

**Corporate Social Responsibility Performance and  
Money Laundering Control Systems: Evidence from  
Australian Financial Institutions**

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**This thesis is presented for the Degree of  
Master of Philosophy (Accounting)  
of  
Curtin University**

**August 2020**

## DECLARATION

To the best of my knowledge and belief this thesis contains no material previously published by any other person except where due acknowledgment has been made.

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## ABSTRACT

This study investigates the relationship between money laundering control systems (MLC) and corporate social responsibility performance (CSR). The moderating effects of use of correspondent banking and tax havens on that relationship are additionally examined. Based on a dataset of 625 firm-year observations comprising publicly-listed Australian financial institutions over the 2008–2017 period, a positive and significant relation between firms' corporate social responsibility performance and the strength of money laundering control systems is observed. A significant and negative association between money laundering control systems and correspondent banking is further observed. However, the interaction term between firms' engagement in correspondent banking and CSR performance is significantly and positively associated with strength in money laundering control systems. The coefficient for tax haven use is significantly negatively associated with strength in money laundering control systems. However, the interaction term between firms' use of tax havens and CSR performance is significantly and positively associated with strength in money laundering control systems.

Additional tests suggest that governance factors such as existence of a dedicated risk committee and existence of a whistleblower policy are complimentary to the existence of positive CSR performance in that they assist firms to establish an effective money laundering control system. Further, using a subsample of firms that have an antifraud policy (AFP), the complementarity of CSR performance and AFP assists firms in their establishment of an effective money laundering control system. In the absence of an antifraud policy, positive CSR performance appears to be superficial in that appears to dis-incentivize management in establishing an effective MLC system.

*Keywords:* Money laundering control systems, CSR performance, Correspondent banking, Tax havens utilisation, Antifraud policy

## **ACKNOWLEDGEMENTS**

I would like to thank my supervisors, parents and friends for your help and encouragement. First and foremost, I would like to say a special thank you to my principal supervisor, Professor Grantley Taylor. Without your encouragement, patience, assistance and guidance, I wouldn't go this far. In particular, when times were tough, and things didn't go to plan you helped me to overcome my self-doubts and move forward. Your care, friendship and sense of humor are greatly appreciated. The words thank you cannot express the level of my sincere gratitude. I look forward to working with you on future research.

I would also like to thank my co-supervisors, Associate Professor Nena Lim who shares her valuable comments on thesis and gives her help, as well as Dr. Baban Eulaiwi who came on board half way through for not only being my statistics coach, but also giving his help. My friends thank you for your belief in me and encouragement. Most importantly, I express my profound gratitude to my dearest parents for their support, patience and understanding throughout. They showed me that anything in life is achievable, any obstacle can be overcome.

## CONTENTS

	<b>Page</b>
<b>1.0 CHAPTER ONE INTRODUCTION</b>	
1.1 Background - Money Laundering	11
1.2 Anti-Money Laundering Act and supporting Regulations	13
1.3 Motivation for Research	13
1.4 Significance of research	15
1.5 Objectives and aims	16
1.6 Contribution of research	16
1.7 Overview of Thesis	17
<b>2.0 CHAPTER TWO LITERATURE REVIEW</b>	
2.1 Legislation development in the financial sector	18
2.2 Money laundering controls	19
2.3 Corporate social responsibility performance	20
2.4 Correspondent banking	20
2.5 Tax Havens	21
<b>3.0 CHAPTER THREE HYPOTHESES DEVELOPMENT</b>	
3.1 Introduction	23
3.2 Hypotheses development	23
3.2.1 Money laundering control systems (MLC) & corporate social responsibility performance (CSRP)	24
3.2.2 Correspondent banking	26
3.2.3 Use of tax haven jurisdictions	28
<b>4.0 CHAPTER FOUR RESEARCH DESIGN</b>	
4.1 Introduction	31
4.2 Data and sample selection	31
4.3 Dependent variable-Money Laundering Control (MLC) System	32
4.4 Independent Variables	33
4.4.1 CSR performance	33
4.4.2 Moderating variables	33
4.5 Control Variables	33
4.6 Statistical Analysis	34
4.7 Sensitivity Analysis	36
4.8 Summary of Chapter 4	36

## CONTENTS

	<b>Page</b>
<b>5.0 CHAPTER FIVE RESULTS</b>	
5.1 Introduction	37
5.2 Empirical results	37
5.2.1 Summary statistics	37
5.2.2 Results-Hypothesis 1	41
5.2.3 Results-Hypothesis 2	41
5.2.4 Results-Hypothesis 3	42
5.3 Additional analyses	46
5.3.1 Governance Factors-I	46
5.3.2 Governance Factors-II	49
5.3.3 Lagged Model	49
<b>6.0 CHAPTER SIX CONCLUSIONS AND IMPLICATIONS</b>	
6.1 Introduction	52
6.2 The association between CSRP and MLC	53
6.3 The association between correspondent banking and MLC	53
6.3.1 The association between the use of correspondent banking and MLC	53
6.3.2 The association between the use of interaction term (CorBank*CSRP) and MLC	54
6.4 The association between tax havens and MLC	54
6.4.1 The association between the use of tax havens and MLC	54
6.4.2 The association between the use of interaction term (TH*CSRP) and MLC	55
6.5 Additional analyses	55
6.6 Implication and assumptions	56
6.7 Contribution of this study and future direction	57
<b>REFERENCES</b>	<b>59</b>
<b>APPENDICES</b>	<b>67</b>

## TABLES

<b>Refer</b>	<b>Title</b>	<b>Page</b>
Table 1	Panel A: Sample Selection	38
Table 1	Panel B: Sample Distribution by year	38
Table 1	Panel C: Descriptive Statistics	39
Table 2	Pearson Correlation Matrix	40
Table 3	Baseline association regression between corporate social responsibility performance (CSR) and money laundering control system (MLC)	43
Table 4	Interaction between CSR performance (CSR) and correspondent banking (CorBank) and its impact on money laundering control system	44
Table 5	Interaction between CSR performance (CSR) and tax havens (TH) and its impact on money laundering control system	45
Table 6	Panel A: Moderating role of Risk Committee (RiskCom)	47
Table 6	Panel B: Moderating role of Whistleblower performance (WBP)	48
Table 6	Panel C: Moderating role of ethical behaviour and values (ANTI-FRAUD POLICY)	49
Table 7	Sub-sample OLS analysis based on individual money laundering control items	50
Table 8	Lagged model results	51

## APPENDICES

<b>Refer</b>	<b>Title</b>	<b>Page</b>
Appendix A	Variable Definitions	67
Appendix B	GRI Index CSR items	69
Appendix C	Westpac Group's 5 key AML/CTF principles	72



## **GLOSSARY OF KEY ABBREVIATIONS**

ACSI	Australian Council of Superannuation Investors
AML	Anti-Money Laundering
AML/CTF ACT	Anti-Money Laundering and Counter-Terrorism Financing Act 2006
AML/CTF Rules	Anti-Money Laundering and Counter-Terrorism Financing Rules
AR	Annual Reports
ASX	Australian Securities Exchange
AUD	Australian Dollar
AUSTRAC	Australian Transaction Reports and Analysis Centre
CB/ CorBank	Correspondent Banking
CBA	Commonwealth Bank of Australia
CSR	Corporate Social Responsibility
CSRP	Corporate Social Responsibility Performance
CSRP-MLC Control	Corporate Social Responsibility Performance and Money Laundering Control
ESG	Environmental, Social and Governance
ETR	Effective Tax Rate
FATF	Financial Action Task Force
FSC	Financial Services Council
GDP	Gross Domestic Product
GRI	Global Reporting Initiative
ML	Money Laundering
MLC	Money Laundering Control
MLR	Money Laundering Risk
NAB	National Australia Bank
NSW	New South Wales
OECD	Organisation for Economic Co-operation and Development
OLS	Ordinary Least Squares
PSM	Propensity Score Matching
PCA	Principal Components Analysis

RISKCOM	Risk Committee
TH	Tax Havens
US/USA	United States of America
WBP	Whistleblower performance

# CHAPTER ONE

## INTRODUCTION

### **1.1 Background - Money Laundering**

Money laundering is defined as “any act that is aimed at frustrating the identification of the origin, the tracing or the forfeiture of assets which he knows or must assume originate from a felony or aggravated tax misdemeanor” (Teichmann 2019, 4). Because of the importance of the financial services industry to the global economy and the dynamics in regulation that those institutions face, money laundering through financial institutions has attracted considerable attention in the media and with governments (Ferwerda and Reuter 2019). In China, there were more than 1.9 million cases of suspicious money laundering transactions reported to China’s central bank in 2005 culminating in some 137.8 billion RMB of suspicious transactions (Wang and Yang 2007, 283).

Money laundering was initially used to describe illegal money laundered by the mafia in the U.S.A (Buchanan 2018). The mafia acquired some washing salons which were mainly based on cash transactions and they used these salons as cover to launder the money (Buchanan 2018). According to the estimation in 2010-2011, the figure for money laundering was approximately equal to 6-8 % of USA’s GDP (Sota and Kolaneci 2013; Buchanan 2018). Money laundering has become international and organized. The International Monetary Fund (IMF) estimated the figure for money laundering was approximately equal to 2-5% global GDP (Buchanan 2018). In Mexico, during the last thirty years, approximately U.S. \$ 900 billion has been laundered. There is a large amount of this laundered money has been used to have power in both economy and political world.

Gambling is another well-known way to launder the money (Buchanan 2018). Taking one case in Europe as example, a large amount of cash (10,000 Euros) is changed into chips in casinos. After playing in the casino, the remaining unused chips will be converted back into

cash. In the end, the approximate 1 million Euros has been laundered through casino (Buchanan 2018). In Australia, casinos have been involved in money laundering transactions with electronic gambling devices being used as a tool to launder money (Buchanan 2018). In 2015, about AUD 5 million profit from selling cocaine was laundered through Sydney Star casino (Buchanan 2018).

Casinos are not the only financial institutions that have been involved in money laundering in Australia. Money laundering is also pervasive throughout the banking industry. For instance, the Commonwealth Bank of Australia (CBA) failed to monitor or report large suspicious money laundering transactions through CBA ATMs in 2017 (Financial Services Royal Commission 2019). More recently, in 2019, Westpac was accused for breaches in anti-money laundering controls including identification of customers involved in illicit transfer of funds. The lack of internal control concerning anti-money laundering legislation and regulations became apparent when the scandal happened (Financial Services Royal Commission 2019). The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry was created to investigate breaches in anti-money laundering (AML) provisions and governance in the financial services industry (banking, investments, gambling, and stockbroking) (Financial Services Royal Commission 2019).

Apart from the public and political attention, money laundering risk has received little attention in prior literature. The paucity of research in this area relates largely to the fact that no measure of money laundering risk has been developed (Balani 2019). Buchanan (2018) further argues that CSR performance will assist in combating money laundering if CSR has been incorporated into policies, processes, and practices of organizations. Hence, in this study, the objective will be to relate firms' CSR performance and the degree to which they are subject to money laundering risks.

## **1.2 Anti-Money Laundering Act and supporting Regulations**

Money laundering involves derivation of funds from an illegal source or sources which is then used to purchase legal assets such as property to disguise the actual source of those funds (Lannin 2017). There are three stages in a money laundering arrangement: “(1) placement; (2) layering; (3) integration” (Buchanan 2018, 220). There are many countries which have been involved in money laundering through gambling such as: the USA, New Zealand and Australia (Buchanan 2018). In Australia, these money-laundering transactions are made with electronic gambling devices which are used as a tool to launder money (Buchanan 2018).

In 2004, there was more than AUD 2,800 million being laundered (Walker and Unger 2009; Buchanan 2018). Therefore, Australia enacted the *Anti-money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF ACT) (Buchanan 2018). This AML/CTF ACT has covered many industries including gambling and financial sectors (Buchanan 2018). However, the AML/CTF Act is considered as an ineffective money laundering law (Van Onselen 2018). At 2010, there was still a significant amount of money being laundered by gambling in New South Wales (NSW), taking up 40% of the money being laundered through nation’s poker machines that year (Carson 2010; Buchanan 2018).

Apart from the occurrence of money laundering cases in gambling and casinos, at 2017, there occurred a money-laundering scandal in CBA (Financial Services Royal Commission 2019). In January 2019, the Australian banking royal commission issued a report regarding the legality and ethics of business practices of banks (Financial Services Royal Commission 2019). This then raised the important questions whether the banks or general financial services sector has been valuated the money laundering risk effectively.

## **1.3 Motivation for Research**

The objective of this research is to examine the relation between money laundering control

systems and corporate social responsibility performance of a large sample of Australian financial services firms over the 2008-2017 period. The relation between CSR performance and money laundering controls (MLC) is examined over that period because major new regulations and legislation relating to both money laundering regulations and CSR have occurred during the time.

Furthermore, corporate social responsibility (CSR) and money laundering controls (MLC) have separately been topics of considerable attention in the media. However, the association between corporate social responsibility performance (CSR) and money laundering controls (MLC) has not been studied in prior literature (Deegan 2002; Balani 2019). Managers tend to use the corporate social responsibility reports as a vehicle to disclose certain information regarding the social and environmental performance of the firms (Deegan 2002). The reason for this is that managers are motivated to disclose social and environmental information to legitimize firms' operations (Deegan 2002).

Although corporate social responsibility is an area that has been extensively researched, there are far fewer studies that have examined corporate social responsibility performance. Corporate social responsibility performance (CSR) is defined as "the measurement of organizational performance relative to their location and community" (Robson and Mitchell 2007, 722). Most of the prior studies have examined CSR disclosures. Only recently is there studies that have examined CSR performance whereby CSR activities and outputs are divided into subgroups where they either have a positive impact or negative impact on the firm, its stakeholders and society. Carroll's (1991) definition of CSR as guidance to measure CSR performance is often applied in this area of research. Carroll (1991) maintains that CSR incorporates a firm's economic, legal, ethical and philanthropic responsibilities. Muller and Kolk (2009) consider three dimensions (environmental, labor and community) as a measure of CSR. Considerable research in the field of corporate social responsibility focuses on the

association between corporate financial performance and corporate social responsibility (Hou 2019; Lin et al. 2019). The focus of this research which examines the relation between corporate social responsibility performance and money laundering control systems differs from the traditional areas of research in that it focuses on a major area of compliance. Additionally, sample firms comprise financial firms which have tended to be overlooked as prior research has focused on an analysis of non-financial firms. Financial firms are economically significant and have strong social linkages with the community which motivates our use of this category of firms.

#### **1.4 Significance of research**

To the best of current knowledge, this is the first study to examine the relation between MLC and CSRP. First, the previous studies in similar areas more focus on money laundering (ML), the control over ML and compliance (Teichmann 2019; Cassella 2018). Secondly, current research in the field of CSR focuses on the association between corporate financial performance and CSR (Hou 2019; Lin et al. 2019). Firm managers are motivated to disclose certain social and environmental information to legitimize that organization's operations with the community. Thus, managers may use corporate social responsibility performance measures as a vehicle to disclose certain information regarding the social and environmental performance of the firms in order to align themselves with that of community expectations (Deegan 2002). Alternatively, higher levels of CSR performance could be used as a vehicle to disguise other activities that could potentially include tax avoidance or money laundering. Ultimately, the relation between CSRP and MLC is an empirical question.

Second, in January 2019, the Australian banking royal commission issued a report regarding the legality and ethics of business practices of banks (Financial Services Royal Commission 2019). The report from the commission showed that advisors from many of the top Australian financial firms had provided incomplete, or incorrect information to clients

highlighting the real lack of transparency around business practices of these institutions.

Third, the results from this study are expected to be of interest to regulators and firm management. The reason is that higher levels of CSRP may have flow-on impacts in a major area of risk and compliance for financial institutions, and capacity to increase efforts in this area may serve to increase levels of brand capital and reputational capital for those institutions. Fourth, we assess the moderating or mediating effects of strength of governance structure on the relation between CSRP and MLC. Governance factors impact both areas and there is a paucity of work on the intermediary impact of these factors on such a relation. Lastly, the unique measures of money laundering control systems are developed and hence a methodological contribution is provided.

### **1.5 Objectives and aims**

The objective of this study is to examine if a statistically significant relation between money laundering control systems (MLC) and Corporate Social Responsibility Performance (CSRP) in Australian listed financial firms over the 2008-2017 period exists and if this relation is moderated by use of correspondent banking and tax haven jurisdictions.

### **1.6 Contribution of research**

This study makes contributions to the literature in several ways. First, there is a paucity of research that has examined the relation between firms' engagement in CSR and a major area of compliance, money laundering. The expectation is that firms that engage in stronger CSR performance are likely to have well developed money laundering controls in place. However, this is an empirical question. Second, accounting based research in the Australian financial services industry is significantly less as compared to that in the non- financial services industry. Third, a methodological contribution is offered in terms of measurement of money laundering control systems.



The measure of money laundering control systems is an index that comprises items pertaining to a) existence of specific money laundering controls, b) existence of an anti-money laundering program c) existence of money laundering training or employment of a money laundering compliance officer d) existence of money laundering policies and procedures e) specific anti-money laundering risk assessment, f) anti-money laundering attestation and g) a formal customer identification program.

The impact of correspondent banking practices and tax haven use on the MLCs and CSRP relationship is examined (Haniffa and Hudaib 2006, 1034). Finally, we examine the relationship between CRSP and MLCs for subsample of firms with a risk committee, a whistleblowing policy and an antifraud policy. The findings are likely to be of interest to policymakers and regulators in the financial services industry.

This study will be beneficial not only in adding to theory but also in terms of offering practical insights. For regulators, the significance of an effective AML act is highlighted after the money-laundering scandal of Commonwealth Bank (CBA). For financial sectors, they might consider not only to establish their own AML policies but also strengthen compliance and corporate governance.

## **1.7 Overview of Thesis**

This thesis proceeds as follows. Section 2 summarizes the literature review and briefly describes the legal framework regarding combating and preventing anti-money laundering activities. Section 3 presents the theory and hypotheses. Section 4 details the research design including sample selected, variables and research methodologies used. Section 5 shows the statistics results. Section 6 concludes on overall results, presents limitations, implications, and contribution of this study.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Legislation development in the financial sector**

As early as 2006 Australia published Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (AML/CTF Act), but this act has been criticized as an ineffective anti-money laundering law in the world (Van Onselen 2018). This ineffectiveness was then proved by the scandal of Commonwealth Bank (CBA). CBA failed to monitor or report large suspicious money laundering transactions through its ATMs in 2017 (Financial Services Royal Commission 2019). In addition, it is also found that CBA also breached its obligations to checks 80 suspicious customers and it also did not monitor a number of transaction accounts during the period 2012 to 2015 (Doran and Janda 2018). Due to these misconducts of CBA as well as some other misleading practices from other financial institutions such as National Australia Bank (NAB)'s adviser services fees, the royal commission, therefore, started this investigation (Financial Services Royal Commission 2019). According to the finding from the final report of the royal commission, the failure of risk management and compliance is one of the major issues, which leads to the CBA scandal (Financial Services Royal Commission 2019).

Since the ineffectiveness of AML act 2006 is proved, there are a series of anti-money laundering and counter-terrorism financing rules (AML/CTF Rules) made in accordance with the S229 of the AML/CTF Act. The purpose of the anti-money laundering act, as well as a number of amended anti-money laundering rules, is to prevent money laundering by establishing many rules for the financial sector including banks, brokers, casinos, money transfer services, bullion dealers and so on (Office of the Australian Information Commissioner 2019). According to these rules, the financial institutions are obliged to gather and verify the information about customers' identity at the time of serving (Office of the Australian

Information Commissioner 2019). In addition to AML act 2006 and AML/CTF Rules, many financial institutions initiate their own AML/CTF policies such as Westpac's AML/CTF-Westpac Group policy<sup>1</sup>.

## **2.2 Money laundering controls**

Riccardi, Milani, and Camerini (2019) summarize the definition of money laundering controls based on the relevant literature. Money laundering controls requires consideration of not only the possibility of occurrence of money laundering activities, but also any impacts caused (Riccardi, Milani, and Camerini 2019). In 2006, Australia enacted the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF ACT), which applies in particular to the gambling and financial sectors (Buchanan 2018). Under the AML/CTF Act, the remittance services providers are required to make register in Australian Transaction Reports and Analysis Centre (AUSTRAC) (Rees 2010). Furthermore, there are other requirements of service providers to combat money laundering events, including the procedure of identifying customers' identity, annual compliance report to AUSTRAC and AML/CTF program (Rees 2010).

In 2017, the Fintel Alliance was established and has been operated under the instruction from the Australian Transaction Reports and Analysis Centre (AUSTRAC) to combat financial crimes especially the money laundering crimes (Australian Transaction Reports and Analysis Centre 2020). The purpose of setting up the Fintel Alliance is to make the prevention of money laundering by encouraging cooperation and sharing information among its members (Australian Transaction Reports and Analysis Centre 2020). Meanwhile, many financial institutions initiate their own AML/CTF policies such as Westpac's AML/CTF-Westpac Group

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<sup>1</sup> Details of Westpac's AML/CTF-Westpac group policy can be found in appendix c.

policy. However, the scandals in the banking industry were still exposed in 2017 (Financial Services Royal Commission 2019).

### **2.3 Corporate social responsibility performance**

Naheem (2016) suggests that in the presence of strong CSR performance, firms could avoid illicit activities such as money laundering activities. This is also supported by Stachowicz and Amann (2017). Current research in the field of CSR focuses on the association between corporate financial performance and CSR (Hou 2019; Lin et al. 2019).

### **2.4 Correspondent banking**

The correspondent bank is considered as an intermediary that help cross borders transactions. A correspondent bank not only provides the account of deposit or liability but also a variety of services to the institutions that get involved. Due to the nature of transactions, the correspondent banks are inclined to be international banks. The institutions that get involved in cross borders transactions with correspondent banks are called respondent institutions/banks (International Monetary Fund 2020). The correspondent banking services are provided through the ways as follow (1) “correspondent accounts” means an agreement under which the correspondent banks process the payments on behalf of respondent institutions; (2) “nested accounts” means the customers of respondent institutions use correspondent banking relationships for their clients;(3) “payable through accounts”, the respondent firms giving their customers access to correspondent banks to deal with business directly (International Monetary Fund 2020, 262). Hence, the correspondent bank is chosen to launder the money (Teichmann and Falker 2020). The institution that have many correspondent banks are normally chosen to open account for the purpose of money laundering (Teichmann and Falker 2020). The Financial Action Task Force (FATF) supports this finding in its report to the government of Kuwait, pointing out the cross-border correspondent bank relationship being abused and not having

adequate compliance for example customer due diligence in place (Naheem 2020). According to the survey conducted by the World Bank, the nations with small amount of business transactions and volumes are more likely to have correspondent banking relationship declined. What is more, the nations that are considered as high-risky money laundering countries are also more likely to have this relationship declined (International Monetary Fund 2020).

## **2.5 Tax Havens**

A tax haven is defined as a “jurisdiction” in which (1) the relevant taxes are in no existence; or (2) taxes are at low rates, being profitable from the foreign sources; or (3) certain privileges are given to some group of tax payers or events (Roberts 1995). The theory of jurisdiction is also accepted by Calderón and Álvarez-Arce (2011), describing tax haven as the nation with jurisdiction for the purpose of paying less taxes and avoiding tax liabilities. However, they also point out the main function of tax haven that has been changed from simple reducing tax liabilities and avoiding tax (Calderón and Álvarez-Arce 2011). Financial planning also brings benefits to tax havens, attracting additional attention to it (Calderón and Álvarez-Arce 2011). Postponed tax imposition could bring other benefits to tax haven, enhancing investment in capital and promoting company’s development (Dharmapala and Hines 2009; Calderón and Álvarez-Arce 2011). Addison (2009) adds following characters to complete the definition of tax haven (1) no or few business activities existing ;(2) little transparency ;(3) being lack of information exchanging (Addison 2009; Calderón and Álvarez-Arce 2011). The famous tax havens include Cayman island, Hong Kong, Antigua and Barbuda, Bahamas, Ireland and Luxembourg (Kemme, Parikh ,and Steigner 2020). The tax haven is always linked to scandals for example: money laundering (Van Fossen 2003). The reason why the tax havens are always involved in money laundering scandal is tax havens are found to help not only hiding the original source of illegal money, but also legitimizing it (Van Fossen 2003). However, it is still not certain if there exists any association between tax havens and money laundering. In order

to solve the puzzle, Schwarz (2011) performs the study, finding there is no inherent relation between the status of tax haven and anti-money laundering policies.

## **CHAPTER THREE**

### **HYPOTHESES DEVELOPMENT**

#### **3.1 Introduction**

Financial service firms tend to have a strong customer following given their economic importance and standing in society. Many banks have distinctive brands and hence are visible to stakeholders that include customers, capital market participants, and regulators. Ex-ante, firms that exhibit strong corporate social responsibility (CSR) performance are more likely to develop money laundering control systems. The reason is that these firms would like to sustain their reputation and will put in more effort and resources to mitigate money laundering risks so that they could continue to legitimize their operations with society. Financial services firms are subject to a high degree of regulation and this extends to social and environmental engagement. If the firms have put in resources into CSR performance, then it follows that they will have put resources into anti-money laundering policies and procedures and be subject to lower levels of money laundering risk and increased money laundering controls.

#### **3.2 Hypotheses development**

Given the crucial role of financial institutions economically, regulators have placed considerable emphasis on firms' adopting codes of conduct and controls with respect to money laundering, including the identification of the source, nature, and identity of parties behind transactions. An important element of money laundering control as outlined in money laundering codes of conduct is the identification of the party or parties involved in the transfer of funds. Given the pervasive nature with which financial institutions in the U.S. and Australia have been subject to convictions/fines around weaknesses in money laundering control systems and firms inability to fully account for the source and parties behind the transfer of funds, it is

easy to be cynical with regards to the level of compliance of firms and their officers in respect to combating money laundering activities.

Conceptually, firms that adopt money laundering deterrent or control systems should enhance monitoring efforts and thereby reduce the risk of a money laundering conviction or penalty. However, anecdotal evidence suggests that money laundering controls may not fully address the issue of risks around customer identification. Further, appropriate authorities appear to lack sufficient resources to follow-up with financial institutions following breaches in money-laundering controls. In reality, it is thus unclear as to whether firms' CSR performance will enhance or reduce their money laundering risk management systems/control systems.

### ***3.2.1 Money laundering control systems (MLC) & corporate social responsibility performance (CSR)***

On the one hand, increased levels of CSR may reduce MLR or serve to enhance money laundering control systems because firms that have better compliance with respect to their CSR systems are also likely to have better placed money laundering management systems. Slutzky, Villegas, and Williams (2019) find that after implementation of risk management policies regarding new AML policies in banks, the number of deposits from the areas with a high level of drug trafficking activities declined. They find a negative relation between effective risk management systems and money laundering risk. On the other hand, in the presence of strong CSR performance, firms could avoid illicit activities such as money laundering activities (Stachowicz and Amann 2017). CSR is an effective risk mitigation mechanism (Li, Lu, and Li 2019; Col and Patel 2019). Since CSR is considered to be an effective risk mitigation mechanism, firms engaging in positive CSR could mitigate the extent of money laundering risk. Money laundering activities can generate significant costs for society, so the development of management systems designed to increase money laundering control systems is likely to



increase societal welfare. The Internal Revenue Service (IRS) claims that money laundering is a major threat to the U.S. taxation system, social security system and jobs in that illegal source proceeds go undetected (IRS 2015). Hence, the extent and timing of the development of money laundering control systems are likely to be exacerbated when firms have stronger CSR performance.

Increased CSRP may lead to increased transparency and monitoring of policies and procedures, including risk management and compliance within the firm thereby reducing the level of MLR or will serve to enhance MLC systems. According to Jensen and Meckling (1976), corporate governance is considered from two dimensions - transparency and risk management (Pavone and Parisi 2018). Clarkson et al. point out transparency are motivated by CSRP (Cho et al. 2013). Cho et al. (2013) maintain that CSRP could exert a positive influence on transparency and reliability of financial reporting. This increased transparency may also assist with the development and disclosure of money laundering controls. Increased CSRP may mitigate the opportunities for firm management to engage in agency effects because there is reduced information asymmetry (Cho et al. 2013; Cui et al. 2018).

On the other hand, if CSRP is considered to be a form of risk management, firms may engage in higher levels of CSRP to mask poor controls with respect to money laundering risk. (Col and Patel 2019). Based on the risk management theory, institutions deliberately increase their level of CSR activities in the two years immediately following the establishment of tax havens for the reason that CSR could negate any negative reputational risks arising from tax avoidance activities (Col and Patel 2019). Thus, Col and Patel (2019) find a positive relation between CSR ratings and corporate tax avoidance. Their perspectives are further developed by Li, Lu, and Li (2019). CSR could be beneficial for the firms which are involved in tax avoidance activities (Li, Lu, and Li 2019). They consider CSR as a form of insurance to diminish negative reputational risks especially for those firms that are involved in aggressive

tax planning (Li, Lu, and Li 2019). Their arguments further support the possibility of a positive relation between tax avoidance and CSR. Based on that evidence, firms that may be performing strongly in respect to their CSR practices could be doing so to disguise weaknesses in other areas of compliance including establishment of money laundering control systems. The focus is on the positive side of CSRP because CSRP is related to development of an effective MLC system.

Based on the aforementioned discussion, we posit a non-direction relation between development of money laundering control systems (MLC) and corporate social responsibility performance (CSRP):

**H1:** All else being equal, strength in money laundering control systems is related to CSR performance.

### ***3.2.2 Correspondent banking***

In Australia, the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act) was introduced to combat money laundering and terrorism related financial activities. This Act requires financial institutions to report on their use of correspondent banking practices and the risks that such use may impose on compliance with that Act. Section 5 of the AML/CTF Act defines a correspondent bank as one where a financial institution provides services to another financial institution where the activities are carried at or through permanent establishments in other countries (e.g. as a branch or subsidiary). Correspondent banks may in fact be related parties (e.g. a subsidiary).

Typically, correspondent banks assist in cross-border transfer of funds which may make it difficult for the primary bank in Australia to assess money laundering risks associated with such transfers (International Monetary Fund 2020). However, in terms of money laundering compliance, correspondent banks are considered to impose an additional layer of risk in terms of adequately assessing the flow of funds from different customers, the underlying business

purpose behind such transactions and in terms of reporting compliance pursuant to the provisions under the AML/CTF Act. The guidance from the Australian Transaction Reports and Analysis Centre (AUSTRAC) highlights the financial institutions that have correspondent banks place significant risks in terms of being able to comply with anti-money laundering provisions and regulations irrespective of whether they have an anti-money laundering policy or set of practices in place even though they have adequate control in place (Australian Transaction Reports and Analysis Centre 2007). Malakoutikhah (2020) highlights that there exists a negative relation between compliance with the AML/CTF Act and maintaining a correspondent bank relationship. In fact, there have been many large international banks that have decided to withdraw from a correspondent bank relationship in order to comply with the AML/CTF Act (Malakoutikhah 2020). Based on the aforementioned discussion, a negative relation between strength in money laundering control systems and existence of a correspondent banking relation is proposed (H2a). Firms that rely on use of correspondent banking practices are exposed to greater money laundering related risks and hence are less likely to have the resources to develop strong money laundering controls.

If firms have strong CSR performance, this may potentially moderate the hypothesized negative relation between Correspondent banking (CB) and MLC proposed as H2a. If firms have strength in CSR performance, then it follows that they are more likely to undertake adequate due diligence and risk assessments when entering into or being part of correspondent banking relations. Based on subsection 97(2) of the AML/CTF Act, the primary institution (often known as the first institution) is required to carry out due diligence if necessitated by any risks identified in a preliminary risk assessment. Financial institutions with strong CSR performance are more likely to adequately assess the quality of AML regulations in place in the country of residence of any correspondent institution (referred to as the second institution), the adequacy of controls of the correspondent institution such as record keeping and customer

due diligence, and the management and ownership structures of that institution. Additionally, strongly performing CSR firms are likely to also carry out regular risk assessments of the potential for the correspondent relationship to involve or facilitate money laundering. Based on the argument provided, firms' correspondent banking relations moderate the relation between CSR performance and strength of money laundering controls. Ultimately, it is an empirical question as to whether correspondent banking relations enhance or suppress the strength of money laundering control systems in the presence of strong CSR performance. Hence, I propose the H2b to assess the moderating effect of correspondent banking relations.

**H2a:** All else being equal, strength in money laundering control systems is negatively related to reliance on correspondent banking systems.

**H2b:** All else being equal, strength in money laundering control systems is moderated by the joint reliance on correspondent banking systems and CSR performance.

### ***3.2.3 Use of tax haven jurisdictions***

Firms' use of tax haven jurisdictions has received considerable attention in the media over the past decade. Prior governmental reports have highlighted tax havens<sup>2</sup> as jurisdictions with typically weak regulatory and legislative regimes, as having opaque practices including poor information exchange and secret bank accounts for clients (Dharmapala and Hines 2009; Gravelle 2010). The widespread use of tax havens by Australian Financial firms involve achievement of tax benefits via a reduction in group tax liabilities and a variety of costs pertaining to opaque financial reporting and information exchange, earnings management, agency, regulatory and other costs (e.g. reputational and legal costs) (Scholes et al. 2008;

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<sup>2</sup> The OECD (2006, 2012) has developed a comprehensive list of 33 tax havens denoted as follows: Anguilla, Antigua and Barbuda, Bahamas, Bahrain, Bermuda, Belize, British Virgin Islands, Cayman Islands, Cook Islands, Cyprus, Dominica, Gibraltar, Grenada, Guernsey, Isle of Man, Jersey, Liberia, Malta, Marshall Islands, Mauritius, Montserrat, Nauru, The Netherlands Antilles, New Caledonia, Panama, Samoa, San Marino, Seychelles, St. Lucia, St. Kitts and Nevis, St. Vincent and the Grenadines, Turks and Caicos Islands, and Vanuatu.

Dhaliwal et al. 2009). The use of tax havens raises an important research question concerning how these jurisdictions facilitate money laundering risks or negate the effectiveness of money laundering control systems. Further, the joint effect of strong CSR performance (an indicator of transparency) and tax haven use of development of money laundering control systems is of interest because strong CSR performance could ensure that tax havens are used for legitimate capital management purposes and not just purely as conduits for tax avoidance and money laundering (Li, Lu, and Li 2019).

Tax havens generate benefits and costs that may impact on the propensity of those firms to develop effective money laundering control systems. Prior research finds that firms that use tax havens have lower group tax liabilities (Dharmapala 2008; Slemrod and Wilson 2009; Dyreng and Lindsey 2009). Given the weak regulatory regimes that typify tax haven jurisdictions, firms that do rely extensively on tax havens can obtain regulatory benefits. For instance, if firms allocate their treasury or insurance functions to tax haven jurisdictions, they may not be exposed to same high level regulatory framework as in the U.S. Thus, tax havens may assist firms to conceal the ownership of funds, making it harder to follow an audit trail of financing and investing activities. The incentive of management to develop a comprehensive money laundering code of conduct and control system may be reduced in the presence of effective tax and regulatory benefits.

Tax haven use could impact the flow of information amongst key stakeholders including analysts, regulatory bodies, investors and lenders giving rise to agency related issues including informational asymmetry, uncertainty and an increase in firm risk because tax haven use tax encompasses higher levels of legal and firm complexity (Balakrishnan et al. 2011; Rego and Wilson 2012). Given the obscurity in financial reporting and complexity associated with tax haven use, it may be for a firm's auditors to monitor transactions and activities in those centres.

The evidence presented in the aforementioned discussion clearly suggests that firms that rely on tax haven use are less likely to have the incentive and/or opportunity to devote resources in developing a strong system of money laundering controls. Hence, we hypothesize a negative relation between extent of tax haven use and strength of money laundering control systems:

**H3a:** All else being equal, strength in money laundering control systems is negatively related to use of tax haven jurisdictions.

However, firms that rely on an extensive use of tax havens may do so for legitimate capital management or competitive reasons. Firms that exhibit strength in CSR performance may ensure that tax havens are used in a manner that does not exacerbate agency related costs and risks. Hence, tax haven use may moderate the relation between strength in CSR performance and development of money laundering controls. Hence, as H3b, it is hypothesized that use of tax havens may moderate the relation between CSR performance and money laundering controls:

**H3b:** All else being equal, the relation between money laundering control systems and CSR performance is moderated by tax haven use.

## **CHAPTER FOUR**

### **RESEARCH DESIGN**

#### **4.1 Introduction**

This chapter outlines the research methodology used to test the association between Money Laundering Control (MLC) and Corporate Social Responsibility Performance (CSRP). The study further explores the possibility that the relation between MLCs and CSRP is moderated by reliance on correspondent banking or tax haven use. Information regarding data collection, dependent variables, independent variables and control variables are provided below.

#### **4.2 Data and sample selection**

Over the 2008–2017 period, our sample initially comprised 77 firms (763 firm-year observations) publicly-listed Australian financial firms. However, given that some annual reports were not accessible or data was missing, the sample was reduced to 625 firm-year observations over that period. Table 1 (Panel B) provides the frequency and cumulative sample distribution by year. Data pertaining to CSR performance (CSRP) and money laundering controls (MLC) were hand collected from firms' annual reports. Financial data was obtained from *Compustat Global*.

The time period is chosen because major new regulations and legislation relating to both money laundering and CSR have occurred at some point in that period. In 2006, the first anti-money laundering law in Australia was enacted and it has been replaced by new Anti-Money Laundering and Counter-Terrorism Financing Act 2017. The new Act took effect 1st of April, 2018. Three significant changes are being added in this Act including increased regulatory powers of the Australian Transaction Reports and Analysis Centre (AUSTRAC), the inclusion of digital currency exchange providers as well as industry regulatory relief (Deakin and Liu 2018).

Furthermore, during the study period, the first environmental, social and governance (ESG) reporting guide for Australian companies was published jointly by the Australian council of superannuation investors (ACSI) as well as the Financial services council (FSC) in 2011. The ESG reporting guide aims to help companies from different sectors disclosing ESG related risks to investors. The ASX corporate governance council principles & recommendations, published in 2014, mandate disclosures of CSR activities by listed entities (Financial Services Council and Australian Council of Superannuation Investors 2015).

#### **4.3 Dependent variable-Money Laundering Control (MLC) System**

This study measures strength of money laundering control systems (MLC) based on several attributes which have been recognized as essential in mitigating risks pertaining to money laundering in case studies such as that of the CBA. The money laundering control attributes identified as being an essential to an effective money laundering code of conduct are: existence of a conviction/deficiency, evidence of fraud in a firm or its officers, existence of specific ML system of controls, existence of an anti-money laundering program, training programs or officers specifically trained in anti-money laundering techniques, existence of ML policies and procedures framework, whether specific ML risk assessments are undertaken, AML attestation by the firm, existence of a customer identification program, and non-compliance with reporting pursuant to Suspicious Activity Reporting requirements. Each of these variables are scored 1 if in existence, otherwise 0. A MLC index will then be constructed based on the occurrence (or otherwise) of each of these attributes with a maximum score of 8. The justification for choice of each of these items is also from Brown (2009).



## **4.4 Independent Variables**

### ***4.4.1 CSR performance***

Following Alhadi et al. (2019), a measure of CSR performance (CSRP) is developed. Corporate social responsibility (CSR) performance comprises a set of positive (or negative) CSR activities based on 75 items reported in the Global Reporting Initiative (GRI) G4 sustainability reporting guidelines. Items listed in the GRI are categorized into positive areas of CSR activity (43) based on prior work in this area by Cho et al. (2013). Positive CSR activities comprise activities pertaining to improvement or development of social and environmental activities. Our measure of CSR reporting is based on the number of positive CSR items disclosed by a firm in a given year: POS\_CS RP = natural log of the number of positive CSR items (43) reported in the annual report. Activities that comprise positive CSR performance are provided in Appendix B. Sample firms' annual reports are analyzed to obtain information pertaining to each of the individual positive CSR activity items. Evidence of engagement in each of the positive CSR activities results in a score of 1, otherwise 0.

### ***4.4.2 Moderating Variables***

This study tests whether the relation between CSRP and MLC is moderated by firms' use of correspondent banking and tax haven use. Reliance on correspondent banking and tax havens are each measured as 1 if present, otherwise 0. Use of correspondent banking practices and tax havens are likely to change the risk dynamics around whether management is incentivized to establish money laundering control systems.

## **4.5 Control Variables**

Several control variables in our regression models including firm size, return on assets (ROA), market to book value of equity, leverage, research and development (R&D) intensity, current ratio, level of intangible assets, big 4 external auditor, firm cash holdings, financial

slack, firm age, industry sector and year effects, are included in this study. Firm size (SIZE), measured as the natural log of total assets, controls for differences in level of resourcing. We expect larger firms to have better developed MLC frameworks. Leverage (LEV), measured as short-term debt divided by total assets, controls for the level of a firm's exposure to liquidity risk and capital maintenance. We control for firm growth using a ratio of market-book value of equity (MTB). R&D intensity (R&D), measured as R&D expenditure divided by total assets, controls for firms' level of innovation and potentially degree of risk taking. We include firm's financial slack and cash holdings (SLACK and CR) to control for liquidity, asset mobility and financial distress. We control for firm's profitability using return on assets (ROA). Level of intangible assets controls for innovation and visibility. Big four auditor is included (BIG4) as a measure of audit quality, scored as 1 if the firm employs a big 4 external auditor, otherwise 0. Firm age is included (AGE) to control for level of maturity and financial stability. Finally, industry sector (IND) variables to control for differences in regulations across financial services sub-sectors (banks, insurance, casinos, mortgage brokers). We also control for year fixed effects to control for differences in regulatory and political pressures over our sample period.

#### 4.6 Statistical Analysis

Ordinary Least Squares (OLS) regression is employed to test the hypotheses.

The OLS regression model to test H1 is estimated as follows:

$$MLC_{it} = \alpha_{it} + \beta_1 CSR_{Pit} + \beta_2 SIZE_{it} + \beta_3 ROA_{it} + \beta_4 MTB_{it} + \beta_5 LEV_{it} + \beta_6 INTANG_{it} + \beta_7 AUD_{it} + \beta_8 R\&D_{it} + \beta_9 SLACK_{it} + \beta_{10} CR_{it} + \beta_{11} AGE_{it} + \beta_{12-15} INDSEC_{it} + \beta_{16-25} YEAR_i + \epsilon_{it} \quad (1)$$

The OLS regression model to test H2 is estimated as follows:

$$\begin{aligned} \text{MLC}_{it} = & \alpha_{it} + \beta_1 \text{CSR}_{Pit} + \beta_2 \text{CorBank}_{it} + \beta_3 \text{CSR}_{Pit} * \text{CorBank}_{it} + \beta_4 \text{SIZE}_{it} + \beta_5 \text{ROA}_{it} + \\ & \beta_6 \text{MTB}_{it} + \beta_7 \text{LEV}_{it} + \beta_8 \text{INTANG}_{it} + \beta_9 \text{BIG4}_{it} + \beta_{10} \text{R\&D}_{it} + \beta_{11} \text{SLACK}_{it} + \beta_{12} \text{CR}_{it} + \\ & \beta_{13} \text{AGE}_{it} + \beta_{14-17} \text{INDSEC}_{it} + \beta_{18-27} \text{YEAR}_{it} + \epsilon_{it} \end{aligned} \quad (2)$$

The OLS regression model to test H3 is estimated as follows:

$$\begin{aligned} \text{MLC}_{it} = & \alpha_{it} + \beta_1 \text{CSR}_{Pit} + \beta_2 \text{TH}_{it} + \beta_3 \text{CSR}_{Pit} * \text{TH}_{it} + \beta_4 \text{SIZE}_{it} + \beta_5 \text{ROA}_{it} + \beta_6 \text{MTB}_{it} + \beta_7 \text{LEV}_{it} \\ & + \beta_8 \text{INTANG}_{it} + \beta_9 \text{BIG4}_{it} + \beta_{10} \text{R\&D}_{it} + \beta_{11} \text{SLACK}_{it} + \beta_{12} \text{CR}_{it} + \beta_{13} \text{AGE}_{it} + \beta_{14-17} \text{INDSEC}_{it} \\ & + \beta_{18-27} \text{YEAR}_{it} + \epsilon_{it} \end{aligned} \quad (3)$$

where  $i$  = firms 1–77;  $t$  = the financial years 2008–2017; MLC = Money laundering control systems; CSR<sub>P</sub> = positive CSR performance index; CorBank = If firms rely on use of correspondent banking, the firm is scored as 1, otherwise 0; TH = If firms use at least one tax haven, the firm is scored as 1, otherwise 0; SIZE = the natural logarithm of total assets; ROA = pretax profit scaled by total assets; MTB = market value of equity to book value of equity; LEV = short term debt scaled by end of year market capitalization; INTANG = total intangible assets divided by total assets; Big4 = Big 4 auditor scored as 1 if yes, otherwise 0; R&D = natural log of total research and development expenditure; SLACK = cash divided by total property, plant & Equipment; CR = current assets divided by current liabilities; AGE = natural log of the years since date of incorporation; INDSEC = a dummy variable, coded as 1 if the firm is represented in a specific GICS category (banks, insurance, other financial services, broking, casinos), 0 otherwise; YEAR = dummy variable scored as 1 for each year; and  $\epsilon_{it}$  = the error term.

To negate the risk that heteroscedasticity will result in model mis-specifications, robust standard errors have been computed, which are one-way clustered by firm (see, e.g., Petersen 2009), for all of the regression models run in this study. A robustness check will be carried out at the firm level using the base regression model in equation (1). This robustness check is carried out to determine whether there is serial dependence in our data (see, e.g., Hoi et al.,2013), as variables such as CSRP or MLC could remain relatively stable over time.

#### **4.7 Sensitivity Analysis**

As part of sensitivity testing, the relation between CSRP and MLC are examined for subsamples of firms with and without a dedicated risk committee, existence of a whistleblower policy and existence of an anti-fraud policy. Each of these variables may potentially moderate the relation between CSRP and MLC.

#### **4.8 Summary of Chapter 4**

This study uses OLS models to test the relation between CSRP and MLC of a sample of 77 listed financial firms over the 2008-2017 period. CSRP and MLC data was hand collected from firms' annual reports. Moderating variables were also hand collected from firms' annual reports.

## CHAPTER FIVE

### RESULTS

#### 5.1 Introduction

This chapter provides an analysis of the variables used as the dependent, independent and control variables. Descriptive statistics, Pearson product-moment correlations comprise the univariate statistics and multivariate analysis including ordinary least square regressions (OLS) and a lagged model research design.

#### 5.2 Empirical results

##### 5.2.1. *Summary statistics*

Table 1 (Panel A) reports the reconciliation between the initial sample (763) and the final sample (625) as a consequence of missing data relating to key variables. Table 1 (Panel B) provides the frequency and cumulative sample distribution by year.

Table 1 (Panel C) provides the descriptive statistics for all of the variables used in the regression models. The dependent variable money laundering control (MLC) has a mean (median) of 0.15 (0.000) which indicates that firms on average 3 out of the 7 items of money laundering control. The independent variable corporate social responsibility performance (CSR) has a mean (median) of 0.22 (0.19) indicative of, on average, moderate levels of activities designed to address positive CSR engagement. Table 1 (Panel C) also shows the means (medians) of all of the control variables included in regression models (SIZE, MTB, LEV, ROA, INTANG, CR, SLACK, RD, BIG4, and AGE).

The Pearson correlation results are shown in Table 2. A significant positive correlation between MLC and CSR ( $p < 0.01$ ) is evident. Table 2 reports significant correlations between a number of corporation characteristics (SIZE, LEV, ROA, INTANG, CR, BIG4, and AGE)

and MLC ( $p < 0.01$ ). Table 2 shows that only moderate levels of collinearity exist between the explanatory variables.

**Table 1 Panel A: Sample Selection**

Total sample	763
Missing on MLC, CSRP and controls variables	138
Total	625

**Table 1 Panel B: Sample Distribution by year**

Year	Freq.	Percent	Cum.
2008	49	7.84	7.84
2009	50	8.00	15.84
2010	50	8.00	23.84
2011	56	8.96	32.80
2012	60	9.60	42.40
2013	60	9.60	52.00
2014	66	10.56	62.56
2015	76	12.16	74.72
2016	78	12.48	87.20
2017	80	12.80	100.00
Total	625	100.00	

**Table 1: Panel C: Descriptive Statistics**

Variable	N	Mean	S.D.	0.25	Mdn	0.75
MLC	625	0.15	0.34	0.00	0.00	0.00
CSRP	625	0.22	0.12	0.14	0.19	0.26
SIZE	625	7.85	2.69	5.83	6.92	9.74
MTB	625	71.70	225.88	1.15	2.21	12.97
LEV	625	153.29	343.89	13.52	30.39	118.55
ROA	625	0.80	2.20	0.03	0.11	0.55
INTANG	625	99.99	0.03	100.00	100.00	100.00
CR	625	0.41	1.75	0.01	0.05	0.18
Slack	625	29.56	131.51	0.46	2.17	11.39
RD	625	0.02	0.12	0.00	0.00	0.00
BIG4	625	0.33	0.47	0.00	0.00	1.00
AGE	625	2.90	1.07	2.20	2.83	3.56

**Table 2: Pearson Correlation Matrix**

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
MLC	1.00											
CSRP	0.50***	1.00										
SIZE	0.53***	0.72***	1.00									
MTB	0.01	0.04	0.00	1.00								
LEV	-0.14***	-0.12***	-0.12***	0.23***	1.00							
ROA	-0.10***	-0.19***	-0.44***	0.01	-0.11***	1.00						
INTANG	0.07*	0.04	0.25***	-0.01	0.06	-0.47***	1.00					
CR	0.07*	0.06*	0.14***	0.00	-0.07*	-0.07*	0.03	1.00				
Slack	0.01	-0.14***	-0.18***	-0.01	0.04	0.09**	0.03	-0.04	1.00			
RD	-0.04	-0.06*	-0.11***	0.00	-0.05	0.11***	-0.01	-0.01	0.00	1.00		
BIG4	0.48***	0.43***	0.50***	0.01	-0.22***	-0.14***	0.09**	0.07*	-0.13***	-0.05	1.00	
AGE	0.23***	0.40***	0.49***	0.01	-0.20***	-0.14***	0.09**	0.10***	-0.04	-0.04	0.28***	1.00

\*\*\*, \*\*, and \* denotes statistical significance at the 1%, 5%, and 10% levels (two-tailed tests), respectively.



### **5.2.2 Results-Hypothesis 1**

The results of the regression analysis designed to test the association between CSR and the strength of money laundering controls (MLC or MLC\_Fac) are shown in Table 3 (with coefficient estimates and t-statistics provided in parentheses). The  $p$ -values are reported for two-tailed for the non-directional hypothesis. For brevity, the coefficients for INDUSTRY and YEAR are not reported.

In Table 3 (Column 1 and Column 2), the coefficient for CSR is significantly positively associated with MLC and MLC\_Fac respectively ( $p < 0.01$ ). We also observe that some of the control variables (SIZE, LEV, ROA, CR, SLACK, and BIG4) are significantly associated with MLC ( $p < 0.10$  or better) in our regression model. In Table 3 (Column 1 and Column 2), the coefficient for CSR (3.58) (3.62) is significantly positively associated with MLC and MLC\_Fac respectively ( $0.0144 < 0.05$ ). These results show that firms which demonstrate strength in development of positive corporate social responsibility activities and attributes assist firms' more broadly in development of sound money laundering control systems, policies and procedures.

### **5.2.3 Results-Hypothesis 2**

The results of the regression analysis designed to test the association between use of correspondent banking and the strength of money laundering controls (MLC or MLC\_Fac), and the moderating effect of correspondent banking on the relationship between CSR and MLC (or MLC\_Fac) are shown in Table 4 (with coefficient estimates and t-statistics provided in parentheses). The  $p$ -values are reported for one-tailed for directional hypotheses. For brevity, the coefficients for INDUSTRY and YEAR are not reported.

In Table 4 (Column 1 and Column 2), the coefficient for CSRP is significantly positively associated with MLC and MLC\_Fac respectively ( $p < 0.01$ ). Consistent with the hypothesis 2a, coefficient for CorBank is significantly negatively associated with MLC and MLC\_Fac respectively ( $p < 0.01$ ). Firms that engage in correspondent banking are less likely to develop strength in money laundering controls. We also observe that the interaction term between firms' engagement in correspondent banking and CSRP (i.e. CorBank\*CSRP) is significant and positively associated with MLC. These results show that firms with strength in positive CSRP and use of correspondent banking magnify the positive relationship with MLCs. Firms that engage in positive CSR activities that simultaneously rely on correspondent banking practices are more likely to develop strong money laundering control systems. We also observe that some of the control variables (SIZE, LEV, ROA, SLACK, and BIG4) are significantly associated with MLC ( $p < 0.10$  or better) in the regression model.

#### **5.2.4 Results-Hypothesis 3**

The results of the regression analysis designed to test the association between use of tax haven jurisdictions and the strength of money laundering controls (MLC or MLC\_Fac), and the moderating effect of tax haven utilization on the relationship between CSRP and MLC (or MLC\_Fac) are shown in Table 5 (with coefficient estimates and t-statistics provided in parentheses). The  $p$ -values are reported for one-tailed for directional hypotheses. For brevity, the coefficients for INDUSTRY and YEAR are not reported.

In Table 5 (Column 1 and Column 2), the coefficient for CSRP is significantly positively associated with MLC and MLC\_Fac respectively ( $p < 0.01$ ). Consistent with the hypothesis 3a, coefficient for tax havens (TH) is significantly negatively associated with MLC and MLC\_Fac respectively ( $p < 0.01$ ). Firms that use tax havens are less likely to develop strength in money laundering controls. We also observe that the interaction term between firms' use of tax havens

and CSRP (i.e. TH\*CSRP) is significant and positively associated with MLC. These results show that firms with strength in positive CSRP and use of tax havens magnify the positive relationship with MLCs. Firms that engage in positive CSR activities that simultaneously rely on use of tax havens are more likely to develop strong money laundering control systems. We also observe that some of the control variables (SIZE, LEV, ROA, SLACK, and BIG4) are significantly associated with MLC ( $p < 0.10$  or better) in the regression model.

**Table 3:** Baseline association regression between corporate social responsibility performance (CSRP) and money laundering control system (MLC)

VARIABLES	Model 1	Model 2
	MLC	MLC_Fac
Constant	-3.9928 (-0.17)	-13.0697 (-0.18)
<b>CSRP</b>	<b>0.0144***</b> <b>(3.58)</b>	<b>0.0440***</b> <b>(3.62)</b>
SIZE	0.0406*** (5.15)	0.1220*** (5.11)
MTB	-0.0009 (-0.78)	-0.0029 (-0.79)
LEV	-0.0001*** (-2.74)	-0.0002*** (-2.73)
ROA	0.0147** (2.44)	0.0444** (2.44)
INTANG	0.0369 (0.15)	0.1173 (0.16)
CR	0.0108* (1.90)	0.0328* (1.90)
Slack	0.0003*** (3.45)	0.0010*** (3.44)
RD	0.0797 (1.15)	0.2434 (1.16)
BIG4	0.1704*** (4.98)	0.5109*** (4.94)
AGE	-0.0121 (-1.11)	-0.0353 (-1.07)
Year effects	YES	YES
Industry effects	YES	YES
Observations	625	625
R-squared	0.433	0.432

\*\*\*, \*\*, and \* denotes statistical significance at the 1%, 5%, and 10% levels (two-tailed tests), respectively.

**Table 4:** Interaction between CSR performance (CSRP) and correspondent banking (CorBank) and its impact on money laundering control system

	<i>Model 1</i>	<i>Model 2</i>
<b>VARIABLES</b>	<b>MLC</b>	<b>MLC_Fac</b>
Constant	-2.2943 (-0.10)	-7.9149 (-0.11)
<b>CSRP</b>	<b>0.0109**</b> <b>(2.56)</b>	<b>0.0333***</b> <b>(2.59)</b>
<b>CorBank</b>	<b>-0.2066***</b> <b>(-3.42)</b>	<b>-0.6212***</b> <b>(-3.39)</b>
<b>CSRP_CorBank</b>	<b>0.0093***</b> <b>(3.19)</b>	<b>0.0282***</b> <b>(3.17)</b>
SIZE	0.0469*** (6.08)	0.1408*** (6.02)
MTB	-0.0004 (-0.33)	-0.0014 (-0.34)
LEV	-0.0001*** (-3.21)	-0.0002*** (-3.20)
ROA	0.0161*** (2.67)	0.0484*** (2.67)
INTANG	0.0200 (0.09)	0.0659 (0.09)
CR	0.0103* (1.78)	0.0311* (1.78)
Slack	0.0003*** (3.46)	0.0010*** (3.45)
RD	0.0828 (1.19)	0.2524 (1.19)
BIG4	0.1740*** (5.07)	0.5216*** (5.02)
AGE	-0.0130 (-1.22)	-0.0376 (-1.17)
Year effects	YES	YES
Industry effects	YES	YES
Observations	625	625
R-squared	0.447	0.446

\*\*\*, \*\*, and \* denotes statistical significance at the 1%, 5%, and 10% levels (two-tailed tests), respectively.

**Table 5:** Interaction between CSR performance (CSRP) and tax havens (TH) and its impact on money laundering control system

<b>VARIABLES</b>	<i>Model 1</i>	<i>Model 2</i>
	<i>MLC</i>	<i>MLC_Fac</i>
Constant	-6.4202 (-0.28)	-20.4371 (-0.29)
<b>CSRP</b>	<b>0.0104**</b> (2.55)	<b>0.0316**</b> (2.57)
<b>TH</b>	<b>-0.0064**</b> (-2.41)	<b>-0.0195**</b> (-2.43)
<b>CSRP_TH</b>	<b>0.0006***</b> (2.99)	<b>0.0019***</b> (3.01)
SIZE	0.0350*** (4.24)	0.1048*** (4.19)
MTB	-0.0004 (-0.37)	-0.0014 (-0.38)
LEV	-0.0001*** (-2.97)	-0.0002*** (-2.96)
ROA	0.0130** (2.18)	0.0390** (2.18)
INTANG	0.0619 (0.27)	0.1932 (0.28)
CR	0.0056 (1.06)	0.0169 (1.05)
Slack	0.0003*** (3.50)	0.0010*** (3.49)
RD	0.0663 (0.94)	0.2025 (0.94)
BIG4	0.1747*** (5.20)	0.5241*** (5.16)
AGE	-0.0127 (-1.07)	-0.0372 (-1.04)
Year effects	YES	YES
Industry effects	YES	YES
Observations	625	625
R-squared	0.448	0.448

\*\*\*, \*\*, and \* denotes statistical significance at the 1%, 5%, and 10% levels (two-tailed tests), respectively.

### **5.3 Additional analyses**

#### ***5.3.1 Governance Factors-I***

Additional tests are conducted to assess the effect governance attributes pertaining to existence of a a) risk committee b) whistleblower policy and c) anti-fraud policy on the relationship between CSRP and MLC. These attributes constitute important governance factors that are likely to play a role in influence establishment of an effective CSRP and thus are likely to moderate CSRP-MLC relations.

Strength in the corporate governance structure of firms is likely to be reflected in the establishment of anti-money laundering policies, reduced risk about customer identification, increased monitoring and establishment of a framework around the establishment of committees to deal with ML related risks (Pavone and Parisi 2018). Pavone and Parisi (2018) argue that the function of AML, risk management, and compliance must be aligned in order to be effective. The risk committee is another effective weapon to mitigate money laundering risk (Abdullah and Said 2019). The conventional way to manage risks of business operation is for audit committees to take this responsibility (Abdullah and Said 2019). However, after considering the situation that operational risks could cover not only financial risks but also non-financial risks, the range of risk management is wider than the functions that audit committees can perform (Abdullah and Said 2019). Whistleblower policies and antifraud policies are also considered as an effective approach to mitigate the impact of ML risk (Naheem 2016; Tsingou 2018).

In the presence of strong CSR performance, firms could avoid illicit activities such as money laundering activities (Stachowicz and Amann 2017). Naheem (2015) states money laundering risk assessment is considered and viewed as a form of CSR commitment. Jayasuriya (2009) also supports this perspective by examining the relation between anti-money laundering effort and corporate governance, stating that the development of anti-money laundering

policies and risk management devices can be influenced by strong corporate governance practices. Strength in corporate governance can significantly reduce the possibility of money laundering risk by developing and refining anti-money laundering practices. For example, Akpomemie and Ojah (2018) point out that bank-targeted AML measures are only effective with support from the role of the bank's board to ensure compliance. This is evident in the case of a bank of Westpac. In their anti-money laundering policy, it clearly states that board members and senior managers have duties to oversee banks' anti-money laundering policies and procedures (Repousis, Lois, and Veli 2019).

Based on the aforementioned discussion, we first test whether the positive relationship between CSRP and MLC hold for subsamples of firms with and without a risk committee. The positive and significant relationship between CSRP and MLC holds only for the subsample of firms with a stand-alone risk management committee (see Table 6, Panel A). This suggests that governance factors such as risk committees are complimentary to the existence of positive CSR performance in assisting firms establish an effective money laundering control system.

**Table 6: Panel A: Moderating role of Risk Committee (RiskCom)**

VARIABLES	<i>Model 1</i>	<i>Model 2</i>	<i>Model 3</i>	<i>Model 4</i>
	<i>MLC</i>		<i>MLC_Fac</i>	
	RiskCom =1	RiskCom =0	RiskCom =1	RiskCom =0
CSRP	<b>0.0211***</b> (4.37)	0.0042 (0.91)	<b>0.0643***</b> (4.40)	0.0129 (0.92)
Other controls	YES	YES	YES	YES
Year effects	YES	YES	YES	YES
Industry effects	YES	YES	YES	YES
Observations	370	255	370	255
R-squared	0.437	0.313	0.436	0.312

\*\*\*, \*\*, and \* denotes statistical significance at the 1%, 5%, and 10% levels (two-tailed tests), respectively.

We then test whether the positive relationship between CSRP and MLC hold for subsamples of firms with and without a whistleblower policy. The positive and significant relationship between CSRP and MLC holds only for the subsample of firms that have an established

whistleblower policy (see Table 6, Panel B). This suggests that governance factors such as existence of a whistleblower are complimentary to the existence of positive CSR performance in assisting firms establish an effective money laundering control system.

**Table 6: Panel B:** Moderating role of Whistleblower performance (WBP)

VARIABLES	<i>Model 1</i>	<i>Model 2</i>	<i>Model 3</i>	<i>Model 4</i>
	<i>MLC</i>		<i>MLC_Fac</i>	
	WBP =1	WBP =0	WBP =1	WBP =0
CSRP	<b>0.0266***</b> (4.21)	0.0006 (0.11)	<b>0.0807***</b> (4.23)	0.0021 (0.13)
Other controls	YES	YES	YES	YES
Year effects	YES	YES	YES	YES
Industry effects	YES	YES	YES	YES
Observations	198	427	198	427
R-squared	0.533	0.435	0.533	0.433

\*\*\*, \*\*, and \* denotes statistical significance at the 1%, 5%, and 10% levels (two-tailed tests), respectively.

Finally, we then test whether the positive relationship between CSRP and MLC hold for subsamples of firms with and without an antifraud policy. The positive and significant relationship between CSRP and MLC holds for the subsample of firms that have an established antifraud policy (see Table 6, Panel B). Interestingly, for the subsample of firms that do not have an established antifraud policy in place, a significant and negative relation exists for firms that have strength in CSR performance and MLC systems. This suggests that in the case of the subsample of firms that do have an antifraud policy, the complementarity of CSRP and AFP assist firms to establish an effective money laundering control system. However, in the absence of an antifraud policy, positive CSRP may be superficial such that it de-incentives management to establish MLC systems that are effective.



**Table 6: Panel C: Moderating role of ethical behaviour and values (ANTI-FRAUD POLICY)**

VARIABLES	<i>Model 1</i>	<i>Model 2</i>	<i>Model 3</i>	<i>Model 4</i>
	<i>MLC</i>		<i>MLC_Fac</i>	
	ANTFRD =1	ANTFRD =0	ANTFRD =1	ANTFRD =0
CSRP	<b>0.0176***</b>	<b>-0.0031***</b>	<b>0.0538***</b>	<b>-0.0093***</b>
	<b>(2.63)</b>	<b>(-2.98)</b>	<b>(2.65)</b>	<b>(-2.96)</b>
Other controls	YES	YES	YES	YES
Year effects	YES	YES	YES	YES
Industry effects	YES	YES	YES	YES
Observations	211	414	211	414
R-squared	0.372	0.163	0.372	0.161

\*\*\*, \*\*, and \* denotes statistical significance at the 1%, 5%, and 10% levels (two-tailed tests), respectively.

### 5.3.2 Governance Factors-II

The individual attributes that comprise an effective MLC systems are then assessed using the base line model (see Table 7). CSRP is significant and positively associated with each of the seven attributes that comprise MLC other than existence of an anti-money laundering policy. This confirms H1.

### 5.3.3 Lagged Model

To mitigate the risk that endogeneity could be impacting the results through biased regression coefficients, lagged analysis is conducted. The independent variable and all the control variables are lagged by one year. The results are provided in Table 8. Hypothesis 1 is again supported. Bellemare, Masaki, and Pepinsky (2017) find that use of a model with lagged explanatory variables can be effective in mitigating endogeneity concerns.

**Table 7:** Sub-sample OLS analysis based on individual money laundering control items.

VARIABLES	Model 1 MLSC	Model 2 AMLPP	Model 3 MLTC	Model 4 MLPP	Model 5 MLRA	Model 6 AMLA	Model 7 CIDP
Constant	-15.9412 (-0.59)	-14.8170 (-0.55)	4.1332 (0.26)	-6.6270 (-0.24)	-8.3838 (-0.31)	-8.4535 (-0.32)	22.1399 (0.97)
<b>CSRP</b>	<b>0.0124***</b> <b>(2.67)</b>	<b>0.0071</b> <b>(1.57)</b>	<b>0.0206***</b> <b>(4.87)</b>	<b>0.0200***</b> <b>(4.45)</b>	<b>0.0168***</b> <b>(3.66)</b>	<b>0.0134***</b> <b>(3.00)</b>	<b>0.0107**</b> <b>(2.32)</b>
SIZE	0.0417*** (4.86)	0.0498*** (5.40)	0.0206** (2.49)	0.0379*** (4.36)	0.0447*** (4.79)	0.0390*** (4.43)	0.0507*** (5.67)
MTB	-0.0007 (-0.50)	0.0000 (0.00)	-0.0018 (-1.63)	-0.0012 (-1.03)	-0.0013 (-0.98)	-0.0011 (-0.88)	-0.0005 (-0.38)
LEV	-0.0001*** (-3.19)	-0.0001*** (-3.81)	-0.0000 (-1.32)	-0.0000** (-2.03)	-0.0001** (-2.57)	-0.0001** (-2.57)	-0.0000* (-1.85)
ROA	0.0167** (2.43)	0.0171** (2.54)	0.0071* (1.76)	0.0159** (2.32)	0.0165** (2.41)	0.0156** (2.31)	0.0142** (2.27)
INTANG	0.1566 (0.58)	0.1460 (0.54)	-0.0445 (-0.28)	0.0627 (0.23)	0.0808 (0.29)	0.0816 (0.30)	-0.2249 (-0.98)
CR	0.0083 (1.32)	0.0122* (1.81)	0.0118* (1.75)	0.0082 (1.31)	0.0206*** (2.62)	0.0083 (1.33)	0.0065 (1.04)
Slack	0.0003*** (3.42)	0.0004*** (3.53)	0.0003** (2.57)	0.0003*** (3.50)	0.0004*** (3.66)	0.0004*** (3.51)	0.0004*** (3.64)
RD	-0.0098 (-0.28)	0.0013 (0.03)	0.1335 (1.35)	0.1106 (1.11)	0.1058 (1.09)	0.1146 (1.17)	0.1021 (1.08)
BIG4	0.1599*** (4.16)	0.2102*** (5.62)	0.0934*** (2.62)	0.1340*** (3.42)	0.1701*** (4.31)	0.1837*** (4.74)	0.2412*** (6.20)
AGE	0.0007 (0.05)	-0.0149 (-1.06)	0.0098 (0.94)	-0.0154 (-1.21)	-0.0203 (-1.40)	-0.0069 (-0.55)	-0.0378*** (-2.81)
Year effects	YES	YES	YES	YES	YES	YES	YES
Industry effects	YES	YES	YES	YES	YES	YES	YES
Observations	625	625	625	625	625	625	625
R-squared	0.396	0.418	0.321	0.380	0.414	0.384	0.398

\*\*\*, \*\*, and \* denotes statistical significance at the 1%, 5%, and 10% levels (two-tailed tests), respectively.

**Table 8: Lagged model results**

<b>VARIABLES</b>	<b>Model 1</b>	<b>Model 2</b>
	<b>MLC</b>	<b>ML Perf_Fac</b>
Constant	-7.8449 (-0.32)	-24.6241 (-0.33)
CSRP <sub><i>t-1</i></sub>	0.5918*** (3.17)	0.0420*** (3.20)
SIZE <sub><i>t-1</i></sub>	0.0433*** (5.11)	0.1302*** (5.07)
MTB <sub><i>t-1</i></sub>	-0.0008 (-0.61)	-0.0024 (-0.62)
LEV <sub><i>t-1</i></sub>	-0.0001*** (-2.74)	-0.0002*** (-2.73)
ROA <sub><i>t-1</i></sub>	0.0155** (2.49)	0.0467** (2.49)
INTANG <sub><i>t-1</i></sub>	0.0753 (0.31)	0.2323 (0.32)
CR <sub><i>t-1</i></sub>	0.0140** (2.29)	0.0424** (2.29)
Slack <sub><i>t-1</i></sub>	0.0003*** (3.38)	0.0011*** (3.37)
RD <sub><i>t-1</i></sub>	0.1322 (1.08)	0.4008 (1.08)
BIG4 <sub><i>t-1</i></sub>	0.1830*** (5.07)	0.5490*** (5.03)
AGE <sub><i>t-1</i></sub>	-0.0094 (-0.83)	-0.0274 (-0.80)
YEAR	YES	YES
INDUSTRY	YES	YES
Observations	544	544
R-squared	0.474	0.473

\*\*\*, \*\*, and \* denotes statistical significance at the 1%, 5%, and 10% levels (two-tailed tests), respectively.

## CHAPTER SIX

### CONCLUSIONS AND IMPLICATIONS

#### 6.1 Introduction

The objective of this study is to test the significance of the association between money laundering control (MLC) and corporate social responsibility performance (CSR). The study further explores the possibility that the relation between MLC and CSR is moderated by firms' reliance on correspondent banking or tax haven use. Furthermore, additional tests also have been performed to assess the effect of governance attributes (pertaining to existence of risk committee, whistle-blower policy and anti-fraud policy) on the relationship between CSR and MLC.

The sample used to test hypotheses initially comprised 77 (763 firm-year observations) publicly-listed Australian financial firms over the 2008–2017 period, which was then reduced to 625 firm-year observations over that period given that some annual reports were not accessible or data was missing. Through use of regression analysis, the researcher first examined if the association between MLC and CSR exists with the several attributes of strength of MLC and a set of positive (or negative) CSR activities based on 75 items reported in the Global Reporting Initiative (GRI) G4 sustainability reporting guidelines. Furthermore, the researcher examined if the association between use of correspondent banking and the strength of money laundering controls (MLC or MLC\_Fac), and the moderating effect of correspondent banking on the relationship between CSR and MLC (or MLC\_Fac). Moreover, the association

between use of tax haven jurisdictions and the strength of money laundering controls (MLC or MLC\_Fac) was tested and the moderating effect of tax haven utilization on the relationship between CSRP and MLC (or MLC\_Fac) was also examined.

## **6.2 The association between CSRP and MLC**

According to the Pearson correlation results, there exists positive association between CSRP and MLC. Evidences shows a significant positive correlation between MLC and CSRP ( $p < 0.01$ ) is evident. Furthermore, the result also indicates that the coefficient for CSRP is significantly positively associated with MLC and MLC\_Fac respectively ( $p < 0.01$ ). Meanwhile the evidences also show the existence of significant correlations between a number of corporation characteristics (SIZE, LEV, ROA, INTANG, CR, BIG4, and AGE) and MLC ( $p < 0.01$  or better).

These results show that firms with strength in development of positive corporate social responsibility activities and attributes assist firms' more broadly in development of sound money laundering control systems, policies and procedures.

## **6.3 The association between correspondent banking and MLC**

### ***6.3.1 The association between the use of correspondent banking and MLC***

Findings of this study indicate that the coefficient for CSRP is significantly positively associated with strength in MLC systems that include development of *anti-money laundering programs* and *money laundering policies procedures*. This result

applies to both measures of strength in money laundering control systems MLC and MLC\_Fac with significance of  $p < 0.01$ . The findings also show that coefficient for CorBank is significantly negatively associated with MLC and MLC\_Fac respectively ( $p < 0.01$ ). Firms that engage in correspondent banking are less likely to develop strength in money laundering controls.

### ***6.3.2 The association between the use of interaction term (CorBank\*CSR) and MLC***

Empirical results indicate the interaction term between firms' engagement in correspondent banking and CSR (i.e. CorBank\*CSR) is significant and positively associated with MLC. These results show that firms with strength in positive CSR and use of correspondent banking magnify the positive relationship with MLCs. Firms that engage in positive CSR activities that simultaneously rely on correspondent banking practices are more likely to develop strong money laundering control systems. Meanwhile, the findings also show that some of the control variables (SIZE, LEV, ROA, SLACK, and BIG4) are significantly associated with MLC ( $p < 0.10$  or better) in regression models.

## **6.4 The association between tax havens and MLC**

### ***6.4.1 The association between the use of tax havens and MLC***

Findings of this study indicate that the coefficient for CSR is significantly positively associated with strength of MLC systems that include attributes pertaining to the presence of *anti-money laundering program* and *money laundering policies*

*procedures*. The significant and positive association applies to both MLC and MLC\_Fac with  $p < 0.01$ . The findings also show coefficient for tax havens (TH) is significantly negatively associated with MLC and MLC\_Fac respectively ( $p < 0.01$ ). Firms that use tax havens are less likely to develop strength in money laundering controls.

#### ***6.4.2 The association between the use of interaction term (TH\*CSRP) and MLC***

Empirical results indicate the interaction term between firms' use of tax havens and CSRP (i.e. TH\*CSRP) is significant and positively associated with MLC. Firms that exhibit strength in development of positive CSRP attributes and use of tax havens magnify the positive relationship with MLCs. Firms that engage in positive CSR activities that simultaneously rely on use of tax havens are more likely to develop strong money laundering control systems. Additionally, the findings also show some of the control variables (SIZE, LEV, ROA, SLACK, and BIG4) are significantly associated with MLC ( $p < 0.10$  or better) in the regression model.

#### **6.5 Additional analyses**

Additional tests are conducted to assess the existence of governance factors such as: a) risk committee b) whistle-blower policy and c) anti-fraud policy on the relationship between CSRP and MLC. The result of first test indicates that governance factors such as risk committees are complimentary to the existence of positive CSR performance in assisting firms establish an effective money laundering control system. According to

the outcome from the following test, the governance factors such as existence of a whistleblower are proved to be complimentary to the existence of positive CSR performance in assisting firms establish an effective money laundering control system.

Finally, we then test whether the positive relationship between CSRP and MLC hold for subsamples of firms with and without an antifraud policy. The outcome suggests that in the case of the subsample of firms that do have an antifraud policy, the complementarity of CSRP and AFP assist firms to establish an effective money laundering control system. However, in the absence of an antifraud policy, positive CSRP may be superficial such that it de-incentives management to establish MLC systems that are effective.

Furthermore, the outcome of base line model indicates CSRP is significant and positively associated with each of the seven attributes that comprise MLC other than existence of an anti-money laundering policy. This result confirms Hypothesis 1. Meanwhile, lagged analysis is performed to mitigate risk. And the results of this analysis again support Hypothesis 1.

## **6.6 Implication and assumptions**

This study is subject to several limitations. First, the scoring of GRI index items to develop a CSR performance system involves some level of judgement and hence involves some level of subjectivity. Second, as CSRP, correspondent banking and tax haven data was hand-collected from firms' annual and corporate sustainability reports,



and as data was often located in different parts of those reports, it is possible that some items of data were overlooked. Third, positive CSR performance items are limited to disclosures in published reports. Therefore, this disclosure may not fully capture all the CSR activities of sample firms. Finally, the generalization of the result of this study beyond Australia context may not be appropriate as there are different CSR related regulations in other jurisdictions.

There are several implications arising from this study. First, firms' extent of CSR engagement, its activities and outputs can have an important influence on managements' propensity to participate in ML compliance, and the legal, governance, and information dissemination around illicit money flows. This can shape that firm's norms and values and its engagement with its stakeholders. Second, establishment of positive CSRP regime can assist firms to comply with an important element of legislation designed to combat ML and other illicit activities that also extend to terrorism and tax evasion.

## **6.7 Contribution of this study and future direction**

This study makes the following contributions to the literature. First, there is a paucity of research that has examined the relation between CSR performance and a major area of compliance, money laundering. The results provide evidence of the existence of the positive association between CSRP and MLC. This means that firms' which demonstrate strength in development of positive corporate social responsibility

activities and attributes assist firms' more broadly in the development of sound money laundering control systems, policies and procedures.

Second, there is a paucity of accounting-based research in the Australian financial services industry as compared to that in the non- financial services industry. Third, a methodological contribution is offered in terms of measurement of money laundering control systems. The measure of money laundering controls is an index that comprises items pertaining to existence of anti-money laundering program and development of anti-money laundering control systems. Finally, the impact of correspondent banking and tax havens on the MLC and CSR relation is examined.

Finally, the study will be beneficial not only in adding to theory but also in terms of offering practical insights. For regulators, the significance of an effective AML act is highlighted after the money-laundering scandal of CBA and Westpac. For financial sectors, they might consider not only to establish their own AML policies but also strengthen compliance and corporate governance.

Further research in this area could examine the relation between development of money laundering controls and tax evasion as the two may go hand in hand especially if they arise from a common source such as tax haven use. Second, the development of money laundering controls and audit characteristics could be examined since the audit function has some responsibility to assist in mitigating risks around illicit activities such as money laundering.

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## APPENDICES

### Appendix A

#### Variable Definitions

Variable	Description
Dependent Variables	
MLC	Sum of the seven money laundering control system characteristics that were used to generate MLC (ml specific system controls, aml program, ml training_complianceofficer, ml policies procedures, ml risk assessment, aml attestation and customer id program), scaled by the total expected score of these seven variables.
MLC_Fac	Factor Analysis of money laundering control system, is an eigenvalue obtained from seven MLC characteristics: <ul style="list-style-type: none"> <li>• ML specific system controls (MLSC)</li> <li>• AML program (AMLP)</li> <li>• ML training compliance officer (MLTC)</li> <li>• ML policies procedures (MLPP)</li> <li>• ML risk assessment (MLRA)</li> <li>• AML attestation (AMLA)</li> <li>• Customer id program (CIDP)</li> </ul>
Independent Variables	
CSR	Corporate Social Responsibility Performance index
Moderating Variables	
CorBank	An indicator variable that equals one if the firm has a dedicated correspondent banking, and zero otherwise.
TH	Total number of tax havens scaled by total number of foreign subsidiaries.

RiskCom	An indicator variable that equals one if the firm has a dedicated risk committee, and zero otherwise.
WBP	An indicator variable that equals one if the firm has a dedicated Whistleblower policy performance, and zero otherwise.
ANTFRD	An indicator variable that equals one if the firm adopted anti-fraud policy, and 0 otherwise.
Control Variables	
SIZE	Natural logarithm of total assets.
ROA	Net income divided by total assets.
MTB	Market Capitalization divided by total booking value of equity.
LEV	Total short-long term debt scaled by market capitalization end of the year.
INTANG	Intangible assets divided by total assets.
BIG4	An indicator variable that equals one if the firm is audited by a big auditor firm, and zero otherwise.
R&D	The ratio of research and development expenses to total assets.
SLACK	The ratio of cash to PPE.
CR	The ratio of current assets to current liabilities.
AGE	Natural logarithm of the number of years since the firm was established.

**Appendix B**  
**GRI Index CSR items**

<b>Positive GRI Index CSR items</b>
Materials used by weight or volume EN1
Percentage (or amount) of materials used that are recycled input materials EN2
Energy saved due to conservation and efficiency improvements EN5
Initiatives to provide energy-efficient or renewable energy based EN6
Reductions in energy requirements of products and services EN7
Percentage and total volume of water recycled and reused EN10
Operational sites owned, leased, managed in, or adjacent to, protected areas and areas of high biodiversity value outside protected areas EN11
Description of significant impacts of activities, products, and services on biodiversity in protected areas of high biodiversity value outside protected areas EN12
Habitats protected or restored EN13
Strategies, current action and future plans for managing impacts on biodiversity. EN14
Initiative to reduce of greenhouse gas (GHG) emissions achieved EN18
Total water discharge by quality and destination EN21
Initiatives to mitigate environmental impacts of products and services EN26
Percentage of products sold and their packaging materials that area reclaimed by category EN27
Total environmental protection expenditures and investments by type EN30
Total workforce by employment type, employment contract and region LA1
Total number and rate of new employee hires and employee turnover by age group, gender and region LA2
Benefits provided to full-time employees that are not provided to temporary or part-time employees, by significant locations of operation LA3
Return to work and retention rates after parental leave, by gender LA15
Percentage of employees covered by collective bargaining LA4
Minimum notice period(s) regarding operational changes, including whether it is specified in

collective agreements LA5
Percentage (or description) of total workforce represented in formal joint management-worker health and safety committees that help monitor and advise on occupational health and safety programs LA6
Health and safety topics covered in formal agreements with trade unions. LA9
Average hours of training per year per employee by gender, and by employee category LA10
Programs for skills management and lifelong learning that support the continued employability of employees and assist them in managing career endings LA11
Percentage of employees receiving regular performance and career development reviews, by gender by employee category LA12
Composition of governance bodies and breakdown of employees per employee category according to gender, age group, minority group membership, and other indicators of diversity LA13
Ratio of basic salary and remuneration of women to men by employee category, by significant locations of operation LA14
Percentage (or description) and total number of significant investment agreements that include clauses incorporating human rights concern or that have undergone human rights screening HR1
Percentage and significant suppliers, contractors and other business partners that have undergone human rights screening and actions taken HR2
Total hours of employee training on policies and procedures concerning aspects of human rights that are relevant to operations including the percentage of employees trained HR3
Operations and significant suppliers identified in which the right to exercise freedom of association and collective bargaining may be violated or at significant risk, and actions taken to support these rights HR5
Percentage of security personnel trained in the organization's policies or procedures concerning aspects of human rights that are relevant to operations HR8
Percentage (or description) of operations with implemented local community engagement, impact assessments, and development programs S01
Operations with significant potential or actual negative (or positive) impacts on local communities (Charity donations) S09
Significant actual and potential negative (or positive) impacts on society in the supply chain and action taken SO10
Percentage of employees trained in organization's anti-corruption policies and procedures S03

Actions taken in response to incidents of corruption SO4
Public policy positions and participation in public policy development and lobbying SO5
Total value of political contributions by countries and recipient / beneficiary SO6
Type of product and service information required by procedures, and percentage of significant products and services subject to such information requirements PR3
Practices relating to customer satisfaction including results of surveys measuring customer satisfaction PR5
Programs for adherence to laws, standards and voluntary codes related to marketing communications, including advertising, promotion and sponsorship PR6

## **Appendix C**

### **Westpac Group's 5 key AML/CTF principles**

1. Comply with AML/CTF legislation in the countries we operate in
2. Strive to fulfil international standards as detailed in the recommendations of the Financial Action Task Force (FATF)
3. Work in conjunction with the Australian Government and the governments of the countries we operate in, and support their objectives in relation to the prevention, detection and control of ML/TF
4. Westpac may decide not to provide products or services based upon decisions guided by ML/TF risk appetite and corporate social responsibility
5. Maintain and comply with an AML/CTF program, as required by Australian AML/CTF legislation.