

A FINE TIME FOR MOVING MONEY

There are many circumstances in which doing nothing gets us into trouble and leads to penalties. The announcement by AUSTRAC that it is seeking to impose penalties on CBA relating to lack of action about suspected money-laundering activities by users of its banking system is such a case.

The amounts of identified money-laundering transactions do not appear to be huge compared to some overseas cases. The AUSTRAC filing with the Federal Court indicates maybe \$100 million dollars or so.

But the alleged failure of CBA's systems and processes to comply with the requirements of the AML/CTF Act of 2006, if proven, is an enormous failing of governance and risk management, which happened over the period 2012 - 2016.

Questions will no doubt be asked about who among current and past bank executives and Board members should take responsibility. Perhaps it is a pity that the BEAR (Bank Executive Accountability Regime) is not already in place. It could be a good test of whether it will be a cuddly or grizzly bear!

This episode did not involve bad behaviour towards customers involved -indeed the problem was being too accommodating to some undesirables. But it is another black mark for banks whose reputations have been badly tarnished by a range of other cultural, ethical and governance issues.

CBA's lack of actions (apparently) involved: (a) not putting in place adequate systems to identify possible money laundering activities; (b) not acting promptly in cases of transactions that should have been raised red flags and generated reporting to AUSTRAC; and (c) not preventing further such transactions.

The AML/CTF Act of 2006 places obligations on banks (and others) to take actions to prevent and report money laundering and terrorism financing actions. But a fundamental issue is "how much" action? Rules and regulations promulgated by AUSTRAC answer this using a principles-based and risk-based approach. They require an AML/CTF program involving matters such as having adequate systems for identifying suspicious transactions and undertaking due diligence of customers and staff.

As in most aspects of principles based regulation, most things are a shade of gray. Spending more on an AML/CTF program may improve its effectiveness, but ultimately a cost-benefit calculation comes into play. How does a regulator determine whether a bank that spends, say, \$100 million a year on such a program is taking enough action? If it is, should a bank half its size also be spending that amount, or half as much, or what? How does a bank's board make such a decision?

Thus it is likely that only when there are clear breaches of some very specific requirements can significant regulatory penalties be made to stick. In this case, it appears from the

AUSTRAC filing with the Federal Court, that CBA did not take required actions on a number of fronts, even when it had received information from law enforcement officials.

The size of any resulting fine can be expected to reflect the extent of the transgressions of the requirements, but the deterrence effect on other institutions is also a very important consideration for AUSTRAC. In March of this year, Tabcorp was ordered to pay a penalty of \$45 million for its failings in this area. That signalled to the finance and gambling sectors, said the CEO of AUSTRAC, “that if you do not take your AML/CTF Act obligations seriously, AUSTRAC will take action”.

Overseas the recent trend has been for very significant penalties to be imposed. For example, Deutsche Bank had penalties of over USD 600 million imposed in the US and UK for inadequate anti-money laundering actions on its part – where the amounts suspected of being laundered were in the order of USD 10 billion.

The amounts of identified money laundering in the AUSTRAC filing (around \$100 million), involving six syndicates are miniscule compared to the Deutsche Bank case.

But the amounts of funds deposited through the (poorly named!) “Intelligent Deposit Machine” ATMs through which much of the identified money laundering occurred) appear to have been huge. Some \$1 billion per month was being deposited in mid 2016, some of which could also involve as yet unidentified money laundering.

Added to that are significant failings to provide required reports to AUSTRAC and to carry out adequate due diligence. For example there were 53, 506 cases of not filing “threshold transactions reports” (where over \$10,000 cash is involved).

Put together with the Tabcorp case, far more than a slap on the wrist is likely to be involved. That is not good news for bank shareholders, although the effect of whatever monetary penalty is decided will probably be much smaller than the resulting further trashing of bank reputations.

The odds on a Royal Commission or further Parliamentary Inquiry into banking have just shortened significantly.

Kevin Davis
Professor of Finance, The University of Melbourne
Research Director, Australian Centre for Financial Studies and Professor, Monash University
August 3, 2017