

COMMONWEALTH LAW ENFORCEMENT BOARD

SUBMISSION TO FINANCIAL SYSTEM INQUIRY

EXECUTIVE SUMMARY

Law enforcement issues are integral to the credibility, health and security of the Australian financial system.

The economic effects of financial crime are particularly acute in a market the size of Australia's. Financial crime not only has a direct monetary cost, but also threatens the integrity of Australia's financial markets, the interests of investors and creditors, wider public confidence in our markets, and the levels of domestic and international investment and commercial activity which takes place in our markets.

Australia experiences a significant level of financial crime. Currently, organised and white collar crime is generating profits of some \$1.5 billion per annum in Australia. Corporate crime, or crime against business in Australia, has direct costs of \$1.5 billion per annum and indirect costs of a further \$5 billion per annum. Altogether \$3.5 billion in criminal profit is generated and laundered in and through Australia every year.

Financial crime and its frequent links with organised crime are recognised as one of the most serious problems in the international community, with the ability to undermine the financial and political stability of nations. Action to counter financial crime is being taken in a number of international fora, including the G-7 Financial Action Task Force on Money Laundering, the United Nations, the International Organisation of Securities Commissions and APEC. Developing a robust regulatory regime which complements international initiatives meets our international obligations and enhances our attractiveness as a safe and stable economy in which to do international business.

Australia has experienced one warning of the effects of corporate criminality and misconduct in the corporate collapses of the late 1980's, which had severe detrimental effects on confidence in the financial system and on the economy in general. The Australian Securities Commission was created in response to the economic and political injuries suffered in that era.

Arguments supporting a purely self-regulatory or prudentially based financial environment ignore both the 1980's experience and the fact that significant financial crime continues to occur. Ongoing corporate malfeasance is not confined to the 'shonky' end of town - since 1990, many of the largest and most powerful corporate entities in Australia have been involved in breaches

of the law. Alan Bond is the 127th white collar criminal jailed in Australia since 1990.

The Australian financial system needs to adjust to a number of significant trends, including economic deregulation, self-regulation, electronic commerce, and the globalisation of markets and commerce. These trends create new opportunities for both honest and dishonest players, not least organised crime. As a result, the risks to the financial system and the emerging threats from financial crime are changing, and will become increasingly sophisticated.

Specific emerging areas of concern include:

- technologically-based financial crime, including money laundering, manipulation of trading systems, abuse of electronic currency and transaction via the Internet;
- disintermediation of financial sector services, as well as the emergence of alternative, non-traditional and relatively unsupervised financial intermediaries and service providers; and
- the potential for increased risk of major fraud, corruption and theft in the vast and growing insurance and superannuation industry.

Developments in these areas will require regulatory agencies to become more proactive and technologically proficient. The capacity for effective law enforcement to counter increasingly sophisticated financial crime cannot be regarded as peripheral to financial regulation; it must be built into the system.

The present regulatory and enforcement system is based on a hierarchy of responses to breaches of the law, ranging from prudential supervision through to criminal prosecution. For the regulatory measures at the lower end of the hierarchy to be effective, the real deterrent of punitive action through criminal prosecution must exist. In the many cases where breaches of the law cause significant harm, remedies that are reliant purely on the operation of the market are not an appropriate response. In the emerging areas of concern listed above, self-regulation or prudential control will not be sufficient to protect the financial system from the risk of criminal attack.

In light of the above, the Commonwealth Law Enforcement Board (CLEB) considers that if new regulatory arrangements to be implemented as a result of the Financial System Inquiry are to succeed in ensuring stronger economic performance, financial stability and international competitiveness for Australia, they must take into account and integrate the economic imperatives of effective law enforcement. In this context, the Board makes the following four recommendations:

- To discourage misuse of systems, law enforcement should be specifically referred to in the statutory charters of the mainstream regulatory agencies

and be backed up by those agencies having staff appropriately skilled in law enforcement.

- The financial system should foster financial activity and growth that does not have adverse consequences for other government objectives. Accordingly, a 'whole of government' approach to law enforcement in the financial sector is required, involving formal liaison structures between regulators, including wider consultative groups.
- It needs to be acknowledged that self-regulating organisations within the regulatory regime cannot and will not consistently impose appropriate penalties and sanctions, and therefore must be backed up by statutory regulators with a full range of powers to enforce the law.
- Compliance with laws and requirements governing the financial sector must be actively and continuously pursued by regulators. Passive supervision is inadequate. The law must be enforced intelligently and comprehensively to be meaningful.

The International Monetary Fund has found that serious negative consequences for national economies result from money laundering, and recommends that policies aimed at developing financial markets and anti-money laundering policies be coordinated. The containment of money laundering represents good economic governance, as does the containment of financial crime in general.

If our regulatory regime is to evolve towards a more efficient and competitive system, it must take into account the implications of these developments, including new opportunities for criminal activity, and must be proactive, not merely reactive.