COMMONWEALTH LAW ENFORCEMENT BOARD

SUBMISSION TO FINANCIAL SYSTEM INQUIRY

Introduction

The Financial System Inquiry is charged with making recommendations on the nature of the regulatory arrangements that will best ensure an efficient, responsive, competitive and flexible financial system in Australia, to underpin stronger economic performance, consistent with financial stability, prudence, integrity and fairness.

The Commonwealth Law Enforcement Board (CLEB)[1] believes that an effective law enforcement capability delivers fundamental economic benefits to any financial system. Indeed, a healthy and competitive economy requires effective, consistent and integrated enforcement of the laws passed to govern the business community.

The health and well-being of a country's financial system depends on a range of factors, many of which operate in the background: creating an atmosphere or climate in which an economy performs. Whilst it is true that the ability of a country's financial system to contribute to the growth and stability of the country depends largely upon the way in which the financial system itself is regulated, it is equally true that the social and legal framework in which the financial system operates is very influential. A financial system in which participants are subject to both appropriate regulatory requirements and well conceived laws and adequate enforcement mechanisms promotes financial stability, prudence, integrity and fairness.

Financial transactions can and all too often do involve serious crime. Supervisory or prudential regulation alone is not sufficient to deal with criminal financial activity and serious contraventions of the law; such regulation must be supplemented by effective punishment and deterrence.

Thus issues of law enforcement are not irrelevant or peripheral to a consideration of Australia's financial well-being. They are integral to credible financial regulation.

Effective law enforcement is also important to the Australian business community and the public in general, as demonstrated by the consistent responses to market research conducted on behalf of the Australian Securities Commission in 1994 and 1996, which reveals that the public believes

---

[1] CLEB membership includes: Mr John Broome, Chair (Chairperson NCA); Mr Mick Palmer (Commissioner AFP); Mr Alan Cameron (Chairman ASC); Mr Stephen Skehill (Secretary Attorney-General's Department); Ms Elizabeth Montano (Director AUSTRAC); and Mr Daryl Smeaton (Executive Member CLEB).

enforcement to be the single most important role or function of the companies and securities regulator.[2]

This submission sets out:

- the risks inherent in failing to contain the degree of financial crime in our economy;
- the benefits to our financial system of an integrated and effective law enforcement capability;
- the potential implications to date and in the future of the continuing changes to that financial system, particularly in the areas of deregulation, globalisation and technological development; and
- some recommendations in relation to making financial sector regulation more effective.

The economic benefits of effective law enforcement

An efficient and stable financial system is essential for Australia's economic growth and international competitiveness. Financial crime not only has a direct monetary cost, estimates of which are provided below, 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 investment and commercial activity, both domestic and international, that takes place in our markets.

The economic effects of financial crime are particularly acute in a market the size of Australia, which, being mature (and therefore lacking any prospect of dramatic growth) but small compared to other mature markets, can be very easily marginalised if there are any real doubts about the integrity of its financial system. Any degree of apparent tolerance of financial crime will have clear economic consequences for Australia and its economy.

The experiences of other countries, whose systems have been corrupted[3], show that those economies suffer adverse reaction from both other governments and the international business community, in terms of negative publicity, withdrawal of international assistance and support, and reluctance to invest in those jurisdictions. In extreme cases these adverse reactions extend to withdrawal of access to strategically important financial clearing and banking systems.

---

[2] Chant Link & Associates: Report on Customer Satisfaction with Performance of the ASC; 1994 and 1996.

[3] Italy provides an enduring example, while Russia presents a good emerging example. For further examples see: The Regulation and Prevention of Financial Crime Internationally (Ed. J Reuvid, Kogan Page Ltd, London 1995).

There are clear and demonstrable advantages, both nationally and internationally, in being (and being seen to be) a well regulated and 'clean' market.

The international perspective

Financial crime and its frequent links with organised crime have been recognised internationally as one of the most serious problems facing the international community. Its potentially disastrous effects on nations' financial and political stability are such that sustained efforts to deal with these crimes are undertaken in a number of international fora.

For example, the G-7 originated Financial Action Task Force on Money Laundering (FATF), of which Australia is a member, works to create financial systems which are hostile to money laundering activities, not only in an effort to reduce organised crime, drug trafficking and other serious crime but also to minimise the vulnerabilities of financial systems to unpredictable and potentially destabilising capital flows.

The United Nations is poised to take on money laundering as a major issue. United States President Clinton, in his address to the United Nations Assembly on the occasion of the 50th anniversary of the United Nations, said:

> "Yesterday, I directed our government to identify and put on notice nations that tolerate money laundering. Criminal enterprises are moving vast sums of ill-gotten gains through the international financial system with absolute impunity. We must not allow them to wash the blood off profits from the sale of drugs from terror to organised crimes. Nations should bring their banks and financial systems into conformity with the international anti-money laundering standards. We will work to help them do so. And if they refuse, we will consider appropriate sanctions."

Working Party 4 of the International Organisation of Securities Commissions (IOSCO) is also currently reviewing the work done under its earlier mandate on money laundering.

Similarly, the Communique issued following the APEC Finance Ministers' Meeting in Kyoto, Japan, on 17 March 1996 stated:

> "We continue to recognise money laundering as a priority concern and one which could threaten legitimate institutions and economic policies. We endorse established international cooperative work and encourage adherence to international standards in the anti-money laundering field as well as ongoing regional efforts including the one in the context of the Financial Action Task Force towards enhanced cooperation in this area. We will be briefed regularly on the progress made toward improved international and regional cooperation."

The link between economic stability and the prevention or containment of financial criminal activity has been recognised at a political level; and imposes a moral obligation on Australia, as a good international citizen, to develop a robust regulatory regime which is able to complement wider international regulatory initiatives. Australia’s law enforcement system enhances the country’s attractiveness as a place to do international business.

The cost of financial crime

The cost of crime in Australia is high. While estimating this cost is difficult, on the best available information gathered by Commonwealth law enforcement agencies, crime costs the Australian community a total of some $10 billion to $12 billion per annum (2.5 per cent of Gross Domestic Product, or between $555 and $666 per capita)[4].

The above estimate does not include those costs associated with the maintenance of the Commonwealth, State and Territory criminal justice systems[5], or the costs of such crime prevention measures as may be privately implemented by the Australian business community.

Nor does it include the secondary or flow-on effects of fraudulent activity. Major corporate or banking fraud can have serious economic effects, as demonstrated internationally by the collapses of the Bank of Credit and Commerce International and more recently Barings Bank. Domestically the $250 million fraud involving the National Safety Council of Australia, and the failure of entities such as the Pyramid Building Society have shown that such failures have the capacity to cripple or even destroy local or industry specific economies.

Fraud or white collar crime

Of the total referred to above, it is estimated that organised crime and white collar crime generate profits in Australia of some $3.5 billion per annum. Corporate crime, or crime against business in Australia, is estimated to have direct costs of $1.5 billion per annum and indirect costs of a further $5 billion per annum.

Indeed the 1994 Report of the Review of Commonwealth Law Enforcement Arrangements noted that, on the basis of the most conservative assessments, fraud imposes the greatest economic cost on the Australian community of all forms of major and organised crime[6]. (This includes both fraud against the Commonwealth or State, which constitutes primarily revenue, social security and medical benefits fraud; and fraud in the private sector, which includes companies fraud, securities fraud, fraud on banks and financial institutions, insurance fraud, superannuation fraud, fraud on consumers and retail fraud.)

Money laundering

---

4 John Walker Consulting Services: Estimates of the costs of crime in Australia: revised 1995 (prepared October 1995 for the CLEB).

5 For example, estimated costs of State, Territory and Commonwealth policing systems alone are $2.7 billion (Cth Grants Commission 1994 data).

6 Report of the Review of Commonwealth Law Enforcement Arrangements, 1994, p 38.

Money laundering also has a major impact on the Australian economy. It is estimated by AUSTRAC that some $3.5 billion in funds is generated in Australia and laundered, in and through Australia , every year. (Estimates of international money laundering range from $500-1100 billion per annum.)

AUSTRAC concludes that financial crime and money laundering have three different types of effects upon the economy[7]:

- first, the losses to the victims of the crime;
- secondly, the gains made by the criminals; and
- thirdly, the "collateral damage", or in essence the distortion, to the national economy.

By way of example, AUSTRAC notes that:

> "When illicitly gained money is spent on lavish real estate there is probably a net loss to the economy, but where it is turned into legitimate businesses the net effects can be quite positive to the economy. The unfair competition that such money introduces to an industry is, however, potentially disastrous to legitimate operators in the industry. When money is brought into Australia from overseas for laundering, one might conclude that from a purely economic view the effect on the Australian economy is an entirely positive one, however it also competes unfairly with legitimate operators, and has the potential to encourage corruption of public officials and business structures in Australia."[8]

A recent International Monetary Fund (IMF) analysis of the effects of money laundering[9] also concludes that it can distort economic data, macroeconomic analysis and policy making. In addition, it notes that there may be direct effects on saving, resulting from induced changes in income distribution and the erosion of confidence in financial markets; and that there is also some evidence of a depressant effect on economic growth.

According to the IMF[10], the potential macroeconomic consequences of money laundering include:

- changes in the demand for money that seem unrelated to measured changes in fundamentals;
- volatility in exchange rates and interest rates; and

---

7 AUSTRAC: Estimates of the extent of money laundering in and through Australia (September 1995)

8 AUSTRAC: Estimates of the extent of money laundering in and through Australia (September 1995), p ix.

9 International Monetary Fund: Monetary and Exchange Affairs Department - Macroeconomic Implications of Money Laundering (Peter J Quirk, April 1996)

10 International Monetary Fund: Macroeconomic Implications of Money Laundering - IMF Staff Statement, Meeting of Financial Action Task Force (June 26-28, 1996)

- increased instability of liabilities and heightened risks for asset quality for financial institutions, creating systemic risks for the stability of the financial sector.

The IMF report also highlights the implications of money laundering for economic policy makers, concluding that public policy considerations would support an anti-laundering role for financial institutions which are involved in prudential banking supervision, tax evasion monitoring, statistical reporting, and legislation[11].

The IMF report concludes that there is no conflict between policies aimed at developing financial markets and anti-money laundering policies, but that rather, there is considerable synergy to be gained from coordinating them:

> "Successful efforts to counter money laundering can assist the stability and confidence of the financial markets, and thus contribute to macroeconomic efficiency and growth[12]."

In other words, the containment of money laundering activities represents an element of good economic governance. This concept can readily be extended to the containment of financial crime in general.

Lessons from the 1980's

In the late 1980's the Australian financial system was rocked by a large number of corporate collapses, including investment companies such as Bond Corporation and the Qintex Group, operating companies such as Budget and Southern Cross Holdings (Compass Airlines Mark Two), and merchant banks including Rothwells and Spedley Securities. There is no question that these collapses had severe detrimental effects upon the Australian economy and confidence in Australia's financial system; and a significant number of them were connected with the commission of crimes by those in charge of the relevant entities[13].
The corporate collapses of the 1980's and their dramatic effect on the Australian economy and investor confidence in Australian companies and securities markets, both nationally and internationally, resulted in Australian governments, both state and federal, recognising the need for an appropriately funded body with necessary powers and will to administer and enforce corporate and securities laws on a nationally consistent basis, in concert with consistent enforcement action by other regulatory agencies.

However, on occasion it appears that the lessons learnt from the 1980's are being all too quickly forgotten. This is particularly evident in the arguments put in support of a purely self-regulatory or prudentially based financial environment. These arguments often appear to disregard the fact that

---

[11] International Monetary Fund: Monetary and Exchange Affairs Department - Macroeconomic Implications of Money Laundering (Peter J Quirk, April 1996).

[12] International Monetary Fund: Monetary and Exchange Affairs Department - Macroeconomic Implications of Money Laundering (Peter J Quirk, April 1996), p 29.

[13] For further examples see Appendix 1 to this submission.

Australia continues to experience incidents of serious financial crime, which cannot be adequately dealt with by self-regulation or narrowly-focused prudential supervision.

Beyond the 1980's experience, significant financial crime is ever-present in Australia. Since January 1991, the joint approach to corporate prosecutions adopted by the Australian Securities Commission and the Commonwealth Director of Public Prosecutions has offered greater coordination and management of cases involving serious corporate wrongdoing. This cooperation resulted in forty-two convictions of company officers in the 1994/95 financial year and forty-nine convictions of company officers in 1995/96 in matters prosecuted by the Commonwealth Director of Public Prosecutions. The recent jailing of Alan Bond is the 127th white collar criminal jailed since 1990.[14] Indeed since 1990, many of the largest and most powerful corporate entities in Australia have been involved in breaches of the law.[15] Clearly corporate malfeasance in Australia is not confined to so-called 'shonky' end of town operators. A further extensive list of both domestic and international examples of financial crime and, where possible, the regulatory responses to it, is contained in Appendix 1 to this submission.

Forces of change in the Australian financial system

There are several major and easily identifiable forces of change which are shaping events in the Australian financial system, and which bear upon both the future nature of financial crime and the appropriate responses to it[16]. These forces include:

- economic deregulation, which presents new opportunities to the business community;

- the growing incidence of self regulation, which has in many instances proved effective but which does have acknowledged limitations, arising from its inherent conflicts of interest, limits on investigative powers and lack of access to real punitive or criminal sanctions;

- electronic commerce and advances in technology and communications, particularly relevant given the high 'take-up' rate of new technology in Australia;

---

14 Some big business names of the 1980's wanted in relation to suspected corporate crime remain beyond the reach of Australian extradition laws, including Christopher Skase in Majorca, Abe Goldberg in Poland, and Antony Oates also in Poland.

15 For example, matters recently dealt with by the ACCC involving major corporate entities include; oil companies (price fixing arrangements), building/concrete/telephone companies (anti-competitive conduct), retail giants (related party transactions), and mining companies (environmental degradation in PNG).

16 For a detailed environmental scan see: Office of Strategic Crime Assessments, Issue Analysis: Criminal Threats to the Financial System in Australia, Assessment 3/95 (September 1995)

- the globalisation of markets and commerce, and the related breakdown of Australia's geographic isolation as a barrier to crime; and

- the increasing sophistication of financial crime.

These forces are creating new opportunities for both honest and dishonest players, on an international scale. For just as sophisticated communications and information systems can be beneficially exploited by legitimate participants, they can also be compromised, disrupted or misused by organised crime.

For example, the potent combination of globalisation and technological development can be used to[17]:

- take advantage of gaps and vulnerabilities in Australia's regulatory regimes;

- develop flexible, rapid and anonymous schemes for the transfer of funds and movement of assets across national boundaries;

- conceal the origin of funds ownership and control through complex software programs; and

- exploit the availability of offshore banks offering financial secrecy.

The Australian financial system must be capable of responding quickly, effectively and consistently to changes and developments such as these, to maximise the opportunities for honest players and limit them for the dishonest.

Financial crime of whatever type puts the integrity of our financial system at risk. The risk may be direct (for example, the potentially disastrous consequences of the collapse of a major financial institution) or indirect (through flow-on effects, such as loss of value of assets or increased costs to market participants through premiums or charges). Financial crime also inevitably weakens public confidence in the criminal justice system and in the soundness of the regulatory regime overall.

In the environment of change that currently characterises our financial system, the risks to that system and the emerging threats from financial crime are changing, and can be expected to involve increasing levels of sophistication.

If our regulatory regime is to evolve towards a more efficient and competitive system, it must be aware of the implications of developments such as those set out above, must take into account the opportunities created for criminal activity, and must be proactive and not merely reactive.

---

17 Office of Strategic Crime Assessments, Issue Analysis: Australia's Move Towards Electronic Commerce: Some Implications for Law Enforcement, Assessment 2/95 (September 1995)

Emerging areas of concern

Commonwealth law enforcement agencies in Australia have identified several areas, directly related to the forces of change referred to above, which are expected to generate major challenges for regulators now and in the future. These are:

- the broad spectrum of what might be called 'technologically based' financial crime. This has numerous and varied manifestations, including money laundering, manipulation of trading systems, abuse of electronic currency and transactions via networks such as the Internet. Some of these are further referred to below;

- the increasing trend towards disintermediation of financial sector services, as well as an anticipated explosion in the number 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. This is also further discussed below.

The three areas identified above cannot be viewed as separate issues, but are clearly linked; and indeed each contributes to the others. Thus, for example, technology exacerbates the trend towards disintermediation. Disintermediation dilutes the effectiveness of traditionally focussed regulation.

Risks arising from technology

Some particular potential risk areas arising from the first of the areas identified above, that is, technology, include[18]:

- developments in digitised currency and transactions via computer networks, which challenge the ability of financial regulators to trace such transactions;

- emerging payment instruments such as electronic money, smart cards and stored value cards, which carry with them the potential for computer abuse, and no guaranteed redeemability. (These risks are in addition to those already in existence in this context, such as theft and counterfeiting of cash, fraudulent use and counterfeiting of cheques and payment cards, and theft of pre-paid cards); and

---

[18] For details see: Office of Strategic Crime Assessments, Issue Analysis: Criminal Threats to the Financial System in Australia, Assessment 3/95 (September 1995)

- the continuing potential for insider trading, stock market manipulation, false trading and market rigging, given the continuing emergence of new electronic trading systems.

Such technological advances also challenge the ability of the regulatory authorities to ensure that these systems are prudentially sound. In order to determine the stability and security of these new payment systems, regulators must take into account the ability of the legal framework and the capabilities of law enforcement to minimise instances where such stability and security will be threatened by criminals: the systems must not be vulnerable to attack via fraud, manipulation, blackmail or other criminal activities.

In addition, the systems themselves should not be designed in such a way that they are 'law enforcement unfriendly'. Advances in technology ought *not* to follow the example set by the introduction of digital mobile telephones, which were allowed to proliferate (to meet legitimate market demands) without there being an effective monitoring capacity developed in tandem with the digital system itself.

Risks in the superannuation industry

The explosive growth in excluded superannuation funds over the last few years is an unintended consequence of changes in superannuation legislation and the industry. Notwithstanding the prudential and regulatory arrangements in the Superannuation Industry (Supervision) Act 1993 (Cth), there is reason for concern at the potential criminality involved in the exploitation of superannuation funds, on the basis of local and overseas experience[19].

The SIS legislation vests primary responsibility for the viability and prudential operations of the superannuation industry with trustees and funds managers, because there is no other efficient way to prudentially supervise in excess of 90 thousand superannuation funds. Yet trustees and fund managers can be the very people who are in the best position to carry out a fraud against a superannuation fund.

A particular concern with the very large amounts of money now accumulating in superannuation funds is the threat of infiltration by organised criminal elements, with a view to stealing those funds or using them for illegal purposes, especially laundering the proceeds of other crimes. For example, in the United States, major organised crime syndicates have penetrated labour unions with the primary purpose of obtaining access to union pension funds. Australian law enforcement agencies have not discovered any significant indication of involvement of organised criminal groups in superannuation funds, but the analysis of the cases of superannuation fraud discovered in Australia discloses a wide variety of offences committed by the full range of people involved in administering superannuation funds. However, there has been little analysis of

---

19 For a detailed analysis see: National Crime Authority: Assessment of the Vulnerability of Australian Superannuation Funds to Criminal Attacks.

superannuation fraud cases after the introduction of the SIS legislation to demonstrate the continuation of the trend, and the current structure of the industry, with 80% of all superannuation monies controlled by life assurance companies, may be a significant protection against fraudulent attack.

It has been strongly argued in some quarters that prudential supervision of the superannuation industry is all that is required. However, it should be noted that in 1995 the Australian Securities Commission sought the winding up of a group of companies involved in that industry on public interest grounds, and it is currently continuing an investigation of activities associated with those companies. Further, given:

- the priority that superannuation has been given in government policy;
- the overseas experience such as Robert Maxwell's assault upon the Mirror Group's pensions funds; and
- the need for community trust in the safety of retirement funds held by superannuation entities;

prudential supervision alone is unlikely to prove sufficient.

Responses to the risks of financial crime

Because perpetrators of financial crime have shown that they are able to adapt to the emerging environment in innovative and flexible ways, regulatory agencies will also be required to become more proactive and technologically proficient, to prevent and detect emerging sophisticated forms of financial crime. But this capacity for effective law enforcement cannot be regarded as irrelevant or peripheral to financial regulation; it must instead be built into the system.

Ensuring that we have mechanisms for limiting, monitoring and managing the myriad risks associated with financial crime is integral to promoting the reliability and stability of our financial system, as it minimises the potential for, and therefore the economic cost of, financial crime.

<u>The hierarchy of responses</u>

The many and varied potential breaches of the law that exist already and that are certain to develop with further advances in communication and technology, require a wide range of possible responses and remedies; ranging, for example, from prudential supervision, to licensing, administrative and disciplinary action, to civil proceedings, to criminal prosecution.

Each of these potential responses must be available and must be considered in any given case, having regard to the evidence and other factors such as the indicia of dishonesty, so that the right decision can be made on the basis of all relevant information and from a comprehensive set of alternatives. Further,

each of the possible responses and remedies has to be properly integrated into an overall system of financial regulation, so that it is readily accessible and familiar to all relevant authorities.

The current scheme of Commonwealth law enforcement and regulation relating to the operation of the financial system provides a wide variety of responses to aberrant behaviour. This variety of responses is essential both from the perspective of the regulators and the participants within the system.

At the lowest level, regulators and law enforcement bodies can respond to aberrant behaviour by advice and counsel, seeking to remedy a situation by persuasion. Such responses are appropriate where no substantial harm has been inflicted and no deliberately dishonest behaviour has occurred.

Regulators can also respond to aberrant behaviour with a range of administrative sanctions, such as suspension of licences to participate in certain sectors of the financial system, or banning individuals from holding corporate office or providing particular services. Actions of this nature protect other participants in the financial system (in particular the less sophisticated, such as retail investors) from the activities of the dishonest, unscrupulous or incompetent. In cases where there is evidence simply of incompetence without dishonesty, no action other than removal from the industry may be required; however where criminal intent is involved, it is appropriate that additional sanctions, such as prosecution, be pursued.

Some law enforcement agencies are also empowered to take civil action in the courts, either in the public interest or on behalf of certain classes of affected people. Examples include the powers given to the Australian Securities Commission to commence proceedings in the public interest under section 50 of the ASC Law, or to seek the winding up of a company or appointment of a receiver in prescribed circumstances.

Civil penalty orders are also available for contravention of certain provisions. The civil penalty regime in Part 9.4B of the Corporations Law governs, for example, breaches of directors' duties, related party transactions and insolvent trading. It allows the imposition of penalties not exceeding $200,000, and prohibition of persons from involvement in the management of a corporation for a given period of time.

As an ultimate sanction, the law enforcement agencies can prosecute for criminal conduct. Decisions to prosecute are made by the Commonwealth Director of Public Prosecutions in accordance with the Prosecution Policy of the Commonwealth, which requires, first, that a prosecution should not proceed if there is no reasonable prospect of a conviction being secured, and secondly, that the prosecution be in the public interest.

One of the factors to be taken into account in determining whether prosecution is in the public interest in any given case is the availability and efficacy of alternatives to prosecution. This explicitly recognises the existence of

alternatives, and is intended to ensure that these alternatives are considered prior to the prosecution path being selected.

The inclusion of punitive measures in the hierarchy of responses available to regulators and law enforcement agencies is essential. Clearly effective enforcement does not always equal criminal process, but criminal process must be there as a final option, to deal with cases of serious and deliberate breach. In such cases, disgorgement of profits is not sufficient to act as a deterrent; and indeed is viewed by some as merely a risk to be considered relative to the potential gain, ie. a cost of doing business. For regulatory measures to be effective, the real deterrent of punitive action through criminal prosecution must exist.

It must also be stressed that many breaches of the law by participants in the financial system can and do result in significant harm to individuals, who are often not in a position to pursue any recompense or recover from the harm that has been inflicted. Remedies that are reliant purely on the operation of the market are not an appropriate response to the harm which has been inflicted upon those individuals.

There is no justification for a regulatory stance which would result in the participants in Australia's financial system being conferred with a special status which exempts them from the normal rigours of the law. The community expects those who flagrantly and unconscionably breach its norms, in whatever field, to be appropriately punished. It is also rightly expected that misdeeds of similar magnitude will attract sanctions of comparable severity, that there will be consistency in the regulatory responses pursued, and that there will be cooperation and coordination between the regulatory agencies.

The regulatory agencies operate with limited resources, requiring the agencies to target the most appropriate cases and make appropriate use of the range of sanctions available to them. The law enforcement community actively establishes and maintains constructive relationships between regulatory and enforcement agencies in those areas where their respective jurisdiction, function, skill or powers need to be used co-operatively for the most cost-effective and efficient enforcement of law.

Role of the Commonwealth Law Enforcement Board

The Commonwealth Law Enforcement Board ("CLEB") was established as a direct response to the acknowledged need[20] to ensure that all Commonwealth agencies with law enforcement responsibilities were able to adapt to the changing criminal environment and work together to pursue Australian regulatory and law enforcement interests.

---

[20] Articulated in the 1994 Report of the Review of Commonwealth Law Enforcement Arrangements.

CLEB engages in an ongoing strategic planning process, aimed at identifying and prioritizing the challenges facing Australian law enforcement agencies, and developing the responses appropriate to meeting those challenges.

Through that process it has identified several imperatives, including:

- continuing to develop the arrangements that now exist for coordination and priority setting across all relevant agencies, to ensure a whole-of-government approach to addressing current and emerging areas of criminal activity;

- ensuring that regulatory and enforcement responses are appropriately 'graded' or placed in the continuum of possible responses to illegal activity;

- continuing to develop innovative information technology and communications capabilities, including investigation, surveillance, targeting and forensic science techniques. This is clearly essential given the growing sophistication and complexity of financial crime; and

- continuing to pursue and develop international consultation and cooperation arrangements, including participation in international networks, conclusion of agency-to-agency agreements, and if possible integration of databases and sharing of information and research.

The above are matters that are considered to be essential requirements for an effective law enforcement capacity.

Enforcement priorities:

The ongoing analysis by CLEB of the issues facing the Australian financial markets and business community has inevitably resulted in the identification of priority areas, where development of effective responses and management mechanisms is considered crucial if the integrity of our financial system is to be maintained.

Three of the areas assessed as high priority, (perhaps not surprisingly, having regard to the estimates given above in relation to the costs of crime), are:

- corporate and other serious white collar crime;

- electronic and technology-based crime; and

- money laundering.

Essentially, the high priority afforded to these types of criminal activity is due to an acknowledgment by each CLEB agency of the significant impact they can have on the economy, Australia's financial markets, investors and creditors, the

community, and Australia's international reputation. Some of the initiatives undertaken to limit this impact are referred to below.

Fraud Control Policy of the Commonwealth

In 1994 CLEB coordinated a Commonwealth-wide review of fraud control arrangements. The resulting Fraud Control Policy of the Commonwealth[21] is designed to improve fraud prevention, detection and investigation across Commonwealth departments and agencies. It outlines the agreed principles of fraud control and provides a consistent set of national standards and policies for combating fraud.

Office of Strategic Crime Assessments

The Office of Strategic Crime Assessments (OSCA) was established in February 1995, to provide Government, through CLEB, with strategic assessments of emerging trends that may threaten the Commonwealth's law enforcement interests, with particular emphasis on organised criminal activity. Estimative analytical techniques are used to provide a sophisticated understanding of the dynamics of particular classes of criminal activity. This understanding - in particular, of the forces which help create criminal opportunities and the means for exploiting them - will enable governments to proactively address those dynamics in their policy and resource decisions.

The first OSCA assessment, submitted to the Minister of Justice in December 1995 and released by him for restricted circulation to Australian Police Minsters in January 1996, provided a forward-looking insight into a number of issues, including the strategic setting for crime in Australia, threats to the Australian financial system, electronic commerce (particularly in the form of stored value cards, electronic purses and Internet transactions), and computer and communications crime.

Electronic Commerce Task Force

CLEB has also sponsored the formation of an Electronic Commerce Task Force,[22] aimed at identifying the emerging law enforcement issues in respect of a range of payment systems which facilitate financial transactions over the Internet or by use of stored value cards. Issues being addressed by the Taskforce include the capacity of authorities to intercept and detect crimes, prosecute offenders, establish evidence and proof, and recover the proceeds of crime, as well as jurisdictional issues of responsibility and territoriality.

Interaction between financial sector and law enforcement

---

21 Best Practice for Fraud Control: Fraud Control Policy of the Commonwealth - Commonwealth Law Enforcement Board (1994)

22 Chaired by AUSTRAC. As discussed in correspondence between AUSTRAC and the Inquiry, the report of the Task Force will be provided to the Inquiry when completed.

The flow of information and interaction between the financial sector and the law enforcement community also serves to promote better standards within the financial system in Australia. An example of this may be found in the cycle of financial reporting whereby financial dealers report suspect transactions to AUSTRAC, which analyses the transactions and refers those which generate concerns to the Australian Tax Office and law enforcement agencies for investigation. Following the investigation, feedback is provided to AUSTRAC about the utility of the contents of the report, which in turn allows AUSTRAC to provide the financial sector with guidelines as to targeting and accurate determination of which transactions should be reported.

There is thus a tangible mutually beneficial working relationship between the financial sector and law enforcement. It is clearly in the interests of the financial sector to report instances of misconduct and suspected breaches to the law enforcement agencies, to ensure market credibility in Australia.

This interaction is also crucial in ensuring relevant and dynamic legislative reform and policy development. The consultative process that has characterised the simplification of the Corporations Law, and the extensive debate and industry participation that accompanied the licensing review recently conducted by the Australian Securities Commission, are examples of initiatives that have benefited significantly from interaction with and feedback from the business community. If regulation and law enforcement in Australia is to remain responsive to the needs of the financial sector, it must continue to seek and obtain that interaction and feedback.

Law Enforcement Imperatives for the Financial System

CLEB believes that there is a general community expectation that the Commonwealth will:

- administer and enforce its legislation in a coherent, consistent and objective manner using appropriate administrative, civil and criminal sanctions;

- operate as transparently as possible so as to be accountable to the Government and the community;

- take appropriate action against offenders and contraveners; and

- operate efficiently and effectively within its resources.

Conclusion

Issues of law enforcement are integral to credible financial regulation in Australia. If the regulatory arrangements that are to be implemented as a result of the Financial System Inquiry are truly 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.

Recommendations

In reviewing the structure and regulation of the financial system in Australia, the Financial System Inquiry should acknowledge the contribution of effective law enforcement, and in so doing:

- recognise the significance of law enforcement for each regulatory agency in Australia;
- recognise the benefits of a 'whole of government' approach to law enforcement in the financial sector;
- recognise the limitations of self-regulatory organisations; and
- recognise the necessity for effective surveillance of compliance.

Firstly, the financial system must be set up in such a way that it is able to anticipate and effectively respond to criminality. It should not be easy for people to avoid the barriers and road blocks. This means making sure that the systems which are set up do not encourage the misuse of the systems either by the players themselves (through allowing access to markets and then failing to regulate the activity of players once they are in them), and also in relation to the systems being used by criminals to defeat law enforcement. This may be achieved in two ways; by ensuring that law enforcement is specifically referred to in the statutory charters of the mainstream regulatory agencies,[23] and by ensuring that it is reflected in the skills of the staff at each agency.[24]

Secondly, a financial system should not only foster financial activity and growth but it should be fostering the right kind of financial activity and growth, the kind which does not have adverse consequences in respect of other government objectives. This may be achieved by encouraging formal liaison structures between various regulators, not only the regulators within the Treasury portfolio

---

[23] Enforcement is already expressly referred to in the statutory charter of the ASC (Section 1(2)(g)) but it does not appear in the charters of many of the other regulators. A statutory basis for law enforcement responsibilities could lead to appropriate outcomes whereby mainstream regulatory agencies are obliged to take into account not only there own core legislative objectives but also take into account and consult with other interested areas of government.

[24] This would entail recruiting staff with appropriate skills in law enforcement, or at least ensuring that they have access to those skills, for example, through arrangements whereby AFP officers are seconded to other agencies.

but wider consultative groups so that the whole of government approach referred to above could be adopted.

Thirdly, while there is a place for self-regulatory organisations in the regulatory regime, it must be acknowledged that there are things they cannot and will not do, in terms of imposing penalties and sanctions; and therefore they must be backed up by statutory regulators with a full range of powers to enforce the law.

Finally, once a set of laws are passed or requirements imposed, there must be active steps taken by the regulators to ensure compliance with those requirements on an on-going basis. Passive supervision is inadequate. In short, the law must be enforced intelligently and comprehensively to be meaningful.

APPENDIX 1

Recent Financial Crimes and their Regulatory Responses

- In May 1993, transactions totalling more than USD$40 million were wired to Sydney and Melbourne from Beijing. The money was found to be the proceeds of a fraud on the People Republic of China. The Chinese authorities were notified of the transactions, and on 2 September 1993 two people were arrested and charged in Australia. Arrests were also made in the United States of America and Canada;

- An NCA investigation uncovered a multi-million dollar fraud on a major Australian financial institution. Forged travellers cheques with a face value of $32 million were manufactured and distributed. Five people were arrested and charged;

- A recent investigation discovered that staff of a foreign bank's representative offices had developed a system for its Australian clients to anonymously deposit cash in parcels of less than $10,000 in its account with the Australian bank managing the foreign bank's account. The money was then transferred to the foreign bank offshore and, on the advice of the staff of the two representative offices, credited to individual clients' accounts in the foreign bank. Two bank managers pleaded guilty to having breached Australian banking laws. The bank's restricted licence was suspended by the Reserve Bank of Australia;

- A finance company has allegedly engaged in the practice of overstating the amount of cash transported into Australia, enabling undeclared cash to be repatriated overseas without raising suspicion. Investigations have shown that reports made by the company under the Financial Transactions Reports Act, which claim that the currency is repatriated from overseas, are false and are made to disguise the true source of the funds. One person has been arrested so far;

- A company dealing in Commonwealth Government bearer bonds came to the attention of regulators in 1990. It was alleged that the three directors used $2 million worth of bank accepted bills, on deposit with the company, to open a $5 million line of credit with the AMP. Due to a lack of evidence, all changes against the three directors were dropped;

- Criminal charges brought by the Australian Securities Commission have in the last 18 months seen over 35 people, most of them company directors, sentenced to terms of imprisonment;

- Alan Bond and Peter Mitchell, former directors of Bell Resources Ltd and Bond Corporation Holdings Ltd, were committed to trial in January 1996 on charges of conspiracy to defraud in relation to the alleged "cash strip" of Bell Resources in 1988/89;

- Former directors and company secretary of Australian Coachlines Holdings Limited were committed to trial in July 1996 on charges of insider trading and making misleading statements in relation to securities;

- Public relations consultant Murray Williams was committed for sentencing in July 1996 on charges of insider trading in relation to the purchase of shares in Australis Media Limited;

- Criminal charges remain outstanding against former chairman of Qintex Australia Ltd, Christopher Skase, relating to the alleged misuse of more than $10 million in company funds;

- The Barlow Clowes investment advice scheme, which was marketed illegally in the United Kingdom and was not stopped by the UK Department of Trade and Industry, finally caused the British Government to step in and pay 250 million pounds compensation to the investors.

- Former Perth entrepreneur Alan Bond was sentenced to three years jail on four offences against the WA Companies Code, relating to transactions involving the Manet painting *La Promenade*, whereby he defrauded Bond Corporation Holdings of more than $9 million.

Select bibliography:

AUSTRAC: Estimates of the extent of money laundering in and through Australia (September 1995)

Best Practice for Fraud Control: Fraud Control Policy of the Commonwealth - Commonwealth Law Enforcement Board (1994)

Chant Link & Associates: Reports on Customer Satisfaction with Performance of the ASC; 1994 and 1996

International Monetary Fund: Macroeconomic Implications of Money Laundering - IMF Staff Statement, Meeting of Financial Action Task Force (June 26-28, 1996)

International Monetary Fund: Macroeconomic Implications of Money Laundering - IMF Working Paper, Prepared by Peter J. Quirk, June 1996

National Crime Authority: Assessment of the Vulnerability of Australian Superannuation Funds to Criminal Attacks

Office of Strategic Crime Assessments, Issue Analysis: Criminal Threats to the Financial System in Australia, Assessment 3/95 (September 1995)

Office of Strategic Crime Assessments, Issue Analysis: Australia's Move Towards Electronic Commerce: Some Implications for Law Enforcement, Assessment 2/95 (September 1995)

Prosecution Policy of the Commonwealth: Commonwealth Director of Public Prosecutions (1992)

Report of the Review of Commonwealth Law Enforcement Arrangements (February 1994)

John Walker Consulting Services: Estimates of the costs of crime in Australia: revised 1995 (prepared October 1995 for the CLEB)
