention by the person has been made under section 1317E; and (aa) the contraventions is of a corporation/scheme civil penalty provision; and (b) the contravention: (i) materially prejudices the interests of the corporation or scheme, or its members; or (ii) materially prejudices the corporation's ability to pay its creditors; or (iii) is serious'.

⁴⁵² Gilligan, Bird and Ramsay, 'Civil Penalties and Enforcement', above n 48, 423.

Thus, the civil and criminal penalty systems function as alternate systems, determined by separate proceedings. Both types of penalties occupy the same level of the ‘pyramid’ because they are commonly exclusive sanctions; using one would be a bar to the use of the other, so it is a hybrid sanction.⁴⁵³

The enforcement pyramid theory will not work as originally envisaged (that is, relying on separating civil penalties and criminal sanctions, with criminal above civil and banning orders even further above (see figure 4 above)). Placing certain civil penalties with the criminal sanctions in the upper level of the variant model pyramid does not quite match the Braithwaite model, especially as in some cases these sanctions are actually combined. This challenges Braithwaite’s theory.

Another concern that exists regarding the placement of penalties, whether civil or criminal, is their size. Although able to apply a fine of up to AUD200,000, the penalties imposed until 1999 were commonly range between AUD1000 and AUD40,000.⁴⁵⁴ The imposition of low civil penalties could not fairly be considered a sanction that belongs to the upper levels of the enforcement pyramid.

The enforcement pyramid theory is not comprehensive. There are some difficulties facing regulatory agencies and their enforcement mechanisms. This does not mean that the theory has failed in trying to ensure the best enforcement mechanism practices to obtain higher levels of compliance; rather it is not totally comprehensive , nor is its application in practice necessarily always in accordance with the classical or even variant model.

⁴⁵³ Ibid.

⁴⁵⁴ Ibid.

In conclusion, ASIC has the right to impose civil penalties on non-compliance. It is clear that it imposed civil penalties on very few occasions, especially in its early years, with civil penalties applied just 14 times in the 6 years to 1999. Yet this type of sanction needs to be reasonably applied where required in order to enforce compliance and provide deterrence.

In more recent years, however, including 2009⁴⁵⁵ and 2010, ASIC has imposed 30 civil applications for civil penalties and obtained more than AUD287 million in recoveries, fines and costs.⁴⁵⁶

In contrast, AUSTRAC has applied none since its establishment, even after its role was expanded with the entry into force of the *AML Act*. According to the retired CEO of AUSTRAC, Neil Jensen as recently 2009, ‘AUSTRAC has not enforced civil penalties’.⁴⁵⁷ Again the question is, ‘Why?’ Again the upcoming chapters of this thesis will attempt to answer this question as well.

4.4.4.2 Civil Penalties as an Enforcement Power for ACCC

The ACCC has an important role in managing competition and consumer protection law in Australia. It has also deals with competition matters and enforces the *Trade and*

⁴⁵⁵ Eg, in April 2009 ASIC imposed civil penalty fines between \$30,000 and \$350,000 on the former non-executive directors and executives and James Hardie Industries Limited (JHIL – a Australian listed entity) who were found to have breached the Corporations Act when making statements in 2001 about the adequacy of asbestos compensation funding. James Hardie Industries NV (JHINV – based in the Netherlands) was also found to have breached its continuous disclosure obligation in 2003’. More information could be found at: ASIC, ‘09-152 James Hardie Civil Penalty Proceedings’ <<http://www.asic.gov.au/asic/asic.nsf/byheadline/09-152+James+Hardie+civil+penalty+proceedings?openDocument>> at 17 February 2011.

⁴⁵⁶ ASIC, ‘Annual Report 2009–2010’ <[http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/ASIC_AnnualReport-2009-10.pdf/\\$file/ASIC_AnnualReport-2009-10.pdf](http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/ASIC_AnnualReport-2009-10.pdf/$file/ASIC_AnnualReport-2009-10.pdf)> at 17 February 2011, 4.

⁴⁵⁷ Jacobs, above n 18, 9.

Practices Act 1974 (Cth) (*TPA*), later the *Competition and Consumer Act 2010* (Cth) (*CCA*).⁴⁵⁸

In order to operate an effective enforcement mechanism, ACCC requires a variety of enforcement actions and sanctions to apply in the event of non-compliance. Under the *Competition and Consumer Act 2010* (Cth) (*CCA*), the ACCC cannot apply any civil penalties on non-compliance. The range of the sanctions which are available under the Act are limited to corrective advertising, reimbursement for losses incurred, injunctions, and community service. The ACCC and CDPP share the role of investigating and prosecuting criminal contraventions. Each authority works according to its enforcement action hierarchy and will decide whether it is more appropriate to pursue a case criminally or civilly.⁴⁵⁹

The ACCC emphasises the enforcement of compliance and the application of the consumer protection laws. Where breaches do occur, the ACCC strongly pursues those in breach, sometimes assisting those injured by the breaches to attempt to access the required redress.

Effective prevention requires an enforcement mechanism with a wide range of actions available, including administrative resolutions and criminal sanctions. Sometimes an effective deterrent (such as the threat of damaging the business's reputation) does not

⁴⁵⁸ On 1 January 2011 the *Trade Practices Act 1974* was renamed the *Competition and Consumer Act 2010*. 'The Australian Competition and Consumer Commission is reviewing this website and its publications to reflect this name change, and changes to the law brought about by the Australian Consumer Law (ACL) which forms part of the renamed Act': ACCC website <<http://www.accc.gov.au/content/index.phtml/itemId/3653>> at 16 February 2011.

⁴⁵⁹ Memorandum of Understanding (MoU) between the Office of the Commonwealth Director of Public Prosecution (CDPP) and Australian Competition and Consumer Commission (2008) 1–2. According to this MoU, the ACCC investigates for cartel conduct and gathers evidence, running the prosecution process in consultation with the CDPP and referring serious cartel conduct to the CDPP. The CDPP prosecute serious cartel offences under the *Competition and Consumer Act 2010* and seek associated remedies. Comparatively minor conduct will normally be pursued civilly and not referred to the CDPP.

also need a criminal sanction. The regulatory agency could make a balanced reaction based on the circumstances of each case.⁴⁶⁰

However, the range of civil remedies that the ACCC could have at its disposal and the lack of civil penalties under the *Competition and Consumer Act 2010* creates a shortfall in its enforcement mechanism, and it cannot achieve all of its enforcement aims. This deficit in the federal consumer protection regime needs to be remedied.

Braithwaite's regulatory enforcement pyramid theory aims to create the most effective enforcement system, where a regulator has a variety of sanctions available. On this view, a regulatory agency with a wide range of sanctions at its disposal will be more effective more than one with limited sanctions in place. In this regard, the imagined ACCC 'pyramid' would resemble the following:

⁴⁶⁰ Parliament of Australia, 'Finding a Balance: Towards Fair Trading in Australia', House of Representatives Standing Committee on Industry, Science and Technology Report (1997) 12–13 <<http://www.aph.gov.au/house/committee/isr/fairtrad/report/CHAP1.PDF>> at 17 February 2011.

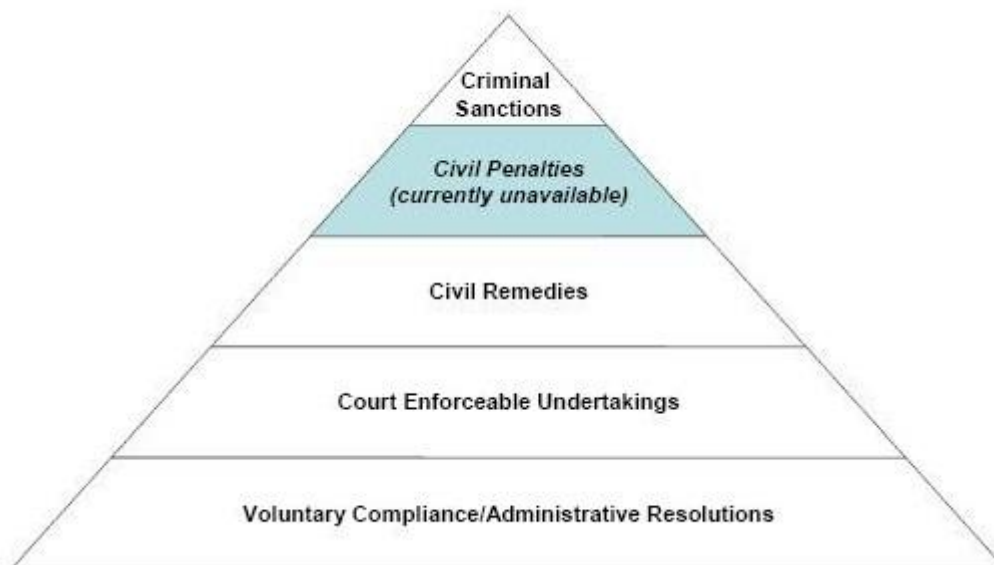


Figure 9: The Enforcement Pyramid According to the Competition and Consumer Law

**Adapted from the Australian Competition and Consumer Commission (ACCC),
‘Civil Penalties for Australia’s Consumer Protection Provisions’ Submission to
Discussion Paper Issued by Ministerial Council on Consumer Affairs (2005).⁴⁶¹**

The ACCC enforcement mechanism begins with voluntary compliance and administrative resolutions for a company that has contravened the Act. The company must move rapidly to recompense affected customers. Enforceable undertakings follow, then civil remedies (including statements that the *Competition and Consumer Act* has been breached, community service orders and so on).

Wherever the party is guilty, yet the offence is not worthy of a criminal sanction, a civil penalty may be the most appropriate sanction. However, to ensure the higher level of compliance, some behaviours need to be deterred by criminal sanctions. Criminal sanctions are more likely to be sought where the offence contains ‘fraud’ (such as mass-

⁴⁶¹ ACCC, ‘Civil Penalties for Australia’s Consumer Protection Provisions’, Submission to Discussion Paper Issued by Ministerial Council on Consumer Affairs (2005) 27.

marketed scams),⁴⁶² blatant misconduct, and serious or repeated illegal activity. These actions deserve the highest level of sanctions, namely the criminal sanction. For example, in the case of the *ACCC v Chubb Security Australia Pty Ltd*, the defendant's earlier civil breaches were taken into consideration as an aggravating factor in sentencing for a subsequent criminal breach, and on 30 December 2004 the Federal Court in Sydney imposed a fine of AUD1.51 million against Chubb for criminal breaches of the *Competition and Consumer Act* (then the *Trade Practices Act*).⁴⁶³

Nevertheless, criminal prosecutions are not always the best option to enforce compliance, because sometimes an effective and proportionate response requires a flexible range of remedies and not a criminal sanction. Criminal sanctions must only be applied to any illegal activity where the nature of that activity demands the harsher sanction that is associated with a criminal deterrent. Therefore the need for civil penalties should be addressed and this sanction activated at an appropriate level for a more effective ACCC enforcement mechanism.

Both partner agencies' enforcement mechanisms have been more effectively and properly used than AUSTRAC's. The following gives an idea of the task facing the regulator. In 2009–10 alone AUSTRAC received over 21.5 million transaction reports (almost 10 per cent up on the previous year), these generated over 43,000 SUSTRS and SMRs and almost 1,400 financial intelligence assessments for relevant partner agencies

⁴⁶² *ACCC v Chubb Security Australia Pty Ltd* [2004] FCA 1750. See also ACCC, *Working Globally to Combat Mass Marketing Fraud* (2010) <<http://www.accc.gov.au/content/index.phtml/itemId/930803>> at February 2011.

⁴⁶³ ACCC, 'New and Finalised Cases', *ACCC Journal*, <<http://www.accc.gov.au/content/index.phtml/itemId/647973?pageDefinitionItemId=535792>> at 16 February 2011. According to ACCC: 'The ACCC also notes the financial contribution of \$500 000 made by Chubb to the Australian Security Industry Association Limited for the establishment of a new centre for security. Others in the security industry should note that Chubb obtained a significant discount off the likely penalty (of \$6 million ...) for the breaches, primarily because of: its early plea of guilty, its cooperation with the ACCC, the reparations paid to consumers (of approximately \$630 000 to customers on affected runs), its good prospects of rehabilitation. In the absence of such mitigating factors, the ACCC would be seeking a significant criminal penalty against any other security provider which is engaging in similar conduct.'

who make further evaluations.⁴⁶⁴ As regulators of the Australian financial system, ASIC, the ACCC and APRA take enforcement actions seriously and are working to use their enforcement mechanisms when needed. In terms of referrals to partner agencies, the following table shows some of partner agency enforcement actions for the years 2001 to 2004:⁴⁶⁵

Agency	2001–02	2002–03	2003–04
ACCC	Cases commenced: 60 Cases before courts: 74	Cases commenced: 39 Cases before courts: 71	Cases commenced: 22 Cases before courts: 43
ASIC	Criminal cases: 19 Civil Proceedings: 81 Litigations concluded: 205	Criminal cases: 29 Civil proceedings: 67 Litigations concluded: 222	Criminal cases: 28 Civil proceedings: 51 Litigations concluded: 220
APRA	Superannuation industry: 107 Other enforcement actions: 92	Superannuation industry: 261 Other enforcement actions: 127	Superannuation industry: 277 Other enforcement actions: 114

Table 3: The Enforcement Actions of ACCC, ASIC and APRA from 2001 to 2004.

Adapted from: Richard Grant, ‘Australia’s Corporate Regulators - The ACCC, ASIC and APRA’ (Politics and Public Administration Section, Parliamentary Library, Parliament of Australia, 2005).

4.5 Conclusion

The most effective enforcement mechanism is crucial for countries establishing enforcement mechanisms for any regulatory agency, especially one related to combatting ML crimes. Regulatory capture and political pressures should be kept at bay

⁴⁶⁴ AUSTRAC, *AUSTRAC Annual Report Summary 2009-10* (2010) <http://www.austrac.gov.au/files/annual_rprt_2009-10_summary_brchr.pdf> 3. Minister for Home Affairs, Minister for Justice (Hon Brendan O’Connor), ‘Launch of AUSTRAC Financial Crime Report [Transcript], 29 June 2010 <http://www.ag.gov.au/www/ministers/oconnor.nsf/Page/Transcripts_2010_29June2010LaunchofAUSTRACfinancialcrimereport> at 23 February 2011.

⁴⁶⁵ Grant, above n 404.

by the regulatory agency so that these influences cannot affect its enforcement decisions.

However, a country's pre-existing regulatory culture and legal institutional framework for regulatory agencies play a vital role in determining the type of enforcement mechanism adopted. Thus, the US system, especially after September 11, has become more serious in supervising the level of compliance and taking action against non-compliance. FinCEN has been noticeably using harsher civil penalties and sanctions and imposing higher fines on non-compliant reporting entities, due to its regulatory culture and the pressures created by 9/11.

In contrast, the Netherlands has followed the EU directives and has a system that relies on the trust that the government bodies and regulatory agencies have built up between themselves and the reporting entities. Its AML system has a noticeably soft enforcement mechanism and powers accorded the FIU-NL.

Neither of these two countries' AML system is fully comprehensive; both enforcement mechanisms have shortcomings. The harsh US enforcement mechanism with its combination of severe sanctions for failing to notify and 'safe harbor' provisions (where reporting entities are statutorily protected from legal action from the party reported) generates huge numbers of reports (of both low and high suspicious transactions, and thus lesser and greater value) for FinCEN evaluation. Reporting entities are effectively 'crying wolf', producing a high number of low value and not useful reports.

The Netherlands' AML system, on the other hand, had a pre-existing legal institutional framework that dealt softly with non-compliance. Building its AML system similarly has produced some difficulties for the FIU-NL in fulfilling its duties and imposing

sanctions on entities that fail to report unusual transactions. Yet time is wasted concentrating on the UTRs (many of which prove lawful) that could otherwise have been spent on higher value suspicious transaction reports emanating from higher value UTRs. The current UTR reporting scheme produces of a large number of reports with a low value that the FIU-NL must eliminate.

Consequently, it is not a case of being a ‘harsher’ or ‘softer’ FIU, but of being a regulator with most effective sanctions that can used in the event of non-compliance, especially where a country has a pre-existing culture of enforcing compliance and applying harsh sanctions when required. Australia’s government has created a number of regulatory agencies to address a spectrum of regulatory responsibilities involving a multiplicity of reporting entities in its financial system. Differing mechanisms with various powers have been developed.

ASIC and ACCC have actively utilised soft and harsh sanctions in enforcing compliance. Because the regulatory culture in Australia is flexible, the reaction of a regulatory agency will be specified according to the level of the damage that could occur (or has occurred) due to the breaching activity.

Therefore, civil penalties were taken as a case study, to reflect this flexibility and to show their role in circumstances where criminal sanctions were not the best option for the regulatory agency to impose on non-compliant entities.

ASIC has civil penalties among its enforcement powers (according to the *Corporations Law 1993*). Initially these were used sparingly (14 instances 1993–1999), but more recently they have been applied more frequently (30 instances 2009–2010).

The ACCC lacks the ability to impose civil penalties (*Competition and Consumer Act 2010*). Studies have shown that the Act requires amendment to give the ACCC the ability to impose civil penalties in the event of non-compliance. This would enhance the effectiveness of its enforcement mechanism.

In the Australian regulatory system, ASIC, the ACCC and AUSTRAC are regulatory enforcement agencies. They work to ensure the financial system's integrity and guarantee the highest level of compliance, at the same time being able to respond quickly and react appropriately to any non-compliance when this occurs. Their goals include: to further improve surveillance and strengthen enforcement.

AUSTRAC has a wide range of adequate sanctions in accordance with its enforcement policy and the relevant legislation. Sanctions include issuing notices for AML assessment, undertaking external audits and compliance monitoring, utilising persuasion and education, issuing infringement notices and remedial directions, seeking injunctions, accepting enforceable undertakings, imposing civil penalties and prosecuting criminal offences.

AUSTRAC shares the same regulatory culture as ASIC and ACCC. Its culture is not harsh like FinCEN's, which often applies very severe sanctions in a manner that could harm the Australian system; nor is it generally lenient like the Netherlands with its regime of very soft sanctions for non-compliant reporting entities. However, AUSTRAC appears never to have used any of its harshest sanctions. The harshest sanctions that could be found were accepting a very small number of enforceable undertakings; cases involving civil penalties or criminal sanctions have yet to occur.

Any suggestion that the level of compliance of the reporting entities is working so well as to make AUSTRAC's consistent use of soft sanctions justifiable is countered by the knowledge that there is estimated to be a ML volume worth \$4.5 billion passing in and through Australia every single year.⁴⁶⁶ Operating in the same environment as ASIC and the ACCC, the question must then be asked as to why, given that figure, AUSTRAC appears to be so lenient a regulatory agency when compared to other partner agencies?

If one look at the nature of the regulatory activities of ASIC, ACCC and AUSTRAC, we see that all deal with the same kind of businesses and indeed, often, the same businesses but they deal with them in demonstrably different ways. AUSTRAC has always been softer and far less intrusive in its regulatory responses, while ACCC and ASIC have applied more active enforcement mechanism on non compliant entities.

The problem that AUSTRAC does not seem able to deal with efficiently is that it regulates a significant number of businesses with a wide variety of business types with the same apparent mind set: whether it be a one person remitter or one of the major banks in the country. To be a regulatory agency with consistent regulation does not mean that it needs to deal with regulated entities in the same way, consistency is not about treating all of these entities in identical ways, it is about being able to recognise that different circumstances require different responses and be able to demonstrate why there are differences in regulatory responses. It is about saying a small fine to a one person operation is a significant sanction while a hundred million dollar fine for a large bank is not necessarily an effective sanction. It is not the volume of the sanction, it is about how it relates to the nature of the business, how it will be seen within the entity and by customers and stakeholders and whether it will secure compliance.

⁴⁶⁶ Walker and Stamp, above n 193, 5.

One of the problems with AUSTRAC is that it fundamentally failed to build its enforcement approach around a realistic assessment of the nature of the reporting entities it regulates and the commercial environment in which they operate. Large financial institutions are machines designed to produce profits in any way they can and AUSTRAC needs to consider this fact. Assumptions that banks and other financial institutions will always behave as good corporate citizens with high levels of voluntary compliance have been shown through the GFC to be no longer valid, if they ever were.

One of the challenges for AUSTRAC is to deal with a financial sector, which has over the last 5 years shown that it is prepared to ignore or break regulatory structures across the globe. While the most notable examples have been in Europe and US, Australian companies have not been immune. There are many examples of illegal or unlawful behaviour during the GFC and unless one understands that is the environment in which AUSTRAC is operating then the determination of the appropriate regulatory model for AUSTRAC will remain flawed.

It is essential to remember that the reason for the need for stronger and effective regulation is the different nature of the reporting entities.

In addition to those matters and returning to the requirements and the attributes needed to achieve the most effective enforcement mechanism, new questions will be raised:

- 1 Are the current AUSTRAC's strategies and policies effectively targeting all reporting entities?
- 2 Does AUSTRAC actively engage with the reporting entities, and is it involved in a productive relationship with them?

- 3 Has AUSTRAC protected itself from being affected by regulatory capture? How did AUSTRAC deal with non-compliance during the GFC and after it? And why?

The two upcoming Chapters address all of these questions.

5 DISCREPANCIES BETWEEN ‘WHAT AUSTRAC SAYS’ AND ‘WHAT IT DOES’ IN REGARD TO NON-COMPLIANCE WITH REPORTING OBLIGATIONS

5.1 Introduction

AUSTRAC has undertaken the dual role of being the Australian FIU and the regulator for the Australian AML system, putting into practice the new legislation and regulatory structure. After five years, AUSTRAC has been found to be an active agency (especially during the last two years) in terms of issuing policies, providing reporting entity education and initiating (and in some instances completing) a number of enforcement actions.⁴⁶⁷

However, as AUSTRAC’s role has expanded, the challenge of meeting its obligations as an effective AML regulator and FIU has become increasingly difficult, primarily due to two facts:

- 1 *Experience:* The new Australian AML system needs an experienced FIU as well as regulator with a ‘full set of tools’ to analyse, investigate and enforce compliance when needed, especially when considering the fact that the responsibilities under the role of the FIU differ from those under the role of regulator in the field of AML. As AUSTRAC CEO, John Schmidt, indicated:

As the AML/CTF regulator, we are responsible for ensuring that Australian businesses understand and comply with their obligations under AML/CTF legislation. These obligations are designed to protect businesses, and the wider Australian community, from the harmful effects of money laundering, terrorism financing and other serious crime. By working together to ensure compliance with AML/CTF laws, AUSTRAC and industry present a united front against criminals attempting to exploit weaknesses in our financial systems.

⁴⁶⁷ See, eg, Table 3: ‘AUSTRAC Activities Summary 2009–10’, Appendix A of AUSTRAC, *AUSTRAC Supervision Strategy 2010-11*, 10 <<http://www.austrac.gov.au/files/supervision.pdf>> at 11 April 2011.

As Australia's FIU, AUSTRAC analyses and disseminates financial intelligence to domestic partner agencies and international counterparts. In doing so, AUSTRAC supports these agencies to uncover and investigate financial crimes, and to prosecute criminals. AUSTRAC information has assisted Australian law enforcement agencies and other government authorities to trace those involved in the importation and trafficking of illegal drugs, tax evasion, superannuation fraud, credit card fraud, people smuggling and other serious crimes.⁴⁶⁸

- 2 *Comprehension:* The new Australian AML system needs a comprehensive FIU, whose directions and operations are also easily understood and followed for high quality data to be received from reporting entities, as well as a regulator sensitive to differences in the regulated entities sector, including the risk and size of the reporting entities and the type of services that they provide.

The records of the last five years reveal AUSTRAC's difficulties in those areas, despite a number of actions that the regulator has taken to strengthen its performance. In its specific strategy documents that have been published for 2010–11, AUSTRAC points to a number of those actions, such as increasing its supervision of the fulfilment of reporting obligations, their provision of the necessary intelligence for AUSTRAC, and ensuring enforcement of compliance.⁴⁶⁹ Other AUSTRAC publications, such as annual reports,⁴⁷⁰ AUSTRAC's survey series (2010),⁴⁷¹ and typologies and case study reports

⁴⁶⁸ AUSTRAC, *AUSTRAC Overview 2009*, 3 <http://www.austrac.gov.au/files/overview_brchr.pdf> at 11 April 2011.

⁴⁶⁹ AUSTRAC, 'Strategies' (26 October 2010) <<http://www.austrac.gov.au/strategies.html>> at 12 March 2011. For mention of AUSTRAC, *AUSTRAC Supervision Strategy 2009–10* (released 1 July 2009), see AUSTRAC, *AUSTRAC Supervision Strategy 2010–11*, 2, 10 <<http://www.austrac.gov.au/files/supervision.pdf>> at 11 April 2011.

⁴⁷⁰ For AUSTRAC annual reports since 1998–99, but particularly those since its role incorporated that of the FIU, namely from the 2005/06 Annual Report, see AUSTRAC, *AUSTRAC Annual Reports* <http://www.austrac.gov.au/annual_report.html> at 11 April 2011.

⁴⁷¹ AUSTRAC, *AUSTRAC Survey Series* <http://www.austrac.gov.au/survey_series.html> at 11 April 2011.

(issued annually from 2007),⁴⁷² among others, have also contributed to the information available for reporting entities and researchers.⁴⁷³

However, a number of interviewed reporting entities questioned AUSTRAC's ability to apply these policies and strategies 'in real life,' and whether the regulatory body was able to achieve its ultimate goal, namely reducing ML activities as well as detecting the proceeds of crime.

As stated in Chapter 1, this thesis examines the responses of nine interviewees from nine reporting entities that differed in the type of work and services provided to customers as well as in size. They comprised five compliance managers or officers for five financial institutions, one real estate agent and three accountants, who discussed the strengths and the weaknesses of AUSTRAC's enforcement mechanism regarding non-compliance with reporting obligations. The overall response was:

- 1 Only one compliance manager was very satisfied with the AUSTRAC enforcement mechanism and indicated that there were no weaknesses to be mentioned in relation to AUSTRAC operations.
- 2 Two compliance officers were partly satisfied with AUSTRAC's enforcement mechanism and pointed to a number of strengths and also a number of weaknesses in AUSTRAC's operations.
- 3 Three accountants and the one real estate agent interviewed were partly dissatisfied with AUSTRAC enforcement mechanism and pointed to a small number of strengths and larger number of weaknesses in AUSTRAC operations.

⁴⁷² For typologies and case study reports available for the years 2007–10, see, AUSTRAC, 'AUSTRAC Typologies and Case Studies Reports' <<http://www.austrac.gov.au/typologies.html>> at 11 April 2011.

⁴⁷³ For a more detailed list, see AUSTRAC, 'Publications' <<http://www.austrac.gov.au/publications.html>> 11 April 2011.

- 4 Two compliance managers were not satisfied with AUSTRAC enforcement mechanism and pointed to a large number of weaknesses and very limited strengths in AUSTRAC's operations.

Thus, when looking at the interviewee responses in terms of satisfaction with AUSTRAC's enforcement mechanism, satisfaction is arguably low. If one views responses as divided in two between positive (that is, 'very satisfied/partly satisfied') and negative (that is, 'partly not satisfied/unsatisfied'), the positive to negative ratio is 3:6. Contributing to the qualitative value of their responses, reporting entity interviewees made significant comments about the current AML system scenario, AUSTRAC's strengths and weaknesses in terms of enforcing compliance, and their entities' level of compliance with the reporting obligations. Interviewees discussed in some detail the contrast between 'what AUSTRAC says' and 'what it actually does' in relation to its enforcing compliance obligations.

This Chapter will compare some of AUSTRAC's main publications with the interviewees' responses to the first question of those listed at the conclusion of Chapter 4, namely whether the current AUSTRAC strategies and policies target all reporting entities and whether they do so sufficiently effectively or not.

In addition, this Chapter will try to determine whether AUSTRAC has produced achievable strategies that would demonstrate its effectiveness, and if not, what are the contributing factors?

5.2 Statement of AUSTRAC's Strategies

From its inception AUSTRAC has issued information in various documents regarding strategies adopted by the body in the course of fulfilling its mandate.⁴⁷⁴ These documents have sought to clarify its policies, address main concerns and areas of its interest, and attempt to provide industry with sufficient information to prompt effective compliance. More recently, AUSTRAC has issued successive 'Strategies', specific strategy documents in three areas outlining to stakeholders how it proposes to direct its efforts over the ensuing year and beyond, and providing insight into the organisation's operations. AUSTRAC's Strategies comprise a supervision strategy, an intelligence strategy, and an enforcement strategy.⁴⁷⁵

5.2.1 Supervision Strategy

AUSTRAC issued its Supervision Strategy for 2010–11 to accompany its previous enforcement policy. It also reflects its endeavours to evaluate compliance behaviour against its 2009–10 Supervision Strategy and outlines the strategy adopted. This strategy embodies a regulatory enforcement pyramid that starts at a broad base level that supervises and enhances the level of compliance through a number of engagement activities, including mail outs, e-newsletters, and distribution of guidance material. If the use of 'engagement activities' fails, AUSTRAC will move to the use of 'heightened activities', such as desk reviews, themed assessment, transaction monitoring, and behavioural assessment, with the aim of securing compliance. If that also fails, AUSTRAC will move up to the level of 'escalated activities', including on-site

⁴⁷⁴ See, eg, the *Advice on an AUSTRAC On-Site Inspection Strategy* (2007) (Doc 07/335) and an *Anti-Corruption Strategy* (2006) Doc 22786: AUSTRAC, *AUSTRAC File List 1st January 2007 – 30th June 2007* <http://www.austrac.gov.au/files/senate_file_lists_jan2007_june2007.pdf> at 11 April 2011; its annual reports See, eg, mention of AUSTRAC, *AUSTRAC Supervision Strategy 2009–10*, released 1 July 2009: AUSTRAC, *AUSTRAC Supervision Strategy 2010–11*, above n 469, 2, 10.

⁴⁷⁵ AUSTRAC, 'Strategies', above n 469.

assessment, information gathering notices and consideration of enforcement. Finally, AUSTRAC will use its enforcement mechanism⁴⁷⁶ if all of these lower level approaches do not work. The following regulatory pyramid (Figure 10) reflects the supervisory activities of AUSTRAC outlined above.



Figure 10: AUSTRAC Supervision Activities.⁴⁷⁷

According to AUSTRAC’s executive summary of its 2010–11 Supervision Strategy, the body’s approach transitioned from ‘start-up activities’ to ‘business as usual’ during the course of 2009–10, following the cessation in March 2010 of the application of the Policy (Civil Penalty Orders) Principles 2006, which had until that date ‘provided reporting entities with a period of assisted compliance after the phasing in of obligations

⁴⁷⁶ In the classic Braithwaite enforcement pyramid, what AUSTRAC refers to as ‘enforcement’ are the upper levels of the model; what AUSTRAC sees as ‘supervision’ would be regarded by Braithwaite as the lower levels of its enforcement pyramid.

⁴⁷⁷ For ‘AUSTRAC Supervision Activities’, see AUSTRAC, *AUSTRAC Supervision Strategy 2010–11*, above n 469, 6.

under the AML/CTF Act'.⁴⁷⁸ Consolidation of this 'business as usual' approach to its supervisory activities is to continue in 2010–11, but with a change of emphasis.

A key focus for AUSTRAC over 2009–10 was to increase coverage across the regulated sector by matching different supervisory tools and techniques to different industry sectors. In 2010–11 the focus on improved coverage continues with greater emphasis on targeting our supervisory activities towards those entities where improvements in regulatory compliance are likely to yield the highest impact on achieving our key goals.⁴⁷⁹

AUSTRAC has a number of priorities and issues to be targeted through its supervision strategy. These include:⁴⁸⁰

- 1 Supervising non-reporting, under reporting and the quality of reports,
- 2 Presenting education, guidance and training to small and less-resourced reporting entities, and
- 3 Evaluating AML programs and compliance with Know Your Customer obligations for reporting entities.

5.2.2 Intelligence Strategy

In its Intelligence Strategy for 2010–12, AUSTRAC has tried to illustrate the multifaceted and energetic way in which it functions. It mentions a number of key strategic factors that could influence its intelligence operations, including the priorities of its main partner agencies, global and national AML/CTF frameworks, and enhancements to information technology systems.⁴⁸¹

⁴⁷⁸ For the relevant executive summary', see *ibid* 1.

⁴⁷⁹ *Ibid*.

⁴⁸⁰ For AUSTRAC's 'Priorities for 2010–2011' in regard to its Supervision Strategy, see AUSTRAC, *AUSTRAC Supervision Strategy 2010–11*, above n 469,4.

⁴⁸¹ For the relevant executive summary, see AUSTRAC, *AUSTRAC Intelligence Strategy 2010–12*, 1 <<http://www.austrac.gov.au/files/intelligence.pdf>> at 12 March 2011.

The intelligence strategy takes into consideration the Australian Government's 2008 *National Security Statement* which encourages the development of information sharing and cooperation between all agencies that are working within the Australian jurisdiction. It has played a vital role in shaping the intelligence strategy's objectives, including aligning them with 'whole of government priorities', such as combatting organised crime and terrorism, maintaining national security, securing border management, and enforcing international sanctions.⁴⁸²

The AUSTRAC intelligence strategy aims to support the priorities of AUSTRAC's main partner agencies, such as the Australian Crime Commission (ACC), the Australian Taxation Office (ATO), the Australian Customs and Border Protection Service (ACBPS) and the Australian Federal Police (AFP).⁴⁸³

In order to achieve all the above, AUSTRAC has established priorities when applying its intelligence strategy, including:

- 1 Further developing the process of information sharing between AUSTRAC and partner agencies,
- 2 Enhancing analysis and monitoring systems,
- 3 Updating AUSTRAC's research tools and strengthening its strategic research and macro-analysis,
- 4 Enhancing AUSTRAC's organisational capacity for carrying out its AML activities, and

⁴⁸² Ibid.

⁴⁸³ For a list of partner agencies, see *ibid* 2.

5 Sharing AUSTRAC's experience in combating ML activities with the international community of AML agencies and regulators.⁴⁸⁴

5.2.3 Enforcement Strategy

AUSTRAC issued its Enforcement Strategy for 2010–11 to communicate with stakeholders regarding its role as the FIU and the AML/CTF regulator and record enforcement decisions. It uses an evidence-based decision making approach to decide appropriate cases for use of enforcement powers, and measures its enforcement effectiveness.⁴⁸⁵ Enforcement activities are 'designed to achieve remedial compliance at both an individual reporting entity ... and industry level, through selective, targeted action' as well as act as a 'deterrent to non-compliance', and thus ensure a 'level playing field' for all industry participants by ensuring compliance.⁴⁸⁶ As shown in its Supervision Strategy pyramid, AUSTRAC will use its enforcement as a last option if a reporting entity remains non-compliant.

In its 2010–11 Enforcement Strategy, AUSTRAC again emphasised the benefits offered by judicious enforcement.

Decisive, measured and proportionate enforcement action benefits both regulated industry participants and the wider community by contributing to the integrity of, and promoting public confidence in, a competitive, sound and fair financial system and to the administration of justice.⁴⁸⁷

⁴⁸⁴ For further detail, see *ibid* 2, 8–11.

⁴⁸⁵ For the relevant executive summary, see AUSTRAC, *AUSTRAC Enforcement Strategy 2010–11*, 1. See also at 2 <<http://www.austrac.gov.au/files/enforcement.pdf>> at 13 March 2011.

⁴⁸⁶ *Ibid*.

⁴⁸⁷ *Ibid*.

AUSTRAC's enforcement team's strategies priorities are expressed as managing 'a selection of entities: through to compliance using persuasive means and AUSTRAC's formal enforcement powers',⁴⁸⁸ involving:

- 1 Using persuasion and education with a select group of non-compliant entities before any formal enforcement action;
- 2 Working with supervisory teams to select 'suitable candidates' for enforcement action; and
- 3 Working closely with the supervisory team to identify non-compliant designated remittance services that would be likely to be subject to deregistration should their non-compliance continue.⁴⁸⁹

Necessarily limited funding for operations means that AUSTRAC will attempt to target appropriate entities, and select and utilise its enforcement actions in a manner it believes will achieve maximum impact.⁴⁹⁰ AUSTRAC says it selects its enforcement powers on the basis of a number of factors:⁴⁹¹

- 1 Whether a reporting entity breach of the *AML Act* and system is of a nature (in terms of its extent and impact) that necessitates enforcement action;
- 2 Whether the reporting entity remains unwilling to comply with the Act and AML/CTF Rules (as shown by a poor compliance history, for example);
- 3 Whether the breach has, or has a potentially high risk of having, a detrimental impact on the overall integrity of the Australian financial system (for example,

⁴⁸⁸ Ibid 2.

⁴⁸⁹ Ibid.

⁴⁹⁰ Ibid 4.

⁴⁹¹ See 'How Matters are Referred to Enforcement': *ibid*.

when an entity's non-compliance renders it highly vulnerable to ML and TF activity); and

- 4 Whether the exercise of the enforcement power is likely to have a deterrent effect on other entities in the same sector – that is, whether enforcement will affect not only the culture of non-compliant entity but also that of a whole industry group.

AUSTRAC's enforcement strategy has selected targets, but what of AUSTRAC's overall targets that have been identified through its Supervisory, Intelligence, and Enforcement Strategies?

5.2.4 AUSTRAC's Strategies Overall Targets

Utilising these strategies, AUSTRAC has indicated a number of targets *to be achieved* in 2010–11 and beyond. These include:

- 1 Improving AUSTRAC's system to regulate the various reporting entities, and improving the guidance that it provides to these entities by making it clear and sufficiently comprehensive.
- 2 Strengthening the AML framework and regulation by consolidating AUSTRAC's compliance and enforcement powers and its measured use of its enforcement mechanism.
- 3 Enhancing information sharing between AUSTRAC and partner agencies to achieve best practice in the area of supervision and intelligence.
- 4 Providing advice to the Attorney-General's Department on improving the AML framework.

- 5 Applying harsher measures to regulate alternative remittance dealers within the Australian jurisdiction.
- 6 Implementing new intelligence tools and systems to cover the new methods that are being adopted by those engaged in tax evasion or other criminal activities, so as to enhance the detection and analysis skills of AUSTRAC.
- 7 Providing the required assistance to a number of international FIUs (in Asia, Africa and the Pacific) and sharing information with other FIUs with the aim of developing Australia's AML framework to meet international standards.
- 8 Continuing to build the AUSTRAC enforcement team's partnerships with the reporting entities community and partner regulatory agencies.
- 9 Protecting the integrity of the Australian economy and the financial sector by preventing dangerous activities by organised crime, such as TF and ML.
- 10 Focusing its efforts on securing the benefits of the AML improvements.

It is worth noting that none of the ten targets, however, actually states that AUSTRAC will take enforcement action as required. Indeed, AUSTRAC needs to evaluate its achievements in relation to the above targets utilising the current policies and activities, draw its conclusions about the level of AML system compliance with the AML obligations, and respond accordingly.

5.2.5 AUSTRAC's Strategies for Measuring Agency Effectiveness

In all the three strategies, AUSTRAC states it wishes to measure the effectiveness of its operations.⁴⁹²

Overall indicators that AUSTRAC is relying on to measure its effectiveness through these three strategies are:

- 1 AUSTRAC's contribution to revenues raised.
- 2 The intensity of the compliance behaviour, that is, the quality and volume of that compliant behaviour (reflecting the regulated entity's attitude).
- 3 Number of intelligence products disseminated annually and partner agencies feedback on their quality, relevance and usefulness.
- 4 Value of public money saved and proceeds seized.
- 5 The number of fruitful enforcement outcomes from successful cooperation between the AUSTRAC enforcement team and its frontline Supervisory team.

Again, it is obvious that AUSTRAC is assuming compliance and does not want to confront the problem of non compliance which requires action on its part.

AUSTRAC has, however, indicated that strategy outcomes will be available in its annual reports.⁴⁹³ Hence, AUSTRAC's annual reports, particularly in relation to strategy outcomes and any major weaknesses revealed will be considered in this thesis.

⁴⁹² Ibid 2: AUSTRAC, *AUSTRAC Intelligence Strategy 2010–12*, above n466, 11.

⁴⁹³ See 'Measuring Effectiveness': AUSTRAC, *AUSTRAC Enforcement Strategy 2010–11*, above n 485, 2.

5.3 AUSTRAC's Annual Reports, Reporting Obligations and Operational Effectiveness

Section 226 of the *AML Act 2006* requires the AUSTRAC CEO to prepare an annual report as soon as practicable after 30 June each year.⁴⁹⁴ The annual report generally contains information on the statistics of the financial transaction reporting, domestic and international trends, future priorities, and performance summaries on a financial year basis.⁴⁹⁵

The *AML Act 2006* obliges reporting entities to report suspicious activities. Every reporting entity which has a 'reasonable ground' for suspicion about any matter that may be related to investigative or prosecutory processes is required to submit a report to AUSTRAC.

These 'suspicious activity reports' (SARs) may take the form of a 'suspicious matter report' (SMR) or a 'suspect transaction report' (SUSTR) and are an important source of intelligence. Both often provide data that may not be obtained in other reports to AUSTRAC, such as threshold transaction reports (TTRs) and international funds transfer instructions (IFTIs). Thus the reports are very important. Both can greatly assist trace the 'footprints' (or trail) of unlawful monetary transactions, and so help combat ML activities.

Given that these reports are an important measure of effectiveness, a number of relevant indicators will be examined — namely volume received and quality as reflected in number of reports disseminated to partner agencies — as reflected in the 2009/10 Annual Report.

⁴⁹⁴ See the Anti Money Laundering and Counter Terrorism Financing Act 2006 (Cth) s 226, above n 78.

⁴⁹⁵ AUSTRAC, 'AUSTRAC Annual Reports', above n 470.

5.3.1 Number of SARs Indicator

Since the introduction of the *AML Act* in 2006, the number of SARs lodged by reporting entities has increased. According to AUSTRAC, it received 17,373 SUSTRs and 30,013 SMRs in 2009–10, combined total of 47,386 SARs representing an increase of 46 per cent over 2008–09.⁴⁹⁶

Year	SUSTRs	SMRs	SARs (SUSTRs plus SMRs)	Percentage change in SARs over previous year (2008–09)
2009–10	17,373	30,013	47,386	+46%

Table 4: Number of SARs 2009–10

Each report made under the *AML Act* must include a description of the suspected offence (‘offence type’) as well as a statement of the grounds which led to the formation of the suspicion (‘reasons for suspicion’) which generated the issuing of the report.⁴⁹⁷

The number of the SMRs significantly increased in 2009–10, with ‘large increases’ recorded across many categories.⁴⁹⁸ Categories of reasons for suspicion include (in decreasing order of frequency of citing for suspicion) ‘avoiding reporting obligations’, ‘unusual account activity’, ‘unusually large cash transaction’, ‘suspicious behavior’, and transaction ‘inconsistent with the customer’s profile’.⁴⁹⁹ Reports were also lodged because of suspicion arising from ‘country of interest’, ‘industry/occupation of interest’, ‘advanced fee frauds/scams’, ‘superannuation-related issues’ and the ‘refusal by

⁴⁹⁶ AUSTRAC, *AUSTRAC Annual Report 2009–10*, above n 189, 52.

⁴⁹⁷ Ibid 58–9. This was particularly the case in regard to: money laundering; offences against Commonwealth, State or Territory law; and person/agent not being whom they claim to be.

⁴⁹⁸ Ibid 58–9.

⁴⁹⁹ Ibid.

customer to show identification/complete transaction reports'.⁵⁰⁰ AUSTRAC analysis revealed 'significant increases' in reports in these categories of suspect activity type in 2009–10.⁵⁰¹

Increasing volumes place additional load on the regulator. AUSTRAC supervises submissions, examines them, and encourages high quality, accuracy as well as timeliness of the data provided. The sheer volumes and diverse entity sources entities and activities must impede follow-up -and make effectiveness measurement difficult.

Effectiveness measurement is not only about the number of reports forwarded to partner agencies or about the number received; it is also about their quality, accuracy, and timeliness, a point clearly acknowledged by the body itself:

AUSTRAC continued to actively monitor the quality and integrity of financial transaction reports it received from industry using a range of tools. Working with its regulated entities, it addressed more than 5000 quality and data integrity-related reporting issues in 2009–2010.⁵⁰²

However, a number of reporting entity interviewees argued that although AUSTRAC assists in relation to different issues, including provision of feedback about report quality by answering phone calls and e-mails, it often does not give sufficient help as it fails to answer the questions posed. In other words, its assistance is very limited. As one interviewee states:

I was basically seeking some form of confirmation that is it worth my [firm's] ... time and effort to put in an application seeking relief for a particular requirement. ... I got 4 hyperlinks back, To add insult to injury it was referring to material that I had ...[put] in my email to demonstrate what I was trying to get at ...

⁵⁰⁰ Australian Taxation Office (ATO), Targeting Tax Crime: A Whole-of- Government Approach (2011) <<http://www.ato.gov.au/print.asp?doc=/content/00271327.htm>> at 14 March 2011.

⁵⁰¹ AUSTRAC, *AUSTRAC Annual Report 2009–10*, above n 189, 56–7.

⁵⁰² *Ibid* 25.

Do they assist? The answer is yes, because they pick up the phone and they respond to emails. Does it help? ... The answer is no.⁵⁰³

Another compliance manager argued that AUSTRAC makes limited efforts to assure the integrity of the reporting system as well as the quality of the reports. The compliance manager complained that the guides issued had a minimum of useful information:

ASIC is a master at improving practice — they issue guides; they issue them about improving industry; about how they want to see things; [but] ... they are not bound by it, which is really poor.⁵⁰⁴

The compliance manager compares AUSTRAC unfavourably with ASIC, which he describes as

Probably the best regulator I have ever seen. They have a very streamlined method for applying for relief, it is done within a certain timeframe, [and] you have got a pretty clear idea about how soon they will respond, [and] that is just for class form of relief from the legislation, and everyone has visibility for that relief and we can all see what everyone else has got.⁵⁰⁵

Their written guidance materials — and the processes adopted for their construction — are also considered eminently superior.

...when they [ASIC] issue guides, so they have got one for increasing capital for responsible entities, they issue that out to the industry, they ... make people run them through what they are proposing so they are getting the best feedback possible to make that the best policy possible, and when they have got all of it, they will finalise it internally and then issue it.⁵⁰⁶

The interviewee was highly critical of AUSTRAC, however:

A lot of their regulatory practices are poor ... Basically this is a guide but you cannot rely on it ... you are ... looking at it, going 'Well; that is wrong' ... [They] have not had any feedback from anybody.

⁵⁰³ Interview with Compliance Manager D, a financial institution (telephone) (Melbourne, 9 September 2010).

⁵⁰⁴ Interview with a Compliance Manager A, a financial institution (Sydney, 21 October 2010).

⁵⁰⁵ Ibid.

⁵⁰⁶ Ibid.

Again, ASIC's processes were more positively viewed:

Some of the small ones [might be] might update[d] without feedback but they probably had feedback on it in different ways but they have got to know the content before they do that, and that is a very good regulatory approach because it actually engages everyone in the process, and it gives a regulator a much wider view around these topics because there are a lot of things they don't know, and it is their mechanism to learn as well not just to regulate, it is more than a one way street in this regard.⁵⁰⁷

Thus the increase in the number of SARs alone is not a solid indicator as to AUSTRAC's effectiveness in the AML field or to possible avenues of increased efficiency. Report quality is the key to securing the best reporting outcomes.

AUSTRAC's *Annual Report 2009–10*, spoke generally about report quality in terms of the number of reports disseminated by AUSTRAC to partner agencies (see below) but did not indicate what feedback they had given about the quality of the information supplied.⁵⁰⁸ As the annual report appears to provide no specific information in this regard, it is difficult to make any finding; other than perhaps this 'one way' journey of reports reflects on the relationship between AUSTRAC and partner agencies or a possible lack of transparency on the part of the regulator if more is known. If the statistics involved are too complex (see further below) to manage to produce meaningful data, this should be admitted. These matters need addressing in the interest of report quality.

5.3.2 Number of Reports Disseminated to Partner Agencies Indicator

The number of reports submitted is not directly related to the number of reports disseminated to partner agencies for investigation. A number of factors may be involved.

⁵⁰⁷ Ibid.

⁵⁰⁸ Ibid 48.

AUSTRAC disseminated a total of 58,242 SUSTRs/SMRs to partner agencies in 2009–10, including both proactive disseminations and responses to requests from partner agencies. This represented a 34 per cent increase on the previous year's figures. Complexities abound. First, the number of disseminations exceeds the number of SUSTRs/SMRs received, as a single SAR may generate reports to multiple agencies. Disseminations may also include reports received in previous years that relate to current partner agency investigations.⁵⁰⁹

Alternatively, the quantity may be disproportionately low if there are many low quality or low impact reports that fail to prompt further investigation. Preliminary investigations of high volumes of low level reports may occupy a disproportionate amount of AUSTRAC team members' time and 'crowd out' or delay the investigation of more important matters. Or these factors may simply cancel each other out.

However, returning to the figures that have been published in AUSTRAC's annual reports since its *Annual Report 2005–06* up until its *Annual Report 2009–10*, the figures show that the partner agencies that have benefited most from the SUSTRS dissemination process are the Australian Taxation Office (ATO), the Australian Federal Police (AFP) and the Australian Customs and Border Protection Service (ACBPS).⁵¹⁰ A number of other partner agencies receive small quantities. Table 5 (below) shows the number of the SUSTRs that have been disseminated to the first three partner

⁵⁰⁹ Ibid 52.

⁵¹⁰ Australian Customs and Border Protection Service (ACBPS), *About Custom and Border Protection* <<http://www.customs.gov.au/site/page4222.asp>> at 15 March 2011. Formerly the Australian Customs Service. The new name recognises its 'important border protection responsibilities, including ... people smuggling.'

agencies.⁵¹¹Table 6 (further below) shows the number of SUSTRs and SMRs disseminated to the first four partner agencies.

Partner Agency	2005–06 Total of 24,276 SUSTRs	2006–07 Total of 24,440 SUSTRs	2007–08 Total of 29,089 SUSTRs ⁵¹²	Rank as a beneficial partner agency of the dissemination process
ATO	24,468	23,740	27,730	1
AFP	2,963	2,279	3,072	2
ACBPS	973	891	1,468	3

Table 5: AUSTRAC dissemination of SUSTRs to ATO, AFP, ACBPS

Partner Agency	2008–09 Total of 43,564 SUSTRs/SMRs	2009–10 Total of 58,242 SUSTRs/SMRs	Rank as a beneficial partner agency of the dissemination process
ATO	32,850	46,962	1
AFP	3,096	2,422	2
ACBPS	1,403	1,724	3

Table 6: AUSTRAC dissemination of SUSTRs/SMRs to ATO, AFP, ACBPS

It is clear from the above tables that the greater part of reported data is disseminated to the ATO, then the AFP and then the ACBPS. Thus, the ATO is the partner agency that has most benefited from the process of the dissemination.

⁵¹¹ Note: the figures show disseminations of SUSTRs to partner agencies and include SUSTRs received in the previous year of each annual report but disseminated in the annual report concerned. Reports may be disseminated to more than one agency.

⁵¹² As the AML system prior to December (2008) required the submission of SUSTRs, the statistics record only this type of reports and does not include SMRs until changes came into effect after December (2008), when the statistics started to take SMRs as well as SUSTRs into consideration, as it is obvious in Table 5.

In fact, the main modern reason for AUSTRAC to exist is that the information about the transactions can be looked up by ATO.

The relationship between AUSTRAC and other partner agencies including ATO has grown since AUSTRAC's inception in 1988. Over time, AUSTRAC has established with its partner agencies a double level of interaction. For this purpose, AUSTRAC has located a number of its staff as designated staff at other partner agencies offices including the ATO, and the other partner agencies did the same by locating a number of their staff at AUSTRAC as designated staff as well. It is a fruitful way of interaction between these agencies as this system helps the information to flow within a legal limitation on what agencies can do with this information.

Certainly these days the major user of AUSTRAC general information tends to be the ATO. Thus, AUSTRAC notes in its *Annual Report of 2009–10*, explaining that:

Under the AML/CTF Act, the Tax Office is entitled to access AUSTRAC information for any purpose relating to the facilitation of the administration or enforcement of a taxation law, and AUSTRAC automatically disseminates to the Tax Office most SUSTRs/SMRs received by AUSTRAC in 2009–2010.⁵¹³

Government sees the ATO use of AUSTRAC information as important. One example of this information flow is through the Wickenby project.⁵¹⁴ The importance of AUSTRAC as source of information for tax evasion investigations is shown by the emphasis placed on Project Wickenby and the specific funding provided for this Project. The Government expects it will receive increased tax collections as a result of this

⁵¹³ AUSTRAC, *AUSTRAC Annual Report 2009–10*, above n 189, 52.

⁵¹⁴ Project Wickenby is an ongoing joint taskforce involving the Australian Taxation Office (ATO), the Australian Federal Police (AFP), the Australian Securities and Investments Commission (ASIC), the Australian Crime Commission (ACC), the Commonwealth Director of Public Prosecutions (CDPP), the Australian Transaction Reports and Analysis Centre (AUSTRAC). It has a purpose to protect the integrity of Australian financial and regulatory systems by preventing people from promoting or participating in any of tax evasion activities, crime and avoidance: Australian Taxation Office (ATO), *Project Wickenby* above n 419.

cooperation but the effectiveness of AUSTRAC data depends on its accuracy and timeliness. In fact, if AUSTRAC can improve the quality of information coming to it, the effectiveness of AUSTRAC will be improved.

Thus, it is essential for AUSTRAC to improve the quality of the material it passes to other agencies, and if the ATO is the major user, then the ATO will achieve more benefit if AUSTRAC regulates better.

However, since 2006 to the time of writing of this thesis, most data and information received in SUSTRs and SMRs that were submitted by reporting entities because of a suspicion of AML activities appeared to be of limited benefit, given the number that actually may result in a prosecution. This is a figure that is difficult to relate to annual data report submission as a number of SARs may relate to a single party, just as a single SAR may be later referred to several agencies.

The vast majority of the disseminated reports go to the ATO for investigation in relation to tax evasion rather than for prosecution for ML offences in and of themselves. This renders AUSTRAC essentially an intelligence unit working for the ATO for tax evasion detection purposes rather than being the FIU and the regulator for AML purposes. It should be recalled, however, that ML as a process includes ‘laundering’ funds only available due to tax evasion (including in relation to otherwise legitimate earnings), which ‘white collar’ crime is considered along with drug-trafficking and so forth as ‘serious crime to be reported and prevented’, under the EU Second Directive,⁵¹⁵ the US Bank Secrecy Act⁵¹⁶ and Australia’s FTR Act⁵¹⁷ and AML Act.⁵¹⁸

⁵¹⁵ See text (Hopton) above n 100.

⁵¹⁶ See text above n 328.

⁵¹⁷ See text above n 259.

⁵¹⁸ See text above n 105.

From the above figures it can also be seen that the AFP is dealing with disseminated information for the purpose of combating organised crime, including drug trafficking, rather than for AML purposes, perhaps reflecting AFP priorities.

Therefore, correctly evaluating AUSTRAC's effectiveness in terms of fulfilling its obligations as an FIU and the AML regulator is not simply about the increase in the number of the disseminated reports from AUSTRAC to partner agencies. It is also about how useful are these reports for combating ML offences.

5.3.3 Number of SMR Submissions by Reporting Entities Indicator

Anyone looking at AUSTRAC's annual reports, and particularly those for 2008–09 and 2009–10, will find AUSTRAC claims that the increase of the SUSTRs and SMRs from different reporting entities sectors to AUSTRAC is a sign of the effectiveness of AUSTRAC's operations and the whole AML system.

In its 2008–09 Annual Report, AUSTRAC indicated that the number of SMRs had increased noticeably for a variety of reporting entities sectors. Superannuation funds, managed investment scheme trustees, and gold bullion dealers were among those sectors whose SMRs more than doubled, while those for the pubs and clubs sector increased by more than 500 per cent.⁵¹⁹ In the same period, SMR volumes related to the alternative remittance dealer sector increased by 56 per cent.⁵²⁰ This indicates the reason for AUSTRAC targeting alternative remittance dealers and suggested the threat of applying harsher measures to regulate them.

⁵¹⁹ AML Magazine, 'Positive Changes in the Reporting of Suspicious Activity to AUSTRAC' *Anti Money Laundering Magazine* (December 2010) 31.

⁵²⁰ Ibid.

However, the banking sector (which has ceased reporting under the *FTR Act* and now reports under the *AML Act*) has reported a lower increase in SMRs, with a rate of only 10 per cent across the sector during 2008–09.⁵²¹ However, while the lower rate of growth may be seen as a sign of regulatory success as there are fewer suspicious transactions to report in the sector, it can also be seen as evidence of a possible failure to report or of a shift in ML activity to other sectors or better ML strategies within the sector. These remain matters of conjecture. However, in this sector even a small percentage increase represents a large number of reports to be evaluated.

It is argued that the targeting of alternative remittance dealers reveals that AUSTRAC's strategies represent an effort to concentrate on the regulation of small business, including alternative remittance dealers, while making a minimum level of effort in terms of ongoing supervision of big reporting entities, including the larger banks and other big financial institutions in Australia.

During 2009–10, AUSTRAC received more than 21 million transaction reports, 2 million more than in 2008–09.⁵²² This represented a nine per cent increase, including almost 50 per cent rise in SMRs. The growth in SMR volume recorded seems high when compared to that recorded in annual reports from 2005–06 until 2007–08, but that is only due to the continuing rise in IFTIs,⁵²³ and the inclusion of the SMRs with the previously listed SUSTRs only after 2007–08.⁵²⁴

Thus, the growth in SMRs from reporting entities (see Figure 11 below) does not indicate any improvement to the nature of the reporting obligations or the extent of

⁵²¹ Ibid.

⁵²² AUSTRAC, *AUSTRAC Annual Report 2009–10*, above n 189, 7.

⁵²³ Approximately 10%: *ibid* 27. Again the number of reports submitted from 2005–06 to 2007–08 comprise IFTIs submitted under the *FTR Act*. The totals for 2008–09 and 2009–10 include IFTIs submitted under both the *FTR* and the *AML Act* (which came into effect 12 December 2008).

⁵²⁴ *Ibid* 27.

reporting entity compliance or demonstrate the actual effectiveness of the combined work undertaken by the industry and AUSTRAC.

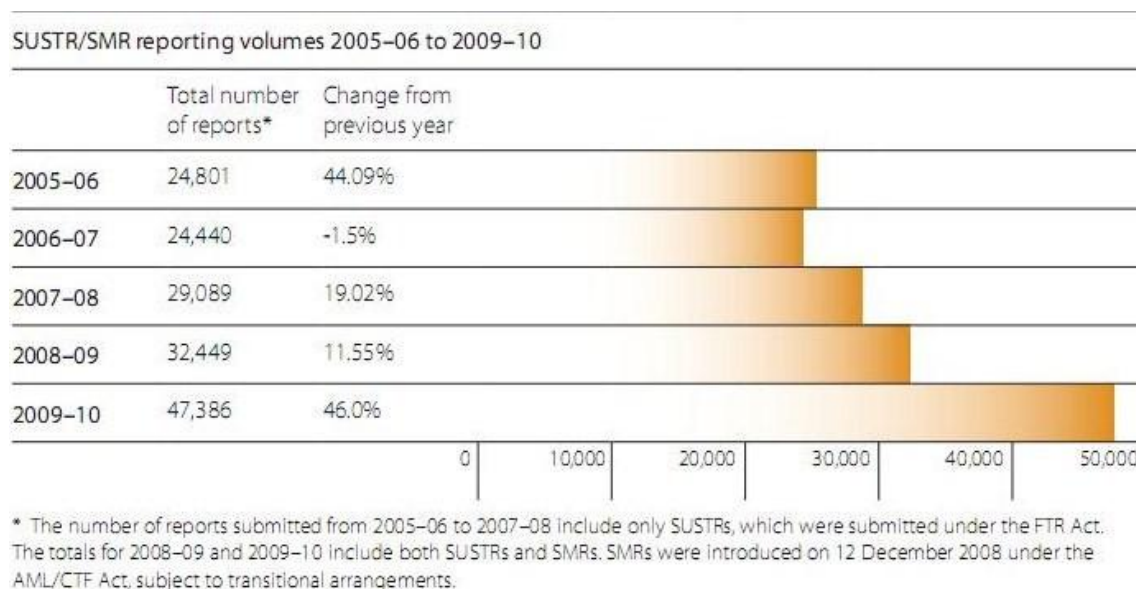


Figure 11: AUSTRAC SUSTRs/SMRs Reporting Volumes 2005–06 to 2009–10⁵²⁵

AUSTRAC’s strategy goals include improving the reporting system. To improve the system of reporting obligations, it needs effective tools. A better measure of AUSTRAC’s effectiveness may be the volume of *useful* reports and information, the intensity of the compliance behaviour and the level of the quality and volume of that compliant behaviour within the regulated entities. This would also reflect a cooperative attitude between regulator and regulated entities required if AUSTRAC wishes to achieve its goal. More and better communications with the reporting entities to increase its understanding of the market that it is dealing with as FIU and regulator would assist. As one of the reporting entity interviewees said:

I think AUSTRAC has a problem in the way ... it deals with the reporting entities community. It is because they [the regulators] come from a different background: they are suspicious of everybody, so suddenly they are dealing with organisations

⁵²⁵ AUSTRAC, *AUSTRAC Annual Report 2009–10*, above n 189, 27.

... it [has] changed over time but certainly a level of suspicion around the organisations they are dealing with⁵²⁶

Suspiciousness is not the only flaw, there are reports of a lack of cooperation from AUSTRAC:

I cannot see that they help us so we can do better, so we can detect stuff that helps them. Most organisations are spending the money to implement these programs; they want to implement [them] ... as efficiently as possible ... there is a lot of frustrations in dealing with AUSTRAC ... things that just need to be dealt with, [it] would not.⁵²⁷

Overall, it seems clear that AUSTRAC is paying more attention in its annual reports to the quantity of the reports it receives and disseminates and very limited attention to their quality. The quality issue is crucial to the success of the AML system. And for quality, accurate knowledge on the part of those reporting is required, which is facilitated by a positive relationship.

Yet the difficulty highlighted by the interviewees above, namely unresponsive personnel and incomprehensible or inadequate materials, are echoed in a survey that AUSTRAC itself conducted.

5.4 AML/CTF Compliance Officers in Australia Survey and the Effectiveness of AUSTRAC

In late 2009 AUSTRAC published the *AML/CTF Compliance Officers in Australia Survey*. This directly reflected on the actual scenario of the AML system and AUSTRAC's functions in this domain, as well as in regard to the level of AUSTRAC effectiveness in terms of supervising the reporting entity obligations.

⁵²⁶ Interview with a Compliance Manager A, above n 504.

⁵²⁷ Ibid.

One hundred and fifty⁵²⁸ compliance officers⁵²⁹ completed this survey, which presented a number of issues in the field of AML that are important for compliance officers and their reporting entities.⁵³⁰

5.4.1 AUSTRAC Survey: Major Positive Findings

The AUSTRAC survey of AML/CTF compliance officers contained a number of positive findings.

- 1 The reporting entities systems are successful; there is no systemic failure to comply with the obligation to designate an AML/CTF compliance officer ‘at the management level’.
- 2 A large number of compliance officers (98 per cent) were in senior level positions and ready to identify major deficiencies in their AML obligations and to effect change where required.
- 3 95 per cent had three or more years in compliance or risk management (and more than 33 per cent had over a decade of such experience)⁵³¹
- 4 86 per cent had tertiary educational qualifications, including bachelor degrees, graduate certificates and diplomas.⁵³²

⁵²⁸ From an email to 420 reporting entities (in regard to whom 64 ‘undeliverable’ email reports were received). Of those successfully contacted 356, 150 supplied respondents: this represents a response rate of just over 42%: AUSTRAC, *AML/CTF Compliance Officers in Australia*, above n 245, 8.

⁵²⁹ The agreed definition of the ‘Compliance Officers’, according to AUSTRAC, is those employees who are working in a senior level and responsible for review and oversight of the AML systems, establishing ML risk assessment, approving processes for new products and designated services, providing a central contact for AML matters and carrying the role of completion and submission of the compliance reports to AUSTRAC.

⁵³⁰ AUSTRAC, *AML/CTF Compliance Officers in Australia*, above n 245, 4.

⁵³¹ Ibid 4.

⁵³² Ibid 4, 13.

- 5 A number (over half) were undertaking assurance activities to evaluate their entity's compliance with the AML obligations.
- 6 A large number were found to report directly to the Board or to another executive position or committee.⁵³³

Overall the officers that responded to this survey represented a highly-experienced, well-educated, group of professionals well placed ready to effect change where required and fulfill their reporting obligations under the AML Act and AML/CTF Rules. The Survey, however, made a number of less positive observations.

5.4.2 AUSTRAC Survey: Major Negative Findings

The Survey also revealed a number of issues that give rise to concern

- 1 A lack of reporting of AML issues to the Board, then (as a result) to AUSTRAC, within some reporting entities. Some 72 per cent of compliance officers reported one or more AML matters to the board but 28 per cent of respondents did not report a single matter.⁵³⁴
- 2 Compliance officers were having difficulties following up on the updates on AUSTRAC publications, the AML Act and the AML/CTF Rules.
- 3 67 of the 150 were spending 10 per cent or less of their actual work time on AML issues: including one bank, 17 credit unions, 24 superannuation, 12 managed investment schemes, 6 securities/derivatives dealer or trader, 2 casino and 4 finance/lending.

⁵³³ Ibid.

⁵³⁴ Ibid 6.

- 4 40 of the 150 were spending between 25 per cent and 10 per cent of their actual work time on AML issues: including 3 banks, 16 credit unions, 8 superannuation, 7 managed investment schemes, 1 securities/derivatives dealer or trader, 1 casino and 3 finance/lending.
- 5 4 of the 150 had no idea about AUSTRAC's Guidance Notes.
- 6 7 of the 150 had no idea about AUSTRAC's Regulatory Guide.
- 7 16 of the 150 had no idea about AUSTRAC's Information Circulars.
- 8 19 of the 150 had no idea about AUSTRAC's e-learning courses.
- 9 23 of the 150 had no idea about AUSTRAC's Public Legal Interpretation series.
- 10 25 of the 150 did not know that AUSTRAC's Typology Reports existed.
- 11 30 of the 150 did not know that AUSTRAC's monthly newsletter existed.⁵³⁵

This cannot but be a source of concern for AUSTRAC, as it appears that the additional educational materials and opportunities provided to assist compliance officers in fulfilling their duties are either unknown to many of them or ignored by them.

5.4.3 In the Wake of the AUSTRAC Survey

AUSTRAC has tried through its survey to assist AML reporting entities and their officers to realise the extent of their role and comply correctly with the AML system. The questions used made compliance officers consider a number of important issues in relation to their work, including time devoted to AML issues, reviewing and making variations to AML programs, establishing and reviewing ML risk assessment

⁵³⁵ Ibid 30.

methodologies involved in approval process for taking on high risk customers and new products/designated services, conducting ML risk awareness training for staff and employee due diligence, record keeping, KYC policies and procedures, transaction monitoring systems and SMRs, TTRs, ITFIs and compliance reports.

Overall, it was a considerable achievement and enhanced the understanding of compliance officers regarding AML-related issues. It also served to focus on the system's strengths and the weaknesses.

In order to be effective, reporting entities and their staff, including compliance managers and officers, should seriously consider the findings.

One weakness in the approach, however, is that AUSTRAC itself was examining its effectiveness, and on its own terms. A number of weaknesses in its functions and reactions to non-compliance with reporting obligations and other AML matters are observed:

- 1 In terms of the lack of reporting: AUSTRAC took too soft an approach in encouraging the enhancement of reporting systems (and greater compliance) by reporting entities, especially those who had not reported a single AML matter to their Board (or equivalent designated senior executive) and then subsequently to AUSTRAC (as part of the reporting process). It only indicated that:

AUSTRAC urges entities to review the criteria of reporting AML/CTF matters to their board (or equivalent executive body) to ensure [that] appropriate oversight arrangements are in place.⁵³⁶

No action by AUSTRAC has been found to have been taken in this domain since this survey was undertaken in late 2009⁵³⁷ until the time of writing this thesis, and

⁵³⁶ AUSTRAC, AML/CTF Compliance Officers in Australia, above n 245, 7.

thus no major change in the policy of AUSTRAC in regard to following up on this outcome.

- 2 In terms of the limited time devoted to AML matters, AUSTRAC again took too soft an approach, simply encouraging reporting entities and their compliance officers to allocate the time required.

AUSTRAC urges entities to review the amount of time they spend on AML/CTF matters, especially as entities implement policies and procedures for ongoing customer due diligence and reporting under AML/CTF Act.⁵³⁸

Given the above, what measurable change, if any, was effected in this regard?

One wonders whether AUSTRAC followed up on this issue.

- 3 AUSTRAC has indicated that most respondents are experienced, educated professionals, aware of their AML obligations and ready to effect change where required, and well placed to do so. Yet many of these same people have not heard about one or more of AUSTRAC's publications, despite these relating directly to their work.

While the reporting entities and their compliance officers are responsible for following up AUSTRAC updates, it does not acknowledge its own role in this apparent discrepancy between educated, willing, well-placed officers and their ignorance of AUSTRAC publications. Either their education ill-prepares them for the role they are to play or they are less willing than their responses to the survey would appear to indicate. Nevertheless, there is still a lack of training for them on how to deal with their AML role effectively. While AUSTRAC must bear some responsibility in educating the relevant personnel in the reporting entities and in

⁵³⁷ Published in June 2010: *ibid.*

⁵³⁸ AUSTRAC, AML/CTF Compliance Officers in Australia, above n 245, 20.

following up on their level of compliance by utilising enforcement when required. AUSTRAC needs to also be aware that part of the ongoing problem may stem not just from the lack of available materials, a lack of awareness of available materials but also the quality of those materials. During this period covered by the survey, it initiated long-term plans for providing education to the reporting entities community. This survey results show that the available educational opportunities are underutilised. Furthermore, when material was accessed, a number of reporting entities found it inadequate.

The above shortcomings reflect weaknesses in AUSTRAC's processes of persuasion and education, which also serve to weaken the AUSTRAC enforcement mechanism. AUSTRAC and the reporting entities must share the responsibility for that. AUSTRAC also needs to follow up on the outcomes of such surveys, especially the negative outcomes.

A number of variables (over and above AUSTRAC's selection of recipients), such as the degree of self-selection of respondents in this survey, may have tilted the sample composition towards the more diligent, highly educated respondent, influencing responses accordingly. Such surveys, therefore, should be seen as very valuable but to some extent limited.

The annual reports too can reveal some facts, but not all. It would be beneficial if AUSTRAC would follow-up on what it has started to add more value to the issues that have been raised in these surveys series.

If the reporting entities are always asking for feedback to make things easier and clearer to them, then AUSTRAC as a regulator needs to understand the nature of business that its regulated entities do and learn from its experience with them and certainly try not to

give them any excuse for not being compliant. Ensuring the legislation and the regulations are unquestioned (that is, not subject to dispute about its scope or nature and so forth) is one of the attributes and recommendations discussed earlier (Chapter 4). If AUSTRAC does not follow up on its survey series' findings then it fails to make the regulation unquestioned. Clear comprehensive feedback is important not only for the reporting entities but also for AUSTRAC itself and its staff so that they are able to learn from their experience.

5.5 Typology and Case Studies Reports and the Effectiveness of AUSTRAC

Since 2007, AUSTRAC has provided annual typologies and case study reports to support reporting entities, to enable them to have a clear idea of their obligations under the AML Act and to comply appropriately. Those reports include several case studies that reveal a range of techniques that criminals frequently use to disguise reality and the source of the illegal funds and their movement inside and outside Australia.⁵³⁹

The AUSTRAC Typologies and Case Studies Report issued in June 2010 followed the regulator's efforts in the four previous reports and provided needed feedback to reporting entities for AML purposes. The following section will discuss the extent to which these reports helped and whether this reflects upon AUSTRAC's effectiveness.

5.5.1 What AUSTRAC Said about its Typologies and Case Studies Reports

A close examination of AUSTRAC's Typologies and Case Studies Reports from 2007 to 2010 reveals a number of statistics and indicators helpful in assessing the value of

⁵³⁹ AUSTRAC, AUSTRAC Typologies and Case Studies Reports, above n 472.

these reports. The number of case studies totals 174 and, according to AUSTRAC, they broadly reflect ML activities in Australia.⁵⁴⁰

AUSTRAC has relied on a number of criteria to choose the cases for discussion and analysis in these reports, including:⁵⁴¹

- 1 Where the use of data from financial transaction reports contributed to a successful investigation by authorities.
- 2 Where a SUSTR or SMR triggered a law enforcement investigation.
- 3 Where AUSTRAC and partner agencies pooled resources to advance an investigation.
- 4 Where analysis of information from financial transaction reports identified ML or TF activities.

Thus, AUSTRAC has selected for cases built on useful reports from reporting entities, and used them to prevent ML crimes.

AUSTRAC has categorised these case studies according to three main key trends (note that here ‘trend’ refers to a distribution or frequency of incidence not the difference in distribution or incidence over time). The three ‘trends’ are offence types, use of designated services for ML and TF affected industries. See Tables 7, 8 and 9, below:⁵⁴²

⁵⁴⁰ AUSTRAC, *AUSTRAC Typologies and Case Studies Reports 2007-10: Overview of Trends* <http://www.austrac.gov.au/case_studies07_10.html> at 19 March 2011.

⁵⁴¹ Ibid.

⁵⁴² Ibid.

Offence type	Percentage of Cases in Typologies Reports
Fraud and ML	52%
Drug importation	13%
Drug trafficking	8%
Structuring financial transactions	8%
Tax evasion	6%

Table 7: Offence Types Recorded in AUSTRAC Case Studies 2007–10⁵⁴³

Designated Service	Percentage of Cases in Typologies Reports
Account and deposit-taking services	39%
Remittance services	14%
Electronic funds transfers	12%

Table 8: Use of Designated Services for Money Laundering as Recorded in AUSTRAC Case Studies 2007–10⁵⁴⁴

Industry	Percentage of Cases in Typologies Reports
Banking industry	45%
Remittance services	18%
Gambling services	9%
Professional services	13%

Table 9: Industries Involved: AUSTRAC Case Studies 2007–10⁵⁴⁵

⁵⁴³ Ibid (adapted from pie-graph, Figure 2).

⁵⁴⁴ Ibid (adapted from pie-graph, Figure 1).

⁵⁴⁵ Ibid (adapted from pie-graph, Figure 3).

5.5.2 AUSTRAC's Typologies and Case Studies Reports; Positive Outcomes

The coverage of different new methods of ML in AUSTRAC's reports was one of their important achievements, particularly in its *Typologies and Case Studies Report* for 2010, where AUSTRAC pointed to a number of current and emerging criminal threats that are becoming more important. For example:

- 1 Bulk cash smuggling: One of the most popular and dangerous methods that money launderers could use when laundering illicit funds. Australian law enforcement agencies indicated that a number of criminals were smuggling sums of cash out of Australia to avoid the cross-border reporting obligation.⁵⁴⁶ A reporting entity accountant interviewed pointed out that lawyers usually deal with cash, which will put this category of reporting entities at a high level of risk, because of their vulnerability to conducting deals with smuggled funds. The interviewee, as a former officer of a state legal professional association, indicated that:

....I came across a number of instances where cash was stolen ... I became aware that ...lawyers' compliance with AML requirements was non-existent — maybe something like 26 per year in 2005/2006 of lawyers reporting.⁵⁴⁷

Due to a lack of available materials at the time, the interviewee then launched an education campaign in publications on their website trying to increase solicitors' awareness of their reporting requirements. However the interviewee remains pessimistic:

I would suspect it is still the same because it does not seem there is much improvement, and solicitors have a lot of cash. They do receive huge amounts of cash and they deal with cash as well.⁵⁴⁸

⁵⁴⁶ AUSTRAC, *AUSTRAC Typologies and Case Studies Report 2010*, 11<http://www.austrac.gov.au/files/typ_rpt.pdf> at 20 March 2011.

⁵⁴⁷ Interview with Accountant B (Wollongong, 31 August 2010).

Thus, it is highly recommended that the second tranche of the AML Act be implemented as soon as possible to oblige lawyers to report suspicious transactions, but up to the time of writing of this thesis, the decision remains in the policy makers' hands.

- 2 Trade-based ML: This involves trade transactions designed to hide and move the proceeds of crime with the aim of making the source of the funds appear legitimate, through misrepresentation of price, quantity or quality of imports or exports.⁵⁴⁹

AUSTRAC indicated this as one of the emerging criminal threats in a number of typology reports, including the 2008 report (Case number 12 'Tax Evaded through Exporting Goods'),⁵⁵⁰ and its 2010 report.

However, it remains an area with a certain level of ambiguity. For example, FATF issued a paper in 2006 to discuss the trade-based ML (*Trade Based Money Laundering 2006*). Some two years later, FATF issued its *Best Practices Paper on Trade-Based Money Laundering 2008* with the goal of trade-based ML being considered a high risk area, although the Wolfsberg Group indicates that it 'does not ...believe that ... there is sufficient evidence to support an assessment of this area as high risk for AML/Sanctions purposes'.⁵⁵¹

While there is no obligation in the FATF Recommendations for countries to deal with trade-based ML (as FATF generally does not deal with specific type of ML

⁵⁴⁸ Ibid.

⁵⁴⁹ AUSTRAC, AUSTRAC Typologies and Case Studies Report 2010, above n 546, 10.

⁵⁵⁰ AUSTRAC, *AUSTRAC Typologies and Case Studies Report 2008* <http://www.austrac.gov.au/files/austrac_typologies_2008.pdf> at 22 March 2011, 30. According to the Typologies Report 2010: 'A SUSTR was crucial to an investigation into a taxpayer claiming fraudulent Goods and Services Tax (GST) refunds': at 30.

⁵⁵¹ Wolfsberg Group, *The Wolfsberg Trade Finance Principles*, 1 <[http://www.wolfsberg-principles.com/pdf/WG_Trade_Finance_Principles_Final_\(Jan_09\).pdf](http://www.wolfsberg-principles.com/pdf/WG_Trade_Finance_Principles_Final_(Jan_09).pdf)> at 22 March 2011.

offences but the generic issues), it is still commendable that AUSTRAC highlighted it in its typologies as a threat that reporting entities should care about.

- 3 Mules and third parties: AUSTRAC has pointed to the ‘mules’ (people who, unrelated to the initial criminal activity, are used to unwittingly transfer funds to criminals overseas),⁵⁵² and to the third parties who have no criminal record being involved in ML activities. This can include family members of money launderers, students or unemployed persons who are looking for work. Money launderers could try to approach this category of people and use them to launder their illicit funds.⁵⁵³

5.5.3 What do the Typologies and Case Studies Reports Reveal of AUSTRAC Effectiveness?

A number of outcomes affecting AUSTRAC’s strategies to achieve operational effectiveness can be discussed from the Typologies and Case Studies, especially those related to reporting obligations of the reporting entities and AUSTRAC’s role in supervision, intelligence and enforcement actions.

- 1 AUSTRAC’s Typologies and Case Studies Reports for 2007–10 provided the reporting entity community with information regarding the latest criminal threats and methods, in order to strengthen the AML system, particularly these entities’ reporting obligations.

A number of questions remain, such as how can these reports achieve their goals without trust between AUSTRAC and its reporting entities, and how can that trust be achieved?

⁵⁵² AUSTRAC, AUSTRAC Typologies and Case Studies Report 2010, above n 546, 11.

⁵⁵³ Ibid.

A number of reporting entity interviewees indicated that reporting entities are undertaking their reporting obligations because they want to stay ‘on the safe side’; they report as much as they can. This reflects a lack of trust on both sides: AUSTRAC does not trust reporting entities’ RBAs so encourages them to report as much as they can, and reporting entities do not trust AUSTRAC in its compliance role and fear its reaction when non-compliant regarding reporting obligations, so they report ‘self-protectively’ without great concern for report quality. This will persist as long as the feedback from AUSTRAC about these reports (generally through annual reports, typologies reports and other publications) does not provide clear feedback to those entities. According to one interviewee:

We will always report the suspicious matter, even if it has been reported already. If the activity continues, there will be always reporting obligations as per the requirements. We are working to make sure we are reporting as much as we can to AUSTRAC to be on the safe side.⁵⁵⁴

Another compliance officer indicated that feedback is actively sought:

We use the AUSTRAC online portal which is prescriptive and gives us the information we must to comply with, including the mandatory fields that need to be completed. We are also aware of the required information as outlined in the AML/CTF Rules. We also encourage feedback from AUSTRAC on a regular basis about the quality of our submissions to as to enhance the existing controls.⁵⁵⁵

AUSTRAC regards feedback to the reporting entities in matters like SMRs analyses as confidential and uses confidential bilateral discussions with the reporting entity concerned.⁵⁵⁶ However, a number of reporting entities (as shown previously), regard AUSTRAC’s annual reports and typologies reports as

⁵⁵⁴ Interview with a Compliance Manager E, a financial institution (telephone) (Northern Territory, 21 September 2010).

⁵⁵⁵ Interview with a Compliance Manager F, a financial institution (telephone) (Melbourne, 6 September 2010).

⁵⁵⁶ AUSTRAC, AUSTRAC Typologies and Case Studies Report 2010, above n 546, 9.

insufficient feedback and argue that AUSTRAC is not very informative in the confidential discussions, as this agency lacks the solid experience and the capacity to do so.

- 2 Because AUSTRAC has ostensibly relied on the factors listed earlier to choose the cases for in depth analysis in its reports, these should present instances of the most serious threats that are then shared with reporting entities. However, while AUSTRAC seems to say that its typology reports are based on an assessment of high risk cases, and that it is publishing these because it wants to alert the industry to areas of greatest ML activity and concern, this is clearly not the case. AUSTRAC simply publishes typologies on cases where it can be seen to be more effective, that is, where it can appear to have taken effective action (such as in its clamp down on remitters). This is not the correct — nor a particularly helpful — approach to take. For example, tax evasion represents only 6 per cent of the cases that have been analysed, while fraud and ML together account for the largest percentage, representing a total of 52 per cent of the cases.(See Table 7 above: from Typology Report 2009–10). Corporate and technology-based fraud is of specific concern, frequently involving huge sums and numerous victims.⁵⁵⁷ However, as shown previously (Tables 5 and 6 above), AUSTRAC has disseminated a far larger number of SUSTRs/SMRs to the ATO in 2007–10 — almost 107,542 reports for the period.⁵⁵⁸ Thus, most data and information provided in SUSTRs and SMRs submitted by reporting entities because of their suspicions about ML activities are going to the ATO for tax evasion purposes rather than ML.

⁵⁵⁷ Ibid 13.

⁵⁵⁸ Ibid, 18, 19 (Tables 1 and 2)The total number is the result of adding the number of the reports that have been disseminated to ATO as recorded in the annual reports of AUSTRAC 2007–08, 2008–09, 2009–10.

AUSTRAC says it has a strategic plan to achieve high quality reports and strengthen the reporting system; however, indications are otherwise — the weaknesses in this domain remain. In other words, it is a case of showing that this agency is picking ‘easy targets’ to represent in its reports rather than the more difficult ones that it should be focusing on. AUSTRAC would be better off really focusing on all major risk areas. Typology reports would then benefit reporting entities far more.

- 3 A breakdown of statistics for AUSTRAC’s case typologies revealed that account and deposit-taking services and the banking industry comprise the largest percentage of cases in the typologies reports for the period 2007–10. Account and deposit-taking services account for the largest single service area in the ‘Use of Designated Services for ML’ (39 per cent of cases analysed) (Table 8 above). In terms of ‘Industries Involved’, the banking industry was the most frequently represented in the typologies (45 per cent of cases) (Table 9 above), with, remittance services the second highest recorded in both the Use of Designated Services (14 per cent of cases) and in ‘Industries Involved’ (18 per cent of cases). Again, the frequency of cases simply reflects AUSTRAC’s selection of cases. Banks could, however, be expected to comprise the largest number, given the structure of the industry and the way it operates in Australia.

ML is more likely to occur in the banking industry than in the remittance sector (in terms of overall frequency, that is, in terms of percentage of reports to the regulator) and this could be reflected in the allocation of typology reports. (But again, given that the typology reports simply reflect cases selected by AUSTRAC for analysis — ostensibly but not demonstrably — on the basis of risk posed, it is

difficult to reflect upon with confidence). A higher ML level in banking may reflect the relatively greater amount of funds going through the banking sector which is far greater than the total for the remittance sector. The difference in terms of risk within each sector may differ in terms of risk expressed as a percentage of the volume of transactions. Again, if risk is evaluated in terms of percentage of total funds involved rather than as a percentage of transactions, the figure would again vary. The difference between the sectors in terms of risk posed may alter substantially if the relative amounts of funds going through each system were taken into consideration when estimating the sectors' relative level of risk. AUSTRAC should include this when strengthening its supervisory framework.

The typology statistics for Use of Designated Services reveal that the banking sector is more frequently represented than the remittance sector by some 25 percentage points, and in Industry Trend by some 27 percentage points. Thus, if the proportional representation in typology reports is to be taken at face value as reflecting risk, the banking and deposit-taking services sector would be facing at least the same level of risk as the remittance services sector, if not somewhat higher. However, AUSTRAC has built into its strategies' goals, the possibility of applying harsher regulatory measures for non-compliant alternative remittance dealers within the Australian jurisdiction, specifically referring to that sector rather than to applying these measures effectively to both sectors.

The question is why has AUSTRAC put so much of its efforts towards regulating the alternative remittance dealers and left the banking sector to a more 'normal' level of supervision and enforcement? The vast majority of businesses in alternative remittance dealer category are small — such is the nature of

establishing these businesses that they do not require a large number of people and can be operated by a single individual to provide limited services; while the majority of banking sector businesses are large due to high capital establishment costs the greater number of employees required and the varied services provided. The banking sector also represents higher risk (according to both the level of representation in the typology reports and the relative volume of funds going through the sector), and yet it appears that alternative remittance dealers are attracting disproportionate attention. The reasons are explained below.

5.5.4 Alternative Remittance Dealers

The Australian Minister for Home Affairs announced new AML Rules (effective 16 April 2010) that granted the AUSTRAC Chief Executive Officer (CEO) the authority to deregister remittance dealers (remitters) whose activities represent a significant ML risk and thus require commensurate action.⁵⁵⁹ Aiming to strengthen the remittance system, he also issued a discussion paper on 23 April 2010 entitled ‘Enhanced Regulation of Alternative Remittance’, followed three months later by the release of specific proposals for an improved AML registration system, and consultations on impacts of the proposals. The goals were to give the Government a solid understanding as to how reforms could affect remittance service businesses and help to guarantee an effective result.⁵⁶⁰

These efforts to strengthen the AML activities in the remittance sector (including large institutions with international reputations, such as MoneyGram, and small, simply

⁵⁵⁹ Minister for Home Affairs, ‘Laws Amended to Prevent Abuse of Money Transfer System’, Media Release, 16 April 2010 <http://www.ministerhomeaffairs.gov.au/www/ministers/oconnor.nsf/Page/MediaReleases_2010_SecondQuarter_16April2010-LawsAmendedtoPreventAbuseofMoneyTransferSystem>.

⁵⁶⁰ Attorney General’s Department, *Regulation Impact Statement- Enhanced AML/CTF Regulation of the Alternative Remittance Sector*, 11<http://ris.finance.gov.au/files/2011/03/04_Remittance_Dealers_RIS.pdf> at 24 March 2011.

structured institutions, such as Thi Kim Hong Tran Company) stemmed from the detection of abuse by criminals of this sector's services, including for ML activities.⁵⁶¹ Criminals could use this system to send illegal funds inside or outside Australia, using cash, cheques or other type of payments to another person.

Before 16 April 2010, the Australian *AML Act 2006* obliged remitters to register their businesses with AUSTRAC before providing services. (They also had to create an AML Program and identify their customers and transfer actions). However, the Discussion Paper revealed deficiencies that prompted the Rules' amendment, among them that:

- 1 There were no conditions on remitter registration for either a person or a business.
- 2 AUSTRAC had no authority to reject an application for registration or to deregister an existing remitter (the latter deficiency eliminated from 16 April 2010).
- 3 Only limited sanctions were available for remitter non-compliance.
- 4 Remitters were not obliged to update their details or identify businesses associates.⁵⁶²

Amendments have since changed the Rules to include (since 16 April 2010):⁵⁶³

- 1 The AUSTRAC CEO can cancel, reject, suspend, apply conditions on registration and deregister any non-compliant remitters.

⁵⁶¹ Australian Institute of Criminology, *Risks of Money Laundering and the Financing of Terrorism Arising from Alternative Remittance Systems*, Transnational Crime Brief No 7 (Australian Institute of Criminology, April 2010) <<http://www.aic.gov.au/publications/current%20series/tcb/1-20/tcb007.aspx>>.

⁵⁶² AUSTRAC and Attorney General's Department, Discussion Paper Enhanced Regulation of Alternative Remittance Dealers, 3 <[http://www.ag.gov.au/www/agd/rwpattach.nsf/VAP/\(3A6790B96C927794AF1031D9395C5C20\)~remittance+dealers+discussion+paper.pdf/\\$file/remittance+dealers+discussion+paper.pdf](http://www.ag.gov.au/www/agd/rwpattach.nsf/VAP/(3A6790B96C927794AF1031D9395C5C20)~remittance+dealers+discussion+paper.pdf/$file/remittance+dealers+discussion+paper.pdf)> at 24 March 2011.

⁵⁶³ Ibid 4.

- 2 Applicants are required to disclose beneficial owner of the business, and control matters, and issues related to character, including history of regulatory non-compliance or criminal convictions.
- 3 AUSTRAC can publish a remitter registers and a list of deregistered remitters.
- 4 Reporting entities are obliged to submit an SMR to AUSTRAC when they suspect they are dealing with unregistered remittance services businesses.

The new AML Rules greatly improve AUSTRAC's ability to enforce compliance of the AML non-compliant remitters. AUSTRAC's role also is extended as the improved Rules require new efforts to secure higher levels of compliance, including educating the reporting entities community and getting closer to those entities in order to discuss and clarify their new obligations. AUSTRAC began this in 2010 and should continue through 2011.

AUSTRAC has tried through its *Typologies and Case Studies Report 2010* and *Annual Report 2009–10* to highlight the importance of the new AML Rules in terms of strengthening the supervision process for remitters. It is clear from these publications, and especially the annual report, that AUSTRAC is concentrating its efforts on regulating small businesses in general (more specifically small remitters) because of higher risks that these could pose in relation to the level of the compliance. AUSTRAC 'recognises that some smaller regulated entities have experienced difficulties complying with their obligation to implement risk-based AML/CTF programs'.⁵⁶⁴

AUSTRAC says that its new targeted approaches are working:

⁵⁶⁴ Ibid 35.

We engaged with the major remittance service network providers in an effort to identify the smaller remittance businesses which have proved difficult to contact in the past. This resulted in a marked increase in the number of remittance businesses who were registered under the AML/CTF Act.⁵⁶⁵

While strengthening the regulatory process for smaller businesses is laudable, large businesses in general and, more specifically, large remittance businesses (which could engage in money transfer services with those small remitters) and other money services businesses could also benefit from similar attention. In other words, AUSTRAC said remitters were a problem because it was reacting to this sector of the market. That is, AUSTRAC was saying it was addressing a real problem. It may have been a small problem but as AUSTRAC could do something it did so, rather than take on major players.

In its *Annual Report 2009–10*, AUSTRAC revealed that the Money Services Businesses category includes more than 7000 reporting entities and included:⁵⁶⁶

- 1 remittance services providers,
- 2 cash carriers, and
- 3 currency exchange dealers.

These entities varied in size, and according to AUSTRAC the larger entities tended to be well-resourced and accustomed to regulation and risk management, while the smaller entities were found to be less prepared to carry their AML obligations.⁵⁶⁷

However, one wonders if it is sound policy to neglect to ensure regulatory attention and supervision because larger bodies ‘tend’ towards greater compliance. If the response is

⁵⁶⁵ Ibid 6.

⁵⁶⁶ AUSTRAC, *AUSTRAC Annual Report 2009–10*, above n 189, 32.

⁵⁶⁷ Ibid 31–2.

guided by the AUSTRAC typologies reports (particularly that of 2010) then this approach is the opposite of that suggested by the relationship observed between compliance and size in those reports. AUSTRAC's concentration on banking in its typologies reports indicates that the banking sector is a more risky sector in terms of non-compliance with the AML system than others (according to the relative amounts of funds going through the banking sector given the structure of the industry and the way it operates in Australia) (see Table 9 above).

One also wonders about the position of other types of money services businesses, such as currency exchange dealers for example.

It is unreasonable for AUSTRAC to make major efforts in regards to small remitters and give relatively low levels of attention to the other large and small businesses, where the lack of attention will be disproportionate to the risk posed. For example, currency exchange businesses could pose a risk similar to that of remittance service providers when their services are abused by criminals. However, AUSTRAC has made a clear distinction between the two when it discusses supervision, compliance and registration. Other money service businesses appear to have been given a privileged status in contrast to the supervision and enforcement of compliance of remitters:

AUSTRAC undertook a dedicated remitter registration campaign to increase the number of remittance service providers registering with AUSTRAC. Remitters are an important segment of this industry sector, and as at June 2010, 94 per cent of the estimated remittance population had registered with AUSTRAC.⁵⁶⁸

Is it about the number of the registered businesses or about the level of the compliance of those entities? And why did AUSTRAC not take other types of money services businesses into consideration when strengthening the regulation of this sector?

⁵⁶⁸ Ibid 23.

A personal experience with a Sydney currency exchange business may prove informative:

A friend of the researcher wanted to exchange AUD10,000 into USD. In order to observe how currency exchange businesses deal with a large amount of money where a customer has insufficient ID, the researcher asked his permission to attempt the transaction for him.

In March 2011 the researcher conducted an indirectly case study at one of the currency exchange businesses in Sydney. The researcher first asked about the exchange rate for exchanging AUD10,000 into USD, and for that the employee indicated the exchange rate. The researcher accepted the exchange rate and handed the money to the currency exchange employee. As he was obliged, the employee asked for an official ID from the researcher. The researcher, as an overseas student, does not have an Australian ID. Therefore, the employee asked for the researcher passport. After thinking the researcher answered that he left his passport at home and the only ID he had was his overseas driving licence issued 10 years ago, with a photo that didn't resemble the researcher because it had been taken about 15 years earlier, sometime before its use on the driving licence. The employee hesitated: From a financial viewpoint the transaction offered a healthy profit, but the AML Act and Rules obliges such businesses to obtain sufficient customer identification. The employee called his employer by phone and asked if he was supposed to do the deal given this suspicious identification — and the employer after about 30 seconds conversation decided to let the employee do so subject to photocopying the driving licence and asking usual questions about name and phone number.

Yet the driving licence could easily have been a fake. This business is probably not alone in its lack of understanding of their AML obligations. AUSTRAC needs to strengthen the system in regard to these businesses too.

In fact, the poor adherence to rules by the currency exchange business reflects poor supervision and either poor knowledge of the rules and a lack of industry education or deliberate preparedness to break the rules. This outcome did not come from nowhere, it arose due to three factors:

- 1 AUSTRAC is struggling both with applying RBA to regulated entities and the AML training issue.
- 2 AUSTRAC's enforcement powers are not sufficiently mature and have shortcomings affecting their influence on enforcing compliance.
- 3 AUSTRAC is facing a shortfall in effectively achieving its Guiding Principles, which makes it appear to be subject to influence during the GFC.

These factors were revealed by comparing what AUSTRAC says with what it does; those conclusions that have been reached by interviewing a number of compliance officers from Australian reporting entities. The factors are the area discussed in the next chapter.

5.6 Conclusion

What AUSTRAC says in general is useful but there are shortfalls in terms of its functioning. AUSTRAC has tried through its publications to illustrate its success on different issues, and highlight its strategies as a considerable achievement that it will be used to measure and describe its effectiveness. However, it has been clear that

AUSTRAC has fallen short in the way it performs its obligations under the AML Act and in terms of its own Rules. While AUSTRAC released strategies that would affect positively its policies, its own publications such as annual reports, typologies and case studies reports, and its surveys series have in many places reflected the contrast between ‘what AUSTRAC says’ and ‘what it does’. This, together with accounts of how reporting entities see AUSTRAC, has served to reveal weaknesses in AUSTRAC’s performance regarding non-compliance with reporting obligations and other obligations.

AUSTRAC is relying on a number of indicators to measure its effectiveness. However, analysis has shown that it is not satisfactorily reaching these indicators and strengthening its level of effectiveness

- 1 On the basis of measuring its effectiveness by looking at indicators related to the intensity of the compliance behaviour and its quality and volume (first indicator), AUSTRAC’s annual reports show that it is still receiving low value reports, and that AUSTRAC itself is still having problems differentiating between high and low quality reports, especially when it is observed to have disseminated large numbers of reports in 2009–10 with limited benefit to partner agencies, including the ATO, AFP and ACBPS.

The 2009 AUSTRAC compliance officers survey also revealed problems in the compliance behaviour and the quality of the work of the reporting entities and their staff, when it noted a significant lack of reporting of AML issues by some reporting entity compliance officers to their boards and, as a result, to AUSTRAC. More than one in four respondents did not report a single matter, while more than 4 in 10 spend 10 per cent or less of their actual work time on AML issues. Just under 30 per cent spend more than 25 per cent of their work time on AML issues.

The above indicates a disconnection between reporting entities and the AML system, and not only calls into question AUSTRAC's enforcement mechanism but also AUSTRAC's educative strategy for reporting entities community. Compliance officers also report inadequate feedback on their reports, with a number of them saying that they repeatedly asked for feedback on report quality but received nothing. Again, this does not encourage cooperation and compliance, crucial to the effectiveness of the AML system (and AUSTRAC's operations).

- 2 On the basis of looking at the number of reports disseminated annually and partner agencies' feedback on their quality, relevance and usefulness (third indicator), the findings showed that it is not the number of the disseminated reports that could reflect the effectiveness of AUSTRAC's operations, but rather their usefulness to different partner agencies, and not only in terms of being useful to combat tax evasion and drug trafficking but in achieving the ultimate goal of AUSTRAC's operations as the AML regulator, which is combating ML crimes. (In addition, the large number of disseminated reports noted in the *AUSTRAC Annual Report 2009–10* may not reflect any substantial improvement in the quality in these reports because of a number of statistical anomalies.)
- 3 The fourth and fifth indicators are looking at the value of the savings of public money and of proceeds seized, and the number of fruitful enforcement outcomes that have been found to have occurred after successful cooperation between the AUSTRAC enforcement team and its frontline supervisory team. In relation to those indicators, AUSTRAC will not be able to substantially increase public monies saved and proceeds seized unless it has outcomes that reflect fruitful cooperation between the Enforcement teams and Supervisory team, and especially

between reporting entities and AUSTRAC. Thus far AUSTRAC is hampered by an enforcement mechanism that is limited in a number of respects. Its use is ‘immature’ (that is, not all aspects are used when and as required) which obstructs AUSTRAC maximising the savings of public money and seizure of proceeds.

In existence prior to the release of the Strategies, these problems persist, as was confirmed by the reporting entity interviewees. To strengthen its performance, AUSTRAC needs to surmount its inadequacies.

The analysis of AUSTRAC’s Strategies and whether they are able to evaluate AUSTRAC’s effectiveness found that the answer to the question ‘Are the current AUSTRAC strategies and policies targeting all reporting entities and doing so sufficiently effectively’ (the first question at the conclusion of Chapter 4) is ‘No, they are not’. AUSTRAC has yet to strengthen its performance in terms of its enforcement mechanism in regard to reporting obligation non-compliance, and a number of issues will continue to impede its strategies and limit its effectiveness unless AUSTRAC takes quick positive action to find solutions.

6 FACTORS AFFECTING AUSTRAC'S ENFORCEMENT MECHANISM FOR NON-COMPLIANCE WITH REPORTING OBLIGATIONS

6.1 Introduction

The new Act passed in 2006 changed the basis on which the law tests compliance. The *AML Act* has moved from an Act that imposed compliance obligations on entities because of the general nature of their businesses to one which imposes obligations on anyone who provides defined services. In addition, the AML compliance system depends on an RBA. This means compliance is not a 'black and white' issue, and to have a high-quality AML system requires the active regulator and the FIU to measure compliance in such a regulatory environment.

The *AML Act* enlarged the community of reporting entities to all those entities providing the services defined, who were then required to submit a number of particular types of reports to AUSTRAC, including SMRs, SUSTRs, TTRs, IFTIs, reports related to physical currency and those related to bearer negotiable instruments, as well as annual compliance reports. The interview data collection methodology adopted by this thesis was trying to obtain responses from different types of businesses under the first tranche of the Act, which has already been implemented, and which covers reporting entities that provide the 'designated services'. These entities include the financial sector, gambling sector, and the trustee and superannuation sectors. These types of reporting entities now face tougher obligations regarding CDD, reporting requirements, and record-keeping obligations than those required under the *FTR Act 1988*. The data collection process also tried to obtain responses from those who will be obliged under the second tranche to provide different types of reports (with such entities including accountants and real estate agents) in order to access their understanding of the AML system and their role in the near future.

Chapter 5 discussed reporting entities' experience of the Australian AML and revealed a number of major problems with the application of AUSTRAC's enforcement mechanism regarding reporting entity non-compliance. Although many respondents deem the AML Act and Rules as crucial in improving Australia's AML regime, an analysis of AUSTRAC publications and the outcomes of reporting entities' interviews demonstrated that reporting entity low quality reports perpetuated by AUSTRAC's minimal feedback level to those entities are negatively influencing AUSTRAC's work in general and the enforcement mechanism for reporting obligations non-compliance in particular.

AUSTRAC's intention is to get closer to the reporting entities in order to understand businesses and their use of RBA, so as to know how better to deal with these entities and influence these entities' staff in regard to the design of more systematic training both internally for the entities and by and of AUSTRAC staff. This is essential to enhance the quality of reporting. Other important aspects are the importance of providing reporting entities with better feedback and of achieving transparency in AUSTRAC's work. Many Australian institutions (partner agencies and reporting entities) should collaborate more effectively with AUSTRAC in detecting and defeating ML activities.

However, a number of thesis findings do not quite fit the above scenario and have adversely affected AUSTRAC's enforcement mechanism regarding non-compliance with reporting obligations. These will be discussed in this chapter.

6.2 Results

The financial institutions interviewed (including major banks, trustees and executor services institutions, investment and superannuation institutions and bookmaker and

betting institutions) were obliged under the *AML Act 2006* to be reporting entities. These institutions indicated in their responses that they believed that they are all familiar with the AML system and its obligations (especially as they already familiar with risk management even before the creation of the AML model, and had subsequently become more familiar with — and now long observed — its general practices, including identifying customers, record keeping, and customer due diligence). However, they nevertheless indicated that they were experiencing difficulties in providing useful reports and complained about a lack of guidance needed to adequately fulfill their obligations. This clearly indicates that reporting entities in Australia should become even more familiar with AML practices. Nevertheless, the compliance managers and officers supplied valuable data in the current AML scenario in Australia. They also supplied valuable data on that scenario to the researcher, material that indicated that their reporting practices could be improved and better serve the AML system and contribute to AUSTRAC's effectiveness.

By way of contrast, neither the real estate agents nor accountants interviewed believe themselves well-versed at any level or aware of AUSTRAC's role regarding gathering and examining financial transactions because they are not yet obliged under the AML Act and Rules to be reporting entities, and so it is hardly surprising that these types of businesses are inexperienced with the *AML Act 2006*. Nevertheless, given that the government has officially indicated that they will be required to act as reporting entities under the second tranche, it appears somewhat remiss of AUSTRAC to not to have at least begun some preliminary education of the sectors involved.

Whilst the size of the sample is far too small to draw statistically reliable conclusions, data is nevertheless perhaps indicative. The essentially preliminary data comprised

responses to a small number of formal interviews with real estate agents and accountants as well as a number of informal interviews with real estate agents and accountants through the CPA Australia/Forensic Group Discussion). The responses indicated that both types of businesses (real estate agents more so than accountants) are almost totally unaware of their reporting obligations when offering specific financial services to their customers or clients. Even lawyers (who may deal with trust monies and so forth, as well as their own accounts) appear to be falling short of expectations. In terms of the lawyers sector, one of the accountants interviewed spoke from the perspective of having been a former officer of a state legal professional association, and observed (somewhat damningly) that although this sector relies on cash dealings, lawyers in the sector rarely comply with reporting obligations.⁵⁶⁹

A number of the respondents were of the opinion that the AML system needs to eliminate its shortcomings regarding non-designated services businesses, especially those who are dealing with cash more than with banking transactions. This sector includes lawyers, accountants and real estate agents, among others. Members of the sector may prove resistant to some aspects.

In terms of lawyers reporting, there was not any requirement to have a designated officer. The accountants are quite comfortable with complying ... So we will just wait and see what it will look like when the second tranche comes into effect.⁵⁷⁰

Thus, those interviewed in regard to this type of businesses (non designated services) have not yet been provided with an adequate set of reporting guidelines nor sourced this information for themselves. Having never visited AUSTRAC's website, contacted AUSTRAC's assistance line or read its publications, they were found to be lacking knowledge and information about AUSTRAC's role in preventing ML crimes or even

⁵⁶⁹ Interview with Accountant B, above n 547.

⁵⁷⁰ Interview with Accountant B, above n 547.

knowing that they will soon be obliged (under the second tranche of the *AML Act*) to meet AML requirements and obligations as institutions that provide designated services are already required to do.

Lawyers and solicitors, who are already required (since the amendment of the *FTR Act 1988* in 1997) to report threshold transactions of AUD10,000 or more in currency or foreign currency equivalent ‘when entering into by, or on behalf of, the lawyer in a practice’, shared a lack of knowledge of their obligations under the *AML Act* or AUSTRAC’s role with other non-designated services providers mentioned above.

However, all respondents indicated that *AML Act* and Rules are essential to combat ML crimes. Respondents (representing major banks, trustees and executor services institutions, investment and superannuation institutions and bookmaker and betting institutions) indicated that they are familiar with AML practices and policies and their obligations under the AML system, including identifying customers and undertaking OCDD. Universal awareness was assumed: ‘For the purposes of this legislation there are standard requirements and everybody [is] familiar with it anyway.’⁵⁷¹

All respondents advanced the case that their relevant institutions were trying to achieve high levels of compliance. Some tried to show that there is limited ML penetration by ML of their institutions. Real estate agents, accountants, trustees and executor services institutions, investment and superannuation institutions complained because they do not accept cash payments from customers — all monies received by go directly to their bank accounts). Thus, the role of banks in suspect ML is more effective due to their functions (which involve more frequent handling of cash transactions) than that of the non-designated services providers. This is a dangerous misunderstanding of the role of

⁵⁷¹ Interview with Compliance Manager D, above n 503.

the reporting entities in the AML system, because these institutions share responsibility with the banks and are vulnerable to ML risk, as are banks and other financial institutions that are in a 'face to face' relationship with customers. This is especially so given the increase in identity crime that has flourished with the vast availability of personal information through internet websites such as 'Facebook'. According to the Australian Crime Commission (ACC):

Australia's high take-up of communications technology also facilitates identity crime. This global phenomenon has become a hallmark of serious and organised crime and has significant social and financial ramifications. The large volume of personal information on social networking sites such as Facebook provides an opportunity for organised crime groups to obtain data and create identification documents for criminal purposes. Criminals have access to a range of options through information and communications technology systems to obtain or produce high-quality and low-cost fraudulent identity documents.⁵⁷²

In addition, the ACC considered self-managed superannuation funds (SMSFs) (a business that is not in a 'face to face' relationship with customers) to be at high level of ML activity risk. The total amounts of superannuation located in these funds are substantial. At the end of 2009, there were 416,145 SMSFs, 'accounting for 30.9 per cent of assets across various fund types and 99 per cent of the total number of super funds'. A further 2,500 are being added to that number each month.⁵⁷³ They are also in danger of abuse due to a number of factors:

While all fund trustees have a responsibility to detect or prevent fraud, in the case of self-managed superannuation funds the responsibility is placed on trustees who may be inexperienced, poorly trained and unqualified to perform the role and, sometimes, complicit in the fraud, making these funds particularly vulnerable to exploitation by negligent or disreputable trustees or professional service providers.⁵⁷⁴

⁵⁷² ACC, *Organised Crime in Australia 2011* (ACC, 2011) 26 <http://www.crimecommission.gov.au/publications/oca/_files/2011/oca2011.pdf> at 27 May 2011.

⁵⁷³ Ibid 79.

⁵⁷⁴ Ibid.

Although, one real estate agent did not see the need for the inclusion of his entity category in AML, believing that was the banking sector's role. He explains:

When we ... sell a property, ... the buyers are required to give us 0.25 per cent deposit of the sell price ... — on average 15,000 dollars ... around 20,000 dollars — , we do accept that in cash. However, after 5 days they have to pay the 10 per cent deposit — the 10 per cent deposit from 500,000 is 50,000 dollars.

If somebody com[es] to me with 50,000 in cash, I will refuse it. ... send them to the bank [for] ... a bank cheque ...the buyer can send it through the post office or deposit the money directly into our account ...

So we trust the bank as a financial institution [that] has a policy in place to determine if it is legal or illegal money. I do not see why us — real estate agents — should we take that further step in the AML scheme; rather ... it should be more focusing on the large financial institutions, such as banks for example.

Another respondent representing the trustees and executor services institutions indicated that their type of work makes it hard to detect suspect ML activity and report it to AUSTRAC. They mainly rely on managing non face-to-face investment schemes and the money obtained is generated in the system through bank accounts, therefore banks carry the big load or undertake the major task in this relationship.

We are a diverse financial services firm. It's rather different from a bank: we don't generally see the clients face to face ... usually the funds are given to the firm electronically ... Or via a cheque, which means you have to have an existing relationship with a bank in order to [obtain it]. The bank ... perform[s] the customer identification procedure required.

So ... if you're looking at money laundering at the various stages ... [at] placement stage that's not an issue, for managed investment schemes, generally ... Where it becomes more of a challenge ...is where it starts to get to the more sophisticated layering and, of course, [in the] integration stages.

[T]o be perfectly honest, it is really [a] very difficult sort of thing to say quite independently, "Oh that looks suspicious, therefore that could be money laundering." ... But to actually sort of prospectively say: "This is money laundering", it's a very difficult proposition with managed investment schemes.⁵⁷⁵

These respondents clearly reflect in their responses that even while reporting entities are trying to demonstrate their control of their systems, and compliance with their AML, they still are not confident of whether or not they are efficiently and effectively fulfilling their responsibilities under the AML system. Comparing these responses with

⁵⁷⁵ Interview with Compliance Manager D, above n 503.

material recorded in AUSTRAC's publications (including the compliance officers survey), it is clear that one reason for such ongoing difficulty could be that compliance officers are not spending sufficient time on AML matters. Moreover, those spending little time on their AML responsibilities believe that their time spent can be better spent, as only limited AML achievements could be anticipated in their sectors. This calls into question their understanding as to their risk when relying on RBA. It also calls into question the effectiveness of AML training systems for both reporting entities and AUSTRAC.

Their responses show the relative lack of sophistication of many of reporting entities. These entities think that if money has been through a bank, it must be 'legal' money. Such beliefs facilitate ML as everyone just wants the banks to be the AML frontline with no one else having any responsibility.

6.2.1 AUSTRAC's Struggle to Apply the Risk-Based Approach on Regulated Entities and AML Training

The thesis found a major problem in this area. It extends to include the monitoring of transactions and reportable transactions area and the application of RBA and the necessity for strategic training. AUSTRAC has been found simply unable to explain the nature of RBA to reporting entities. In fact, this may say more about the lack of commercial understanding of AUSTRAC staff and their inability to communicate effectively with those in industry, than about the nature of RBA itself.

Thus, after years of activity and almost ten years since the RBA approach was adopted in 2003, AUSTRAC still is predicting the need to further evolve its policies and to develop its regulatory role in the AML legislative environment, which surely includes applying RBA in dealing with its reporting entities:

AUSTRAC's policies will evolve ... over time to reflect the growing experience of reporting entities and the regulator with the new legislative environment. In all cases AUSTRAC aims to create an environment of continuous voluntary compliance with the legislation it administers and to build cooperative relationships with its reporting entities.⁵⁷⁶

In fact, the actual scenario so far reveals that AUSTRAC does not deal with reporting entities equally and professionally, that is, in accordance with their level of risk, because AUSTRAC is thrashing about trying to apply RBA for a number of reasons: inexperience, unpreparedness, disengagement, and inadequacy in the response to the FATF guidance on RBA (detailed coverage below).

6.2.1.1 AUSTRAC's Lack of Experience and Capacity

AUSTRAC is still grappling with the nature of the diverse reporting entities' communities. This is reflected in AUSTRAC's uneven spread of policies and actions. AUSTRAC is not covering businesses that could pose a similar risk to an equal extent. According to one remitter's compliance manager, it is a matter of business entity size and power:

Basically, I believe AUSTRAC is concentrating on us (small remittance businesses) because they simply cannot go to one of the large financial institutions and say "Look, you are not complying", simply because they are weaker [when] taking an action against these businesses.⁵⁷⁷

However, another compliance officer interviewed, from a major Australian bank, was happy with the current situation regarding AUSTRAC's dealings with the reporting entities. She pointed out that AUSTRAC should not be under more pressure to change and improve itself because that would not give the desired result. She expressed a belief

⁵⁷⁶ AUSTRAC, *Policies* <<http://www.austrac.gov.au/policies.html>> 28 May 2011.

⁵⁷⁷ An informal talk with a compliance manager for one of the remittance services businesses in Sydney, during the ACAMS workshop entitled 'PCI Compliance', Sydney on 10 of May 2011.

that AUSTRAC needs time to do so as did the US FIU, FinCEN, and the UK's SOCA.⁵⁷⁸

However, AUSTRAC has been the FIU and regulator for about 25 years, and even if it lacked the necessary governmental resources to undertake that task effectively, it has been exercising regulatory responsibilities in the financial sector for that period. No one can predict to when AUSTRAC will overcome this difficulty, because it depends on AUSTRAC's efforts to get the required experience and capacity to 'think out of the box' when it find the balance between its role as the regulator and the FIU for the benefit for the AML system.

AUSTRAC has not got communicating the requirements for the superior implementation of the RBA principle under control. A senior manager in the Major Reporters team within AUSTRAC's Frontline Supervision area, in her presentation to the ACAMS group discussion 2010, spoke of the difficulties that reporting entities are having trying to understand the meaning of the RBA and how they should implement it in their work, despite having actively lobbied for it, and the difficulties that AUSTRAC faces in dealing with this issue.⁵⁷⁹ The AUSTRAC representative, four years after the promulgation of the AML legislation and a similar period of applying the RBA, was wondering 'whether lobbying for a RBA provided the outcome that the industry may have initially thought it would or if in hindsight it may have chosen more prescription?'.⁵⁸⁰ This might also show a problem with the policy development process as Government did not really know what it was agreeing to either.

⁵⁷⁸ Interview with Compliance Manager H, financial institution in Sydney, 16 September 2010.

⁵⁷⁹ ACAMS, *Evolution of the Risk Based Approach Discussion*, Sydney 19 August 2010<<http://www.acams.org/ACAMS/ACAMS/Archive/Communities/Chapters/Australasian/>> at 12 April 2011.

⁵⁸⁰ Ibid.

RBA remains a problem for both AUSTRAC and reporting entities, if the volume of quality (as compared to low quality) reports is to be taken as any indication. Where it appears to have begun to consider reports as being of high quality, the actual scenario is proving the opposite. The analysis of AUSTRAC publications revealed that it continues to receive significant volumes of low quality reports. Moreover, a response from one of AUSTRAC's Supervision Directors on the question of the quality of the reports received indicated a degree of variation in reports received in the basis of entity and report type. The Director responded that

[The short answer is] generally the quality is quite good. The longer answer is that, as you expect, we are regulating thousands of reporting entities and [that varies] ... a lot. With IFTIs and TTRs they are generally automated. When we do find errors in those sorts of reports, we would know that there is some sort of things changed or happened to the systems of the reporting entities which are so much complex businesses, and to my experience they are pretty active in fixing these problems. In terms of the SMRs, they are quite valuable and typically you find it high quality because the staff of the reporting entities were trained on that.⁵⁸¹

While another AUSTRAC Director pointed to the issue of low quality, she said that AUSTRAC is not the one who should follow up this matter. She noted that it is intelligence material that could help the enforcement bodies to achieve the investigation even with its low quality.⁵⁸² This reflects a situation where the quality issue is not regarded as a priority in AUSTRAC's work. She suggested that law enforcement bodies were the appropriate bodies to follow up with reporting entities in the event of a lack in the competence in the analysis by the reporting entities in specific reports to ensure that they obtain the additional information required to cover any shortfall in these reports:

From [an] intelligence perspective, it is also important to talk to law enforcement and say these reports it can use only for intelligence and there is a lack in the quality and they should not rely on it ... [I]f they really want to use it for

⁵⁸¹ AUSTRAC Director X, *ACAMS: Anti-Money Laundering & Proceeds of Crime: Laws & Counter Measures*, ACAMS Course held at the University of New South Wales (UNSW) 2 May 2011.

⁵⁸² AUSTRAC Director Y, *ACAMS: Anti-Money Laundering & Proceeds of Crime: Laws & Counter Measures*, ACAMS Course held at the University of New South Wales (UNSW) 2 May 2011.

evidentiary purposes they should go back to the banks or whoever to get the information [for] the brief of evidence, because if there is a data quality issue and they [are] relying on that financial intelligence there could be ... big trouble. ... [I]t is only intelligence. Data quality is an issue and law enforcement bodies need to use it as an avenue to know where to go to get further information.⁵⁸³

This is a strange admission, as this Director believes that the law enforcement bodies should not have to follow up on the overall matter of low quality reports because this is the FIU's task to ensure quality reporting as it collects and analyses the information before disseminated reports to the law enforcement bodies. Indeed AUSTRAC has put a great deal of effort into data quality but to them this is simply a matter of the accuracy of the reported facts. (This effort has been referred to in its annual reports.)

Continuing questions from reporting entities on RBA boundaries/interpretation and AUSTRAC's lack of adequate response indicate a persistent deficiency in AUSTRAC's experience and perhaps the methodology adopted by the regulator and its reporting entities in their operations. If RBA has failed to achieve the regulatory goals set for it and more prescriptive amendments are required to clarify its operations, this would confirm this observation.

6.2.1.2 Australia's AML System was not ready for the Risk-Based Approach

As shown in Chapter 3, RBA is clearly FATFs' preferred approach; however its choice is a discretionary decision for countries. The FATF Recommendations, and particularly Recommendations 5, 6, 8, 20, 23 and 24 from a regulatory and industry perspective, and Recommendations 9 and 15 from a risk management perspective,⁵⁸⁴ have left the door open to countries to choose the way that best suits their system to regulate the process of combatting ML crimes. Countries can choose their own regulatory framework, whether from the regulator ('Rule Based Approach') or from the regulated ('RBA').

⁵⁸³ Ibid

⁵⁸⁴ FATF, *The 40 Recommendations*, above n 129.

Although FATF does issue Guidance Documents to assist those governments who do choose to adopt an RBA, again these are not prescriptive. It remains a country's decision as to how its RBA is implemented.⁵⁸⁵

Australia took the decision to build its AML system on the RBA through the *AML Act 2006*. It was one of the leading countries in applying this approach, which was to be followed by both reporting entities and the regulator.

However, the application of the RBA in the Australian jurisdiction has experienced many difficulties in its application even after 5 years. This has revealed that the decision to adopt the RBA has been poorly thought out. It was a result of industry lobbying when they did not like the prescriptive approach in the early drafts of the post FATF 2003 Recommendations. AUSTRAC would clearly have preferred the adoption of a Rule Based Approach, as did the Attorney Generals Department.⁵⁸⁶ This was demonstrated by the way the original draft of the Australian AML Act 2006 was turned around.⁵⁸⁷ The RBA approach was effectively foisted upon it, and then the entity has to effectively run with a less desirable (from their viewpoint) option. Thus, both parties required a preparatory period to fully understand their obligations under this approach and to understand each other more before applying it. It cannot therefore be a surprise that they encounter difficulties in administering a scheme that was not their own first choice. The difficulties may reflect the reasons for their own initial recommendation of a Rule Based Approach.

⁵⁸⁵ FATF, *FATF Report: Risk-Based Approach. Guidance for the Life Insurance Sector*, above n 220, 5–6.

⁵⁸⁶ Australian Bankers Association, *Revised Exposure Draft Anti-Money Laundering and Counter Terrorism Financing Bill and Rules* (2006) 2.

⁵⁸⁷ *Ibid.*

For Reporting Entities

Reporting entities faced a big challenge when the *AML Act* required them to move to the RBA, because they had to more closely scrutinise financial transactions to verify the potential risks, and also fund their compliance costs. The new system gives reporting entities greater room for flexibility as to how they achieve the above goals. Thus a number of reporting entities indicated that they were applying less resources to the lower risk transactions; and conversely, the more resources to the transactions identified as posing greater the risks within their AML program.

One of the reporting entities interviewed stated that she believed that RBA is a far better approach. While the value of RBA may be ‘less certain ... it also produces high standards over time’.⁵⁸⁸ She explained:

[T]he rule based approach will be the ‘best rule for today’ and everyone has a rule for today. ... [RBA] is the best practice. If you look into the compliance framework 20 years ago and set rules around what it should look like [as compared] to what they look like today, it is ... very different[ly] based.

[I]f you take a very prescriptive approach to rules, what you will ... get [is] a minimum approach to compliance because this is what it specifically says, whereas [in RBA it] is always on the organisation to ensure it is [an] appropriately based system; ... there ... [are] systems and processes, ...always [having] to change and improve, their [RBA] will have to improve too

I think the outcomes approach of Australian regulation is far more effective than prescription.⁵⁸⁹

However, the new system places greater burdens on regulated entities. FATF itself concedes that ‘a properly applied risk-based approach does not necessarily mean a reduced burden, though it should result in a more cost effective use of resources’.⁵⁹⁰ The burden is not always financial. According to a number of reporting entities interviewed, RBA continually presents a dilemma in that they always need an explanation, especially

⁵⁸⁸ Interview with a Compliance Manager A, above n 504.

⁵⁸⁹ Ibid.

⁵⁹⁰ FATF, *FATF Report: Risk-Based Approach. Guidance for the Life Insurance Sector*, above n 220, 6.

as they have to apply it to both customers and their transactions. One compliance manager interviewed stated:

Transactions and the customers are quite distinct sets. ...[I]n managed investments, looking at the transactions it is quite a challenge ... unique to managed investment schemes.

In respect of dealing with the customers, well basically it is just legislative common sense. Once upon a time you would perform [CDD] ... because you wanted to know who you were dealing with. So it is really fairly old business practices that were reasonably common business practices. So looking at the type of client that you are dealing with... that is not so much of an issue.

The issue then comes around looking at the transactional activity, ... [T]hey're quite different beasts, they're related but different.⁵⁹¹

The monitoring and the reporting systems adopted by reporting entities will be affected by their attempts to address RBA and the concept of high quality reports to which AUSTRAC needs these entities to commit. Reporting entities must also understand their own risk and their customers via an OCDD process, remembering that they can only look at the transaction in the context of the customer.

AUSTRAC not only has to follow up and supervise the application of this obligation with the reporting entities — especially as the RBA is not that dissimilar from their actual risk assessment that these reporting entities carry out generally to face the risk of a product, customer, jurisdiction and delivery —it an obligation to improve its own performance, examine its shortcomings and find correct solutions.

For AUSTRAC

Following the implementation of the *AML Act* in 2006, AUSTRAC had a year to implement the role developed under the new system. However, the enhanced responsibilities of AUSTRAC have created challenges despite, or perhaps because of, the strengthening of its function. AUSTRAC made huge changes when it received

⁵⁹¹ Interview with Compliance Manager D, above n 503.

specific resources in order to adapt to the new situation. It considered modifications at managerial level, created a centre for additional new staff, and increased the number of AUSTRAC executive staff and employees to handle this new era,⁵⁹² but it could not strike a balance between its two main roles: that of an FIU and that of regulator. The problem seems to persist, again reflecting its lack of experience. For example, it sets unrealistic expectations regarding response times to documents issued for comment and their frequency. According to one reporting entity interviewed:

It is a constant frustration, ... [At] least they issue the rules out for commentary, but often not a lot of time ... often every two weeks, but one,... they issue[d] it on Christmas evening and then left. ... this [is] going to change the whole banking system because basically it was bringing into the clearing system every superfund, — ...I said, “I do not think they put this through” ... And ...they have issued it; then it was ...due ...when everyone was still on leave!⁵⁹³

In this regard, a number of respondents made a comparison between regulator effectiveness of AUSTRAC and ASIC, in which ASIC is regarded as having a better understanding of regulated entities. ASIC is noted as having a better feedback mechanism, which some said is why it has more enforcement power than AUSTRAC regarding compliance. A compliance manager stated:

So basically we're starting to increasingly act more like ASIC, but we're not really getting the regulatory guide material in quite the same way from AUSTRAC as ASIC puts out. I mean ASIC is quite categoric[al]: “This is how we interpret the law”, whereas AUSTRAC is guidance and “this is how” and “well, we don't want to tell you how to think about it because well that's your business”.⁵⁹⁴

It appears that this is because no one in AUSTRAC is prepared to commit themselves to a view which the courts might not accept. It also reflects the regulated entities' preference for greater direction, more rules, and particularly, more and higher quality

⁵⁹² Neil Jenson, former AUSTRAC CEO, ‘AUSTRAC Gears Up for New Role’, *Risk Management Magazine*, 17 July 2007 <<http://www.riskmanagementmagazine.com.au/articles/6a/0c04e36a.asp>> at 21 May 2011.

⁵⁹³ Interview with Compliance Manager A, above n 504.

⁵⁹⁴ Interview with Compliance Manager D, above n 503.

feedback delivered in a timely manner. Another compliance manager pointed out that AUSTRAC needs to ‘learn to do this better’. She stated:

[T]here are regulators around that do it well ... I think there is going to be an element of trust that we want to do the right thing ... [and] comply with law, ... [I]f the regulation is efficient, we get good feedback, we can implement it efficiently...⁵⁹⁵

Dialogue is a key ingredient, she maintains.

We need that dialogue, you still get the same outcome, and it works much better because ... our processes operate this way, and that is why ASIC is very good because they can see what you are getting to is nearly the same position and that you do not need to [be] hardcore in this way, and that is why dialogue with the regulator is very important, it actually produces more efficiently ...⁵⁹⁶

But she also points to examples of what she viewed as unviable demands:

[A]nd if you cannot implement it then people just do not! ...[S]ome recent legislation that the government has issued that is in ... not implementable! ... [I]t just assumed that all superfunds are identically ... but they are not. It is sort of [the case] that the regulator must be more flexible in that listening and dialogue.⁵⁹⁷

One more difficulty that AUSTRAC has faced is the large amount of data that it received and is still receiving from reporting entities in the fulfillment of their obligations.

If AUSTRAC wants to achieve its three new strategies, then it should take into consideration all of the above issues, because:

- a) *To be an effective FIU*: In order to achieve the aims embodied in its intelligence and enforcement strategies, AUSTRAC needs better intelligence skills and an enforcement mechanism whose various sanctions are actively used against non-

⁵⁹⁵ Interview with Compliance Manager A, above n 504.

⁵⁹⁶ Ibid.

⁵⁹⁷ Ibid.

compliant reporting entities, no matter what their size, the power of these businesses or the type of services provided.

- b) *To be an effective regulator*: It must have a close relationship with the reporting entities industries, understand them, interact with them on an equal basis, and be alongside them with rigorous supervision in order to achieve the aims of the supervision strategy.

But if the current situation persists, then these strategies will not achieve their targets. They will be considered as AUSTRAC publications rather than effective strategies.

The adoption of a RBA is a great achievement; however, to move to the adoption of RBA, both reporting entities and regulator needed to be well-prepared. Both were not sufficiently prepared, which makes it difficult for AUSTRAC to improve its performance easily and sometimes forces AUSTRAC to take some less effective regulatory decisions, and for the reporting entities to continue to struggle with AML issues, especially the reporting obligations.

Regulating alternative remitters is important; however, other businesses (including the large ones) should not be forgotten. AUSTRAC RBA has to be more accurate and take into consideration the real risk from every side.

This leads this thesis to expose the existence of disengagement between the reporting entities and AUSTRAC in terms of the AML system in general and RBA in particular.

6.2.1.3 Disengagement in the Relationship between AML Parties and the RBA

The thesis found disengagement between AML parties regarding the AML system which is an obstacle to improving the system and the RBA.

- 1 As shown in Chapter 3, the FATF recommendations which are used as a benchmark for regulating systems for AML purposes, have a number of question marks regarding the way in which a system is planned and functions on the basis of a rule based approach rather than an RBA. It has been clear that reporting entities are still having difficulties with different aspects, including the beneficial owner aspect in regard to its definition. The ‘one size fits all’ regime with which FATF followed in its recommendations adds burdens on both levels; the regulatory level (including AUSTRAC) and reporting entities’ level. This leads to disengagement between these parties.
- 2 Reporting entities interviewed still do not agree on a single aim as undergirding their compliance with the AML regime, rather they have two different aims undergirding their level of compliance, namely threat reduction and avoiding regulatory sanctions. The overall tenor of most responses indicates that threat reduction (such as reducing instances of systems compromise, fraud and so forth) on one’s own organisation (rather than system-wide) is an outcome that reporting entities are taking into consideration when complying with the Act. Avoiding sanctions (such as fines) is not major goal when they consider the AML compliance issue, and reflects AUSTRAC’s weak enforcement mechanism and problems with RBA.

RBA should give the reporting entities the flexibility to deal with risk. Thus, — in a healthy risk based system — it could play a vital role in achieving the desired level of compliance; but if the goal of threat reduction is regarded as more important (more likely among some entities than others) than the goal of avoiding regulatory sanction, then this reflects a disconnection in understanding the RBA

and its outcomes. If AUSTRAC understood the reason for the level of reporting entity compliance, this could prompt change and make this system more effective. Nevertheless, it seems that AUSTRAC does not use its enforcement powers (perhaps unsurprising, considering all the difficulties that it faces in imposing such sanctions) to try to build the Australian financial system on the basis of a goal of threat reduction. However, it does not work this way, because the reporting entities community is still trying to create a healthy risk-based system.

- 3 This disengagement could emerge also through the different interests that AML parties have when regulating for AML. As shown previously in this thesis, AML parties have different interests when it comes to the AML system. An AFP officer notes:

AFP is mainly an investigative Commonwealth agency ... one of many Commonwealth agencies in partnership with AUSTRAC in utilising AML reports for intelligence purposes — ...an incredible intelligence database. AFP is not involved in AML compliance issues; however, we do come across cases that evidence non-compliance. Some of the more serious cases are reported to AUSTRAC.⁵⁹⁸

However, one of AUSTRAC's Directors indicated that:

[In their] investigations role through reporting entities, [law enforcement bodies] ...can draw [conclude] that ... reporting entities do not report to AUSTRAC or do not comply [as] they should ... [T]his is what law enforcement ... [refer] to us, but it still early days ...I am sure there is a lot more than what the law enforcement people can cover.⁵⁹⁹

The ACC in its 2011 Report 'Organised Crime in Australia' indicated the need for collaboration between all parties.

⁵⁹⁸ Email from an AFP officer (when author was seeking permission for interview with an AFP officer), 13 August 2010.

⁵⁹⁹ AUSTRAC Director X, *ACAMS: Anti-Money Laundering & Proceeds of Crime: Laws & Counter Measures*, above n 581.

While this report cannot provide the same level of detail as the classified version, it still clearly presents the disparate activities that make up the picture of organised crime in Australia. ... it illustrates why an effective response to organised crime increasingly requires collaboration between many stakeholders — all levels of government, law enforcement agencies, public and private sector agencies, academic institutions and the public⁶⁰⁰ ...

Collaboration will help develop better response strategies that combine the strengths of operational law enforcement activity, regulatory and legislative change and community involvement. Partnerships between law enforcement, industry specialists and governments will offer Australian law enforcement the skills and tools it needs to further improve crime fighting capabilities.⁶⁰¹

This applies to AML activities. Any disengagement and lack of trust between these parties will impede their AML efforts and AML system goals.

6.2.1.4 Inadequacies in the Response to the FATF Guidance on the RBA for AML/CTF

In June 2007, FATF issued its *Guidance on the Risk-Based Approach to Combating Money Laundering and Terrorist Financing*, followed in 2008 and 2009 by a set of guidance documents for a number of non-financial designated businesses and professions (as detailed in Chapter 3).⁶⁰²

FATF's 2007 Guidance Document put in place six important rules for countries for the adoption of RBA:

- 1 Financial institutions and regulators should have access to 'reliable and actionable information about the threats'.
- 2 Cooperative arrangements among the policy makers, law enforcement, regulators, and the private sector must be emphasised.

⁶⁰⁰ ACC, *Organised Crime in Australia* 2011, above n 572, 8.

⁶⁰¹ Ibid 96.

⁶⁰² For more details, see Chapter 3.

- 3 Authorities should publicly recognise that RBA will not eradicate all elements of risk.
- 4 Authorities have a responsibility to establish an environment in which financial institutions need not fear regulatory sanctions where they have ‘acted responsibly and implemented adequate internal systems and controls’.
- 5 Regulators’ supervisory staff must be well-trained in RBA, as applied by both supervisors and financial institutions.
- 6 Requirements and supervisory oversight at the national level should be consistent among similar industries.⁶⁰³

When one takes the FATF rules and use them to reflect on the analysis (above) of the Australian AML scenario with its RBA, the results are disappointing:

- 1 The regulators (including AUSTRAC) are focusing on reducing the harmful influences of ML activities and supporting the reporting entities in reducing such damage. Regulated entities are focusing on controlling regulatory risk related to their AML system where failure to do so may result in regulatory sanctions.

As the first two FATF Guidance rules (above) encourage both regulator and regulated to have the ability to access useful (‘reliable and actionable’) information about threats (Rule 1) and to have cooperative arrangements among policy-makers, law enforcement, regulators, and the private sector (Rule 2) in order to achieve the best practice for the principle of RBA, and consequently the

⁶⁰³ FATF, *Guidance on the Risk-Based Approach to Combating Money Laundering and Terrorist Financing (High Level Principles and Procedures)*, above n 140, 10.

best outcomes, it is necessary for all those parties in the AML regime to share a common purpose.

However, this thesis showed that the current scenario reflects a situation where the AML parties lack a common purpose or approach for regulating the system in the manner it should be regulated.

Reporting entities see themselves as having a limited role in the regulatory system with a minimum (or just slightly above) level of AML risk awareness within their own businesses, though there are some exceptions:

In most cases, we go above the minimum legal requirements so as to have a consistent global minimum standard. Our program was developed in Australia through close consultation with the industry.⁶⁰⁴

On the other hand, partner agencies (as shown previously) see themselves as separate from the AML system. For them, AML is not a major aim or purpose. Their desire is more to achieve a higher level of compliant behaviour in their areas of interest. In addition, AUSTRAC is working away from, or a largely independently of, the reporting entities and not fulfilling the role of an effective regulator but rather assuming the mantle of a tough FIU. As one interviewee commented:

I think it is because they came from a different background. They [AUSTRAC] are suspicious of everybody ... you get a sense ... that changed over time but ... a level of suspicion around the organisations they are dealing with [persists]I ... [I]t is almost [as if] I [a reporting entity] cannot see that they [AUSTRAC] help us so we can do better so we can detect stuff that helps them.⁶⁰⁵

Therefore, a common purpose is hampered by a lack of trust between AUSTRAC, its partner agencies and reporting entities.

⁶⁰⁴ Interview with Compliance Manager F, above n 555.

⁶⁰⁵ Interview with Compliance Manager A, above n 504.

- 2 Rule number 5 encourages the regulator to have a well-trained staff in terms of AML and the RBA as practised both by the regulator's supervisors and by reporting entities. However, this thesis has found that there is a lack of staff training in both AUSTRAC and the reporting entities. Regulatory staff training and knowledge of RBA processes is asserted as part of an all-embracing perception of the ML risks faced by regulated entities. AUSTRAC cannot achieve the goal of a well-trained staff until it better understands ML, the nature of reporting entities and their risks. Without regulatory staff well-versed in the practices of these entities, the reporting entity staff will also suffer from a lack of awareness of their AML role, the threat or risks faced, as their search for guidance and knowledge of optimum practices is hindered and whose practices are, therefore, hampered or inconsistent even across industry sector.

AUSTRAC has tried to provide an online training program to the reporting entities — an e-learning facility⁶⁰⁶ to provide these entities with sufficient training to deal with ML risks.

Nevertheless, the responses on this matter were diverse and ranged from those who see this as a comprehensive source of adequate material to train reporting entity staff and find the cost of the training programs acceptable (when free), to those who sees it as providing material which merely adds greater ambiguity to the RBA and the AML system, and find the cost of additional training contributes to the difficulty. One reporting entity commented:

Every employee within the probation period (the first three months) is required to complete the basic AML training, which is available ... at AUSTRAC website

⁶⁰⁶ See AUSTRAC e-learning website <<http://www.austrac.gov.au/elearning/index.html>> at 7 June 2011.

(AUSTRAC e-learning) facility ... We are quite happy with it (training costs). Actually it is not a ... burden for us, and our institution can handle it easily.⁶⁰⁷

A number of those entities who were supportive of the AUSTRAC e-learning model were found to be under ongoing and external compliance assessment from AUSTRAC, which means that such entities do need more training and preparation for compliance than other entities. The entities under an external compliance assessment surely cannot then be viewed as already well-trained and having the 'know how' to deal with the risk and comply with the Act and the Rules, but rather in the process of being trained.

Those compliance managers who are happy with the current training program and do not complain about the costs of AML programs may be those who do not wish to add to their training burden. If AML training was to become more comprehensive and systematic, they may fear that this would probably add to their costs and impose more responsibilities on them.

We recently have been under compliance assessment from AUSTRAC with external assessment, so what ... they have sent a list of questions and required documents that we have sent through.⁶⁰⁸

Other respondents expressed an opposing viewpoint. For example, one compliance manager⁶⁰⁹ indicated that not all reporting entities were able to provide effective staff training, because the online training (including AUSTRAC's e-learning facility) was focused on the banking sector rather than covering the different reporting entities' sectors. The respondent noted that AUSTRAC uses it as a 'one size fits all' approach; however, this may not suit a

⁶⁰⁷ Interview with Compliance Manager E, above n 554.

⁶⁰⁸ Ibid.

⁶⁰⁹ Interview with Compliance Manager D, above n 503.

reporting entity group's particular circumstances. This 'banking focused' model, for example, does not assist managed investment schemes businesses. These lack the bank sector's 'face-to-face' customer relationship.

A lot of the training that is available out there ... is very bank focused ... a very nice overview ... to become familiar with the terminology ... [T]he most frustrating thing ... [is that] it is very hard to have very structured training by virtue of the fact ... that ... it is the nature of the financial product and part of the financial services niche that this business occupies that really makes it [what it is]. Training actually has to be done, probably as much, if not more, in-house ... The only examples I have got of real world examples [are those] that we deal with [in] the business.⁶¹⁰

The same compliance manager indicated that:

[As] a lot of online training is very bank focused ... there is lot stuff in respect [to] cash. Well, if you do not see cash, then those scenarios really do not assist [your] knowledge ... [T]his includes the AUSTRAC website ... [O]n a day by day basis we're hearing how much money is being thrown ... into the superannuation system. And yet there is very little [material]... [T]hey have all said to a lot of people who are self managed super fund owners and ... invest in managed schemes. ... [T]he focus starts to come around, but no one actually really thought of how you convey that in training materials.⁶¹¹

This respondent also sees training program costs as high, especially when time lost from work is taken into account. This compliance manager (among others)⁶¹² also noted that most online training programs provide less materials for the large number of reporting entities who do not deal in cash and lack a face-to-face customer relationship; and the cost in time and money of inadequate and largely irrelevant training obtained elsewhere can be significant.

We ... cannot [achieve] ... cost efficiencies: because they [AUSTRAC] just do not have enough relevant material, to justify the expense. ... [T]hen there is [also the] work I could be doing for the business that I am not doing, because I actually have to train. So is there a cost to the business There is lost time, from my other

⁶¹⁰ Ibid.

⁶¹¹ Ibid.

⁶¹² Interview with Compliance Manager A, above n 504.

tasks in respect of that particular task, because, as I said, you cannot really and reasonably purchase, [at] a reasonable price, training assistance.⁶¹³

The same compliance manager indicated also that alternative providers were equally unsatisfactory:

We have an online learning provider ... who provides other compliance programs (for example... [OH&S], privacy, bullying, harassment ... , compliance programs), ... [W]hen it came to ... money laundering ., they were quite happy to adapt it for us, but at a significant cost...the other programs are quite reasonable ... but when it comes to this, I have actually had to say, “We have to go through that particular scenario, because that is the way the system is geared, but it is not relevant people.” [I]n order for them to successfully complete the unit, they have to listen, but there is no real value in the knowledge gained, because it is not directly applicable to their day to day tasks in this business.

However, it is not just AUSTRAC’s responsibility to clarify the issues of dealing with the *AML Act* and to increase understanding of the RBA. Reporting entities should put more effort into securing the right training programs, ones that could build their employees understanding of their AML role, especially for those entities more reliant on online training, which are clearly inadequate. More directed, comprehensive and relevant training in person to the employees and those at management level is so important.

According to Professor John Broome:

Through my long experience in the field of AML (for about 30 years), I found reporting entities do not apply the right and systematic training for their staff [with the] ... aim to build their understanding of their role in this field. Most of their training programs are only addressing general issues in terms of combatting money laundering crimes, and on very ... [few] occasions they would go deeply into this domain.⁶¹⁴

- 3 In regard to Rule number 4, which calls on authorities to create an environment in which financial institutions need not fear regulatory sanctions where they have

⁶¹³ Interview with Compliance Manager D, above n 503.

⁶¹⁴ A meeting with Professor John Broome, Centre of Transnational Crime Prevention, Faculty of Law, University of Wollongong, 9 March 2011.

‘acted responsibly and implemented adequate internal systems and controls’, the fact remains that a number of respondents argued for the role of sanctions and penalties to achieve the required common purpose among AML parties and encourage strict compliance.

One response (from a representative real estate agent) argued that the enforcement provisions can make reporting entities concentrate on sanctions rather than focusing on participating in a national undertaking to guard the financial system’s integrity.

AUSTRAC needs to give a hand to the reporting entities to comply with the AML system through enough feedback, and this it will not achieve through concentrating on the enforcement and penalties, because that will drive businesses to comply with the major rules in [the] AML system and then the risk based approach will not be working effectively.⁶¹⁵

Others maintained that enforcement is fundamental in order to secure the amendment of non-compliant behaviour, and most effective enforcement powers are necessary for a breach of regulatory rules. For example, an accountant argued that while AUSTRAC’s educative processes have a central role as:

⁶¹⁵ Interview with Real Estate Agent C, a real estate agency (Sydney, 21 June 2010).

People have to understand what the legislation says and requires of them. It's very important for the community to understand what they should do ..., and then they can comply.⁶¹⁶

Nevertheless, he urged the use of regulatory sanctions.

I believe that AUSTRAC should be tough and active, by showing its teeth and [its] ability to take action [in the event of] ... non-compliance.⁶¹⁷

A banking sector respondent noted:

[I]t is not easy to say whether the enforcement actions taken to date have been effective in deterrence. We are certainly aware of the powers of AUSTRAC when it comes to enforcement ... We, as an industry, are aware that the enforcement powers can be very effective and costly, and therefore work to ensure we are compliant with the requirements.⁶¹⁸

In a jurisdiction like Australia which has built its AML system on RBA, the level of compliance is the outcome of understanding and applying the RBA. The most effective enforcement mechanism and powers used by AUSTRAC are an element that will enhance compliance, especially at this stage when Australia still does not have an effective RBA. Thus, the need for the goal of 'avoiding sanctions' as a motivating factor to undergird compliance by reporting entities is important until the AML parties get together on one goal for the AML system which is the 'threat reduction' goal.

Overall, the evaluation of the outcomes that are generated by an understanding and application of the RBA is the benchmark that reflects the effectiveness of the Australian AML system in regard to the RBA.

⁶¹⁶ Interview with Accountant G, a financial institution (Sydney, 15 July 2010).

⁶¹⁷ Ibid.

⁶¹⁸ Interview with Compliance Manager F, above n 555.

Accordingly, AUSTRAC's outcomes are not reflected in a noticeable increase in compliance levels. The continued difficulties for both reporting entities and AUSTRAC with RBA are an indicator for that. It also indicates the limited benefits — in terms of increasing the compliance level — that the AML system could gain from the greater utilisation of the AUSTRAC enforcement mechanism.

AUSTRAC has not established an environment in which reporting entities believe that they need to comply because of the need for overall threat reduction; neither has it established an environment where reporting entities need not fear regulatory sanctions where they have acted responsibly and implemented adequate internal systems and controls. It also seems that the use of the enforcement powers so far are not sufficiently mature to enforce compliance in general nor in those matters related to reporting obligations specifically.

6.2.2 AUSTRAC Enforcement Powers Still to Fully Mature

It has been clear that there are a very limited number of cases where the enforcement powers have been exercised by AUSTRAC, as is evidenced through the typology reports for the years 2007 to 2010 and those powers were not mature enough to enforce compliance.

6.2.2.1 Enforcement Powers of AUSTRAC for 2006–2011

AUSTRAC has utilised its enforcement powers a number of times since it started to operate under the AML Act on 12 December 2006 until the time of writing this thesis in 2011. These powers range from warning letters, enforceable undertakings, and remedial directions, to removal of non-compliant entities from register of providers of the designated remittance services. See Figure 12 (below).

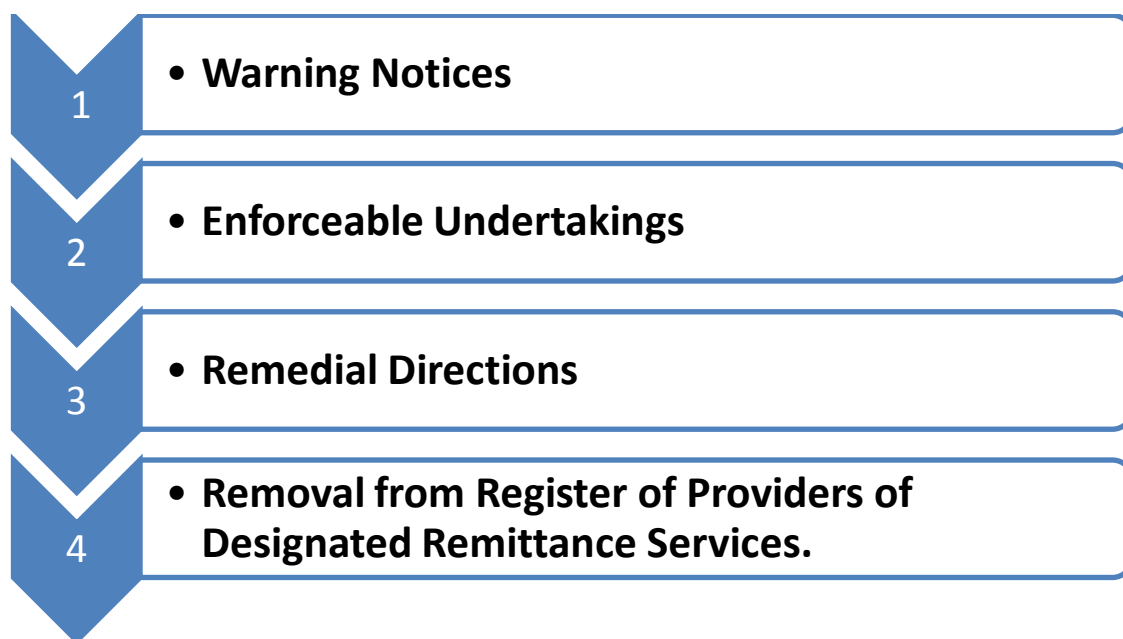


Figure 12: AUSTRAC's Powers of Enforcement until 2011⁶¹⁹

According to the AUSTRAC website (as at 9 June 2011), AUSTRAC has issued:

- 1 Warning Notices: In 2010, AUSTRAC issued 6 warning notices for a number of breaches at 6 branches of George Thomas Hotels Pty Ltd, and 1 warning letter to Argos Investments Pty Ltd.⁶²⁰
- 2 Enforceable Undertakings: In 2009, AUSTRAC issued 4 enforceable undertakings, namely: Barclays Bank, Eastern & Allied Pty Ltd trading as Hai Ha Money Transfer, Mega International Commercial Bank Co and PayPal Australia Pty Ltd. In 2010, it issued 6 enforceable undertakings, one to each of 6 branches of George Thomas Hotels Pty Ltd, and 1 to Argos Investments Pty Ltd.⁶²¹

⁶¹⁹ AUSTRAC, *Enforcement Action*<http://www.austrac.gov.au/enforcement_action.html> at 9 June 2011.

⁶²⁰ *AML Act 2006* (Cth) s 162(2). See also AUSTRAC, *Warning Notices*<http://www.austrac.gov.au/written_notices.html> at 27 March 2011.

⁶²¹ *AML Act 2006* pt 15, div 7, above n 75. See also AUSTRAC, *Enforceable Undertaking*<http://www.austrac.gov.au/enforceable_undertakings.html> at 27 March 2011.

- 3 Remedial Directions: In 2009, AUSTRAC issued remedial direction for Little Persia. In 2011, AUSTRAC issued a remedial direction for Allsafe International Pty Ltd.⁶²²
- 4 Removal from Register of Providers of Designated Remittance Services: In 2010, AUSTRAC issued a decision to remove Thi Kim Hong Tran Company from the AUSTRAC Register of Providers of Designated Remittance Services. In 2011, AUSTRAC issued a decision against Cyril Ihemeje.⁶²³

6.2.2.2 Case Study: AUSTRAC's Enforceable Undertakings

Even with the limited enforcement powers that have been exercised by AUSTRAC against non-compliant reporting entities, the powers that have been used were sufficient. Warning notices sent by AUSTRAC to the George Thomas Hotels, and Argos Investments Pty Ltd did not have the desired effect and they faced enforceable undertakings. Neither warning notices nor AUSTRAC's educative efforts achieved their goal, namely compliance. One wonders whether these entities did not believe in AUSTRAC willingness to utilise its powers of enforcement or whether it was a matter of complex situations that could not be addressed by warning letters. AUSTRAC needs to consider these matters, as the efficient enforcement mechanism need an effective regulator that ensures close supervision of reporting entities with different levels of risk.

Looking at the enforcement mechanism most frequently used by AUSTRAC, that is, the enforceable undertakings (imposed in 2009 on Barclays Bank, Eastern & Allied Pty Ltd trading as Hai Ha Money Transfer, Mega International Commercial Bank Co, PayPal

⁶²² AML Act 2006pt 15, above n 78. See also AUSTRAC, *Remedial Directions*<http://www.austrac.gov.au/remedial_directions.html> at 27 March 2011.

⁶²³ AML Rules [44.2]. See also AUSTRAC, *Removal from Register of Providers of Designated Remittance Services*<<http://www.austrac.gov.au/rpds.html>> at 27 March 2011.

Australia Pty Ltd) it is possible to observe the immaturity of AUSTRAC enforcement mechanism.

It has been clear that AUSTRAC has relied on this type of enforcement power and used it in accordance with its enforcement policy to accomplish a number of aims:

- 1 To serve as an alternative sanction on non-compliant reporting entities (rather than allowing them simply to pay fines for breaching the *AML Act*).
- 2 To impact on other reporting entities in the same sector, by creating fear of reputational damage to non-compliant entities.
- 3 To push reporting entities in different sectors to comply with the *AML Act* and the Rules when they see that AUSTRAC active in this domain.

These enforceable undertakings are, of course, generally applied in an ascending order of severity if the offending behaviour does not cease. It is therefore logical that AUSTRAC has issued warning notices and applied enforceable undertakings more frequently than other types of sanctions available to it.

The question remains to what extent and in what circumstances can the ‘enforceable undertaking’ be categorised as a most effective sanction for non-compliance?

An enforceable undertaking, as one of AUSTRAC’s enforcement powers, faces limits to its level of effectiveness. This can be found by examining its use by AUSTRAC.

- 1 AUSTRAC has gone too far by using the enforceable undertaking as a benchmark sanction, rather than applying (for example) civil penalties on non-compliant reporting entities that are also available to it; and, civil penalties are as important for the regulatory enforcement mechanism as the enforceable undertakings.

- 2 AUSTRAC procedures for the application of enforceable undertakings are to notify the non-compliant reporting entity of its non-compliance in breaching the Act or the Rules, which might involve public acknowledgement of these breaches. AUSTRAC then needs to decide whether it is ready to accept the enforceable undertaking in the form offered by the non-compliant reporting entity.

However, AUSTRAC's experience with enforceable undertakings reveals some facts that reduce its effectiveness as a sanction to enforce compliance. AUSTRAC needs to establish the non-compliant status of the reporting entities on the actual breach committed. Nevertheless, in some of the enforceable undertakings AUSTRAC failed to provide sufficient information about that matter to non-compliant reporting entities. For example, the Barclays Bank enforceable undertaking reflected deficiencies in the information about the type of the breach and in the level of communication between Barclays Bank and AUSTRAC during the period when AUSTRAC discovered the breach in relation to Barclay Bank's failure to submit the required reports for significant cash transactions and ITFIs. The same occurred in regard to the enforcement undertaking between AUSTRAC and Mega International Commercial Bank Co; but, unlike the first two instances when the entities' interaction with AUSTRAC about their non compliance behaviour was unclear, this was not the case in relation to the third enforceable undertaking between AUSTRAC and PayPal (nor in other subsequent enforceable undertakings). AUSTRAC clarified the matter in its communications with PayPal

in February, April and May 2008. This provision of clearer information illustrates the benefits of AUSTRAC's growing experience.⁶²⁴

- 3 The RBA is creating great difficulty for AUSTRAC when it uses enforceable undertakings to enforce the reporting entity compliance with reporting obligations. For instance, a reporting entity could see itself as a low or medium risk but AUSTRAC sees it as a high risk, one that deserves the imposition of an enforceable undertaking when non-compliance has occurred. Questions remain regarding AUSTRAC's confidence in its RBA assessment and that of that reporting entity on the level of the risk in the particular instance. Regulating the reporting entities 'from a distance' and doubts about AUSTRAC's own use of RBA risks reducing system-wide confidence. One of the compliance managers interviewed again first unfavourably compared the RBA-based AUSTRAC with its fellow Australian regulator ASIC. The compliance manager also indicated that the AML Act with its RBA makes the debate between AUSTRAC and the reporting entities about the level of the risk harder, and AUSTRAC does not help:

ASIC has the Corporations Act that says "You will or you must not" it is quite categorist. Whereas the AML/CTF Act is a little bit more — if not principled based — risk [based]. You know the business that you are in. You have done a risk assessment. Our risk assessment says, "We are going to do nothing" — we have done nothing and our risk assessment to show that. ...AUSTRAC then turns around and goes, "Well we are not satisfied with that." So retrospectively they are coming around and saying, "Hang on a tick, that is not how you should be reading the Act." So my question is to AUSTRAC: "If we should not be reading it that way, give us more definitive material to tell us how you would like us to read it." ... [Yet] [h]ow many sound bites have you got off AUSTRAC: "You know your business best"; "You are in the best position to know your risks". Yet they are quite happy to come in and say, "Well, that is not sufficient," I do not think they know it [RBA] themselves.⁶²⁵

⁶²⁴ AML Magazine, 'PayPal's Mojo Takes a Regulatory Hit' *Anti Money Laundering Magazine* (December 2009) 7.

⁶²⁵ Interview with Compliance Manager D, above n 503.

4 The difference in services that reporting entities provide, especially those with online services, adds to AUSTRAC's burden when it has to apply the enforcement undertakings on these entities when they are non-compliant. 'PayPal'⁶²⁶ was one such business that gave an enforceable undertaking to AUSTRAC because it had shortcomings in three important aspects: its OCDD system, procedures for meeting reporting requirements, and the RBA system.⁶²⁷

AUSTRAC imposed an enforceable undertaking on this entity because PayPal did not have a system able to evaluate these accounts, especially new ones. It had six months to complete its remediation requirement, including changing its own system (valid in US) to suit the Australian requirements. It also had to appoint independent experts to examine its remediation achievements within two months.

The situation regarding enforceable undertakings is even more difficult when it involves institutions that operate in different jurisdictions and under differing AML legislation. PayPal is a case in point, especially given that its higher level of the privacy for on-line transactions resulted in its being 'highly commended' in the 'large business' category of the 2009 Australian Privacy Award of the Australian Privacy Commissioner.⁶²⁸ Admittedly, this award is related more to securing customers' ability to make transactions more safely (without exchanging personal and financial information with the seller and thus helping guard their accounts against identity theft and other

⁶²⁶ See PayPal, *About Us* <<https://www.paypal.com/au/cgi-bin/webscr?cmd=p/gen/about-outside>> at 10 June 2011. Founded in 1998, PayPal is a large financial institution located in San Jose, California. It was acquired by eBay in 2002. It provides money remittance services, and one important method was 'eBay' where it was frequently used to sell and buy online. PayPal has received more than 20 awards for excellence from the Internet industry and the business community — most recently the 2006 Webby Award for Best Financial Services Site and the 2006 Webby People's Voice Award for Best Financial Services Site.

⁶²⁷ AUSTRAC, *Enforceable Undertaking [Paypal]* (2009) <http://www.austrac.gov.au/files/eu_paypal.pdf> at 10 June 2011, 2009, 2.

⁶²⁸ PayPal, *PayPal Commended in Australian Privacy Award*, 13 November 2009 <<https://www.thepaypalblog.com/2009/11/paypal-commended-in-australian-privacy-awards/>> at 10 June 2011.

fraudulent activities) than matters relating to AML and reporting transactions. However, PayPal is an attractive case in that it emphasises the difficulties that a great number of international financial institutions face in terms of the function of local AML legislation and its industry-wide internal strategy in non-domestic jurisdictions, and vice versa. It is an issue that needs an appropriate analysis because:

- Existence of regulatory differences: Each business operating in a number of jurisdictions has to identify differences between the ML systems of the jurisdictions and ensure that the parent institution in the first jurisdiction [has] no conflict with the Legislation and the Rules of the second jurisdiction.
- The enforcement powers of the FIU (AUSTRAC) and its privileges to control the AML system. Not all FIUs have the same privileges as AUSTRAC, that is, simultaneously being the FIU and the regulator and having been delegated under the relevant legislation to make rules. Unluckily, while there is overlap in AML legislation internationally, there is no 'one size fits all' approach, and this sometimes makes the decision to take the enforceable undertakings route to enforce compliance not the best power AUSTRAC could use to achieve its aims.

In conclusion, a compliance manager interviewed indicated that the effectiveness of AUSTRAC enforcement mechanism relies on how far AUSTRAC can go with its enforcement mechanism, for example, the power to revoke a licence for non-compliant reporting entities is sometimes as important as enforceable undertakings are in others. The most effective enforcement mechanism is that which could be the most adequate and proper in the circumstances; however, the main discussion remains on the overall power of AUSTRAC, the extent of its powers and its willingness to use them; and the

impacts of such use. The following respondent explored the topic, denigrating court action and applauding enforceable undertakings and the threat of licence revocation.

[E]nforceable undertakings for non-compliance are good ... [and] usually ... adequate ...[for] enforcing activity ... [T]aking people to court is just [a] waste of money ... Certainly ASIC does take people to court, ... they are not afraid to take [non-compliant] entities ...to court. [But] they are far more effective coming in and saying, “This is not right,” because they can take away your licence ... can prevent you from being a reporting entity and doing that activity... [That would be] highly unlikely but there is always a threat and everyone [talks] ... about loss of licence. AUSTRAC does not have that power, but if they had the power to take out your licence then it would be powerful.⁶²⁹

6.2.3 AUSTRAC: Underachievement of its Guiding Principles which Leads it to Appear to be Subject to Influence During the GFC

According to the analysis in this chapter and the previous one, the question here is: ‘To what extent has AUSTRAC been successful in achieving its overall objectives as expressed in its Supervisory Framework, including the Guiding Principles⁶³⁰ of “Integrity”, “Transparency”, “Efficiency” and “Equity”, and to what extent has this required the establishment and maintenance of a successful and equitable regulatory environment with an efficient use of resources? The answers are somewhat disappointing.

6.2.3.1 Assessing AUSTRAC’s Guiding Principles

In its Supervisory Framework, AUSTRAC identified the following as the four main Guidance Principles:

A *Integrity*: AUSTRAC mentions a number of the key elements that determine its strength under this principle.⁶³¹

⁶²⁹ Interview with Compliance Manager A, above n 504.

⁶³⁰ AUSTRAC, *Supervisory Framework*, above n 417, 4–7.

⁶³¹ *Ibid* 4.

- i. The variety of enforcement powers available (significantly expanded under the *AML Act*).
- ii. AUSTRAC being equipped with and willing to use all options available to guarantee compliance; yet it maintains that ‘the most successful AML/CTF environment will be achieved by the willing and continuous participation of all stakeholders’.
- iii. Stakeholder confidence and trust in the regulator, in terms of its expertise and integrity. AUSTRAC notes that its integrity will be evaluated by others according to how well it sustains its commitment to (a) act ‘professionally, fairly, reasonably and without bias’, and to (b) maintain privacy, confidentiality, and other related values.
- iv. Those with obligations under the *AML Act* ‘must have confidence and trust that the decisions made, and the processes used to reach those decisions, are fair even if they do not agree with the outcomes’.⁶³²

It was clear through the analysis conducted by this thesis that the integrity of AUSTRAC’s work has a number of weaknesses:

- i. While there is a variety of AUSTRAC enforcement powers available, the full range of these powers are rarely used and the ones that have been used have been queried regarding their effectiveness in increasing the level of compliance. The transparency and adequacy of these powers has also been questioned.

⁶³² Ibid.

- ii. Most stakeholders have problems with the AML system and with trusting AUSTRAC's ability to regulate the sector. Partner agencies see themselves as distanced from AML obligations, and their role limited. Reporting entities lack confidence in AUSTRAC's skills and remain unsure as to why and how they are to comply with the AML system, whether for threat reduction or to avoid regulatory sanctions. This will affect the level of their compliance, especially in a risk-based system.

B *Efficiency*: AUSTRAC cites a number of the key elements that determine its strength under this principle, such as:⁶³³

- i. AUSTRAC must consider at a practical level the risk that a single entity will not meet its legal responsibilities, not only the likelihood of non-compliance but also the materiality of non-compliance (that is, the severity of the consequences of the non-compliance).⁶³⁴
- ii. Effective regulatory practice for AUSTRAC dictates that those entities evaluated as being of higher risk should be supervised more closely than those of lower risk. In creating a 'high quality, practical risk rating system [AUSTRAC] ... will continue to further develop its system with the aim of building a model which is comprehensive, consistent and readily verifiable'.⁶³⁵
- iii. AUSTRAC's escalation and enforcement powers will be utilised with great respect for efficiency, 'seeking to gain optimal levels of compliance with the most appropriate enforcement tools' in order to achieve the desired

⁶³³ Ibid 3.

⁶³⁴ Ibid.

⁶³⁵ Ibid.

outcome, particularly when moving down the path of prosecution. Decisions will be made based on the facts and circumstances of each case, taking into account issues such as the likelihood of successful prosecution, the deterrent value in relation to others' non-compliant behaviour, and, the risk-profile particular business activity represented.

- iv. The *AML Act* requires AUSTRAC to help and advise reporting entities in relation to their obligations under the Act, the Regulations and the Rules, and similarly help and advise reporting entity representatives in relation to their compliance, hence the importance that AUSTRAC places on educating those required to comply with the *AML Act*. Initial estimates indicate that tens of thousands of entities, varying in size from single person operations to vast multinationals, and dispersed across Australia could potentially fall under the *AML Act*.⁶³⁶ AUSTRAC aims to adopt the most efficient means to reach these reporting entities when developing its education policy and strategy.
- v. Clear and decisive enforcement action, where required, is also considered to be part of the education process where the deterrent impact results in increased voluntary compliance.

In terms of this Principle, it was obvious from the analysis of the responses in this thesis that the efficiency of AUSTRAC work has a number of weaknesses:

- i. AUSTRAC's experience in evaluating the AML risks of businesses has showed weaknesses in regard to achieving the ultimate goal in this domain that is, efficiently regulating reporting entities. Thus, the effective practice

⁶³⁶ Ibid.

that AUSTRAC aims to embody in accordance with this Guidance Principle has not yet been achieved.

- ii. While AUSTRAC pointed to its education activities and the escalation of enforcement powers that it needed to achieve efficiency, a number of interviewed reporting entities indicated that its educative process fell short. Not only was AUSTRAC unable to adequately clarify what was required of reporting entity employees to their satisfaction due to the low level of feedback, which was remarked on by a number of respondents, the e-learning site was also found to be unsuited to the task for those other than banking industry reporting entities. Since November 2009 no enforcement power has been used, except enforceable undertakings in relation to the George Thomas Hotel group (2010) and Argos Investments (2010). Those enforceable undertakings were not entirely clear, so it seems that AUSTRAC is not being efficient according to its standards, especially as it is not imposing any civil penalties. According to one AUSTRAC director, the reasons are essentially threefold: positive responses to notices, cost and uncertainty involved in prosecution:

AUSTRAC ... issued around 300 notices during in 2010 ... [It] did not use any other enforcement action like civil penalties because in many cases, particularly with larger entities, they end up doing what we want them to do, and from supervisors point of view and from financial intelligence point of view, it is better to have compliant entities instead of spend[ing] lots of money in court prosecut[ing] them. In addition, the *AML Act* it might be seen in effect since long time from 2006 until now but in terms of development and prosecution it is not, it still early days.⁶³⁷

⁶³⁷ AUSTRAC Director X, *ACAMS: Anti-Money Laundering & Proceeds of Crime: Laws & Counter Measures*, above n 581.

C *Equity*: AUSTRAC mentions that in this context, equity means ‘neutrality of treatment’ whereby no entity is unfairly discriminated against. Key elements that determine its strength under this principle include.⁶³⁸

- i. Deliberate or unwitting non-compliant reporting entities may enjoy a competitive advantage which AUSTRAC will not ignore. AUSTRAC inspection, enforcement, exemption and education policies will be designed to ensure that all those with obligations under the AML Act take up those obligations. All actions will be characterised by equal and unbiased treatment, including ‘the timing and notification of inspection visits, decisions to escalate action for non-compliance, and the offer of more intensive education services’.⁶³⁹
- ii. Equity does not mean that all reporting entities will be treated in a ‘one size fits all’ approach to regulation. The principle rests on similar treatment being accorded to reporting entities in similar circumstances. In case there are differences in circumstances, the AUSTRAC approach will be customised to the circumstances of each case.

In terms of this Principle, it was clear from the analysis of the outcomes in this thesis that the principle of equity as defined in its Supervisory Framework is not fully consistent in practice. AUSTRAC applies a ‘one size fits all’ approach in educating the reporting entities through the e-learning available on its website, which better suits entities with a ‘face to face’ relationship with customers than those that lack this

⁶³⁸ AUSTRAC, *Supervisory Framework*, above n 417, 3–4.

⁶³⁹ *Ibid* 3.

relationship. Respondents commented on the site's shortcomings and its lack of suitability for a number of enterprises, due to its being based on a banking model.

D *Transparency*: AUSTRAC cites a number of the key elements that determine its strength under this principle, such as:

- i. Actions taken by AUSTRAC must not only be fair and reasonable, they must also be seen to be fair and reasonable.
- ii. AUSTRAC policies and processes will be made clear in order to ensure accountability, and protect its commitment to privacy principles and practical law enforcement needs.
- iii. As far as is possible, AUSTRAC will publish on the website the AML Rules, guidelines and policies to achieve transparency in operations.

In terms of this Principle it was clear through the analysis of the outcomes in this thesis that the transparency of AUSTRAC operations has a number of weaknesses, for example:

- i. A number of reporting entities interviewed see the work of AUSTRAC as lacking transparency, especially when focusing its supervision on one reporting entity cohort and leaving other cohorts with a lower level of supervision. As one compliance manager indicated:

That lack of transparency ... coming from the FIU ... is very damaging. [We need] to improve the approach for everybody, because if other organisations see the bar being raised, everyone then gets a message that it needs to be raised ... I think they force people to do things, but I think again it is not in a very transparent way ... [there's a] certain amount of "we have to do this because AUSTRAC said to it".... I am not saying they should have a fight with the regulator — that is not constructive — but you have got to be pushy ... because you are protecting the business — to make sure you are doing it correctly ...

[B]ecause of the lack of transparency, it does not flow to everybody else out there, so the standard does not increase. So from [a] compliance perspective then, it is not effective. ... [AUSTRAC] are not being transparent ... It's literally who are they ... targeting? Some organisations are forced to do one way more than others.⁶⁴⁰

- ii. Another compliance manager indicated that the low level of feedback that reporting entities are receiving is affecting the transparency of AUSTRAC's dealing with these entities:

I really don't find any reporting that they [AUSTRAC] come back to us with — in respect to the information that's submitted — is helpful, relevant, articulate or transparent. I mean the topology reports ... that they give.⁶⁴¹

Overall, the indicators show that AUSTRAC is facing a deficiency in adhering to its Guiding Principles, and as a result AUSTRAC was subject to influence during the GFC (see below), which affected AUSTRAC's work in general and its enforcement actions in particular. Although currently there is a gap noted between the regulator and the regulated, there is also a danger posed by regulatory capture if it gets too close to those it seeks to regulate, and its Guidelines reflect the needs and concerns of the regulated rather than satisfy the aims of the regulator.

6.2.3.2 The Global Financial Crisis and AUSTRAC Operations

In terms of the Australian experience of the GFC, despite the impacts being substantially less than elsewhere (largely due to China's demand for energy and minerals from Australia⁶⁴² and generally lower exposure to US subprime hedging instruments), there were rising interest rates, falling superannuation returns (indeed negative growth), substantial household debt (still high), financial pain affecting

⁶⁴⁰ Interview with a Compliance Manager A, above n 504.

⁶⁴¹ Interview with Compliance Manager D, above n 503.

⁶⁴² Michael Priestley, 'Australia, China and the Global Financial Crisis' *Briefing Book*, Parliamentary Library, Parliament of Australia, 12 October 2010 <<http://www.aph.gov.au/library/pubs/BriefingBook43p/australia-china-gfc.htm>>. The author attributed Australia's stronger performance to the various stimulus measures, a 'sound and liquid banking system and ... China's robust demand for energy and mineral exports from Australia'.

businesses, and unemployment rose from 3.9 to 5.7 per cent nationally in the 12 months to June 2009 unevenly distributed but affecting many in the Australian community⁶⁴³—hence the ‘stimulus package’ and other government measures, including those by its regulatory agencies, to protect Australians from the worst of the GFC.

The imposition of new obligations on the Australian financial system was and is a major concern at the national level. Vulnerabilities exposed by the GFC must be addressed. Regulators in general, and those concerned with the AML (including AUSTRAC) should be aware of the issues and deal with them wisely. This includes dealing with entities in accordance with its Guiding Principles while taking into consideration their individual circumstance.

Although Australia was one of the countries least affected by GFC, the Australian Government offered support to the financial institutions in the face of any potential risk. In October 2008, the Government announced that it would guarantee bank deposits, and other specific areas were targeted for support:

With the economy facing a recession, an economic stimulus package worth \$10.4 billion was announced. This included payments to seniors, careers and families. The payments were made in December 2008, just in time for Christmas spending, and retailers predominantly reported strong sales. The first home buyer’s grant was doubled to \$14,000 for existing homes, and tripled to \$21,000 for new homes. The automotive industry was also given a helping hand, as several major lenders had withdrawn from the market completely, leaving banks to fill the gaps in lending.⁶⁴⁴

⁶⁴³ For details re unemployment effects, see ABS information cited by Brigid van Wanrooy et al, *Australians at Work: In a Changing World* (Workplace Research Centre, University of Sydney, 2009) 3–4. For a cautionary note on the Australian v US experience, see Steve Keen, ‘Australia’s “Get Out of the GFC Free” Card?’ *Business Spectator*, 29 June 2010 <<http://www.businessspectator.com.au/bs.nsf/Article/sovereign-debt-government-US-recession-Great-Depre-pd20100628-6U573?OpenDocument>>. Linda Hancock and Michael O’Neil, ‘Risky Business: Why the Commonwealth Needs to Take Over Gambling Regulation (Working Paper No 11, Alfred Deakin Research Institute, Deakin University, 2010) <<http://www.deakin.edu.au/alfred-deakin-research-institute/assets/resources/publications/workingpapers/adri-working-paper-11.pdf>> at 17 June 2011, 63.

⁶⁴⁴ See Canstar, *Global Financial Crisis: What Caused it and How the World Responded* <<http://www.canstar.com.au/global-financial-crisis/>> at 18 June 2011.

In a line with this approach, regulators' response is to avoid any potential political pressure, such as from lobbyists (often former politicians)⁶⁴⁵ who may enjoy privileged access to government decision-makers and be perceived as able to exert excessive or unacceptable pressure on government decision-making (even, on occasion being awarded massive 'success fees' when the government makes a decision for the benefit of their client, be it an individual business or a business or industry sector).⁶⁴⁶ This fact will affect regulators' enforcement decisions so that it appears lenient on some non-compliant entities. In such circumstances it would not be an easy task for a regulatory agency, but nor is 'walking the tightrope' between (a) saving the improved reputation, public confidence and communication with reporting entities, and understanding these entities needs and tailoring approaches appropriately, and (b) becoming increasingly subject to the risk of regulatory capture, as staff increasingly identify with the aims of the reporting entity, rather than (as desired) the staff of the reporting entity identifying with the aims of the regulator and adopting its approach.

Unfortunately, the government apparently leant on regulators to 'go soft' on implementing the new arrangements because it did not want to distract management in the banks and other institutions while they were focusing on the GFC. Regulators meekly did as they were told.

For example, it was clear that even the decision-making of the ACCC (with its better enforcement mechanism and better record of decisions when compared with

⁶⁴⁵ John Warhurst, 'Former Politicians Make Incestuous Lobbyists' (2009) 19(16) *Eureka Street* Text: <<http://www.eurekastreet.com.au/article.aspx?aeid=15840>>: 'The lists of political lobbyists published by the various Australian governments that have lobbyist registers are full of familiar political names. In NSW, former Premier Bob Carr, former federal Labor senator Graham Richardson and former state Liberal leader Kerry Chikarovski all lobby. In Queensland former Labor deputy premiers Terry Mackenroth and Jim Elder, former federal Liberal minister Santo Santoro and former federal Labor minister Con Sciacca are active lobbyists. In South Australia former Labor minister Nick Bolkus and former Liberal foreign affairs minister Alexander Downer lobby together'.

⁶⁴⁶ Mathew Jones, *Transparency Good for Government Relations* (24 March 2010) <<http://www.ogilvypr.com.au/tag/government-relations-firms/>> at 15 June 2011.

AUSTRAC enforcement mechanism and decisions), could be challenged and other regulators were not immune (including AUSTRAC) during the GFC. It is worth recalling that bank stocks dropped almost 60 per cent between October 2007 and January 2009 and the Australian banking sector was not isolated from GFC effects (the NAB more exposed than the other three majors). General default risk rose steeply (though unevenly distributed), particularly in relation to the position of other industries.⁶⁴⁷ Against this backdrop, the merger of the St George Bank (and Bankwest) with Westpac proceeded in late 2008 (during the GFC); although under the *Competition Act*, the ACCC has the capacity to block any merger in financial institutions that has potential to reduce competition in the market. The argument was made that the ‘four pillar policy’ remained, guaranteeing competition. Competition, however, was reduced overall as the GFC had resulted by late 2009 in the withdrawal of a number of foreign banks and non-bank lenders. Government fears of the consequences of GFC and the resulting Government pressure has produced a less competitive banking sector. Even the then ACCC chair later questioned the wisdom of its decision.⁶⁴⁸

In the area of AUSTRAC’s attitude during the GFC, it has been clear that instead of being a wise regulatory agency that considered its Guiding Principles, AUSTRAC was ‘too soft’ before the reporting entities community. Although former AUSTRAC CEO, Neil Jenson, and the current CEO, John Schmidt, announced in several publications that in light of the threats posed by the GFC reporting entities were asked to remain vigilant and cooperate with AUSTRAC, there was no indication in these publications or anywhere else regarding whether AUSTRAC was going to deal swiftly and severely

⁶⁴⁷ D E Allen and R Powell, ‘The Fluctuating Default Risk of Australian Banks’ SAFE & FEMARC Working Paper No 1002 <http://www.ecu.edu.au/__data/assets/pdf_file/0005/141593/The-Fluctuating-Default-Risk-of-Australian-Banks.pdf> 1–2, 34, 37–8.

⁶⁴⁸ Andrea Lavigne, ‘ACCC Questions Westpac/St.George Decision’, *Australian Broker News* (7 December 2009) <<http://www.brokernews.com.au/site-search/accc-questions-westpacstgeorge-decision/39101>> at 17 June 2011.

with AML non-compliance. Thus the activities of criminals trying to take advantage of the difficulties that the Australian financial system was going through during the GFC was facilitated by a failure to signal enhanced regulatory oversight. Neil Jenson indicated that:

AUSTRAC is cognisant of the evolving nature of crime — we know that criminals continually look for new techniques to obscure the origins of illicit funds so their activities appear legitimate. It is critical, especially in this time of global financial crisis that the financial and gambling sectors, AUSTRAC and our partner agencies continue to vigilantly work together and share valuable information to maintain the integrity of the Australian financial system.⁶⁴⁹

The current AUSTRAC's CEO, John Schmidt in a review for the annual report of 2008–2009 stated:

[The GFC] added to the complexity of AUSTRAC's regulatory role. Throughout the year, AUSTRAC's message to the business community was to maintain sound AML/CTF practices. We impressed upon industry the need to remain extra vigilant against money launderers and other criminals attempting to exploit weaknesses in global financial markets.⁶⁵⁰

In 2008–09, AUSTRAC demonstrated advanced analytical methods to its partner agencies in several states to identify the changing risks that could occur due to the GFC.

Among them were:

New risk identification techniques and new statistical analysis techniques for SUSTRs/SMRs. AUSTRAC staff also undertook a macro-analysis of the impact of the global financial crisis on money laundering and a joint project with Centrelink to establish fraud risk profiles.⁶⁵¹

A number of partner agencies indicated the elevated ML activities risk for during the GFC, and the role of AUSTRAC in relation to this risk. For example, the ATO indicated that:

⁶⁴⁹ AUSTRAC, *Eagerly-awaited Money Laundering and Terrorism Financing Typologies Report Released Globally*, 16 December 2008 <<http://www.austrac.gov.au/16dec08.html>> at 17 June 2011.

⁶⁵⁰ AUSTRAC, AUSTRAC Annual Report 2008–09, above n 19, 6.

⁶⁵¹ AUSTRAC, AUSTRAC Annual Report 2009–10, above n 189, 63.

Times of economic volatility tend to give rise to opportunistic scams and dodgy schemes, with unscrupulous individuals trying to make money out of other people's difficulties. We've also witnessed the collapse of long-standing dubious schemes because the financial crisis means they can no longer continue to operate [for example] the [US] Ponzi Scheme ... was estimated to have lost investors more than \$50 billion So the GFC has focused the operations of AUSTRAC to identify these sorts of schemes more readily and work with our partners to put a stop to them.⁶⁵²

However, many such schemes operated before the GFC. The GFC merely brought them to light, as when a number of Australian operations collapsed, some legitimate, some not (including an Australian 'Ponzi' equivalent, Chartwell).⁶⁵³ So the question is why were they not noticed earlier? The answer is because of a lack of regulatory supervision, investor gullibility and some may say a degree of regulator ineptitude.⁶⁵⁴ In Australia, AUSTRAC and partner agencies lack of efficiency in this regard and the disconnection between of them could be said to have contributed to the outcomes. The ATO, for example, has been accused of not fulfilling its regulatory responsibility by informing ASIC in a timely manner regarding Chartwell's failure to pay tax;⁶⁵⁵ and regulatory action is underway against auditors in several instances of corporate failure.⁶⁵⁶

Despite all of AUSTRAC's warnings to the reporting entities about the added ML risk due to the GFC and its advice that reporting entities should put extra resources towards their AML systems, the result was disappointing. Half of the reporting entities in the Compliance Officers Survey did not increase their resources to deal with the emerging new risks. (see Table 10 below).

⁶⁵² ATO, *Targeting Tax Crime: A Whole-of-Government Approach*, July 2009 <<http://www.ato.gov.au/Super/content.aspx?menuid=41119&doc=/content/00197432.htm&page=8&H8>> at 17 June 2011.

⁶⁵³ See Aleks Devic, 'Ian Rau Jailed over Chartwell Collapse' *Geelong Advertiser*, 20 August 2010. Here about AUD 80 million lost yet Rau had no licence to be a financial services business. See also Aleks Devic, 'Chartwell Boss, Graeme Hoy Finally Admits to Swindle' *Geelong Advertiser*, 2 December 2010.

⁶⁵⁴ Not all were illegitimate operations but for a number there were subsequent investigations in relation to practices adopted (eg Allco Finance Group). In some cases (eg Westpoint, auditors were investigated). GFC casualties include Babcock and Brown, Storm Financial, Opes Prime etc.

⁶⁵⁵ Jean Jacques du Plessis, Mirko Bagaric and Anil Hargovan, *Principles of Contemporary Corporate Governance* (Cambridge University Press, 2nd ed, 2011) 95.

⁶⁵⁶ Ibid 222. Their lack of independence is also repeatedly criticised: at 223.

Change in the level of resourcing devoted to AML/CTF issues since September 2008		
Response options	Responses (as % of total responses)	Number of responses
Increased	51.4%	76
Decreased	1.4%	2
No change	45.3%	67
Don't know	2.0%	3
Total	100%	148

Table 10: Reporting Entities Percentages of Changing the Level of Resourcing Devoted to AML Issues since September 2008⁶⁵⁷

Changes in level of resourcing devoted to AML/CTF issues since September 2008 – by sector							
	Banks	Credit unions/ building societies	MIS	Superannuation	Securities/ derivatives dealer or trader	Casino	Finance/ lending
Increased	8	31	7	14	4	5	4
Decreased	–	–	2	–	–	–	–
No change	8	13	11	21	7	1	5
Don't know	1	–	1	1	–	–	–

Table 11: Reporting Entities Percentages of Changing the Level of Resourcing Devoted to AML Issues since September 2008 – By Sector⁶⁵⁸

The lack of increased time and resources spent by a number of relevant reporting entities in the face of warnings of increased risk is worrying. Also worrying is the

⁶⁵⁷ AUSTRAC, AML/CTF Compliance Officers in Australia, above n 245, 17.

⁶⁵⁸ Ibid 18.

apparent lack of reasonable action by AUSTRAC. None could be found in this regard. The increased number of compliance assessments (up 42 per cent to 502 in 2019–10)⁶⁵⁹ is one attempt to do so. (There are over 17,000 regulated entities).⁶⁶⁰ And there still appears to be a reluctance to use ‘the big stick’.

AUSTRAC indicated that additional detection had been generated globally as the GFC

... has prompted a more cautious international financial market, there are always opportunities for criminals to exploit the financial sector. Authorities have also noted that the financial crisis has led to increased detection of money laundering and other financial crime, as companies and investors around the globe scrutinise their accounts more closely.⁶⁶¹

For criminals looking for the ‘latest and greatest’ payment mechanisms to facilitate their ML schemes, the GFC provided an opportunity in a volatile market to do so, as financial institutions issued numerous new products to attract clients and retain investors. Such products create new opportunities, not just for reporting entities and their clients, but for criminals to exploit, and for regulators to attempt to deal with.

This thesis has shown that reporting entities still have difficulty implementing their compliance programs, while AUSTRAC faces a difficult time covering all new products being issued by reporting entities and potentially used for ML purposes.

While new regulation may restrict some of the reporting entities’ new products, their continual innovations will make it more difficult for AUSTRAC to control, especially given its existing weaknesses (discussed earlier).

⁶⁵⁹ AUSTRAC, *AUSTRAC Annual Report Summary 2009-10* (2010) <http://www.austrac.gov.au/files/annual_rprt_2009-10_summary_brchr.pdf> 3.

⁶⁶⁰ Ibid.

⁶⁶¹ AUSTRAC, *AUSTRAC Typologies and Case Studies Report 2009*, 7 <http://www.austrac.gov.au/files/typ09_full_rpt.pdf> at 17 June 2011.

One interesting example that reflects weaknesses in AUSTRAC supervision regards a product developed during the GFC, Stored Value Cards (SVCs).⁶⁶² According to FinCEN:

Prepaid products, also variously known as stored value, stored value cards, or prepaid cards, have emerged in recent years into the mainstream of the US financial system ...This migration to electronic delivery has escalated greatly in recent years, most especially over the last 3–5 years.⁶⁶³

Effectively implemented in US during the GFC, SVC systems expanded thereafter. Australia has to deal with this new type of payment with all of the high level of risk that this type of card poses.⁶⁶⁴

Despite the inherent ML opportunities offered by SVCs, particularly those with anonymity features, AUSTRAC does not appear to have made efforts to regulate their use. For example, requiring proof of identity when a person wishes to buy or reload such cards, or requiring the registration or licensing of all SVC issuers.

Either AUSTRAC is easy to be captured by the regulated entities (as AUSTRAC's GFC experience has shown), or it is unable to keep pace with the changes wrought by the regulated entities in terms of product development. For example, the financial arm of a major national department store issued SVCs with anonymous holders⁶⁶⁵ and a

⁶⁶² A Stored Value Card (SVC) refers to monetary value on a card not in an externally recorded account and differs from prepaid cards where money is on deposit with the issuer similar to a debit card. One major difference between stored value cards and prepaid debit cards is that prepaid debit cards are usually issued in the name of individual account holders, while stored value cards are usually anonymous. See Sarah Jane Hughes, Stephen Middlebrook, and Broox W Peterson, 'Developments in the Law Concerning Stored Value and Other Prepaid Payment Products' (2006) *The Business Lawyer* 6.

⁶⁶³ FinCEN, Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations-Definitions and Other Regulations Relating to Prepaid Access, 28 June 2010, 1 <<http://edocket.access.gpo.gov/2010/pdf/2010-15194.pdf>> at 17 June 2011.

⁶⁶⁴ Kim-Kwang Raymond Choo, 'Money Laundering Risks of Prepaid Stored Value Cards' (2009) *Asian Criminology* 11. SVCs are easy to get and use, can be purchased and reloaded, and affordable by customers.

⁶⁶⁵ Ibid.

reloadable value as high as AUD99,999.⁶⁶⁶ Yet to date there is no strict supervision or regulation from AUSTRAC for such cards. Thus regulatory delays added to AUSTRAC's weakness during the GFC which stemmed from its generally weak Guiding Principles and, more specifically, its enforcement decisions and powers. These Principles must be achieved if AUSTRAC wants to ensure compliance and to remain 'rock solid' in the face of any emerging economic crisis.

6.3 Conclusion

Chapter 5 considered AUSTRAC's publications in order to focus on what AUSTRAC says in policies and what it does in real life. The outcome was an accumulation of evidence regarding a lack of quality in the reports that AUSTRAC receives and on the minimum feedback that AUSTRAC provides to the reporting entities about the quality of those reports, as well as a number of other related issues. This Chapter has provided an analysis of the factors that have contributed to and reasons for these outcomes and for the deficiency in the relationship between AUSTRAC and the reporting entities. It has highlighted the weaknesses of AUSTRAC in the area of AML activities.

A Grounded Theory based analysis of the responses of the reporting entities interviewed found a number of factors that help account for this situation as well as for AUSTRAC's poor enforcement mechanism, namely:

- 1 AUSTRAC has failed to apply RBA effectively to regulated entities; and the AML training it provides is inadequate due to:
 - AUSTRAC's inexperience and lack of capacity

⁶⁶⁶ David Jones, *Gift Cards*<<http://www.davidjones.com.au/gift-card>> at 17 June 2011: 'The David Jones Premium Gift Card can be loaded with \$5 to \$99,999. ... you can conveniently purchase your David Jones Gift Cards online.'

- The Australian AML system not being ready for the adoption of RBA
 - A disengagement in the relationship between AML parties (AUSTRAC and reporting entities)
 - Inadequacies in the response to the 2007 FATF Guidance on the Risk-Based Approach to Combating ML and TF.
- 2 The enforcement powers used by AUSTRAC are not sufficiently mature and have shortcomings affecting their influence on enforcing compliance. This is due to:
- Using enforceable undertakings as a benchmark sanction, rather than applying the harsher sanctions available, including civil penalties, on non-compliant reporting entities.
 - Concentrating on some businesses' categories and ignoring others.
 - Targeting small businesses only in most cases.
- 3 Insufficient information being provided by AUSTRAC to non-compliant reporting entities about the actual breach committed (This establishes the non-compliant status of these reporting entities).
- 4 AUSTRAC is facing a shortfall in achieving its Guiding Principles, which leads it to be subject to influence by GFC. This is due to:
- A lack in AUSTRAC's Guiding Principles.
 - AUSTRAC being vulnerable to governmental pressure 'to go soft' during the GFC.

Overall, AUSTRAC's in experience plays a significant role in its poor use of RBA in regards to its application within reporting entities and in the way in which AUSTRAC deals with them and their risks.

Reporting entities require a far more systematic provision of training programs as the low quality problem of data begins with the inadequate analysis within these entities. These entities also need to understand their role and to collaborate in the AML scheme with other AML parties in a model where risk (threat) reduction and avoiding sanctions both is the background and supplies the motivation.

Systematic staff training within AUSTRAC is also required if it is to provide an effective and mature enforcement mechanism for use on non-compliant reporting entities. This mechanism and its power need to be clear to all and correctly sued, targeting all non-compliant entities, whether they are small or large. The need to achieve the Guiding Principles of AUSTRAC (including Transparency, Efficiency, Equity and Integrity) is crucial; but will not occur effectively if there is a shortfall in the above-mentioned areas. Instead AUSTRAC will be seen as a weak regulator and FIU, if not vulnerable to pressure from lobbyists for various interests (including the reporting entities community and their representatives). The danger here is that while its operations may not fall prey to such efforts, AUSTRAC (like other regulatory bodies) has to be seen as totally impartial, impenetrably ethical, not subject to political or reporting entity pressure, and acting always for the sake of the broader community. It must be able to achieve its goals and so contribute to the framework of a stable society, where privacy concerns and necessary financial transparency are suitably balanced.

Regulators must be on the lookout for the emergence of new products so that they effectively regulate them in the interests of the community and minimise the possibility of ML activity.

Effective regulatory activity is crucial to avoid repeating past economic disasters and to deal with future circumstances.

7 CONCLUSION

7.1 Introduction

The original purpose⁶⁶⁷ of AML systems was to reduce the illegal behaviour (predicate offences) which gave rise to the need to engage in related ML activities by making it more difficult for launderers to enjoy their illicit gains. From an economic perspective this makes sense, at least in theory. Even when taking into consideration the differences in the regulatory cultures of various countries, generally policies that decrease the compliance costs which tend to apply to regulated entities (thus encouraging reporting entities to comply) and reduce the benefit of a criminal activity are likely to reduce that behaviour. What is needed is an effective AML system at as low a cost as possible. This is one of the factors that AUSTRAC and many regulators do not seem to understand because they do not have a commercial perspective. Higher compliance costs weaken compliance and probably make it easier for the criminal to engage in ML. On the other hand the regulated entities want to incur no compliance costs and this is also unrealistic. This debate has been clear through the analyses of a number of interviewed reporting entities and a number of AUSTRAC's publications in this thesis.

In 2009–10 alone, AUSTRAC received over 21.5 million transaction reports (of which the vast majority was IFTIs). These involved over 43,000 SUSTRs and SMRs and generated almost 1400 financial intelligence assessments for relevant partner agencies that make further evaluations.⁶⁶⁸ This large and increasing number of reports motivated

⁶⁶⁷ In the Australian AML system, this original purpose has been clear under the FTA Act 1988, but under the AML Act 2006 it seems it is more to meet Australia obligations under the FATF Recommendations rather only achieve that first purpose.

⁶⁶⁸ AUSTRAC, *AUSTRAC Annual Report Summary 2009-10* (2010) <http://www.austrac.gov.au/files/annual_rprt_2009-10_summary_brchr.pdf> 3. Minister for Home Affairs, Minister for Justice (Hon Brendan O'Connor), 'Launch of AUSTRAC Financial Crime Report [Transcript]', 29 June 2010 <http://www.ag.gov.au/www/ministers/oconnor.nsf/Page/Transcripts_2010_29June2010-Launchof_AUSTRACfinancialcrimereport> at 23 February 2011.

the Government to spend more money for AML purposes. The ACC has by its own calculations and from international research conservatively estimated that ‘serious and organised crime (including ML crimes) cost Australia between 10 and 15 billion dollars every year’.⁶⁶⁹ This has necessitated increasing expenditure by the Australian Government (and by industry). The total federal budget allocation to AUSTRAC rose slowly from approximately AUD8.3 million in 1996–97 to AUD11.2 million in 2002–03 before rising steeply in 2003–04 to AUD20.1 million. More recently, the Australian Government provided AUSTRAC with AUD24 million over four years as specific funding on top of its ongoing budget.

...to develop its intelligence systems as part of the government’s wider efforts to tackle organised crime. This money will fund new analytical technologies to enhance our ability to track illicit money trails and detect serious and organised crime, tax evasion and financial fraud.⁶⁷⁰

The fundamental question that must be asked is whether the multimillion dollar regulatory burden is achieving ‘value for the money’ — in other words, can the high costs involved be justified by a correspondingly significant decrease in the criminal activities targeted?

Unfortunately, there seems to be little reason to believe that resources are being intelligently allocated. Studies cannot be located that demonstrate that the Australian AML system has decreased ML crime rates or underlying predicate offences, the very reason for the AML legislation. It is no wonder that (as this thesis has shown) people from the private sector have indicated that the AML systems generate expense but have achieved minimal tangible benefits. These costs might be acceptable if they resulted in less crime.

⁶⁶⁹ ACC, *Organised Crime in Australia 2011*, above n 572, 3.

⁶⁷⁰ AUSTRAC, *AUSTRAC Annual Report 2009–10*, above n 189, 7.

According to the latest estimates (published in 2007), the amount of money laundered in and through Australian financial system is approximately AUD4.5 billion per year.⁶⁷¹ Though difficult to estimate, it is understood to be a ‘significant, widespread and ongoing activity’ that is ‘fuelled by, and reflective of, the amount of profit generated by crime’ with both within and beyond its shores. Real risks continue to envelop the Australian financial system and reporting entity non-compliance facilitates its movement in and through the Australian jurisdiction.

However, AUSTRAC has been found to be lenient on non-compliance, even when the Australian regulatory culture and its pre-existing legal institutional framework provides dynamic tools for regulatory agencies to apply most effective sanctions including severe ones. This has been found despite the experience of other regulatory agencies (such as ASIC, the ACCC, and APRA) demonstrating that the application of harsher sanctions is more likely to have the desired outcome than ‘softer’ option. ASIC and ACCC, for example, have both applied civil penalty sanctions on non-compliant entities besides other ‘softer’ sanctions, such as warning letters. The outcome for these entities has been made possible by the nature of these agencies. ASIC, APRA and ACCC are separate agencies and have had an active enforcement mechanism since their inception, and a better relationship and more consultation with the government. However, AUSTRAC has been found to lack the required level of enforcement, and the necessary budget and experience required since it established under the *FTR Act* in 1988 and even after passing the *AML Act* in 2006 and up until the present.

The thesis also showed that — due to the differences in the regulatory culture and the pre-existing legal institutional framework and ML practices in particular countries—

⁶⁷¹ Walker and Stamp, above n 193, 5.

what works for the FIU in one jurisdiction does not necessarily work in another; and very different approaches may be required in different jurisdictions. For example, a regulatory approach adopted by an FIU such that it relies on the application of harsher sanctions, as is frequently the case the US experience, may not necessarily work for the FIU in another jurisdiction. Replacing the ‘softer’ approach typified by the Netherlands experience, where ‘softer’ sanctions are regularly and predictably imposed on non-compliant entities may not generate the results anticipated; indeed, the particular approach adopted there may be more successful in that jurisdiction. AUSTRAC — with all the tools it has at its disposal to enforce compliance in a regulatory culture that (unlike the Netherlands) permits the FIU to apply what many would consider the most effective and appropriate sanctions given the seriousness of the criminal activities that the FIU is attempting to detect — has chosen to utilise only the ‘softer’ options available to it on non-compliant reporting entities and does not make full and most effective use of the enforcement mechanism. This result was clear when the thesis applied the Braithwaite theory on the current AUSTRAC’s enforcement mechanism’s scenario.

Reporting entities under the Australian AML system are generating massive quantities of data for AUSTRAC, creating a veritable ‘haystack’ of material of very different levels of quality and usefulness with which AUSTRAC has to attempt to deal and select appropriate material for forwarding to appropriate agencies. There is no doubt that the personnel of partner agencies, including law enforcement bodies, experience some difficulty participating in the AML scheme and finding the ‘needle’ of criminal action. This is exacerbated where a relatively inexperienced regulator is operating and which attempts to enforce reporting entity compliance while using only a very limited repertoire from the sanctions and enforcement powers at its disposal. It provides a

minimal feedback about the quality of that data to those supplying it and so fails to maximise the quality of information received. This attitude to some extent is alienating those whose task it is to supply that data. Their attitude will be further fuelled by a move towards ‘user pays’ by the regulator.⁶⁷²

Thus, there is a pathetically low rate of return for a system that represents an investment of many millions of dollars, and requires millions of reports on the financial transactions of the Australian people. Policy makers and regulatory agencies, including AUSTRAC, should seriously consider modifying the AML system and in corporate more effective ways to fight crime.

This thesis showed that low quality STRs have been a problem since the inception of the current Australian AML system in 1988. The shortcomings, as this thesis has showed, stem from the limited experience of AUSTRAC and the difficulties both regulator and regulated alike are having applying RBA, as well as the lack of systematic AML training programs for AUSTRAC and the regulated entities’ personnel.

AUSTRAC’s weaknesses in regulating the system and combating ML crimes call into question its Guiding Principles, including its use of the enforcement mechanism (and its structure) for reporting entity non-compliance with their reporting obligations, and for its other roles and obligations that it must fulfil to regulate the system. It has been clear that its Guiding Principles of ‘transparency, equity, integrity and efficiency’ have not yet been realised. This weakens the ability of AUSTRAC to be an effective agency in the face of the ever-increasing sophistication of money launderers, the challenges posed

⁶⁷² AUSTRAC is anticipating moving to a user pays model from FY2011-12. Reporting entities (law firms in the future) will have to pay to use AUSTRAC services. In the recent Budget 2010-2011 papers AUSTRAC anticipates raising approximately \$30m in FY2011-12 with corresponding amounts in the following 2 years. See Patrick Oliver, *Tranche 2 Implantation Timescale*, Lexcel Law Practice Consultants (14 May 2010) <<http://www.lexcel.com.au/2010/05/14/tranche-2-implementation-timescale/>> at 5 June 2011.

by the severe economic problems (such as the GFC) that face countries world-wide and pressures that may be exerted by interest groups or their lobbyists. The thesis has shown that there are question marks over AUSTRAC's ability to handle such circumstances.

By considering all the above, this thesis found that the Australian AML system does not properly meet the four requirements and attributes that this thesis has suggested would ensure AUSTRAC's ability to utilise an effective enforcement mechanism for non-compliant reporting entities. Necessary changes would involve:

- 1 Different and actively used sanctions in place to be applied in response to non-compliance.
- 2 Concords and agreements between the main regulator of the field and its partner regulatory agencies, and also between the regulators and the regulated entities to increase compliance.
- 3 Unambivalent legislation and regulation essential for a successful enforcement mechanism.
- 4 Avoidance of regulatory capture in the face of pressure (economic or other), and maintenance of independence.

This chapter will show why these attributes do not work effectively with the Australian AML system and AUSTRAC's operations, including its enforcement mechanism at the current time, and what changes are needed in terms of that.

7.2 Obtaining compliance: What works and what does not?

The main question that the thesis asked was: 'What are the strengths and weaknesses of AUSTRAC's approach to non-compliance?'

After building a theoretical basis, and a detailed analysis of AUSTRAC publications including: policies,⁶⁷³ annual reports,⁶⁷⁴ the AUSTRAC survey series (2010),⁶⁷⁵ typologies and case study reports;⁶⁷⁶ and analysis of interviewee responses from reporting entities (mainly, compliance officers and managers) across Australia, the following strengths and weaknesses are evident and reflect what works to what does not in the area of enhancing compliance?

A *The Strengths of the Australian AML system and AUSTRAC's Approach to Non-Compliance*

There were a number of positive outcomes for the Australian AML system overall and AUSTRAC enforcement mechanism in particular. These include:

- 1 The FATF mutual evaluation in 2005 (its third and most recent) found that at that time AUSTRAC was an 'effective FIU ... [with its] 154 AUSTRAC personnel ... adequate for it to effectively perform its FIU functions'.⁶⁷⁷ However, 'while the legal measures are comprehensive they are not fully effective' due to a failure to investigate and refer ML as a separate charge. The number of ML prosecutions was also low.⁶⁷⁸ It identified a number of areas that needed to be improved, some of which have only been recently addressed or are still in the process of being addressed. (For example, the extensions of reporting obligations to a greater number of types of businesses, such as bureaux de change, bullion sellers, solicitors).⁶⁷⁹

⁶⁷³ AUSTRAC, 'AUSTRAC Policies' <<http://www.austrac.gov.au/policies.html>> at 6 June 2011.

⁶⁷⁴ AUSTRAC, 'Annual Reports', above n 470.

⁶⁷⁵ AUSTRAC, 'AUSTRAC Survey Series', above n 471.

⁶⁷⁶ AUSTRAC, 'AUSTRAC Typologies and Case Study Reports', above n 472.

⁶⁷⁷ FATF, *Third Mutual Evaluation Report*, above n 15, 7. Also see AUSTRAC, *AUSTRAC Regulatory Guide* <http://www.austrac.gov.au/rg_app_d.html#51> at 6 June 2011.

⁶⁷⁸ Ibid.

⁶⁷⁹ Ibid 26.

The Report noted that, although a number of areas were rated as Non-compliant or only Partially Compliant,⁶⁸⁰ Australia's level of compliance with FATF Recommendations overall placed its AML system in the range between Partially Compliant and Largely Compliant. However, Australia has since succeeded (particularly after passing the *AML Act 2006*) in covering many important aspects of the FATF Recommendations regarding reporting obligations, including identified classes of reporting entities being required to identify and verify customers and report suspicious or other designated types of transactions as well as fulfil their record keeping obligations.

2 The *Australian AML Act 2006* (Cth). The first tranche of the law, particularly Part 3,⁶⁸¹ requires the reporting entities who are providing 'financial services' to fulfil their reporting obligations by submitting to AUSTRAC the following types of reports:

- Suspicious matter report (SMR)⁶⁸²
- Threshold transactions report (TTR) of transactions equal to or more than AUD10,000⁶⁸³

⁶⁸⁰ Ibid. For example, Recommendations 5–8 (at 76), Recommendation 9 (at 79), Recommendations 15 and 22 (at 94), Recommendation 12 (at 111), and Recommendation 16 (at 114).

⁶⁸¹ According to Part 3 Reporting Obligations, Division 1 Introduction, s 40 Simplified outline of the *AML/CTF Act 2006* (Cth):

A reporting entity must give the AUSTRAC CEO reports about suspicious matters.

If a reporting entity provides a designated service that involves a threshold transaction, the reporting entity must give the AUSTRAC CEO a report about the transaction.

If a person sends or receives an international funds transfer instruction, the person must give the AUSTRAC CEO a report about the instruction.

A reporting entity may be required to give AML/CTF compliance reports to the AUSTRAC CEO.

⁶⁸² AML/CTF Act 2006 (Cth) ss 41–42. See also re Suspicious Matter Report, AUSTRAC, Reporting Requirements, An Introduction to the Anti-Money Laundering and Counter terrorism Financing Act 2006 (AML/CTF Act) Reporting Requirements (n.d.) doc no 140/1008/CC, above n 264, 3.

⁶⁸³ AML/CTF Act 2006 (Cth) ss 43–44. See also re Threshold Transaction Report (TTR) AUSTRAC, Reporting Requirements, An Introduction to the Anti-Money Laundering and Counter terrorism

- International funds transfer instruction report (IFTI).⁶⁸⁴

These types of reports were found to be very important to the AML system, because they help AUSTRAC and law enforcement bodies take further steps in detecting, investigating and prosecuting groups and individuals who are involved in any ML or TF activities.

Part 4 covers another two important types of reports, those relating to:⁶⁸⁵

- Physical currency
- Bearer negotiable instruments

- 3 The Australian AML system (including the Act and Rules) is much improved, and covers a number of important aspects with regards to the verification and identification of customers (including CDD and OCDD, and reporting suspicions).
- 4 AUSTRAC has been found to be an active agency (especially during the last three years) in terms of providing reporting entity education and initiating (and in some instances completing) a number of enforcement actions.⁶⁸⁶

Financing Act 2006 (AML/CMF Act) Reporting Requirements (n d) doc no 140/1008/CC, above n 264, 3–4.

⁶⁸⁴ AML/CTF Act 2006 (Cth) ss 45–46 See also re the two types of IFTI reports, AUSTRAC, Reporting Requirements, An Introduction to the Anti-Money Laundering and Counter terrorism Financing Act 2006 (AML/CMF Act) Reporting Requirements (n d) doc no 140/1008/CC, above n 264, 4.

⁶⁸⁵ According to the *AML/CTF Act 2006* (Cth), Part 4 Reports about cross-border movements of physical currency and bearer negotiable instruments, Division 1 Introduction, s 54 Simplified outline:

- Cross-border movements of physical currency must be reported to the AUSTRAC CEO, a customs officer or a police officer if the total value moved is above a threshold.
- If a bearer negotiable instrument is produced to a police officer or a customer officer by a person leaving or arriving in Australia, the officer may require the person to give a report about the instrument to the AUSTRAC CEO, a customs officer or a police officer.

⁶⁸⁶ See, eg, Table 3: 'AUSTRAC Activities Summary 2009–10', Appendix A of AUSTRAC, *AUSTRAC Supervision Strategy 2010-11*, 10 <<http://www.austrac.gov.au/files/supervision.pdf>> at 11 April 2011.

- 5 AUSTRAC's publications reveal that it has put in place quality policies to combat ML crimes in general and compliance enforcement in particular. It can meet its analytical and regulatory requirements if it effectively applies these policies.

However, considerable weaknesses have been identified that question the effectiveness of AUSTRAC in the field of enforcing compliance, and its ability to apply its policies in real life 'not only as ink on paper'.

B *AUSTRAC's Compliance Weaknesses*

The performance of the Australian AML system has been affected negatively by three main causes:

- 1 The shortcomings in the FATF Recommendations that are the benchmark AML systems:

The thesis showed that the FATF Recommendations are not inclusive in every respect. A number of inadequacies were revealed in the difficulties that countries face in complying with them (implementation) and in some other areas the clarity of the Recommendation (the actual recommendation) itself caused a problem. Areas included in relation to the beneficial ownership issue (illustrating the problems with the verification process in the CDD obligation for reporting entities), the meaning of 'risk' in the RBA obligation, reporting suspicions (not just suspicious transactions), and others.

- 2 Shortcomings in the legislative framework:

The shortcomings in the FATF Recommendations flow through to the legislation based on them and affect the way in which the Australian AML system deals with

issues such as: CDD, the application of the RBA, matters regarding the identification of the beneficial owner, SMRs. The thesis has shown that the Australian AML system has covered a number of important aspects in the Act and the Rules; however, the continued difficulty experienced by reporting entities in their application of RBA to their reporting obligations under this system are evidence of enduring problems.

- 3 The effectiveness of AUSTRAC functions and its enforcement mechanism regarding non-compliance with reporting obligations has been a major theme in this thesis:

AUSTRAC operations are hampered by a lack of resources and expertise to address the severity of the situations it faces. It has a number of powers available to it (that could be further extended), but its use of those it has is unduly restricted. AUSTRAC's personnel and those of reporting entities require better focused training programs in order to fully understand and play their role in the AML system. A number of facts have emerged. These include

- *Complexity of the AML prosecution process and an apparent reluctance to prosecute:* There have been very few ML prosecutions at the Commonwealth level. The 2005 FATF Mutual Evaluation Report indicated ten matters had been dealt with summarily, with three on indictment since 2003, and five convictions. Though a few additional cases may be anticipated, this low level of prosecutions and conviction rate in the face of the estimated level of ML funds indicates that the regime is not being

effectively implemented.⁶⁸⁷The most recent evaluation, the 2010 US Department of State (DoS) report, recommended an increased prosecutorial effort as well as greater focus on AML/CTF deterrence.⁶⁸⁸

- *AUSTRAC's relatively weak enforcement mechanism* compared to those of its partner agencies (ASIC and the ACCC).
- *Reporting entities' need for more and better targeted training and feedback* so that they can better comply with the AML system. Low compliance or poorer quality compliance is likely to occur in its absence. Self regulation in almost every field has been accompanied by significant failures; the degree of responsibility laid upon the reporting entities combined with inadequate education/training/feedback to contribute to the challenges facing the AML system.
- *Significant failures in the overarching RBA*, including (i) inadequate guidelines, education and training offered within the regulator and to some reporting entities, which must negatively impact compliance; and (ii) targeting of specific groups for additional attention at the legislative level and at the regulator's inspection and enforcement level, and even at specific entity level where training inadequacies must impact on performance.
- *Stakeholders' problems with the AML system and distrust in AUSTRAC's ability to regulate the sector*. Partner agencies are 'distant' from their AML obligations and see their role as limited. Reporting entities lack confidence

⁶⁸⁷ FATF, Third Mutual Evaluation Report, above n 15, 6.

⁶⁸⁸ US Department of State, International Narcotics Control Strategy, Volume II (2010), above n 291.

in AUSTRAC's skills and still struggle with compliance concepts and activities.

- *A disconnection between the perceptions of AML parties.* For example, AUSTRAC believes that reporting entities are doing a positive job, and that training is adequate — in stark contrast to the entities' perceptions of their available training programs. Nevertheless, some 72 per cent of compliance officers reported one or more AML matters to their board, and though 28 per cent of respondents failed to report a single matter, they are in the minority.⁶⁸⁹ On the basis of compliance officer working hours spent on AML issues, the value accorded AML compliance appears low. Only 43 of the 150 compliance officers surveyed for AUSTRAC spent more than 25 per cent of their working time on AML.⁶⁹⁰
- *Generation of massive quantities of low value reports by reporting entities,* from which AUSTRAC must try to produce high quality reports. A large numbers of reports disseminated in 2009–10 were, however, apparently of limited benefit to partner agencies, including the ATO, AFP and ACBPS.⁶⁹¹
- *Discrepancies between what AUSTRAC Strategies and Policies outline in relation to its activities, and what occurs,* are reflected in its own annual reports, typologies, case studies and surveys.
- *AUSTRAC's difficulty in distinguishing between the minimum level of enforcement power and the most effective use of enforcement power,* one that could guarantee greater compliance by the non-compliant entity and its

⁶⁸⁹ AUSTRAC, AML/CTF Compliance Officers in Australia, above n 245, 6.

⁶⁹⁰ Ibid.

⁶⁹¹ AUSTRAC, *AUSTRAC Annual Report 2009–10*, above n 189, 51.

reporting sector. AUSTRAC fails to activate its powers as needed and is reluctant to escalate enforcement action to the level where harsher sanctions are imposed.

- *AUSTRAC's inadequate enforcement mechanism*, which reduces its usefulness, and obstructs AUSTRAC's efforts regarding securing savings of public money and seizing proceeds. Its limited powers are used on the basis of the insufficient information, and generally employ only soft sanctions. It would be hard to predict the success of the second tranche of the AML Act as long as AUSTRAC's current problems remain unresolved.

Thus, while AUSTRAC has strengthened its performance, it still faces a number of factors that would limit the effectiveness of its strategies unless it takes urgent action to address these shortcomings. AUSTRAC is facing difficulties in achieving its Guiding Principles of: 'integrity', 'transparency', 'efficiency' and 'equity'.

The current Australian AML system does not properly fit with the four requirements and attributes suggested in Chapter 4 that are needed to ensure AUSTRAC's ability to impose the most effective use of its enforcement mechanism on non-compliant reporting entities.

7.3 AUSTRAC and the Four Attributes Outlined in the Thesis

When applying an analysis of the interview data and other information collected using the four attributes, the results show that the current AML scenario in Australia does not fit inclusively with the four key attributes of the thesis and there is a need for the Government, AUSTRAC, its partner agencies, policy makers and reporting entities to

consider this issue, so as to follow AUSTRAC's Guiding Principles of AUSTRAC and maximise the effectiveness of the Australian AML regime.

7.3.1 AUSTRAC does not Actively Use the Most Effective Sanctions in Response to Non-Compliance

AUSTRAC has issued a number of documents to explain and justify its use of its enforcement mechanism. These include AUSTRAC's Enforcement Policy, and the guiding principles within its Supervisory Framework Policy, and the Enforcement Manual. AUSTRAC uses its enforcement powers where non-compliance has been identified. According to the AUSTRAC Enforcement Policy:

[W]here cooperation and negotiation have demonstrably failed, AUSTRAC will not hesitate to take measured but firm enforcement action for the purpose of securing compliance and rectification.⁶⁹²

However, the 2005 FATF Mutual Evaluation Report on Australia found serious deficiencies in Australia's compliance with FATF Recommendations, namely 17 ('Effective, proportionate and dissuasive criminal, civil or administrative sanctions'),⁶⁹³ 35 ('Conventions and UN Special Resolutions'),⁶⁹⁴ and 40 ('Provision of wide range of international cooperation to foreign counterparts').⁶⁹⁵ AUSTRAC was found to be only partly compliant in its application of sanctions where non-compliance was detected, and its record shows that it does not routinely apply formal sanctions.

Indeed, AUSTRAC has made a very limited use of its enforcement powers since it started to operate under the AML Act on 12 December 2006 until the time of the researcher's writing this thesis in 2011. When AUSTRAC has chosen to utilise the more

⁶⁹² AUSTRAC, AUSTRAC Enforcement Policy, above n 14.

⁶⁹³ FATF, *Third Mutual Evaluation Report*, above n 15, 99–100 [432]–[439], 106, 111 [491], 148, 158–9.

⁶⁹⁴ Ibid 129 [580], 130 [584], 155, 160 referring to problem with beneficial ownership and implementation of Recommendation 5.

⁶⁹⁵ Ibid 139ff, 144.

regulatory intrusive sanctions available to it, it has done so only in regard to a number of small remittance services businesses by removing their registration (after failure to achieve compliance with warning letters, enforceable undertakings, and remedial directions). There is no evidence of any similar serious action against any other entities, which (according to AUSTRAC) represent the biggest risk, more so than the remittance services.

Illustrative of its approach is AUSTRAC's enforcement record for 2009–10: it issued about 300 warning notices,⁶⁹⁶ 10 enforceable undertakings (4 enforceable undertakings in 2009 and 6 enforceable undertakings in 2010), 2 remedial directions (1 in 2009 and the other in 2010), and 2 removals from register of providers of designated remittance services (1 in 2010 and the other in 2011).⁶⁹⁷

If one applies the first attribute (a willingness to actively use the *full range* of sanctions available (including stronger ones where these are the most effective response), he will find that AUSTRAC fails to actively use the full range of tools and sanctions available to it to achieve the most proper enforcement mechanism that suited to the task. Those sanctions that have been used by AUSTRAC have not always been used in a way that guarantees compliance by non-compliant entities. The application of sanctions more appropriate to the breach would promote compliance in the broader range of reporting entity communities.

⁶⁹⁶ AUSTRAC Director X, *ACAMS: Anti-Money Laundering & Proceeds of Crime: Laws & Counter Measures*, above n 581.

⁶⁹⁷ AUSTRAC, *Enforcement Actions* <http://www.austrac.gov.au/enforcement_action.html> at 18 June 2011.

7.3.2 AUSTRAC is Facing a Lack of Agreement with its Partner Regulatory Agencies, and also Regulated Entities

The Australian AML system faces two predicaments that reflect its inability to establish and reflect the second of the four attributes, namely genuine concord and agreement with partner agencies and with regulated entities.

- a) Disengagement in the relationship between AUSTRAC and partner agencies in terms of their active involvement in the AML scheme;
- b) Disengagement in the relationship between AUSTRAC and reporting entities.

Disengagement exists between AUSTRAC and other partner agencies despite the existence of MoUs. The AML system parties' differing interests were clear: reporting entities want to avoid sanctions, protect their reputation and make profits; AUSTRAC (and other regulatory partner agencies such as ASIC, APRA and ACCC) want to ensure greater reporting entity compliance behaviour; other law enforcement partner agencies (for example, the AFP) want to reduce the threat of illegal activities, and successfully detect and prosecute offenders; while the ATO and Department of Social Security would like to recover monies owed.

AUSTRAC is in no better position in terms of its relationship with its reporting entities. AUSTRAC still fails to understand the reporting entities communities and the commercial environment in which they operate. The reporting entities are looking to comply with the AML system not to avoid AUSTRAC sanctions but for threat reduction purposes. Severe sanctions could be more proportionate and potentially more effective *if* the regulator would use them. With these generally utilised by AUSTRAC, unsurprisingly many still have 'threat reduction' uppermost in their mind.

Great effort is needed if the current reporting entity culture regarding AML compliance is to change. Threat reduction and avoidance of harsher sanctions could be tools to do just that. The disconnection between AUSTRAC and the reporting entity communities must also be decreased to the optimum minimum level, by genuine communication. Outcomes will improve if AUSTRAC better understands the regulated community and the regulated community better understands its AML obligations such as avoiding low quality reports and ‘crying wolf’.

7.3.3 Australia having Controversial Legislation and Regulations which have been affected by the Controversial Recommendations of FATF

The ‘one size fits all’ approach that was initially created by the FATF recommendations in 2003 has caused problems in a number of areas. To its credit, the regulator has gradually adapted its approach, but more needs to be done (as can be seen from the interview data). Australian AML legislation and regulations need to clarify aspects of issues relating to the reporting (and other) obligations with which the reporting entities are to comply. These include: beneficial ownership, the best practices in verifying customers under the CDD obligation, the uncertainty of suspicion in SUSTRs, and the meaning of ‘risk’ under the RBA obligations.

These shortcomings pose difficulties for both reporting entities and AUSTRAC. The use of an RBA has proved to be one of the major burdens for the reporting entities and AUSTRAC itself. Reporting entities are still struggling with applying the RBA in the way that AUSTRAC understands it, and AUSTRAC is struggling also on how to best apply it to the various regulated entities.

This controversial system adds further difficulties to AUSTRAC when it decides to enforce compliance. However, if it eventuates that AUSTRAC does not enforce some of

the FATF rules because it believes that these rules are ineffective or have a significant shortcomings, then AUSTRAC has a reason not to insist on the enforcement of such rules (and move towards their amendment). It is not just a question of whether the reporting entities are following the rules; AUSTRAC should be ensuring that the system itself is effective. This might mean ignoring impractical rules. For example, how effective is the reporting of SUSTRs? If it is not effective, then why is that? What do the reporting entities think they must do, and are there problems with this requirement? Or can intensive and relevant education, designed by and conducted in conjunction with the regulated entities and partner agencies, or a close examination and redesign where necessary of their roles and relationships, make their application more successful? The answer is complex.

AUSTRAC needs to consider these questions and when it finds answers to them there will be important consequences that will change the reporting obligation scenario and the whole Australian AML regime positively. An improved AML system will then be in place.

Unquestioned and broadly accepted legislation and regulation will help to achieve superior outcomes with a greater flexibility of process and enhance the regulated entities ability to apply self regulation as well as encourage the ‘culture of compliance’.

7.3.4 AUSTRAC Appearing to be Unable to Avoid Regulatory Capture, and Drawing Away from its Responsibilities Due to Economic Problems

AUSTRAC’s principles of ‘transparency, efficiency, integrity and equity’ must be rigorously upheld. Those of ‘transparency’, ‘integrity’ and ‘equity’ are particularly relevant in relation to the areas of potential regulatory capture and the potential for undue influence on the legislature and the regulator by the larger financial institutions or

the financial sector. This sector was ‘the third largest industry sector’ of the Australian economy in 2004,⁶⁹⁸ but is now the largest industry sector (on the basis of market capitalisation).⁶⁹⁹ Lobbyists (including former politicians) may be engaged by these entities or their representative organisations either as external consultants or directly as employees. AUSTRAC must be seen to be ‘holding its course’, despite the size of the sector and the sector’s potential to negotiate from a position of strength, and also despite changes in economic circumstances that might otherwise put pressure on AUSTRAC’s ability to fulfill its obligations. There is no evidence of any incidence of actual undue influence. This thesis maintains, however, that it is important for AUSTRAC not only actually to *be free* from influence or political pressure and unmoved by economic problems in terms of its processes and decision-making, but also to *be seen to be free* from such pressures. This should especially be the case after its Guiding Principles are strengthened.

AUSTRAC actions during the GFC exposed a weakness. It publicly foreshadowed that it would be lenient with instances of non-compliant behaviour in an environment where there was a harsh economic climate for reporting entities. Even generally high performance regulators like the ACCC (known for its greater independence and strong enforcement profile (compared to AUSTRAC) was influenced by the global economic outlook and approved some bank mergers. The treasurer approved the merger as it appears did Treasury and the ACCC at the time, despite consumer groups concerns regarding a lessening of market competition.

⁶⁹⁸ FATF, Third Mutual Evaluation Report, above 15, 14.

⁶⁹⁹ Australian Securities Exchange ‘ASX’, *Financial Sector Profile*, 1<http://www.asx.com.au/documents/research/financial_sector_factsheet.pdf> at 22 June 2011. It notes that the sector’s 295 companies have a market capital of AUD 480 billion, it comprises the largest industry sector by capitalisation in Australia – and does not take into account smaller players solicitor funds etc - Australia with its small population also has the 4th largest superannuation sector.

Thus, the Australian government and AUSTRAC should consider all the above shortcomings and address the current AML system's shortfalls.

7.4 Recommendations

In terms of the recommendations, these can be directed to the AML system's parties positioned in their three categories and their respective relationships: AUSTRAC, partner agencies and reporting entities.

7.4.1 Recommendations to AUSTRAC and Partner Agencies

As this thesis has addressed a number of shortcomings regarding (a) the enforcement mechanism of AUSTRAC in terms of its response to non-compliance with reporting obligations, and (b) other AUSTRAC functions, AUSTRAC should consider these shortcomings as important issues that need quick positive action to solve them. Below are recommendations for AUSTRAC's operations and partner agencies participation.

- 1 AUSTRAC needs to consider the implementation of far greater effectiveness in the reporting entities' industries. This can be achieved by the sharing of information in terms of what is the best practice, what AUSTRAC sees would work by setting high standards, through a regulatory guidance system which is developed in conjunction with and through a dialogue with the reporting entities' industries. This will help AUSTRAC to set appropriate benchmarks for everybody and make AUSTRAC's job easier, and the reporting entities' job clearer. This will build a dialogue and create greater engagement between AUSTRAC and its reporting entities. When non-compliance occurs, then it will be a reasonable approach for AUSTRAC to enforce compliance and activate its most effective

powers and use the variety set of sanctions it has according to the level of the breach.

- 2 The balance between being a successful regulator and the effective FIU is important to the success of AUSTRAC work in general and its enforcement mechanism specifically. As a regulator AUSTRAC needs to abandon the policy of ‘well this is our view and you should do it even if it is not clear enough’. It risks alienating the reporting entities on whose information is crucial in the fight against ML. A regulator cannot risk fostering an attitude where industry supplies low quality materials (out of fear or even disinterest), the sheer volume of which may displace indicators of serious threats. It would be extremely unhelpful to foster an industry attitude of ‘yeah will do whatever’ due to ‘pressure’ when that fails to produce the best outcome for both regulator or regulated.

AUSTRAC needs to engage with reporting entities at a regulator level and benefit from other regulators’ experiences in this domain. This will add important value to AUSTRAC’s work, and make the operation of the AML system much easier than it is at the current time for many businesses.

- 3 As Australia has relatively new legislation, it needs to revisit the Act and its operation by considering a discussion about the applicability of certain parts of the Act to institutions. This also should not happen separately from considering the experiences of comparable international agencies. AUSTRAC needs to examine what other countries are doing in enforcing compliance — for example, not just the raw data of cases prosecuted but the number of cases taken to court (and those successful) expressed as a proportion of reports received, and their enforcement measures and their use. It should develop some sort of benchmarking of the

performance of the new legislation compared to those other western countries with developed economies.

- 4 AUSTRAC needs to be clearer in its communication with reporting entities in order to ensure the adoption and maintenance of the correct OCDD and in order to complete the KYC verification.
- 5 AUSTRAC must seriously consider the quality of its existing feedback and the need for additional feedback and further guidance and explanations in areas of uncertainty or ambiguity. AUSTRAC's feedback should consider the quality of reporting entity reports so as to enhance the existing controls, as the current feedback that AUSTRAC provides through its publications has proven to be inadequate for reporting entities to understand and deal with the AML system in the way it expects/desires.
- 6 AUSTRAC should consider establishing an annual award (or perhaps a major award and awards per key sub-sectors) and publishing the name of the financial institution that is the best performer in terms of compliance for the year in the annual report. Such awards can provide additional motivation for reporting entities not only as a form of positive recognition by the regulator of their efforts but also as an opportunity to publicise its level of compliance to the public. The adoption of such a system might also help foster a more positive relationship with regulatory agencies and result in helping the reporting entities to start to deal with the AML system not from only a perspective of avoiding regulatory sanctions (which should be enhanced) but also from a perspective that takes its threat reduction aspect into consideration more effectively.

- 7 The experience of partner agencies in enforcing compliance is richer and stronger than AUSTRAC's experience in this domain, as this thesis has shown. Thus, AUSTRAC should consider this outcome and try to learn from other partner agencies' enforcement mechanisms, and how these agencies were be able to activate their range of enforcement powers to enforce compliance. Such agencies include ASIC, ACCC and APRA.
- 8 AUSTRAC and partner agencies such as regulators should examine the current disengagement in their relationship and their role in combating ML activities (according to their MoUs) and what they can achieve in terms of combating ML crimes. This would include regulators being more involved and spending more time in looking at AUSTRAC requests in relation to certain cases. For example, AUSTRAC does not have the ability to revoke the licence of non-compliant businesses but ASIC (the regulator that has the authority to give and revoke licences of non-compliant entities) can. However, there is no evidence of an action by ASIC or any other regulators to revoke licences of any non-compliant entity. Here AUSTRAC should consider other partner agencies' abilities to activate the enforcement mechanism of the AML system, and those partner agencies should be involved and take the AML system and its obligations as a serious matter and one of their priorities.
- 9 AUSTRAC should be provided through its executive and management teams (including: Executive General Managers, Chief Information Officer, and Directors) with personnel with the right talents and a high enforcement profile that would enhance the enforcement decisions in its work so that it achieves the adequate and most effective use of its enforcement mechanism and is able to

handle any external pressure that it might receive that could affect its enforcement decisions. For example, AUSTRAC could benefit from the expertise of other regulators and enforcement agencies' staff such as ASIC, ACCC and APRA, for its enforcement executive and management teams.

- 10 It is essential to remember that the reason for the need for stronger and effective regulation is the different nature of the reporting entities. AUSTRAC needs to consider this fact when enforcing compliance and to insure it receives high quality information from these entities if it wants to achieve greater outcomes in the area of AML enforcement and regulation. As a result, this will enhance the overall outcome of the AML system by improving the quality of information that the partner agencies such as the ATO, ASIC, ACCC, APRA, and AFP receive from AUSTRAC.

7.4.2 Recommendations to Reporting Entities

- 1 Reporting entities should consider the shortcomings in the quality of their reports and ensure that they keep up to date with and follow any amendments to the AML system (Act and Rules) and AUSTRAC instructions so as to maximise regulatory compliance within their institutions.
- 2 This thesis also urges reporting entities to determine where AUSTRAC found shortfalls in reporting entity operations and work together to decide how to avoid similar problems in future.
- 3 The reporting entities need to understand *why* they are reporting to AUSTRAC and what they need to report, in order to enhance the level of compliance.

- 4 The reporting entities also need to understand the use of the enforcement powers (many of which can easily found on AUSTRAC's website) and be able to determine how these actions are arrived at. They are fact-based, but most likely do not reflect all the factors that convinced AUSTRAC to take the enforcement action. However, this understanding can be achieved with better communications and systematic education between AUSTRAC and reporting entities.
- 5 In addition, reporting entities should consider the shortcomings they experience in AUSTRAC's and their own in-house AML training programs and put greater efforts into communicating with AUSTRAC so that the most appropriate and effective systematic programs that will improve the quality of the reports can be put in place.

7.5 Conclusion

The dilemma in the Australian AML system is clear: It is supervised by the Australian FIU and regulator (AUSTRAC), which is suffering from a deficiency in experience in regulating the system in the way it should be, which is affecting its enforcement mechanism negatively. AUSTRAC has been found to have major weaknesses that make it deviate from the four key attributes identified in this thesis. The thesis has shown that AUSTRAC does not actively use the most effective sanctions in response to non-compliance with reporting obligations or other obligations under the AML Act and Rules; AUSTRAC is facing a lack of agreement with its partner regulatory agencies, and also regulated entities; and Australia has controversial legislation and regulations which have been affected by the recommendations of the FATF that remain themselves controversial. AUSTRAC also needs to guard against appearing to be unable to avoid

regulatory capture, or appearing to draw away from its responsibilities due to political pressure or economic problems.

The deficiencies do not stop at AUSTRAC operations; rather it extends to other parties in the AML system. On one hand, regulated entities (reporting entities) in general suffer from a lack of understanding the RBA and deficiencies in AML training programs. This affects their level of compliance with their reporting obligations as well as other obligations under the AML Act and Rules. On the other hand, partner agencies seem to work separately, and at a distance, from the AML system, and their contribution in this domain is very limited. Operational enhancements alone under AUSTRAC will not be sufficient to deal with its current weaknesses. For example, concentrating its efforts on enforcing small business compliance with the AML system (such as by remittance service businesses) may just further blur the thin dividing line between achieving AUSTRAC's Guiding Principles — including integrity, equity, efficiency and transparency in its operations — and adding more weaknesses to its current situation. Such a concentration on small entities may lead to a perception that it is subject to improper influence (whether pressure from lobbyists from larger entities or industry sectors, or from the performance of the economy itself) and so chosen to avoid investigating and imposing harsher sanctions on larger non-compliant reporting entities.

Maintaining sustainable improvements in the relationship between AUSTRAC and its partner agencies could significantly assist AUSTRAC to achieve its common objectives of addressing its enforcement mechanism and utilising it effectively. Given the features of its regulatory culture that permits the regulator (and its partner agencies) to enforce compliance using various enforcement powers (soft and harsh) largely at its discretion, in the long term this necessitates that AUSTRAC develop a clear, more appropriate and

practical solutions for the Australian AML system. AUSTRAC's achievement of this will result in more cost-effective surveillance by and better responses from reporting entities in regard to compliance by their consideration of both threat reduction and avoiding regulatory sanctions. Enhanced surveillance, detection and notification could also discourage the proliferation of criminal intent among those with access to the Australian financial system.

Towards this end, this thesis has made several recommendations which will improve AUSTRAC's operations and organisational structure, and will positively affect its work in general and its enforcement mechanism in particular. It has also made a number of recommendations to enhance the role of partner agencies in regard to the AML system and the advantages that their collaboration can provide to AUSTRAC in this domain. In addition, a number of practical solutions are suggested for reporting entities in terms of the provision of successful AML training programs and enhancing the level of reporting entities' compliance in AML crimes area. Moreover, it has been clear that the thesis has urged the federal government to find the right balance between targeting, monitoring, and criminal justice and civil justice responses ('steering' rather than 'rowing') in consultation with AUSTRAC and the various other key players.

While there are difficulties with the implementation of RBA in AML in Australia, and particularly in relation to poor quality reports, and AUSTRAC's use of its enforcement mechanism, as well as difficulties AUSTRAC has in its relationships with both reporting entities and partner agencies, these are not insurmountable. The benefit of enhanced relationships achieved through better communication between regulator and regulated entities, and the more appropriate use of the enforcement mechanism, would provide substantial benefits for the Australian and the broader international community.

It is well worth the effort that needs to be made to improve the Australian AML system.

It is hoped that this thesis has made a contribution to just such a process.

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ACAMS, *Anti-Money Laundering & Proceeds of Crime: Laws & Counter Measures*, ACAMS course held at the University of New South Wales (UNSW) (2 May 2011)

ACAMS, *Evolution of the Risk Based Approach Discussion*, Sydney (19 August 2010)

ACAMS, *PCI Compliance*, Sydney (10 May 2011)

CPA Australia, *Forensic Group Discussion*, Sydney (12 August 2010)

Interviews

A meeting with Professor John Broome, Centre for Transnational Crime Prevention, Faculty of Law, University of Wollongong, (9 March 2011)

Email from an AFP officer (when author was seeking permission for interview with an AFP officer), 13 August 2010

Interview with a Compliance Manager A, a financial institution (Sydney, 21 October 2010)

Interview with an Accountant B (Wollongong, 31 August 2010)

Interview with Real Estate Agent C, a real estate agency (Sydney, 21 June 2010)

Interview with Compliance Manager D, a financial institution (telephone) (Melbourne, 9 September 2010)

Interview with Compliance Manager E, a financial institution (Sydney, 26 August 2010)

Interview with Compliance Manager F, a financial institution (telephone) (Melbourne, 12 August 2010)

Interview with Accountant G, a financial institution (Sydney, 15 July 2010)

Interview with Compliance Manager H, financial institution in (Sydney, 16 September 2010)

APPENDIX A: OLD AND NEW NUMBERING OF THE FATF RECOMMENDATIONS

THE FATF RECOMMENDATIONS

INTERNATIONAL STANDARDS ON COMBATING MONEY LAUNDERING AND THE FINANCING OF TERRORISM & PROLIFERATION

THE FATF RECOMMENDATIONS

Number	Old Number ¹	
A – AML/CFT POLICIES AND COORDINATION		
1	-	Assessing risks & applying a risk-based approach *
2	R.31	National cooperation and coordination
B – MONEY LAUNDERING AND CONFISCATION		
3	R.1 & R.2	Money laundering offence *
4	R.3	Confiscation and provisional measures *
C – TERRORIST FINANCING AND FINANCING OF PROLIFERATION		
5	SRII	Terrorist financing offence *
6	SRIII	Targeted financial sanctions related to terrorism & terrorist financing *
7		Targeted financial sanctions related to proliferation *
8	SRVIII	SRVIII Non-profit organisations *
D – PREVENTIVE MEASURES		
9	R.4	Financial institution secrecy laws
		<i>Customer due diligence and record keeping</i>
10	R.5	Customer due diligence *
11	R.10	Record keeping
		<i>Additional measures for specific customers and activities</i>
12	R.6	Politically exposed persons *
13	R.7	Correspondent banking *
14	SRVI	Money or value transfer services *
15	R.8	New technologies
16	SRVII	Wire transfers *
		<i>Reliance, Controls and Financial Groups</i>
17	R.9	Reliance on third parties *
18	R.15 & R.22	Internal controls and foreign branches and subsidiaries *
19	R.21	Higher-risk countries *
		<i>Reporting of suspicious transactions</i>
20	R.13 & SRIV	Reporting of suspicious transactions *
21	R.14	Tipping-off and confidentiality
		<i>Designated non-financial Businesses and Professions (DNFBPs)</i>
22	R.12	DNFBPs: Customer due diligence *
23	R.16	DNFBPs: Other measures *

E – TRANSPARENCY AND BENEFICIAL OWNERSHIP OF LEGAL PERSONS AND ARRANGEMENTS		
24	R.33	Transparency and beneficial ownership of legal persons *
25	R.34	Transparency and beneficial ownership of legal arrangements *
F – POWERS AND RESPONSIBILITIES OF COMPETENT AUTHORITIES AND OTHER INSTITUTIONAL MEASURES		
<i>Regulation and Supervision</i>		
26	R.23	Regulation and supervision of financial institutions *
27	R.29	Powers of supervisors
28	R.24	Regulation and supervision of DNFBPs
<i>Operational and Law Enforcement</i>		
29	R.26	Financial intelligence units *
30	R.27	Responsibilities of law enforcement and investigative authorities *
31	R.28	Powers of law enforcement and investigative authorities
32	SRIX	Cash couriers *
<i>General Requirements</i>		
33	R.32	Statistics
34	R.25	Guidance and feedback
<i>Sanctions</i>		
35	R.17	Sanctions
G – INTERNATIONAL COOPERATION		
36	R.35 & SRI	International instruments
37	R.36 & SRV	Mutual legal assistance
38	R.38	Mutual legal assistance: freezing and confiscation *
39	R.39	Extradition
40	R.40	Other forms of international cooperation *

1. The 'old number' column refers to the corresponding 2003 FATF Recommendation.

* Recommendations marked with an asterisk have interpretive notes, which should be read in conjunction with the Recommendation.

Version as adopted on 15 February 2012.

APPENDIX B: PARTICIPATION INFORMATION SHEET

RESEARCH TITLE

An Evaluation of AUSTRAC's Enforcement Mechanism Regarding Noncompliance with Reporting Obligations

The investigators of this study:

Supervisor: Prof. John Broome, Faculty of Law/ Centre for Transnational Crime Prevention, (*phone number*). (*E-mail address*)

Student: Mohammad AlRashdan, PhD Candidate, Faculty of Law/ Centre for Transnational Crime Prevention, (*phone number*). (*E-mail address*)

What is the Research aim?

This research project will examine the strengths and weaknesses of the enforcement mechanism of the Australian Transaction Reports and Analysis Centre (AUSTRAC) in dealing with non-compliance of reporting entities in regards to the reporting obligations. It aims to identify, and critically evaluate, the factors that impact upon AUSTRAC's enforcement decisions. It also aims to understand how reporting entities perceptions of AUSTRAC's enforcement mechanism affect their responses to the reporting obligations.

Why have I been invited to participate?

You have been invited to participate in this study because you are a representative and one of the Compliance Department staff for an Australian Reporting Entity who has had the duty to comply with the Australian Anti- Money Laundering Act and its reporting obligations.

What will I be asked to do?

- You will be asked to participate in a one on one interview with the researcher that will go for approximately one hour.
- You will be asked a series of questions on the Australian anti-money laundering system including AUSTRAC, and the effectiveness of AUSTRAC in enforcing compliance with national reporting requirements (see questions attached).
- The answers you give will be recorded using a tape recorder.
- A transcript will be sent to you to check. If you have any changes you will be asked to mark them on the transcript, and return them to the researcher within two weeks by E-mail.

Will my answers be kept confidential?

All information that is collected during the interview will remain confidential. The information will be stored securely at Centre for Transnational Crime Prevention, University of Wollongong. The information gained from you during the interview will be analysed along with that of the other participants in this study and used in the preparation of a thesis and other academic publications. No personal or identifying data will be included.

How do I consent to participate?

A consent form is attached. By completing this form and bringing it on the day of the interview with the researcher and complying with the interview process, consent will be officially given.

What if I change my mind about participation?

At any time during the study you have the right to withdraw your consent by E-mail to the researcher.

How will I benefit from participating in this study?

This study will not benefit you personally. However, through participating in this research, you may be providing benefit to your institution and other reporting entities as well as the Australian Transaction Reports and Analysis Centre (AUSTRAC). The findings that will come from this study will be referred back to AUSTRAC.

Will participating in this study be harmful to me in anyway?

As you will be asked to answer questions that may reveal information that indicates a lack of compliance in your institution, you will have all rights to decide which questions to answer and which not.

The information provided will be fully de-identified before publication and it is not anticipated that this study will cause you harm in anyway.

Who can I ask any questions I have about this study?

If you have any further questions about this study, please contact Prof. John Broome on (*phone number*). You will also have the opportunity to ask questions before and during the interview.

This study has been reviewed by the Human Research Ethics Committee (Social Science, Humanities and Behavioural Science) of the University of Wollongong. If you have any concerns or complaints regarding the way this research has been conducted, you can contact the UoW Ethics Officer on (*phone number*).

APPENDIX C: CONSENT FORM FOR MANAGEMENT/ ADMINISTRATIVE STAFF

RESEARCH TITLE

An Evaluation of AUSTRAC's Enforcement Mechanism Regarding Noncompliance with Reporting Obligations

RESEARCHER'S NAME

Mohammad AlRashdan

I have been given information about 'An Evaluation of the AUSTRAC Enforcement Mechanism Regarding Noncompliance with Reporting Obligations' and discussed the research project with Mohammad AlRashdan who is conducting this research as part of a PhD degree supervised by Prof. John Broome in the Faculty of Law/ Centre for Transnational Crime Prevention at the University of Wollongong.

I understand that the only burden associated with participation in this research is the time involved in the interview. I understand that some questions will be related to my work place (*Name of the institution*) and may reveal some challenges which are currently facing this institution. I have been informed that all information that I provide will be treated confidentially and that I will not be identifiable in the publications resulting from this study.

I have read the information sheet and have had an opportunity to ask *Mohammad AlRashdan* any questions I may have about the research and my participation. I understand that my participation in this research is voluntary, I am free to refuse to participate and I am free to withdraw from the research at any time. My refusal to participate or withdrawal of consent will not affect *my treatment in any way /my relationship with the Faculty of Law and the Centre for Transnational Crime Prevention or my relationship with the University of Wollongong*.

If I have any enquiries about the research, I can contact Mohammad AlRashdan (*phone number*) **or** John Broome (*phone number*) or if I have any concerns or complaints regarding the way the research is or has been conducted, I can contact the Ethics Officer, Human Research Ethics Committee, Office of Research, University of Wollongong on (*phone number*).

By signing below I am indicating I have consented to

- Participating in the research through an interview.
- Answering all questions related to this research, where I have not agreed the question has not been answered.
- The data collected from my participation will be used for *Mohammad AlRashdan's PhD Thesis*, and related publications.
- Check the transcript of the interview and notify the researcher of any changes I would like to do within two weeks.

Signed

Date

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...../...../.....

Name (please print)

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