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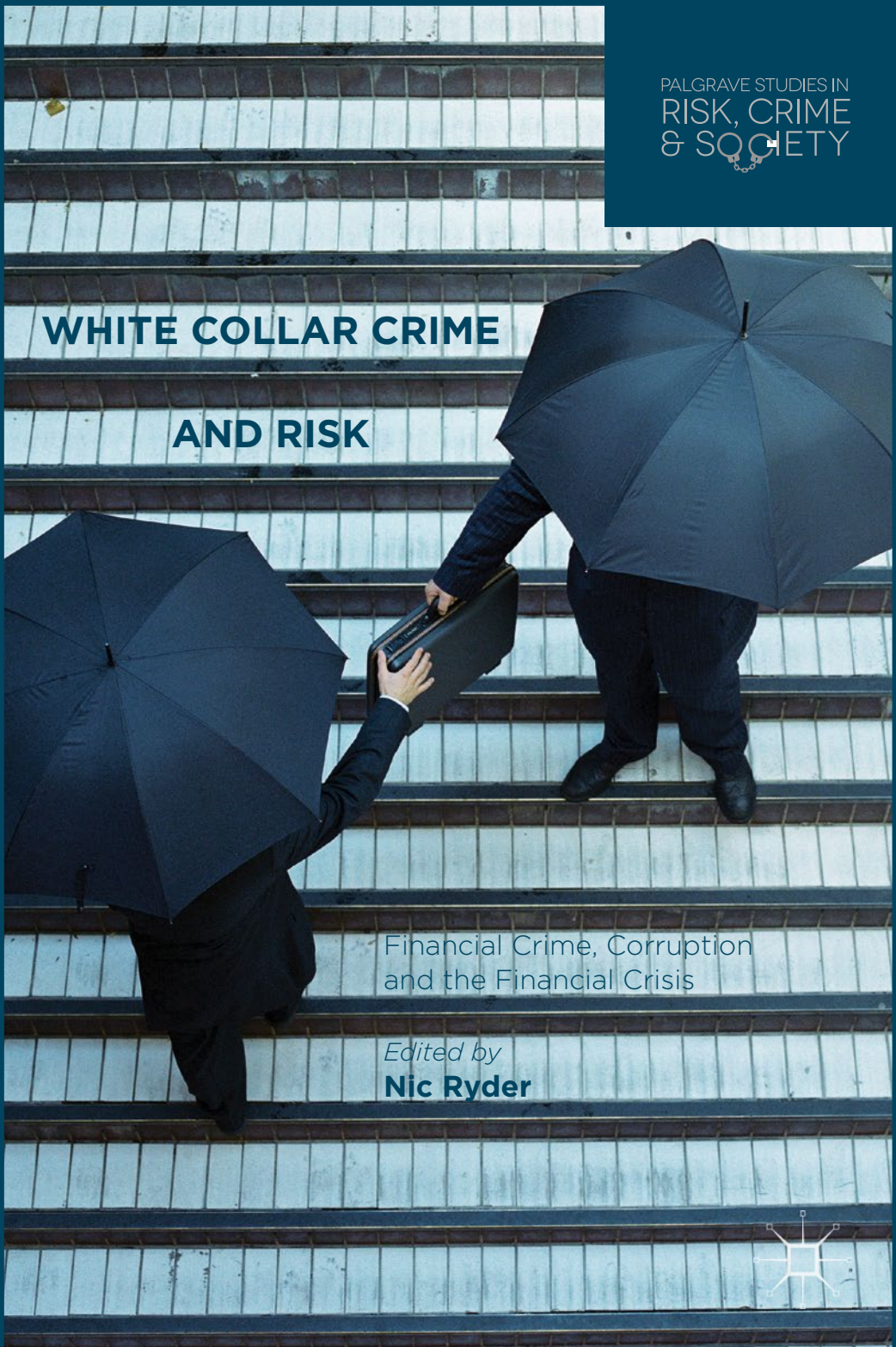

Financial Crime, Corruption and the Financial Crisis

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Palgrave Studies in Risk, Crime and Society

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Editor

White Collar Crime and Risk

Financial Crime, Corruption and the Financial Crisis

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Palgrave Studies in Risk, Crime and Society
ISBN 978-1-137-47383-7 ISBN 978-1-137-47384-4 (eBook)
https://doi.org/10.1057/978-1-137-47384-4

Library of Congress Control Number: 2017950823

Cover illustration: PhotoAlto / Alamy Stock Photo

Printed on acid-free paper

This Palgrave Macmillan imprint is published by Springer Nature
The registered company is Macmillan Publishers Ltd.
The registered company address is: The Campus, 4 Crinan Street, London, N1 9XW, United Kingdom

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Nic is a professor of financial crime who has published widely in this area. He is the author of four monographs, the *Financial War on Terror* (2015), *The Financial Crisis and White Collar Crime* (2014), *Money Laundering an Endless Cycle* (2012) and *Financial Crime in the 21st Century* (2011). Nic has also published two edited collections, *The Financial Crisis and White Collar Crime—Legislative and Policy Responses* (2017) and *Fighting Financial Crime in the Global Economic Crisis: Policy, Trends and Sanctions* (2014). He has also authored three text books, *The Law Relating to Financial Crime in the United Kingdom* (2013 and 2016) and *Commercial Law: Principles and Policy* (2012). He is in the process of writing his fifth monograph, *Market manipulation and the financial crisis*, that will be published in 2018 by Hart. Nic is the series founder and editor for Routledge's *The Law Relating to Financial Crime* and is a member of several editorial boards and contributing editor for Goode: Consumer Credit Law and Practice. Nic is the Co-I for the *Centre for Research and Evidence on Security Threats*, the initial funding is for three years, with £4.35 m from the UK security and intelligence agencies and a further £2.2 m invested by the founding institutions. Nic has been asked to consult on several financial crime matters for the BBC, the Wall Street Journal, Bloomberg, Insight, RBS Radio and ITN News. Ryder is supervising PhD students on money laundering, terrorist financing, tax evasion, banking regulation and bribery. Nic is an external examiner at the London School of Economics and has acted as an external examiner for many PhD exams.

Acknowledgements

This edited collection is the culmination of several years of hard work. I am very grateful to the contributors of this collection and I would like to thank Stephanie Carey for her continued patience and support (thanks for the extension or two!!) during the duration of this project. There are two people in particular who have put up with me during the writing of this monograph, my wife Ruth and son Ethan. It is without their support and love that this monograph would not have been possible. It is them I dedicate this book.

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text books, *The Law Relating to Financial Crime in the United Kingdom* (2013 and 2016) and *Commercial Law: Principles and Policy* (2012). He is in the process of writing his fifth monograph *Market Manipulation and the Financial Crisis* that will be published in 2018 by Hart. Nic is the series founder and editor for Routledge's *The Law Relating to Financial Crime* and is a member of several editorial boards and contributing editor for *Goode: Consumer Credit Law and Practice*. Nic is the Co-I for the *Centre for Research and Evidence on Security Threats*, the initial funding is for three years, with £4.35 m from the UK security and intelligence agencies and a further £2.2 m invested by the founding institutions. Nic has been asked to consult on several financial crime matters for the BBC, the Wall Street Journal, Bloomberg, Insight, RBS Radio and ITN News. Ryder is supervising PhD students on money laundering, terrorist financing, tax evasion, banking regulation and bribery. Nic is an external examiner at the London School of Economics and has acted as an external examiner for many PhD exams.

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Sarah Wilson is a specialist in financial crime and her other research interests include trusts law and the regulatory aftermath of the 2007–2008 financial crisis. Sarah's 2014 monograph *The Origins of Modern Financial Crime in Britain: Historical Foundations and Current Problems* was published by Routledge. Sarah has also published in many prestigious journals including the *Journal of financial crime*, *Law Crime and History* and the *British Journal of Criminology*. Sarah has held academic posts at Keele University, the University of Leeds and the University of Wales, Swansea.

1

Introduction

Nic Ryder

The objective of this edited collection is to critically appraise the association and relationship between white collar crime and risk. The term "white collar crime" was famously used by Professor Edwin Sutherland,[1] who in his seminal 1939 presidential lecture to the American Sociological Society offered the following definition of white collar crime "a crime committed by a person of respectability and high social status in the course of his occupation".[2] The term white collar crime is often used in common parlance and thus is one of which we assume we know its meaning, despite the fact that there is no internationally accepted definition of it. In England and Wales, financial crime can be said to include "any offence involving fraud or dishonesty; misconduct in, or misuse of information relating to, a financial market; or handling the proceeds of crime".[3] The Financial Services Authority, now the Financial Conduct Authority, offered a similar definition, stating that it is "any offence involving money laundering, fraud or dishonesty, or market abuse".[4] The Federal Bureau of Investigation defines financial crime as including the criminal activities of

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N. Ryder (ed.), *White Collar Crime and Risk*,
https://doi.org/10.1057/978-1-137-47384-4_1

corporate fraud, commodities and securities fraud, mortgage fraud, healthcare fraud, financial institution fraud, insurance fraud, mass marketing fraud and money laundering.[5] More recently, the term has been referred to as "financial crime", "economic crime" and even "illicit finance". The most obvious examples of white collar crime include fraud, money laundering, insider dealing, insider trading, terrorist financing, market abuse and more recently market manipulation. Other examples of white collar crime include, for example, "embezzlement, fraud and insider trading, on one hand, and market manipulation, profit exaggeration, and product misrepresentation".[6] These types of white collar crimes have gained significant notoriety in the last 30 years via a plethora of high profile incidents including, for example, Enron, WorldCom, Bernard Madoff, Alan Stanford, Ivan Boesky, Michael Milken, Jérôme Kerviel, Martha Stewart, Azil Nadir, Nick Leeson, John Rigas, Bernard Madoff and the Libor scandal. Furthermore, in response to the threat and risk posed by white collar crime, which costs the UK economy in excess of £70bn per year, the government has implemented an unprecedented number of white collar crime legislative amendments. Examples include the Fraud Act 2006, the publication of the Fraud Review, the creation of the National Crime Agency and the introduction of the Bribery Act 2010. Furthermore, the threat and risk posed by white collar crime to the global economy has been has been graphically illustrated during the most recent financial crisis due to large-scale instances of market manipulation, fraud and abuse of the financial system.

Therefore, this edited collection is divided into five unique parts, each of which focuses on a different type of white collar crime, and its relationship with risk. For example, the first part of the edited collection relates bribery and corruption and contains two chapters by Professor Indira Carr (University of Surrey) and Professor Umut Turksen (University of Coventry). The second part of the edited collection contains two chapters on the association between financial crime and risk and contains chapters from Professor Michelle Gallant (University of Manitoba) and Professor Ester-Herlin Karnell (University of Amsterdam). The third considers the recent criminalisation of market abuse and market manipulation and contains two chapters from Andrew H. Baker (Liverpool John Moores Univeristy) and Dr Rick Ball (University of the West of England, Bristol). The penultimate

part of the collection considers the emerging area of the risk associated with cyber white collar crime and contains two innovative chapters from Alan S. Reid (Sheffield Hallem Univeristy) and Dr Clare Chambers-Jones (University of the West of England). The final part contains chapters dealing with the 2007 financial crisis and white collar crime and contains contributions from Dr Sarah Wilson (University of York), Gary Wilson (Nottinghamn Trent Univeristy), Professor Roman Tomasic (University of South Australia) and Professor Nic Ryder (University of the West of England).

Notes

1. Green, S. 'The concept of white collar crime in law and legal theory' (2004) Buffalo Criminal Law Review, 8, 1–34, at 3.
2. See Sutherland, E. (1940) 'The White Collar Criminal', American Sociological Review, 5(1), 1–12, at 1. Sutherland, E. *White Collar Crime* (Dryden: New York, 1949) 9. Sutherland famously described white collar crime as "White-collar criminality in business is expressed most frequently in the form of misrepresentation in financial statements of corporations, manipulation in the stock exchange, commercial bribery, bribery of public officials directly or indirectly in order to secure favorable contracts and legislation, misrepresentation in advertising and salesmanship, embezzlement and mis- application of funds, short weights and measures and misgrading of commodities, tax frauds, misapplication of funds in receiverships and bankruptcies". See Sutherland, E. (1940) 'The White Collar Criminal', American Sociological Review, 5(1), 1–12, at 2–3.
3. Financial Services and Markets Act 2000, s 6(3).
4. Financial Services Authority, 'Fighting Financial Crime' <http://www.fsa.gov.uk/about/what/financial_crime> accessed 21 March 2012.
5. The Federal Bureau of Investigation, 'Financial Crimes Report to the Public' <http://www.fbi.gov/stats-services/publications/financial-crimes-report-2010-2011/financial-crimes-report-2010-2011#Financial> accessed 21 March 2012.
6. Kempa, M. 'Combating white-collar crime in Canada: serving victim needs and market integrity' (2010) Journal of Financial Crime, 17(2), 251–264, at 253.

Part 1

Bribery and Corruption

2

Corruption, Development, Financial Institutions and Politically Exposed Persons

Indira Carr

2.1 Introduction

Freeing more than a billion "fellow men, women and children from abject and dehumanizing conditions of extreme poverty" and a commitment to "create an environment – at the national and global levels alike – which is conducive to development and to the elimination of poverty" are amongst the goals listed in the United Nations (UN) Millennium Declaration adopted on 18 September 2000.[1] The Declaration was translated into a roadmap, setting out measurable goals such as the Millennium Development Goals (MDG) to be achieved by 2015. The first goal was to eradicate extreme poverty and hunger by reducing "by half the proportion of people whose income is less than $ 1 a day", achieving "full and productive employment and decent work for all, including women and young people", and reducing "by half the proportion of people who suffer from hunger".[2]

The key factors for reducing poverty are seen as infrastructure development, investment, economic growth and equitable distribution within developing and least developed countries.[3] Indeed the Millennium

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N. Ryder (ed.), *White Collar Crime and Risk*,
https://doi.org/10.1057/978-1-137-47384-4_2

Declaration itself links development with the elimination of poverty. However, the year 2015 which had been set as by the MDGs for the elimination of poverty has come and gone but poverty continues to be a problem. Surprisingly, many of the developed nations are also seeing a growth in poverty. For instance, in the UK (the sixth largest economy) one in five of the population live below the poverty line, that is they "experience life as a daily struggle".[4]

The elimination of poverty continues to be a goal when in 2015 the UN adopted the Sustainable Development Goals (SDG). Clause 1.1 states as its target eradication of "extreme poverty for all people everywhere, currently measured as people living on less than $ 1.25 a day" by 2030. The US$1.25 per day figure stated in the SDG reflects the international poverty line that was set by the World Bank (WB) in 2005. The WB has been assessing poverty figures since 1979 and, in 1990, its World Development Report[5] set the international poverty line[6] at US$1 per day which was raised to US$1.25 in 2005. In late 2015, the figure was raised further to US$1.90 per day to preserve the purchasing power of the previous figure of US$1.25 in the poorest countries of the world.[7]

A serious concern facing development, investment, economic growth and equitable distribution is corruption at the highest levels, amongst the political and bureaucratic elite, and the accompanying risk of laundering the proceeds of corruption. In order to reduce these risks, it is important that there are adequate laws and regulatory mechanisms. The international community, consisting of international financial institutions (FIs) such as the World Bank, national development agencies such as UK's Department for International Development (DFID),[8] Swedish International Development Agency (SIDA)[9] and US Agency for International Development (USAID),[10] international organisations such as the UN[11] and the Organisation for Economic Co-operation and Development (OECD),[12] and non-governmental organisations such as Transparency International (TI)[13] have focused their attention to addressing the corruption issue through a variety of measures including treaties, codes of conduct and guidelines, conditionalities (conditions tied to loans) and anti-corruption toolkits. This chapter examines the links between development, corruption, money laundering and the measures adopted to prevent money laundering by the political and bureaucratic

elite (often termed politically exposed persons or PEPs) who, by and large, are the main beneficiaries of corruption.

2.2 Development, Growth and Corruption

As indicated in the Introduction, there is a close link between development and elimination of poverty. Before proceeding with anti-corruption and anti-money laundering initiatives, it is important to see how development boosts economic growth and how corruption negatively impacts upon such growth.

The development agenda is not a recent initiative. The World Bank (WB) which comprises the International Bank of Reconstruction and Development (IBRD) and the International Development Authority (IDA)[14] is a major international financial institution that provides low interest loans and in some cases interest-free loans to countries for infrastructural development. Reconstruction and poverty reduction are important aspects of their work.[15] Since its inception, the WB has provided funds that run into billions of US dollars. For instance, the cumulative lending between 1945 and 2015 to India was US$102,135 million, to Nigeria US$19,319 million, to Kenya US$9851 million and to Tanzania US$11,434 million.[16] The lending covered a number of sectors ranging from agriculture, health, to energy and mining, transportation and public administration, law and justice. Taking the year 2014 as an illustration, the total lending of IBRD and IDA was US$40.8 billion, and of this, the lending in percentage terms by region was 26% to South Asia, 26% to Africa, 15% to East Asia and Pacific, 14% to Europe and Central Asia, 12% to Latin America and the Caribbean, and 7% to Middle East and North Africa.[17] The share of the total lending by sector was Public Administration, Law and Justice 22%; Transportation 17%; Energy and Mining 16%; Water, Sanitation and Food Protection 11%; Education 8%; Health and Other Social Services 8%; Agriculture, Fishing and Forestry 7%; Finance 5%; Industry and Trade 4% and Information and Communication 1%.[18] India, China and Brazil figured among the top ten borrowers from IBRD and for loans from IDA India, Nigeria, Kenya and Tanzania were in the top ten.[19] These data provide an interesting

picture of the amounts of money that are exchanged between the lender and the borrowing state.

Any infrastructural improvement project is inevitably going to involve the bureaucratic (public officials) and political elite and the private sector creating ample opportunities for corruption right from the very start, that is, from the identification of needs and prioritisation of projects to their implementation and completion. Lobbying of these elite groups by the private sector, their local representatives and agents for prioritising projects are commonplace, thus creating a zone for corruption in its various guises including bribes and kickbacks to take root. Bribes are also used as tools in the drafting of specifications with a view to favouring particular tenderers, the award of tenders, and in their implementation and completion. In the performance of the contract, it is not unusual to over invoice and list ghost workers to disguise payment of bribes to public officials. Bribes to public officials for completion certificates despite sub-standard work are not unusual either. An illustration provided by Cremer is an eye-opener. Cyclone shelters that had been built at great cost in Bangladesh were crumbling a few years after construction as sub-standard materials had been used by the contractors. He concluded that it was "safe to say that economic conditions underlie most cases. Civil servants or officials of para-governmental organisations accept inadequate building materials and neglect inspections in exchange for kickback[s] or bribe[s] from the contractor, who gains added income from providing lower quality".[20] Interestingly, a WB report on one of their funded projects indicates that public procurement processes are often manipulated, and the funder finds it extremely difficult to obtain information for the purposes of establishing the "leakages" that occur. In this particular instance, the WB found that "fiduciary practices in procurement, implementation and financial management systems' were weak and 'winners were pre-arranged in a majority of the contracts'".[21]

India is one of the largest borrowers from both the IBRD and IDA and is also a highly corrupt country according to TI's Corruption Perception Index (CPI).[22] In 2014, a credit of US$107 million from the IDA was allocated to road construction in the Indian state of Mizoram with the intention of increasing transport connections between India, Bangladesh, Myanmar and Nepal.[23] While this development is no doubt good for the

region, much caution also needs to be exercised in the expenditure of funds, since the construction sector is globally notorious for engaging in corrupt practices[24] and as the examples cited in the previous paragraph indicate. Given the allegations not so long ago on how millions of dollars were squandered in the Commonwealth Games held in India[25] and the subsequent civil movement by the Indian anti-corruption activist, Anna Hazare,[26] "how much of the monies lent by donors such as the WB at the end of the day do get spent on the projects they were ear marked for? And, do they really help in eliminating poverty or do they help in making the elites richer?" These questions become all the more alarming when there are reports in respected newspapers about how donors turn a blind eye to corruption and lend money. In 2006, in an opinion piece in the *Financial Times*, according to Michael Holman, the dossier that was compiled by Mr. James Githongo, the Kenyan anti-corruption supremo which was backed by secret tape recordings "kept Kenya's parliamentary public accounts committee riveted in last weekend's session at the country's high commission in London. Yet amid all the publicity, we may be missing the point: neither the World Bank nor the bilateral donors seem to have learnt any lesson from their experience in Zaire. And if you hope Mr Githongo's dossier, revealing some US$ 700m of ministerial sleaze, will stiffen the spine of Kenya's donors, do not hold your breath".[27] Another well-publicised case of bribery is the Lesotho Highland Water Project funded by a multitude of bilateral donors and the WB. The project was for bringing water from Lesotho to South Africa. A consortium of companies which included the UK construction company Balfour Beatty[28] was reported to have paid over US$2 million in bribes used to manipulate various processes.[29]

This problem of corruption has not gone unnoticed amongst the Western political circles. In 2004, Emad Mekay reported that the US Senate Committee concluded that the WB had lost US$100 billion, nearly 20% of its lending portfolio, in corruption. Senator Dick Lugar was of the view that every development bank dollar does not reach its intended recipient and corruption remains a serious problem. Lugar relied on the figures estimated by Jeffrey Winters of Northwestern University, one of the panellists. According to him, the WB "has participated mostly passively in the corruption of roughly 100 billion [US] dollars of its loan funds intended for development", whilst "other

experts estimate[d] that between five and 25 percent of the 525 billion dollars the Bank has lent since 1946 has been misused…amount[ing] to 26-130 billion dollars".[30]

The presence of large-scale corruption in the donee countries affecting funded projects was not unknown to the WB officials but historically no action had been taken by the WB until the late 1990s. The reason given was corruption was an internal political matter for the donee state and the WB could not intervene in internal matters. This stance was justified on the basis of the Articles of the WB which did not provide it with a mandate to make lending decisions on the basis of political considerations or to intervene in the political structures and matters of a state.[31] This attitude however suddenly changed in 1996 when the then President of the World Bank James D Wolfensohn saw corruption as an economic matter. According to him, for developing countries to achieve growth and reduce poverty "the cancer of corruption" needed to be dealt with. In his address to the WB and the International Monetary Fund (IMF), he said that "[i]n country after country, it is the people who are demanding action on this issue. They know that corruption diverts resources from the poor to the rich, increases the cost of running businesses, distorts public expenditures, and deters foreign investors. They also know that it erodes the constituency for aid programs and humanitarian relief. And we all know that it is a major barrier to sound and equitable development".[32]

The Wolfensohn speech could be said to have introduced a new era in the anti-corruption movement in the development funding context and also influenced the policies of bilateral donors. Around the same time as the Wolfensohn's speech, the OECD was also making great strides towards the adoption of its Convention on the Bribery of Foreign Public Officials in International Business Transactions (Anti-bribery Convention) in 1997. The driver for this Convention was the aftermath of the US Watergate scandal which had cast shadows on the conduct of US businesses whilst engaging in overseas trade.

The apathy towards (acceptance of) corruption generally, until the late 1990s, could perhaps be historically explained by the widely accepted views of the time. In the 1960s, academics such as Leys,[33] Leff[34] and Nye[35] saw corruption as a function of easing excessive bureaucracy that businesses faced and kick-starting economic growth in the many post-colonial

states such as India and Tanzania which influenced by socialist ideologies had adopted a command economy model with the unfortunate result of restraining economic growth.[36] While payment of bribes to the political and bureaucratic elite kick-started the economy, there was a gradual realisation that whatever positive impact corruption may have had was simply an illusion, especially when a point of saturation is reached. What useful role could corruption play when infrastructure development and economic growth that may be witnessed are based on sub-standard constructions, facilities and amenities that do not benefit the majority of citizens? What is the point of embedding corruption in the value systems of the political and bureaucratic elite that bodes ill for the common man from a governance perspective? There is no doubt that corruption increases red tape (the very phenomenon it was meant to ease) since it is a convenient method of extracting fees from those who wish to engage in transactions with the state be they businesses or citizens. The practice of bribes and kickbacks motivated by self-seeking interests and convenience not only breeds grand corruption amongst the elite but also petty corruption by low-level officials such that everyday life for the common man is a constant journey of negotiations with state officials to obtain basic services such as access to education, health and justice. In extreme forms, the state becomes a financial predator which could result in civil movements and civil unrest.[37] So it is not at all surprising that Wolfensohn in his address said it was the citizens who were demanding that action be taken on the issue of corruption such that there is equitable development. Indeed in many countries the anti-corruption civil movement has mobilised policymakers to focus on combating corruption. The civil movement led by Anna Hazare referred to earlier is an instance of this.

In the 1990s, the anti-corruption narrative found new voices, and economists started linking corruption to lower economic growth. For instance, according to Bardhan (in his widely cited paper) "[c]orruption has its adverse effects not just on static efficiency but also on investment and growth. A payment of bribes to get an investment license clearly reduces the incentive to invest…[W] hen public resources meant for building productivity-enhancing infrastructure are diverted for politicians' private consumption (cement for public roads or dams used for luxury homes) growth rates obviously will be affected adversely".[38]

Klitgaard and Rose-Ackerman[39] whilst viewing corruption as anti-economic growth also offered a model known as the principal-agent-client (PAC)[40] model which outlined the environmental conditions conducive to corruption. According to this model, corruption is the betrayal of the principal's (P) interest by the agent (A) in pursuit of his own interests by accepting or seeking a benefit from the client (C) who is the service seeker. For corruption to occur, P must be in a monopolistic (powerful) position, the agent must have some discretion in administering the services, and there must be a lack or near lack of accountability. This model could be said to reflect the Weberian rational-legal model of administration which promotes the public and private sphere of officials are separate and that this separation has to be maintained.[41]

The key features proposed by the above model were greater transparency and accountability. The WB was influenced by this model and set about improving governance in donee states. It promoted better governance by devoting funds to public administration, law and justice. As we saw above, the share of the total lending to the public administration, law and justice sector was 22% in 2014. In the process of promoting better governance, the WB has also resorted to a mechanism called "conditionalities" which has attracted some criticism.[42] Loans are given by the WB on the understanding that donee states will introduce transparency in their administrative processes of the public sector including public procurement and also make changes to their law that reflect the international standards promoted by regional and international anti-corruption conventions. The upside of this approach is that many developing countries have an impressive and comprehensive set of anti-corruption laws including money laundering. Most of them have ratified regional and international anti-corruption conventions. One could view this cynically and say that they have done this purely in order to obtain loans rather than for bringing about *real* changes in the behaviour of the political elite and public officials. This statement can be supported by the near-total lack of enforcement of anti-corruption laws in developing countries. It must however be acknowledged that recently the political leaders of Nigeria, India and China have pledged their support for enforcing anti-corruption laws. As to whether this gathering momentum will reach the required commitment to make a real difference remains to be seen. Despite the enforcement deficit on the plus side from a legal perspective, there is greater convergence in the anti-corruption laws across states.

The WB has also introduced sanctions in the form of debarment in order to introduce integrity in their funded projects. For instance, in the Lesotho Highland Project referred to earlier, Acres International was debarred by the Sanctions Committee of the WB for three years.[43] This is seen as a sign that the WB is sending out a clear message, although there have been a number of questions raised about the delay in starting enquiries and also the period of debarment. Bilateral donors have also adopted the practices of the WB, and donors such as DFID do require states to have anti-corruption measures. The DFID seems to have evolved its approach over time and has adopted a nuanced approach in that they seem to place the issue in the wider context of the history, politics and existing conditions within the state in order to drive change.[44] This drivers of change (DOC) approach "reject[s] sweeping judgments about governance in particular contexts and espous[es] the somewhat instrumental position that donors must work with whichever agents and institutions in recipient countries".[45] This approach being diplomatic in flavour raises the question of how far it can go in bringing about actual change on the ground. Other bilateral agencies have adopted approaches linked to their foreign policy. Chottray and Hulme's comparative work on the positions adopted by the US and the UK provides a useful starting point.[46]

Before proceeding to the next section on the links between corruption and money laundering and how the anti-corruption conventions address this link, it is important to say a few words about how corruption has been addressed by the non-donor community for the sake of completeness. It is widely acknowledged that businesses (i.e. the private sector) are the major suppliers of bribes.[47] Combating the supply side of bribery has been addressed using a combination of hard law and soft law. The OECD Anti-bribery Convention which has become a major contributor to ensuring that integrity is infused into the overseas dealings of businesses is an illustration of hard law measures. On the soft law side, the OECD's Guidelines for Multinational Corporations are well known and well established.[48] TI has also devised the Business Principles for Countering Bribery which provides a framework[49] for promoting business integrity.[50] Besides, Corporate Social Responsibility (CSR) also has the potential to promote anti-corruption where seriously followed by companies rather than being used as an illusory veil of reputational respectability.[51]

2.3 Money Laundering, Corruption and the Anti-corruption Conventions

It is not the intention here to examine the concept of money laundering and the various techniques used by the money launderers. For the purposes of this chapter, money laundering is understood as disguising or hiding the proceeds of crime from enforcement authorities by largely using the banking and financial sectors.

Initially, money laundering has been associated with the drug trade, and hence the first convention that made the hiding of the proceeds of crime an offence, the UN Vienna Convention against Illicit Trade in Narcotic Drugs and Psychotropic Substances, 1988,[52] focused on drugs. Subsequent legal instruments such as the Council of Europe Convention of the Laundering, Search, Seizure and Confiscation of the Proceeds of Crime 1990 have widened it to include other crimes. There is growing appreciation that the corrupt engage in money laundering also in order to disguise the source of their wealth that has been acquired illegitimately. The close link between money laundering and corruption, however, has been largely ignored. As Chaikin and Sharman observe, the main reason for this lack of connection is because "[t]he policy communities and specific institutions created to fight one or other type of crime arose with separate and unrelated missions. Functional specialization and bureaucratic inertia have tended to freeze this separation in place. Financial intelligence units…see corruption as outside their area of responsibility, and anticorruption bodies regard money laundering in the same way. Additionally, in many developing countries there is a belief that AML [Anti-money Laundering] and anticorruption policies and institutions have been foisted upon them by outsiders".[53] There is however ample evidence that the elite utilise other techniques such as the use of corporate vehicles[54] in the form of shell companies to hide their ill-gotten gains through corruption. When Ferdinand Marcos was removed from power in 1986, it was discovered that he had moved monies accumulated through kickbacks, bribes and diversion of foreign funds received as international aid to a number of foreign jurisdictions including Switzerland.[55] A very recent sensational case, Malaysian

1MDB scandal, exposes the link between corruption and money laundering, where the Swiss authorities investigating suspected bribery involving former 1MDB officials and others found "serious indications" that US$4 billion—earmarked for development projects—had been misappropriated from "Malaysian state companies"[56] leading to the charging of one of the employees of a Swiss private bank BSI SA for money laundering.[57]

2.3.1 Addressing Money Laundering Through the Anti-corruption Conventions

There are numerous regional and anti-corruption conventions. In this section, only those conventions that are in force[58] that have provisions on money laundering are considered. Therefore, the following conventions are considered for the purposes of this chapter, the OECD's Anti-bribery Convention, the Council of Europe's Criminal Law Convention on Corruption (COE Convention), the African Union Convention on Preventing and Combating Corruption (AU Convention) and the United Nations Convention against Corruption (UNCAC). Of these conventions, the UNCAC could be said to be the most comprehensive in creating money laundering offences,[59] and promoting measures for its prevention though the AU Convention is not far behind. The COE Convention by comparison could at first sight seem to be limited in scope, but by making reference to another convention devoted to laundering, confiscation and seizure, the scope is much extended. The OECD Anti-bribery Convention is perhaps the least ambitious when covering money laundering, but that should not come as a surprise, since the Convention was specifically drafted to address corruption of foreign public officials by businesses. The varying scope in these conventions in respect of money laundering and the measures to be taken to address it should not be taken negatively, since the Recommendations formulated by the Financial Action Task Force (FATF)[60] have brought about a great deal of convergence in the anti-money laundering (AML) regime. A brief account of the provisions regarding anti-money laundering in the anti-corruption conventions follows.

The OECD Anti-bribery Convention does not create an offence of money laundering but mandates that those contracting states that have made bribery of public officials a predicate offence in their money laundering legislation extend it to include foreign public officials. By contrast, the Council of Europe's Criminal Law Convention on Corruption creates the route to creating money laundering offences in the contracting states by requiring that they adopt legislative and other measures to establish as criminal offences under its domestic law conduct referred to in Art. 6 paras 1 and 2 of the Council Of Europe's Convention on Laundering, Search, Seizure and Confiscation of the Products from Crime, 1990.[61] The predicate offences for these purposes are those listed in Arts. 2–12 of the COE Criminal Law Convention. This list is quite extensive and includes active and passive bribery of domestic public officials (Arts. 2 and 3), bribery of foreign public officials and members of foreign public assemblies (Arts. 5 and 6), active and passive bribery in the private sector (Arts. 7 and 8), bribery of officials of international organisations (Art. 9) and trading in influence (Art. 12). The AU Convention takes a different approach to AML by devoting its Art. 6 to the issue by creating specific laundering offences. By Para (a) of Art. 6 the conversion, transfer or disposal of property, knowing that such property is the proceeds of corruption or related offences for the purpose of concealing or disguising the illicit origin of the property or of helping any person who is involved in the commission of the offence to evade the legal consequences of his or her action is an offence. The other offences are the concealment or disguise of the true nature, source, location, disposition, movement or ownership of or rights with respect to property which is the proceeds of corruption or related offences (Art. 6(b)) and the acquisition, possession or use of property with the knowledge at the time of receipt, that such property is the proceeds of corruption or related offences (Art. 6(c)). The UNCAC criminalises money laundering in its Art. 23,[62] and measures to combat money laundering are covered in Art. 14. The feature that stands out in Art. 23 is that it does not restrict itself to the laundering of money alone. In using the phrase "conversion or transfer of property", the provision covers assets other than cash such as company shares, luxury properties and antiques. The AU Convention in a similar vein uses the word property in its Art. 6. Art. 23(a)(i) of the UNCAC addresses the issue of both the person who

disguises the illicit origin of the property by converting or transferring them and the person who assists the individual involved in the commission of a predicate offence. The provision is wide enough to include all those who assist in the conversion or transfer such as family members, bankers, lawyers, estate agents and accountants. Like Art. 6(b) of the AU Convention, the UNCAC in Art. 23(a)(ii) makes the concealment, or true nature, source, disposition or ownership of the rights with knowledge that the property is the proceeds of crime an offence. The use of corporate vehicles such as shell companies is a common phenomenon when concealing the proceeds of crime. The OECD definition of a shell company as "entities established not to pursue any legitimate business activity but solely to obscure the identity of their beneficial owners and controllers…"[63] suggests that they are useful fronts for hiding the proceeds of crime. Charitable foundation is another means of concealing the proceeds of crime; while the contributors do not have rights of ownership, they could sit on the board giving them control over the organisation. The setting up of such a foundation by one of the former presidents of the Philippines, Joseph Estrada, provides an illustration. The Erap Muslim Youth Foundation was set up to carry legitimate activities of helping poor Muslim youth, but it was found in 2007 by the Sandigbayan that a sum of US$4.3 million of protection money collected by Estrada from illegal gambling operations had been deposited in the Foundation's bank accounts.[64]

Under Art. 23(b)(i) of UNCAC, the use, possession or acquisition of property which are the proceeds of crime is also to be made an offence as long as the requisite knowledge is present. This is similar to Art. 6(c) of the AU Convention. The effect of these provisions is that a purchaser of, for instance, a Ferrari from a seller knowing that it has been obtained from the proceeds of corruption would have committed an offence. Art. 23(b)(ii) introduces an offence that would catch all who participate, conspire, aid, abet facilitate and counsel the commission of the laundering offences. Were states to implement this provision, it would have the impact of catching (subject to evidence) professionals such as lawyers, financial advisers and accountants who give advice on the methods for laundering illicit funds.

There is however one important difference between Art. 6 of the AU Convention and Art. 23 of UNCAC. Under the AU Convention, Art. 6

on laundering is mandatory, whereas the UNCAC offers some degree of flexibility, in that the contracting state may adapt the provision to fit with the fundamental principles of its domestic laws which inevitably will introduce some degree of divergence when the UNCAC is implemented by the contracting states.

The UNCAC goes further than the AU Convention in putting forward measures to prevent money laundering in its Art. 14. They largely reflect the international standards that have been adopted by many states as a result of Recommendations from the FATF. The Art. 14 provisions impose requirements on banks, financial institutions but also has in its sight other entities that may be particularly susceptible to money laundering (Art. 14(1)(a)). Entities such as estate agents, auction houses and solicitors would fall within this class which means that they have to adopt the kind of mechanisms such as "Know Your Customer" (KYC) which are normally adopted by banks and other financial institutions. The Article also imposes duties on states to set up an AML regime but does not specify the type of regulatory body, thus leaving it to the state to adopt what suits them best. It is not uncommon to find a separate body called the Financial Intelligence Unit (FIU) which engages in collation of information and analysis but does not possess investigative powers. The investigation is normally left to the enforcement agencies which could include a specialised agency such as an anti-corruption commission. The analysis however provided by the FIU plays an important role.[65]

Art. 14(4) also requires states to use "relevant initiatives of regional, interregional and multilateral organizations against money laundering" as a guide. The other provisions address the implementation of measures for detecting the movement of cash and negotiable instrument (Art 14(2)) and the inclusion of accurate and meaningful information when monies are transferred electronically. This is to enable information in respect of the payment chain which in many cases will help in tracing the monies.

2.3.2 The FATF Anti-money Laundering (AML) Regime

Whilst the anti-corruption conventions help towards ensuring that corruption is a predicate offence of money, the AML regime in most countries has largely been influenced through the international standard set by

the FATF.[66] The Recommendations do not have the status of a convention, but it has over time become established and guide the practices to be followed by banks and others providing financial services. Even though the FATF has 36 members (which include two regional organisations), the FATF standards have been endorsed by 180 countries. This wide endorsement puts these Recommendations at par with the UNCAC which has been ratified (or acceded to) by 178 states.[67] The success of the FATF Recommendations despite lacking treaty status could perhaps be explained on the basis that their compliance mechanism extends to non-member states such that a non-compliant state could face countermeasures from compliant states. As de Koker rightly observes "[i]n practice, these countermeasures means that transactions and business relationships with persons from [non-compliant] jurisdictions are closely scrutinized. These countermeasures add to the cost of doing business with such countries, slow down the pace of transactions, and in many cases may even lead to a termination of business relationship".[68]

Drafted in 1990 (as 40 Recommendations), they have undergone periodic revisions to extend the scope of money laundering initially introduced to curb the laundering of the proceeds in drug trafficking offences to include other illicit activities such as terrorist financing[69] and corruption.[70] The latest revision took place in 2012. In brief, the Recommendations list the acts that states should criminalise and also provide client (customer) due diligence (CDD) measures for financial institutions to follow so that the risk of money laundering is lowered. This chapter does not give an account of all the FATF Recommendations but considers the CDD measures (found in Recommendation 10 (R10)) and in particular focuses on Recommendation 12 (R12) in respect of PEPs. It would be reasonable to say that the Recommendations in respect of CDD and PEPs form one of the central pillars supporting the FATF AML strategy.

Before going on to consider Recommendation 10 (R10) and R12[71] in some detail, a brief description of the different stages in the money laundering process follows. The first stage, known as the placement stage, involves placing the cash illegally obtained into the legitimate financial system. This placement could take place in a number of ways: the cash could be physically moved from one place to another (in many cases overseas), the cash could be used to buy chips at casinos, repay loans and credit cards, and for the purchase of foreign currency. Smurfs[72] could also

be used to deposit the cash in banks that are below the threshold limit as set in the banking regulation to avoid suspicion by the enforcement authorities. Co-mingling of illicit cash in legitimate cash-based business is another device used at the placement stage. The second stage, known as layering (or structuring), is the most complex and is likely to involve the international movement of funds using wire transfers and use of financial options. The aim at this stage is to create disassociation between the funds and their illicit origin and to obscure the audit trail, and it is not uncommon to use electronic means for transferring funds. The final stage in the money laundering process is integration, where the funds are integrated fully into the financial system so that they appear as having originated from a legitimate source, thus enabling the criminal to enjoy the proceeds of his crime without arousing suspicion.

2.4 Preventing Money Laundering by Politically Exposed Persons

As stated in Sect. 2.1, the biggest threat to development comes from the bureaucratic and political elite who are on the demand and receiving side of bribes and kickbacks. Much of the proceeds derived from a corrupt transaction are going to be in a tangible (financial) asset such as cash. Where grand corruption is involved, the cash element is likely to be large and the receiver of such funds is likely to seek ways of legitimising the funds to enable enjoyment of the proceeds without arousing suspicion. As seen in the previous paragraph, the money laundering process goes through various stages. The first step in the process is the placement of funds in a financial institution, and so the measures taken at this stage become highly relevant to dissuading money laundering. The FATF seeks to do this in its Recommendations by introducing an extra layer of diligence when it comes to dealing with the bureaucratic and political elite.

CDD is a central pillar of the Recommendations. R10 which lists the measures required of financial institutions (FIs) prohibits them from keeping "anonymous accounts or accounts that are in fictitious names". Financial institution (FI) is defined in the Glossary as a natural or legal person who conducts on behalf of a customer a range of activities. The

activities or operations include acceptance of deposits and other repayable funds from the public, financial leasing, trading in money markets such as derivatives and cheques, money and currency changing, and underwriting life insurance[73] and other investment-related insurance.

The circumstances when an FI is required to undertake CDD are (1) at the point of establishing a business relationship with a customer (for instance, when a customer wishes to open a bank account), (2) when occasional transactions are above a certain threshold which stands currently at USD/EUR 15,000 or (3) where there are wire transfers, (4) where money laundering of terrorist financing is suspected or (5) where there are doubts about the veracity or adequacy of customer identification data that was acquired by the FI previously (presumably when establishing the business relationship). The above requirements indicate that the FI's obligations in respect of CDD do not end once the account is open but is an ongoing one. This is further strengthened by paragraph (d) of R10 which states that "[c]onducting ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the institution's knowledge of the customer, their business and risk profile, including, where necessary, the source of funds". This means that the FI has to have detailed knowledge of the customer and their dealings. The CDD measures address these in paragraphs (a)–(c) in R10. Paragraph (a) requires that the customer is identified and the identification verified through reliable and independent sources including data and information. In practice, this is likely to include tax identification numbers, passports and council tax bills. In the case of legal persons, it could include details such as registered office. These requirements are unlikely to be sufficient where the customer is acting on behalf of another[74] in which case the FI is required to obtain information about the beneficial owner(s) and verify their identity (para. (c)). Where the customer is a legal person such as a company, then the FI also needs to understand the ownership and the control structure. These CDD requirements apply equally to other legal arrangements such as trusts.

As indicated earlier, FI also refers to institutions providing investment-related insurance and life insurance, and the CDD measures outlined in

R10 apply equally to them. However, R10 does not state whether any extra measures need to be undertaken for the identification of customer and beneficial ownership in such transactions. This issue is picked up in the Interpretive Notes to the Recommendations, where a distinction is drawn between named beneficiaries and those designated by class or characteristics (e.g. spouse at the time), or by other means (e.g. a will). In both cases, the FI is required to identify and verify the beneficiaries at the time of the payout and where they are unable to comply to make a suspicious transaction report to the relevant authority in their jurisdiction.

What is apparent from the above is that the FIs have to engage in an extensive amount of "investigative" processes which imposes costs on all the actors, the FIs, the customers and the states (who operate the suspicious activity reports). According to Reuter and Truman, the estimated cost to US under their AML regime is about US$7 billion per annum which "includes costs borne by the government, financial and non-financial private sector institutions, and the general public".[75] The high costs in following the CDD measures do place FIs in developing countries in a difficult situation. There are also other challenges that these FIs face which to an extent are driven by cultural and political environments. For instance, verification by independent sources may prove cumbersome due to the hindrances in obtaining relevant data or the data obtained may be erroneous or fictitious. This may be the case especially in countries that lack transparency and where political allegiances and patrimony have become deeply enshrined in the administrative structures of a country. Even where such constrictions do not exist, the FIs may find it difficult to profile a customer and assess the risk posed by a business relationship due to lack of access to Information Technology (IT) which has the ability to collate information from a variety of sources and databases to provide a historical picture of the customer. In many developing countries, banks and other financial institutions still use old-fashioned ledgers for dealing with clients and record-keeping. Access to IT systems is probably available only in a few main or regional branches. This lack of IT has the potential to create opportunities for exploitation (at the placement or the layering stages, for instance) by those wishing to engage in money laundering unless the banks have strict internal controls such as approval by the main branch before a business relationship is established in a small rural branch

or where the customer asks it to carry out high-value transactions. Training of all employees of the FIs also forms an important aspect of implementing the AML regime. As stated in Sect. 2.2, grand corruption is commonplace in aid-funded projects in developing countries. Against this context, the Recommendations can play a realistic role only where the local practices and existing conditions are appreciated and accommodated to reflect their underlying spirit and purposes. The introduction to the Recommendations does state that the measures should be adapted to the particular circumstances of the countries giving some level of flexibility to the state when formulating the contours of the AML standard in their regulations.[76]

At this stage, it must be pointed out that the bedrock of the Recommendations is a risk-based approach[77] (RBA) which means that the measures adopted by the FIs are commensurate with the risks identified. This allows for some degree of variation, in that where the risk is perceived as low, simplified measures would be appropriate. The level of risk will depend on the local conditions. For instance, in Country X with endemic corruption at the grand level, the risk of money laundering is likely to be high requiring enhanced measures. The enhanced measures may also apply to specific sectors. If Country X has a well-developed banking sector but not an insurance sector, it would make better sense to apply the enhanced measures to the banking sector since it poses a high risk. It is the expectation of the Recommendations that FIs assess risks and have appropriate policies and procedures such that they can effectively manage and mitigate the identified risks.

The bureaucrat and the political elite are a class that pose a high risk. R12 requires FIs to apply additional measures for politically exposed persons (PEPs). So who is PEP for the purposes of R12? The Glossary[78] definition of PEPs lists three categories of PEPs: foreign PEPs, domestic PEPs and persons who are or have been entrusted with a prominent function by an international organisation. Foreign PEPs are individuals who have been entrusted with prominent public functions by a foreign country and include heads of state, senior politicians, senior government, judicial and military officials, senior executives of state trading corporations and important party political officials. Domestic PEPs refer to those entrusted with prominent public functions domestically and include the various political and bureaucratic elite referred to under foreign PEPs. As for

international organisation PEPs (persons entrusted with prominent function in an international organisation), the reference is to members of senior management. This could include directors and deputy directors and board members. The definition in the Glossary also makes clear that the definition is not intended to cover middle- or junior-ranking individuals.

In addition to CDD under R10, the FIs in respect of foreign PEPs should have appropriate risk management systems to determine whether the customer or the beneficial owner is a foreign PEP (R12(a)). They also have to obtain senior management approval for establishing or continuing with an already existing business relationship (R12(b)). So, for instance, where an existing (foreign) customer who is not a foreign PEP at the time of establishing the business relationship is elected to Parliament or becomes a Secretary of State of his country, R12(b) expects that approval is obtained from the relevant person within the FI, depending on its management structure in addition to meeting the requirements of R12(a). It is also a requirement under R12(c) and (d) that reasonable measures are undertaken by FI to establish the source of wealth and source of the funds and that there is continuing enhanced monitoring of the business relationship. The measures listed in paras. (b), (c) and (d) also apply to domestic PEPs of an international organisation. The requirements for domestic PEPs are different from those set for foreign PEPs, in that R12(a) does not apply to domestic PEPs. This reflects the assumption that foreign PEPs are high risk. Middle- and junior-ranking officials in these different categories are excluded. However, R12 includes family members and close associates of all three categories of PEPs.

The approach adopted in R10 and R12 is also to be found in the UNCAC in Art. 52 on prevention and detection on transfers of proceeds of crime. Article 52(1) addresses aspects such as identification of customers, identity of beneficial owners and enhanced security, where accounts are opened or maintained "by or on behalf of individuals who are, or have been, entrusted with prominent public functions and their family members and close associates".[79]

While R10 is onerous and demanding in terms of labour, data management, time and costs, the requirements in R12 pose special challenges to FIs and create uncertainties some of which are explored here. Prominent public function is an important characteristic of a PEP. But what does

"prominent" mean in this context? Leaving it to a FI to determine whether a particular public function is prominent or not could result in unintended consequences. To illustrate, a senior public official may be the public face of a government department by promoting the work and the impact of the department on the wider society through radio and television broadcasts and the social media. Due to the public relations role, the official could be seen as playing a prominent role. Does this make the individual a PEP? Probably not, since playing a prominent role need not necessarily mean that the public official has a prominent public function. The official in our illustration may be well known because of his TV and radio appearances, but this is not the same as saying that the function he carries out is a prominent public function envisaged by the Recommendations (or for that matter the UNCAC which uses the same phrase in its Art 52). The prominent public function seems to be referring to a decision maker at the highest levels, as, for instance, in the case of a senior official who is in-charge of procuring defence equipment but is not well known like the official involved in the public relations role. To a large extent, it could be said the context (the responsibilities of the officials, for instance) within which the official operates contributes to the meaning of the phrase "prominent public function". To some degree, it would be reasonable to expect the FI to have first-hand knowledge of the different functions that public officials assume in its jurisdiction and possibly the "prominence" of the function. However, when it comes to foreign PEPs, the issue of prominent public official becomes more complex. The FATF Guidance on Politically Exposed Persons (Guidance)[80] acknowledges that "the precise level of seniority which triggers the PEPs requirement is not specified".[81] The expectation however is that the jurisdiction "use the risk assessment in Recommendation 1[82] to identify the specific levels and types of PEPs which pose a higher risk". If we were to take such an approach, the official engaged in public relations in the illustration above would not pose as high a risk as the senior public official in charge of procuring defence equipment.

The Guidance does make a number of suggestions but their impact is debatable. Among the good practices suggested by the Guidance are: (1) guidance from countries in what constitutes a prominent public function for domestic and foreign PEPs informed by risk assessment, (2) provision

of a "baseline list of particular positions within the government which are sufficiently prominent so as to qualify for a PEP",[83] (3) use of asset disclosure of public officials and (4) description of the different types of responsibilities that are sufficiently prominent. Similar information is expected of international organisations along with details of the business model and organisation structure.

If the above suggestions are adhered to and followed by the countries that follow the FATF standard, they would, without doubt, make the task of determining whether or not a customer is a PEP easier. However, in practice, some of the suggestions may be unworkable. For instance, many countries do not have laws in respect of asset declarations. This is particularly so in developing countries. If they do have legislation, lack of clarity causes confusion about what assets should be declared. Neither are the declarations monitored or verified nor are they in the public domain.[84]

Another factor that requires consideration is that of time limit. R12 does not state whether PEPs stop being a PEP once the official no longer engages in a prominent public function. The Guidance observes assessment of risk rather than time is relevant since many PEPs have some degree of influence in the corridors of power even after leaving office, albeit unofficially.

The inclusion of "family members" and "close associates" is also a challenge for FIs. The Recommendation is silent about the scope of these phrases. For instance, do cousins twice removed fall within the class of family members? Culture is likely to be a relevant factor. For instance, in Hindu joint families, such cousins are likely to be regarded as part of the family. It may well be that in some cultures even members of a clan may be regarded as family members. Close associates raise uncertainties. Should they, for instance, include officials working in the same department or organisation, boyfriends and girlfriends? The Guidance indicates that factors such as "the influence that particular types of family members have, and how broad the circle of close family members and dependants tend to be"[85] may be relevant. The Guidance is also appreciative that culture would be a contributing factor as well. In respect of close associates, the Guidance provides a list of relationships ranging from known or sexual partners outside the family unit such as mistresses and girlfriends, and prominent members of the same political party to business associates and

membership of the same labour union.[86] While an FI may be aware of the cultural context within its jurisdiction, it is likely to lack knowledge of the culture of a foreign PEP. The expectation is that the FI will consult other "institutions within the same financial group which are doing business in the foreign country or, alternatively through the internet and other relevant sources".[87]

While it is commendable that the Guidance attaches importance to the social and cultural context, its understanding of the social and cultural contexts seems to be rather narrow. It seems to view countries as having a unified country-specific culture. Returning to India that was used as illustration before, in some parts of the northern India, a community's understanding of family members extends to the whole village. It is not uncommon for village elders to call all the young men in the village their sons, even though they have different genetic heritage. Given all the different cultural nuances, the inclusion of family members and close associates does pose a "real" problem for FIs. This however does not mean that they should not have been included, since these connections can be used (abused) by PEPs, for instance, at the placement stage of the money laundering process.

The FIs also have to face the issue of how to obtain information about family members and close associates. The FI may have to use a wide range of sources such as customer, third parties and commercial databases which, of course, leaves room for misunderstanding and mistakes. Another important requirement of R12 is that reasonable measures should be taken to establish the PEP's source of wealth (total assets) and source of the fund (referring to the particular fund). While it is easy to establish the source of the fund and how it was obtained, asking the customer the source of wealth is problematic. In the absence of voluntary disclosure, the FI will have to depend on other sources such as publicly available asset disclosure (part of asset declaration), third-party sources and commercial databases. And where there is voluntary disclosure, reliability of the information provided needs to be verified which could prove to be a slow and lengthy process, especially where foreign PEPs are concerned.

What is apparent from an examination of some of the requirements in R10 and R12 considered in this section is that the FATF has created an

elaborate labyrinth that the FI has to navigate through. The journey is not going to be an easy one unless there is ample experience in the institution and support from "investigative" researchers, be they third parties or from within the institution, in the case of PEPs. As to how far developing countries will follow R10 and R12 is questionable due to the economic constraints. As Reuter and Truman correctly observe "the AML regime is an expensive luxury good".[88] There is also one other complication. The AML regime assumes that bank officials are honest and follow the requirements to the letter. However, officials in FIs are equally prone to corruption which means that regardless of any preventative mechanisms there might be in place money launderers will be able to use the system to their advantage by dealing with dishonest officials. Neither is it unknown for FIs like banks to be corrupt at an institutional level.[89]

2.5 Conclusion

This chapter drew a link between corruption, development and money laundering, and examined the steps taken to combat money laundering in both the anti-corruption conventions and the FATF AML regime. The FATF has developed a sophisticated regime that aims to protect the integrity of the financial institutions by requiring risk assessment and through vetting of the customer. The regime is impressive in its thoroughness, but the nagging worry of its workability remains. The FATF seems to have had the wealthy nations (with their expertise and capacity) in mind and seems to have turned a blind eye to the special needs of developing countries in terms of costs, capacity and expertise. At the end of the day, is the AML regime an overkill?[90]

Notes

1. http://www.un.org/millennium/declaration/ares552e.htm
2. http://www.un.org/en/mdg/summit2010/pdf/List%20of%20MDGs%20English.pdf

3. Anup Shah (2011) *Poverty Around the World* http://www.globalissues.org/article/4/poverty-around-the-world
4. http://policy-practice.oxfam.org.uk/our-work/poverty-in-the-uk
5. https://openknowledge.worldbank.org/bitstream/handle/10986/5973/WDR%201990%20-%20English.pdf?sequence=5
6. Martin Ravallion (1998) "Poverty Lines in Theory and Practice" *Living Standards Measurement Study Working Paper 133*, Washington, DC: World Bank.
7. http://www.worldbank.org/en/news/press-release/2015/10/04/world-bank-forecasts-global-poverty-to-fall-below-10-for-first-time-major-hurdles-remain-in-goal-to-end-poverty-by-2030
8. https://www.gov.uk/government/organisations/department-for-international-development
9. http://www.sida.se/English/
10. https://www.usaid.gov
11. http://www.un.org
12. http://www.oecd.org
13. http://www.transparency.org
14. Besides the International Bank for Reconstruction and Development (IBRD) and International Development Association (IDA), the World Bank also houses three affiliate agencies—the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA) and the International Centre for the Settlement of Investment Disputes (ICSID).
15. For more on the history and evolution of the World Bank (WB) visit http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/0,,contentMDK:20653660~menuPK:72312~pagePK:51123644~piPK:329829~theSitePK:29708,00.html (accessed 12 December 2011).
16. http://pubdocs.worldbank.org/pubdocs/publicdoc/2015/11/804131447347453530/WBAR15-LendingData-rev.pdf
17. World Bank Annual Report 2014, https://openknowledge.worldbank.org/handle/10986/20093 Figure 15.
18. Ibid. Fig. 16.
19. Ibid. Table 1.
20. G Cremer (2008) *Corruption & Aid Development: Confronting the Challenges* (trs. Elisabeth Shüth) London: Lynne Reinner, pp. 39–40.
21. World Bank *INDONESIA: Fiduciary Review of the Second Sulawesi Urban Development Project Overview Report*, 2002 available at http://

www1.worldbank.org/publicsector/anticorrupt/PoliticalEconomy/PREMCourse07/Amit%20background%20material/Fiduciary%20review%20Indonesia.pdf. Interestingly, an internal memorandum from the WB provides a typology and the amounts of informal payments that are normally set aside for funded projects. Five to ten percent is set aside for payments to various authorities including planning to place a project on the priority list at the pre-project stage; 5–30% for inclusion in the approved bidders' list and 5–35% for signing of the contract with the bid winner. During the life of the projects, bribes are also paid for inspection and completion certificates. "World Bank Memoranda On Corruption In Indonesia Confidential: Indon Resident Staff Views Re 'Leakage'", Staff Bank Dunia Di Jakarta Augustus, 1997 Reproduced as Appendix 2 Select Committee On International Development http://www.publications.parliament.uk/pa/cm200001/cmselect/cmintdev/39/39ap07.htm

22. The Corruption Perception Index (CPI) uses a scale of "0" (very corrupt) to "100" (very clean). In 2014, India received a score of 38 and was ranked 85 out of 175 countries. Denmark, in comparison, received a score of 92 (edging very close to "very clean") and was ranked at 1.
23. World Bank Annual Report 2014, fn 12, p. 50.
24. See for instance CIOB (2013) *Corruption in the UK Industry* http://www.giaccentre.org/documents/CIOB.CORRUPTIONSURVEY.2013.pdf; Patrick X W Zou (2006) "Strategies for Minimising Corruption in the Construction Industry in China" *Journal of Construction in Developing Countries* 11(2):15. There have been numerous initiatives to introduce codes of ethics for the construction industry. See, for instance, the UK Contractors Group (UKCG) Code of Business Ethics and Conduct http://archive.ukcg.org.uk/about-us/ukcg-code-of-business-ethics-and-conduct/. Clause 2 of this Code states in relation to bribery and corruption that UKCG "members are committed to ensuring that their businesses operate with the utmost integrity and that they and their employees will not offer, promise or pay bribes to anyone, or request, agree to accept or receive bribes or otherwise breach applicable laws on bribery and corruption".
25. See "Commonwealth Games: Corruption, Chaos & a Race to Avert a Crisis" available at http://www.independent.co.uk/sport/general/others/commonwealth-games-corruption-chaos-amp-a-race-to-avert-a-

crisis-2057234.html, 'India Orders Probe into Commonwealth Games Corruption' available at http://www.voanews.com/english/news/asia/south/India-Orders-Probe-into-Commonwealth-Games-Corruption-105097774.html

26. See "Indian Activist Anna Hazare Refuses to End Hunger Strike" available at http://www.guardian.co.uk/world/2011/apr/07/anna-hazare-hunger-strike (accessed 1 December 2011), "Indian Activist Anna Hazare on Hunger Strike as MPs Debate Anti-graft Bill" http://www.guardian.co.uk/world/2011/dec/27/indian-anti-graft-hunger-strike
27. "The Donors Who Turn a Blind Eye to Kenyan Sleaze" http://www.ft.com/cms/s/1/f09518ac-9e53-11da-b641-0000779e2340.html#axzz4B4hjCjnw
28. See *2000: Balfour Beatty's Annus Horribilis* Oxford: ILISU Dam Campaign available at http://www.thecornerhouse.org.uk/sites/thecornerhouse.org.uk/files/balfour.pdf. See also Appendix I Select Committee on International Development.http://www.publcations.parliament.uk/pa/cm200001/cmselect/cmintdev/39/39ap06.htm
29. Both civil and criminal proceedings were brought against Mr. Sole, the Chief Executive of the L Highlands Developments Authority. Mr. Sole was charged with bribery and fraud and was imprisoned to 18 years which was reduced to 15 on appeals. The civil proceedings were for recovery of funds. See "M 12 Million Bribery Scam on Sole" https://journal.probeinternational.org/1999/08/09/m12-million-bribery-scam-sole/. A number of companies involved in the consortium were also found guilty of corruption and fined various amounts. See "Lesotho fines second dam firm" available at http://www.thecornerhouse.org.uk/sites/thecornerhouse.org.uk/files/balfour.pdf (accessed 1 September 2011). See 'Lesotho Fines Second Dam Firm' available at http://news.bbc.co.uk/1/hi/business/3185145.stm. The WB has debarred two firms, the Canadian firm Acres International and the German firm Lahmeyer. See "Corrupt Lahmeyer Debarment Welcome but Late – NGOs" available at http://www.internationalrivers.org/en/africa/lesotho-water-project/corrupt-lahmeyer-debarment-welcome-late-ngos
30. E Mekay (2004) "Poorest Pay for World Bank Corruption – US senator" http://www.ipsnews.net/2004/05/development-poorest-pay-for-world-bank-corruption-us-senator/

31. The exclusion of politics is clearly stated in Art. III(5)(b) and Art. IV(10) of the IBRD Articles of Agreement which read:

    Art III, Sec. 5 (b)

    > The Bank shall make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations.

    Art IV, Sec. 10

    > The Bank and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political character of the member or members concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighed impartially in order to achieve the purposes stated in Article 1.

32. James D Wolfehnson (1996) 'People and Development' Address to the Board of Governors at the Annual Meetings of the World Bank and the International Monetary Fund, reprinted in *Voice for the World's Poor: Selected Speeches and Writings of World Bank President James D Wolfensohn, 1995–2005* Washington, DC: World Bank, 2005 http://elibrary.worldbank.org/doi/abs/10.1596/0-8213-6156-2
33. Colin Leys (1965) "What is the Problem about Corruption?" *Journal of Modern African Studies* 3: 215.
34. N H Leff (1964) "Economic Development through Bureaucratice Corruption" *American Behavioural Scientist* 8(3): 8.
35. See Joseph S Nye (1970) "Corruption and Political Development: A Cost-Benefit Analysis" in A Heidenheimer (ed) *Political Corruption: Readings in Comparative Analysis* New York: Holt, Reinhart & Wilson.
36. M Dobb (1948) *Soviet Economic Development since 1917* 1948, London: Routledge & Kegan Paul, 2.
37. See L Anderson "Demystifying the Arab Spring" in *The New Arab Revolt* Foreign Affairs/CFR eBook, May/June 2011. Summary available at https://www.foreignaffairs.com/articles/libya/2011-04-03/demystifying-arab-spring

38. Pranab Bardhan (1997) "Corruption and Development: A Review of Issues" *Journal of Economic Literature* 35(3) 1320, 1328. See also S Alatas (1998) *Corruption, Its Nature, Causes and Functions*, Aldershot: Brookfield; Mbaku (1994) "Africa after more than Thirty Years of Independence: Still Poor and Deprived", *Journal of Third World Studies* 11: 13; D. Gould and Mukendi (1989) "Bureaucratic Corruption in Africa: Causes, Consequences and Remedies", *International Journal of Public Administration* 12: 427; "Eliminating World Poverty: Making Globalisation Work for the Poor", Cmnd 5006, (London: HMSO 2000); Susan Rose-Ackermann, "The Economics of Corruption" 4 *Journal of Public Economics* (1975), 187; C.W. Gray and D. Kaufmann (1998) "Corruption and Development", 35 *Finance and Development* 35:7; V. Tanzi (1998) "Corruption Around the World: Causes, Consequences, Scope and Cures" IMF Staff Papers 45: 559.
39. R Klitgaard (1988) *Controlling Corruption* Berkeley, University of California Press; Susan Rose Ackermann (1999) *Corruption & Government* Cambridge: CUP.
40. For more on this, see Indira Carr (2009) "Corruption, the Southern African Development Community Anti-corruption Protocol and the Principal—Agent—Client Model" *International Journal of Law in Context* 5(2):147. This model is used by both Klitgaard and Rose Ackerman to explain corruption in the public sector, especially in the context of the public-private dealings. As to whether the same conditions apply in private sector corruption or public-public sector corruption needs to be explored further. However, the two factors to reduce corruption, transparency and accountability are, in my view, of universal application.
41. Max Weber (1947) *The Theory of Social and Economic Organization*, New York, Free Press. See also see D C North and R P Thomas (1996) *Rise of the Western World: A New Economic History* Cambridge: Cambridge University Press.
42. Paul Collier (1997) "The Failure of Conditionality" in C Gwin and JM Nelson (eds) *Perspectives on Aid and Development* Washington, DC: John Hopkins University Press, Paul Collier, P. Guillaumont, S. Guillaumont and J.W. Gunning (1997) "Redesigning Conditionality" *World Development* 25(9):1399.
43. See F Darroch *The Lesotho Corruption Trials – A Case Study*, Transparency International, 2003 (available at http://www.ipocafrica.org/index.php?option=com_content&view=article&id=71&Itemid=66).

44. See Vasuda Chottray and David Hulme (2007) *Contrasting Visions for Aid and Governance: The White House Millennium Challenge Account and DFID's Drivers of Change* http://www.gprg.org/pubs/workingpapers/pdfs/gprg-wps-062.pdf
45. Ibid., p. 26.
46. Ibid.
47. Roberto A Fredman (2014) "How the World's Biggest Companies Bribe Foreign Governments—in 11 Charts" *The Washington Post* https://www.washingtonpost.com/news/wonk/wp/2014/12/03/how-the-worlds-biggest-companies-bribe-foreign-governments-in-11-charts/
48. http://www.oecd.org/daf/inv/mne/48004323.pdf
49. http://www.transparency.org/whatwedo/publication/business_principles_for_countering_bribery
50. The International Chamber of Commerce has also produced "Rules on Combating Corruption" which focuses on good commercial practice. The document is available at http://www.iccwbo.org
51. See Indira Carr and Opi Outhwaite (2011) "Controlling Corruption through Corporate Social Responsibility and Corporate Governance: Theory and Practice" *Journal of Corporate Law Studies* 11(2); 299.
52. See Art. 3(b)(i) and (ii). Note that the Convention does not use the phrase "money laundering".
53. David Chaikin and J C Sharman (2009) *Corruption and Money Laundering: A Symbiotic Relationship,* New York; Palgrave Macmillan, p. 21.
54. See Indira Carr and Rob Jago (2014) "Corruption, the United Nations Convention against Corruption (UNCAC) and Asset Recovery" in Colin King and Clive Walker (eds) *Emerging Issues on the Regulation of Criminal and Terrorist Assets*, Farnham: Ashgate.
55. The World Bank., *Stolen Asset Recovery (StAR) Initiative Challenges, Opportunities and Action Plan* (The World Bank, Washington, DC, 2007); de Quiros, C., *Dead Aim: How Marcos Ambushed Philippine Democracy* (Foundation for Worldwide People's Power, Pasig City, 1997). See also David Chaikin, "Tracking the Proceeds of Organised Crime – The Marcos Case" Paper Presented at the Transnational Crime Conference convened by the Institute of Criminology in association with the Australian Federal Police and Australian Customs Service, Canberra, 9–10 March 2000.
56. Michael Peel and Jeevan Vasagar (2016) "Malaysia: 1 MDB Money Trail" *The Financial Times* https://next.ft.com/content/0981b2c8-cfe3-11e5-92a1-c5e23ef99c77

57. Jake Maxwell Watts (2016) "Prosecutors: Money Laundering Probe Largest Ever in Singapore" *The wall Street Journal* http://www.wsj.com/articles/prosecutors-1mdb-money-laundering-probe-largest-ever-in-singapore-1464375014
58. Currently, the following conventions are in force:

    – Organisation of American States Inter-American Convention against Corruption 1996 (OAS Convention), in force 6 March 1997.
    – Organisation for Economic Co-operation and Development Convention on Convention on Combating Bribery of Foreign Public Officials in International Business Transactions 1997 (OECD Convention), came into force 15 February 1999. See I.Carr and O.Outhwaite "The OECD Anti-bribery Convention Ten Years On" 2009 5(1) *Manchester Journal of International Economic Law* 3.
    – Council of Europe Criminal Law Convention on Corruption 1999 (COE Convention), in force 1 July 2002.
    – Council of Europe Civil Law Convention on Corruption 1999 (Civil Law Convention), in force.
    – African Union Convention on Preventing and Combating Corruption 2003 (AU Convention), in force 5 August 2006. See I. Carr "Corruption in Africa: Is the African Union Convention on Combating Corruption the Answer?" 2007 *Journal of Business Law* 111 for a critical discussion of this Convention.
    – United Nations Convention against Corruption 2003 (UNCAC) in force 14 December 2005.

59. The UNCAC includes within its list of criminal offences a wide range of activities, all of which may not be immediately fit with the popular notion of corruption. Some of them may well fall within fraud (e.g. embezzlement), but the reason for including activities that could be construed as falling within fraud was to ensure that there was some degree of uniformity across states, and acts such as misappropriation did not escape the net because a contracting state's criminal law did not cover the many shades of fraud. The activities criminalised are bribery of national and foreign public officials including officials of public international organisations (Arts. 15 and 16), embezzlement or misappropriation, or other diversion of property by a public official (Art. 17); abuse of position by a public official for obtaining undue advantage (Art. 19),

trading in influence (Art. 18), illicit enrichment (Art. 20), bribery in the private sector and embezzlement of property in the private sector (Arts. 21 and 22).

60. The Financial Action Task Force (FATF) on Money Laundering was established by the G-7 Summit that was held in Paris in 1989.
61. This Convention came into force in 1993. Arts. 6(1) and (2) state:

> 1. Each Party shall adopt such legislative and other measures as may be necessary to establish as offences under its domestic law, when committed intentionally:
>
>> (a) The conversion or transfer of property, knowing that such property is proceeds, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of the predicate offence to evade the legal consequences of his actions.
>> (b) The concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of, property, knowing that such property is proceeds; and subject to its constitutional principles and the basic concepts of its legal system.
>> (c) The acquisition, possession or use of property, knowing, at the time of receipt, that such property was proceeds.
>> (d) Participation in, association or conspiracy to commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the offences established in accordance with this article.
>
> 2. For the purposes of implementing or applying paragraph 1 of this article:
>
>> (a) It shall not matter whether the predicate offence was subject to the criminal jurisdiction of the Party.
>> (b) It may be provided that the offences set forth in that paragraph do not apply to the persons who committed the predicate offence.

(c) Knowledge, intent or purpose required as an element of an offence set forth in that paragraph may be inferred from objective, factual circumstances.

62. 1. Each State Party shall adopt, in accordance with fundamental principles of its domestic law, such legislative and other measures as may be necessary to establish as criminal offences, when committed intentionally:

(a)

(i) The conversion or transfer of property, knowing that such property is the proceeds of crime, for the purpose of concealing or disguising the illicit origin of the property or of helping any person who is involved in the commission of the predicate offence to evade the legal consequences of his or her action.
(ii) The concealment or disguise of the true nature, source, location, disposition, movement or ownership of or rights with respect to property, knowing that such property is the proceeds of crime.

(b) Subject to the basic concepts of its legal system:

(i) The acquisition, possession or use of property, knowing, at the time of receipt, that such property is the proceeds of crime.
(ii) Participation in, association with or conspiracy to commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the offences established in accordance with this article.

63. OECD (2001) *Behind the Corporate Veil* Paris: OECD. According to a US Senate Report a private banker is used to set up a shell company for a client and open accounts in the name of the company thus hiding the ownership of an individual to the assets (US Senate permanent Subcommittee on Investigations, Committee on Governmental Affairs *Money Laundering and Foreign Corporation Enforcement and Effectiveness of the Patriot Act, Case Study Involving Riggs Bank,* 15 July 2004, p. 13.

64. *People of the Philippines v Joseph Ejercito Estrada* Sandigbayan Criminal case No. 26558 (for Plunder) September 12, 2007 Decision available at http://jlp-law.com/blog/people-philippines-vs-joseph-estrada-sandigan-bayan-criminal-case-26558-plunder/
65. For more on FIUs, see Global Financial Intelligence "Financial Intelligence Units" http://www.global-financial-intelligence.com/central-banks-fius/
66. http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf. The latest version was adopted on 16 February 2012 and updated in February 2013, October 2015 and June 2016. The Recommendations, the Interpretive Notes and the Glossary together comprise the FATF standard.
67. https://www.unodc.org/unodc/en/treaties/CAC/signatories.html
68. Louis de Koker (2013) 'The 2012 Revised FATF Recommendations: Assessing and Mitigating Mobile Money Integrity Risks Within the New Standards Framework' *Washington Journal of Law, Technology & Arts* 8:3: 165 at 168.
69. The inclusion of terrorist financing was included in the 2001 revision and dealt with the issue in its Eight Special Recommendations later expanded to Nine.
70. Recommendation 36 of the 2012 version of the FATF Recommendations states that "countries should take immediate steps to become party to and implement fully the…the United Nations Convention against Corruption 2003…"
71. Note that the requirements in R10 and R10 apply equally to designated non-financial businesses and professions by virtue of Recommendation 22. Lawyers and accountants fall within this category.
72. Smurfs refer to individuals who are used for depositing cash below threshold limits. The threshold limit set by Recommendation 10, is USD/EUR 15,000. This may be slightly lower in some countries. For instance, in India, it is INR 1,000,000 per annum which is around EUR 13,200 at current exchange rates.
73. The inclusion of insurance may at first sight come as a surprise but money launderers could use illicit monies for payment of premiums. For a detailed account of the link between money laundering and insurance, see Sandra Lawrence (n.d.) "Money Laundering in the Insurance Industry" available https://www.world-check.com/media/d/content_pressarticle_reference/aisaninsurance_08.pdf. See also International Association of Insurance Supervisors (IAIS) (2004) "Examples of Money

Laundering and Suspicious Transactions involving Insurance" for examples of case studies, available at http://iais.web.org under Other Supervisory Papers and Reports section.

74. For example, an agent, a representative.
75. Peter Reuter and Edwin M Truman (2005) "Anti-Money Laundering Overkill?" *The International Economy* (Winter): 56, at 59.
76. FATF (2012) *International Standards on Combating Money Laundering and the Financing of Terrorism*, updated June 2016, p. 7.
77. See FATF (2012) Recommendation 1 and Interpretive Notes to Recommendation 1.
78. FATF (2012), p. 123.
79. Art 52(1).
80. This document is not binding.
81. FATF Guidance (2013) *Politically Exposed Persons (Recommendations 12 and 22)* Paris: FATF/OECD, p. 11.
82. Recommendation 1 reads:

> Countries should identify, assess, and understand the money laundering and terrorist financing risks for the country, and should take action, including designating an authority or mechanism to coordinate actions to assess risks, and apply resources, aimed at ensuring the risks are mitigated effectively. Based on that assessment, countries should apply a risk-based approach (RBA) to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified. This approach should be an essential foundation to efficient allocation of resources across the anti-money laundering and countering the financing of terrorism (AML/CFT) regime and the implementation of risk- based measures throughout the FATF Recommendations. Where countries identify higher risks, they should ensure that their AML/CFT regime adequately addresses such risks. Where countries identify lower risks, they may decide to allow simplified measures for some of the FATF Recommendations under certain conditions.
>
> Countries should require financial institutions and designated non-financial businesses and professions (DNFBPs) to identify, assess and take effective action to mitigate their money laundering and terrorist financing risks.

83. Guidance, p. 11. Ibid.

84. U4 Expert Answer (2008) "African experience of Asset Declaration" http://www.right2info.org/resources/publications/asset-declarations/u4-anti-corruption-resource-centre_african-experience-of-asset-declarations
85. Ibid., p. 12.
86. Ibid., pp. 12–13.
87. Ibid., p. 13.
88. Peter Reuter and Edwin M Truman (2005) "Anti-Money Laundering Overkill?" *The International Economy* Winter: 56 at 60.
89. Richard Eskow (2015) "The Big Banks Are Corrupt – and Getting Worse" http://www.huffingtonpost.com/rj-eskow/the-big-banks-are-corrupt_b_7418508.html
90. Borrowing from the title of Reuter and Truman's article, fn 89.

3

Anti-Bribery and Corruption: Perceptions, Risks and Practice for UK Banks

Umut Turksen

Risk is the possibility that an event will occur and adversely affect the achievement of objectives.[1]

3.1 Introduction

Corruption is a serious economic, social, political, legal and moral problem[2] found in many contexts from sports (i.e. doping in athletics and FIFA scandals)[3] to banking practices (i.e. LIBOR,[4] Dark Pool[5]) and international trade (i.e. the BAE bribery inquiries).[6] Corruption is a form of fraudulent activity which can be described as the misuse of public office for private gain, and the common law offences of corrupt practices (i.e. bribery) are limited to public sector corruption. While the UN Convention Against Corruption (UNCAC), 2003, with its 140 signatories[7], sets out the general

I would like to thank Viri Chauhan (LLM, LPC) for his invaluable contribution and inspiration for this chapter.

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N. Ryder (ed.), *White Collar Crime and Risk*,
https://doi.org/10.1057/978-1-137-47384-4_3

anti-corruption mechanisms and strategies, there is not a legal definition of this crime in international law. The above definition has become standard in recent cross-national empirical studies of corruption.[8] Similar to other fraudulent and malfeasant activities, corruption can only occur when there is opportunity, incentive and ability to rationalise it.[9] Without these three things, corruption is unlikely to unfold. Past studies in this field indicate that the risk corruption poses to society at large varies from country to country and is difficult to quantify.[10] Such risk is generally calculated in light of public's perception of the level of public sector corruption in a given society, but there have been studies which also indicate that economic freedom, socio-political stability, tradition of law abidance and national cultures are the major variables that dictate the degree of corruption. Past research findings both by the academia and policy makers link corruption to poor economic growth, low political stability, lack of transparency and accountability to which liberalisation, privatisation and democratisation are offered as preferred policy responses.[11] The literature review also reveals that there is limited legal analysis of this phenomenon. The author takes the view that the narrow focus on developing countries has obscured the more subtle yet costly manifestations of corruption in rich and democratic (developed) countries and as a result the risk of corruption in so-called developed countries is overlooked. This chapter expands the existing knowledge about the determinants of corruption as it focuses on the UK where democracy, economic liberalisation and the rule of law are arguably well-established principles in public office generally and in financial transactions particularly. Firstly, this chapter analyses how the UK's legal instruments address the crime of corruption. Secondly, the risks that bribery and the legal compliance requirements pose for banks are commented. Finally, a number of good practice proposals are considered and evaluated.

Whilst explaining the concepts of corruption and bribery, this chapter also considers how banks are prone to passively or actively encouraging the flow of the illicit financial capital. The international legal instruments (both hard and soft) relating to corruption and bribery are assessed to understand if there are any gaps or loopholes that allow this and whether the banking standards have any weaknesses that can be exploited. The notion of corruption solely being associated with public officials or public office is also challenged.

The notion of culpability of banks with respect to corruption is becoming more widely accepted. For instance, the recent foreign exchange scandal,[12] where banks were found to be manipulating foreign exchange interest rates, resulted in fines of US$3.4 bn[13] and the UK Chancellor of the Exchequer stated that 'I'm absolutely determined that we clean up the corruption in the city so that financial markets work for everyone'.[14]

However, as in the case of the LIBOR scandal, there is a difficulty in identifying an offence with which to charge the offenders and also problem of legislating against crimes that are only likely to occur once. It seems unlikely that Section 91 of the Financial Services Act 2012 (misleading statements relating to benchmarks and the delegated legislation) and the Financial Services Act 2012 (Misleading Statements and Impressions) Order 2013 will be employed for the Foreign Exchange Scandal. This trend epitomises a serious problem and a challenge for the society at large: There is an unsurprising link with corruption, bribery, illicit financial flow and money laundering. Currently, all of these topics are dealt with separately in the context of legislation and preventive measures as well as from an enforcement perspective. This potentially facilitates the flow of illicit capital in banks, and the degree of culpability or knowledge/suspicion that funds are from the illegitimate means is overlooked. Furthermore, such a fragmented approach increases the risks for banks.

3.2 The Origin and Meaning of Corruption

The word corrupt is believed to originate from the Latin word *corrumpere*, which means to break or destroy[15]; literally translated, it means total or collected decay or dissolution. Treisman defines corruption as 'the misuse of public office for private gain'.[16] However, as the demarcation of public office and private corporation blurs, this definition is not adequate. Mikkelsen breaks down the meaning of corruption but still confers to the public office definition and explains it in connection with a subset of the particularistic governing practice.[17] Particularism is the 'exclusive attachment to one's own group, party, or nation'[18] and includes patronism, nepotism, clientism and pork barrel politics. Patronism is

where appointments are assigned by politicians; nepotism is found when jobs are provided by those in power to their friends or relatives. Clientism is known as a social order dependent on relations of patronage. Finally, pork barrel politics is the use of government funds designed to please voters or legislators to win votes.

Mikkelsen clarifies the meaning of corruption against that of the other forms of particularism and against bribery and extortion,[19] concluding that 'corruption consists in deviations from public duty by breach of impartiality for the purpose of material gain'. This aligns with Treisman's standard definition, 'misuse of public office for private gain'.[20] Mikkelsen's key point is that the concept of corruption has moved on from the Latin meaning *corrumpere* and forms a subset of the particularistic form of governing, and the novel evolution is the fact that with corruption there is material gain, which is not necessarily the case with the other forms of particularism. Whilst this advancement of the meaning of corruption is accepted, corruption is not exclusive to public office, although it is a fact that in developing countries corruption does affect the society at large and especially the poor.[21] Corruption often includes offences such as bribery, extortion, kickbacks, embezzlement and conflicts of interest.

The definition of corruption provided by the Organization for Economic Cooperation and Development (OECD) also focuses on the role of a public official in office and 'involves behaviour on the part of officials in the public sector, whether politicians or civil servants, in which they improperly and unlawfully enrich themselves, or those close to them, by misuse of the public power entrusted to them'.[22]

Yet, the evolving nature of global economies, banks, companies, shareholders and civil society means that a wider definition is required to fully explain the concept of corruption. Arguably, one of the reasons for a low number of and discrepancies in successful prosecutions of bribery and corruption is this lack of unified definition.[23]

Transparency International (TI) defines corruption as 'the abuse of entrusted power for private gain'.[24] This definition moves past the exclusive public office restriction and allows the communication of the concept at all levels. The World Bank provides a very comprehensive definition of corruption and illustrates how international anti-corruption organisations have endeavoured to cope with this challenging topic: 'corruption …

takes various forms and is practiced under all forms of government, including well-established democracies. It can be found in the legislative, judicial, and executive branches of government, as well as in all forms of private sector activities'.[25]

This definition dispels the view that corruption only occurs in public institutions of developing countries and states that it also applies to the private sector that includes banks and established democracies and is not just limited to bribes. The origins and meanings of corruption are important because of the public/private connections with banks, which are often private but perform a public service. Clarifying the meaning also allows for an examination of if and to what extent corruption exists in banks.

There is not an internationally agreed legal definition of corruption, which is largely due to the challenges of aligning laws, jurisdictional issues, cultural and societal norms that treat corruption differently. Controversially, it can also be argued that economic factors, of which many developed countries and their banks take advantage of in being the recipient country that handles the proceeds from corruption, are factors that feed off this disarray. This lack of common definition is a key risk in combating corruption across borders and a risk for compliance purposes for banks.

The UN and OECD Conventions[26] do not define corruption. At a national level, neither the UK Bribery Act 2010 nor the US Foreign Corrupt Practices Act (FCPA) 1977 offer a robust definition of corruption. La Palombara suggested that without expressly stating what acts are prohibited, it would be difficult to ascertain what conduct amounts to corruption. Mikkelkelson observes that there are problems with legislation driving the corruption agenda, which is a global challenge, and comparisons across different legal systems are difficult to manage. It is only the offence of bribery that is usually codified and legislated for; thus, other forms of corrupt acts could be excluded and exploited such as diverting stolen money from government revenues through professional intermediaries into the UK financial institutions and property. Professional perpetrators are usually ahead of legislation when it comes to exploiting avenues for illicit gain[27]; therefore, there is a need for more innovative and radical anti-corruption regimes to tackle it.

The definitions of corruption have also been developed by the NGOs; while the NGOs may lack accountability in the way public institutions do, as proactive and focused organisations (e.g. TI and World Bank), they may actually reflect what is happening at societal level and are best placed to observe, report and raise awareness of it. One of the founders of TI, Lambsdorff, defined corruption as the 'misuse of public power for private benefit'[28] and pragmatically warns that theorising about the absolute definition is futile as that effort could be used more constructively.[29] Whilst this stance is plausible, it is important to arrive at an internationally accepted legal definition of corruption so that harmonised preventive measures and sanctions can be utilised. A common definition would also make the awareness and communication of anti-corruption initiatives and harmonisation of laws easier.

3.3 The Threat of Corruption

Kofi Anan, former General Secretary of the UN, identified that corruption was not a problem solely for developing countries, although that is where its impact is most severe.[30] As more cases in the developed world come to the attention of the public, such as the UK Serious Fraud Office's (SFO) investigation into the bribery and corruption allegations into Rolls Royce,[31] and the corruption charges against FIFA,[32] the subject of corruption is attracting greater media and political exposure.[33] This was evidenced at the 2014 World Economic Forum in Davos, which had corruption as a key topic.[34] At a regional level, the EU published its anti-corruption report with the aim of spearheading its corruption policy,[35] albeit this attracted some criticism from TI[36] as the EU's strategy omits cross-border corruption, private sector corruption and, more importantly, the report fails to access the effectiveness of the anti-corruption policy within the EU institutions and attribute any shortcoming to a country by name.[37]

3.4 Extent of Corruption

Attempting to place a numerical figure on the extent or cost of corruption is exceptionally difficult if not impossible, as is finding a consistent, reliable and up-to-date source. It is still important to arrive at an estimate if only to enable awareness of its magnitude. Most commentary still refers to figures published by the World Bank,[38] which estimates that bribery costs the world around US$1 tn a year.[39] The World Economic Forum estimated the extent of corruption at 5% of the world GDP, approximately US$2.6 tn,[40] and that it increases the cost of doing business by 10% globally.[41] The IMF puts the annual cost of bribery at around US$1.5–2 trillion (roughly 2% of global GDP) and asserts that 'the economic and social costs of corruption could potentially be even larger'.[42]

The Asian Development Bank suggests that the cost of corruption for a country is up to 17% of its GDP.[43] Similarly, in 2014, the EU announced that annual losses attributed to corruption totalled €120 bn[44] and sees corruption as an activity that is often linked to other forms of serious crime, such as trafficking in drugs and human beings, tax evasion and illegal immigration.[45] These estimates indicate that corruption is a serious leak in the economy and hinders investment levels, development and growth. Given its magnitude, it also poses a real risk to financial institutions and the competition therein.

3.5 What Is Bribery?

Corruption is often facilitated by a bribe. Bribery, like corruption, is not easy to define,[46] yet attempts have been made to create universal definitions that will not only help law enforcement agencies but also raise awareness of what bribery is and how it finds expression in the context of corruption and financial crime. Bribery facilitates corrupt acts and is often known as the payment or consideration given for an act or service that a public official or private service provider allows or facilitates that s/he is not authorised to do. It can be seen as an enabler for the performance of an act through an illegal payment (a bribe) that would allow

services or contracts to be won or facilitated unduly and unfairly. The UK government's working definition is based on the Bribery Act 2010.[47] Bribery may be classified as direct or indirect.[48] Indirect bribery is using a third party to make the payment that constitutes a bribe and is the more common form where an agent or third party acts for an organisation to secure a contract and/or competitive advantage, for example, where the agent would receive a commission on successful signing of the contract.[49] The reason for clarifying the differences is to do with ensuring that companies or individuals who use third parties cannot plead ignorance to the fact of a bribe that has occurred within or through their organisation implicitly. The SFO defines bribery as 'the giving or receiving something of value to influence a transaction'.[50] The UNCAC does not provide a definition but has created bribery offences,[51] and the OECD defines a bribe as 'an offer, promise, or giving of any undue pecuniary or other advantage, whether directly or through intermediaries, to a foreign public official'.[52]

The UN and OECD Conventions and the UK legislation are generally focused on defining bribery offences as these are more clearly identifiable, and focusing on the bribe payers suggests that this is the start of the life cycle of a corrupt act. It should be noted that the OECD Anti-Bribery Convention is the only international legal instrument that focuses on the person making the bribe (supply side) rather than the recipient (demand side) of the bribery transaction.[53] As corrupt money (bribe) is transferred via banks out of the jurisdiction it was gained, this focus on the briber increases the risk of banks facilitating the transfer of illicit money.

3.6 The Extent of Bribery, International Trends and Counter-Measures

The TI Bribe Payers Index (BPI) 2011 suggests that corruption and bribery are problems for both the developed and the developing world.[54] The index provides evidence of bribery between private companies and dismisses the view that bribery only exists between private individuals/companies and public officials. The index is produced by surveying company executives

from 28 of the largest economies that assessed their perceived likelihood to pay bribes outside of their home country.[55] Since the 2008 publication, there has not been any reduction in the perception of frequency of bribery. Chinese and Russian companies (listed as 21 and 22 on the list both in the 2008 and 2011 reports) were seen as most likely to pay bribes[56] while the UK is listed as the fifth in 2008 and eighth in 2011 out of 22 countries.

Parlour[57] identifies that there is a potential mismatch between the TI Corruption Perception Index (CPI)[58] and the Mintz Group 'Where the Bribes are' Map.[59] According to this data, it is clear that the US enforcement measures (under the FCPA 1977) have focused on particular countries, namely Nigeria, China, Russia and Argentina, in their enforcement initiatives.[60] The Global Financial Integrity Report – 'Illicit Financial Flows from Developing Countries 2001-2010'[61] – seems to mirror the FCPA Map rather than the TI CPI.

This could be explained by the difference between the actual data (in the FCPA map and the illicit flows data) to the perceived indicators from TI. However, from a strategic enforcement point of view and planning perspective, governments and organisations such as the UK's SFO should view this data carefully in order to implement effective strategies. The logical approach would seem to support it; why would a country invest money and time addressing corruption in Somalia, Afghanistan and North Korea which are at the bottom of the TI CPI, when the greatest illegal capital flight seems to originate from China, Russia and Nigeria, and the countries most likely to pay bribes are China, Russia and Mexico, appearing at the bottom of TI's BPI.[62] A more recent OECD 2014 Bribery Report also provides similar trends.[63]

Numerous studies indicate that based on this index, many multinational companies have pulled out of major contracts from developing countries where bribery is rife.[64] At the same time, countries (including the UK) merely sign the OECD Bribery Convention to look attractive to foreign investors.[65] As a result of this piecemeal approach, the OECD has criticised the UK several times,[66] which could have been a catalyst for the enactment of the UK Bribery Act 2010. While the improved anti-corruption legal framework may look good, it can also divert the risk and investment elsewhere. Indeed, Aaronberg and Higgins have commented that since the

Bribery Act came into force, the actual number of convictions has not increased compared to previous years and have questioned the efficacy of the new law.[67] This is in contrast to relatively high number of US FCPA 1977 enforcement actions.[68] Perhaps, this is not a fair comparison, as the US legislation has been in force since 1977 and the UK Bribery Act came into force in 2011. Furthermore, the UK Bribery Act has had a preventative impact as firms are now very reluctant to report cases of bribery and corruption as the penalties are far reaching. The current Director of the SFO, David Green, has made it clear that even with the new deferred prosecution agreements (DPAs),[69] SFO will not allow companies to shirk their responsibilities under the Bribery Act 2010.[70]

While an effective enforcement is welcome, there is a risk that non-OECD countries such as China and India could step in to take the place of the UK or US companies which have decided that certain geographies are too risky to operate in from a point of local companies and officials demanding bribes. If China and India in particular are not subject to the OECD Bribery Convention and lack domestic bribery and corruption laws, then bribing foreign officials may be accepted.

Nadipuram suggests that Russia, India and China (RIC) economies are unlikely to fully engage with the OECD Anti-bribery Convention owing to their poor enforcement on local anti-bribery laws.[71] It remains to be seen whether this will be the case in the future as Russia has recently signed and become the 39th party to the OECD Anti-Bribery Convention on 17 April 2012 and India and China appear to be in discussions with the OECD Working Group on Bribery.[72]

3.7 The European Union

Mitsilegas opines that the EU's anti-corruption policy is based on a number of objectives which include defending the EU budget; protecting the internal market; facilitating judicial cooperation in criminal matters; and safeguarding the rule of law.[73] The EU has recognised that corruption is a problem, and in its communication to the European Parliament, it has expressed concern that the overall rating for the EU member states in the TI CPI has not improved significantly.[74] The first protocol to the EU

Fraud Convention 1995[75] criminalises corruption for both the briber and the bribe recipient[76], sometimes referred to as active and passive bribery, respectively.

The second protocol to the Fraud Convention in 1997 criminalises the laundering proceeds of corruption.[77] However, the EU Convention on the fight against Corruption 1997[78] was introduced as the Fraud Convention and did not go far enough to improve judicial cooperation for corruption-related crimes. This is partly because the cooperation on judicial matters is traditionally seen as an area which is determined by the member states. Mitsilegas contends that 'The 1997 EU Convention on Corruption thus introduced a broad criminalisation of public sector corruption'[79] yet failed to address the intra-community cohesion and coordination needed.

The second objective of protecting the internal market was by criminalising corruption in the private sector, by the post-Maastricht Joint Action implemented in 1998,[80] which was superseded by the Framework Decision in 2003.[81]

The EU is working closely with the Council of Europe[82] against Corruption (GRECO)[83] and more actively involved in the coordination with UNCAC and the OECD Bribery Convention, focusing more on the soft law instruments and exchanging best practice rather than advancing and evolving corruption laws. This approach is also put forward by the European Council Stockholm programme 2010, which places importance on law enforcement cooperation.[84]

The EU recommends member states to adopt a number of legal instruments.[85] These are the Council of Europe Civil Law Convention on Corruption,[86] the Council of Europe Criminal Law Convention on Corruption 1999[87] and the Council of Europe Additional Protocol to the Criminal Law Convention on Corruption 2003.[88]

It is clear that Europe is still in the process of developing a comprehensive, cohesive and effective anti-corruption policy and strategy. This is mainly due to the disparity of its own instruments and the wide-scale adoption of soft laws such as the Financial Action Task Force (FATF) and OECD Bribery Convention. On the other hand, the EU is getting closer to concerted strategy and practice via its Fourth AML Directive[89] and working towards developing its arsenal in countering corruption such as the disbarment from tendering and award of public contracts in the EU

for companies who have been found guilty of corruption. The EU procurement rules are codified in several Directives,[90] yet barring of companies engaged in corruption does not find expression therein.[91]

Whilst numerous financial crimes such as money laundering, insider dealing, market abuse and terrorist financing have been addressed by EU legislation,[92] bribery and corruption and fraud have not been codified.[93] Legal instruments emanating from the Council of Europe constitute an element of the EU anti-corruption regime, and EU's own corruption Convention only covers the EU institutions and not member states. As a result, there is much work to be done in regard to creating a cohesive anti-corruption legal regime that is harmonised across the EU.

In 2014, the EU announced that annual losses attributed to corruption totalled €120 bn.[94] According to the EU, a vast majority of this money is lost through lost tax revenues and foreign investment.[95] Despite its critics,[96] the EU has not begun to address the challenge of bribery and corruption in the 28 EU member states,[97] beyond its own administration.

The EU Anti-Corruption Report uses the general definition 'abuse of power for private gain',[98] moving away from the public office or official definition, and suggests that this is in line with international legal instruments such as the OECD and the UN Conventions. However, it should be noted that neither of these measures are adequate as the OECD is a soft law measure and the UN Convention does not explicitly define corruption.[99]

It has been argued that the UNCAC is the only legal international anti-bribery instrument that allows unifying of the approach to tackle corruption.[100] There are numerous international bodies, organisations, conventions and soft law instruments which do not aid to an integrated approach towards fighting corruption. It could be argued that it is better to have a range of different agile bodies to tackle corruption such as TI and Global Witness rather than having a large unmanageable international agency that would struggle to respond quickly enough to tackle corruption effectively. Many of these organisations are now working together, for example, the World Bank's Stolen Asset Recovery Initiative and the United Nations Office on Drugs and Crime.[101] Nevertheless, for conviction and proper enforcement, municipal action and cooperation are essential.

3.8 The Crime of Bribery in the UK

In the UK, the crime of bribery can be found in the statute books as early as 1889 under the Public Bodies Corrupt Practices Act. Later, the Prevention of Corruption Act 1906 and 1916 were added. Despite numerous legal instruments addressing corruption directly, these measures were deemed to be inadequate and out of line with international developments and multilateral anti-corruption efforts.[102] Following a recommendation by the Committee on Standards in Public Life, the Bribery Act 2010 was enacted which came into force on 1 July 2011 and introduced four distinct bribery offences:

1. Offences of bribing another person (Section 1)[103]
2. Offences relating to being bribed (Section 2)[104]
3. Bribing a foreign public official (Section 3)[105]
4. Failure of commercial organisations to prevent bribery (Section 7)[106,107]

These provisons mean that a person may be guilty of a bribery offence if s/he seeks to manipulate or influence the official – as part of their role as a public official – to perform with the intention of obtaining or retaining business or gaining a business advantage. The means of gaining such unfair advantage may include payments such as facility fees, referral fees and commissions. Unlike the US law (FCPA), the Bribery Act does not permit facilitation payments, which are used to expedite the normal bureaucratic procedures and action. For individuals, any offence under Sections 1, 2 or 6 is punishable by a fine and/or imprisonment for up to 10 years (12 months on summary conviction in England and Wales or Scotland or 6 months in Northern Ireland). The fine may be up to the statutory maximum (currently £5000 in England and Wales or Northern Ireland, £10,000 in Scotland) if the conviction is on summary and unlimited if it is on indictment.

For companies and/or partnerships, an offence committed by a person other than an individual is punishable by a fine. The fine may be up to the statutory maximum (currently £5000 in England and Wales or Northern Ireland, £10,000 in Scotland) if the conviction is on summary and unlimited if it is on indictment. It is worth noting that a conviction

for bribery offences can have collateral consequences such as freezing and/or confiscation of assets under the Proceeds of Crime Act 2002, director disqualifications, EU procurement bans and exclusion from projects funded by the World Bank and its cross-debarment partner development banks.

The Bribery Act aims to create a proactive compliance regime whereby it provides two distinct offences:

1. Bribing a foreign public official (mere intention to influence a foreign official in their official capacity would suffice).
2. Failure to prevent bribery by commercial organisations (including the employees of the organisation as well as associated persons and third-party intermediaries and agents). For the purpose of this criminal offence, an 'associated person' is an individual who 'performs services for or on behalf of the organisation' (Bribery Act, 2010, Section 8).

The novel character of the Bribery Act is made clear not only by its provisions to cover a wide range of persons involved in bribery and corruption but also by enabling prosecutions based solely on an intention to obtain or retain business or an advantage in the conduct of business for that organisation.[108] It needs to be pointed out that these provisions, which create a new trend in corporate criminal liability, have an extraterritorial application, meaning that the law will apply regardless of where the offence takes place.[109]

The liability is established on a balance of probabilities and according to a circular published by the Ministry of Justice (MoJ),[110] six general elements need to be in place for a commercial undertaking to create an adequate anti-corruption environment and so as to mitigate and/or avoid any liability. These include proportionality, top-level commitment to anti-bribery measures, risk assessment, due diligence, communication, and regular monitoring and periodic review.

Under Section 13, a number of exemptions are provided to security agencies: A person, who is charged with an offence under the Bribery Act, may have a defence if s/he can prove that conduct was necessary for 'the proper exercise of any function of an intelligence service, or the proper exercise of any function of the armed forces when engaged on active service'.[111]

The governments state that Section 13 exemptions are necessary for the intelligence services, or the armed forces, to undertake legitimate functions, which may 'require the use of a financial or other advantage to accomplish the relevant function'.[112] Accordingly, the defendant must prove, on the balance of probabilities, that their conduct was necessary.

Contrasting criticism can be found in regard to the Bribery Act. Some commentators suggest that the provisions go too far thus making this new 'gold standard' a barrier to UK's business competitiveness.[113] Pope and Webb also argue that the increased prosecutorial powers under the Bribery Act and the cost and time for effective compliance which firms in the UK are expected to face would disadvantage businesses.[114] On the other hand, the Act has also been described as one of the toughest[115] bribery laws in the world[116] (owing to the Section 7 offence which has a strict liability provision for commercial organisations and the prohibition of facilitation payments)[117] with 'immense practical importance to the conduct of business, whether in the public or private sphere'.[118]

However, Robert Barrington, the Head of TI UK, does not transcribe to this view and suggests that it is a good law that complies with international requirements.[119] In addition, Mark Pieth, the OECD Chair of the Working Group on Bribery, indicated that the UK Bribery Act 'is by no means stricter than the laws of other OECD Member States'.[120] The US anti-corruption laws are equally strict; whilst the FCPA 1977 does not cover all aspects covered by the Bribery Act, they are covered in other parts of US company law.[121]

Since the Bribery Act came into force in 2011, there have only been far and few prosecutions[122] and none so far with respect to banking. However, more and more commentators and politicians are now referring to corruption in banks,[123] and Global Witness continues to highlight how banks and anonymous companies contribute to illicit financial flows and corruption that affect both the developing countries such as Nigeria and also developed countries such as the UK.[124] While it is too early to establish the effectiveness of the anti-corruption regime stipulated by the Bribery Act, with its wide scope and extraterritorial (offshore) application,[125] it is likely to mould the commercial organisations' risk management policy and practices.

The challenge prosecutors face when dealing with corruption in banks is identifying what offence to charge, either because no such offence exists or because new law has to be created to cover such offences, as was the case in the manipulation and corruption involved in the LIBOR scandal. Here, the SFO used the common law offence of conspiracy to defraud to convict traders[126] who abused the LIBOR benchmark.[127] For the SFO, this was a stroke of luck as the recommendation by the Law Commission was to replace this offence when the Fraud Act 2006 was introduced.[128] However, the conspiracy to defraud, sometimes known as the catch-all fraud offence, was retained even though the other deception offences were repealed.

The government responded to the LIBOR scandal by the Financial Services Act 2012,[129] which covers LIBOR-type manipulations, and the Financial Services Act 2012 (Misleading Statements and Impressions) Order 2013,[130] that specifically includes LIBOR. However, the net effect of this is likely to be negligible, as the way LIBOR is managed will be fundamentally changed.[131] The likelihood of a new LIBOR-related crime is very unlikely as it is now an offence to manipulate LIBOR and because of the intense media attention it has received, fraudsters are likely to focus their attention elsewhere, as one opportunity to gain is tightened other new unknown opportunities open up: The recent foreign exchange scandal is a good example.[132] LIBOR is important to examine to find whether there were any elements of corrupt behaviour within these UK and US institutions and, if so, how it compares to countries ranked much lower in the corruption scale.

For example, TI has ranked the UK as the 14th least corrupt country in the world and Nigeria is ranked 136th, respectively.[133] Yet, an example of banks in both jurisdictions being involved equally in grand corruption can be seen by the case of General Sani Abacha[134] where the former president of Nigeria stole billions of dollars from the oil revenues of Nigeria and the money was transferred through UK banks and paid directly into Swiss bank accounts and other offshore destinations. How culpable were the banks in this transfer? Given the volume of transactions and the fact that Abacha was a public officer, alarm bells should have rung for the banks. Yet, he was able to transfer funds with ease.

It has been very difficult to find a suitable criminal offence to charge bankers who engage in malfeasant activity and assist criminals.

The accountability and culpability of the banks continue to be a challenge for politicians who want to show they are tough on economic crime yet also be seen not to stifle business and revenue that is generated from activity that is not perhaps illegal but morally dubious and unethical.[135]

The culture in banking is akin to that in politics, where the key senior executives are well protected from disclosing information that could later be used as evidence in court. The LIBOR manipulation demonstrates this quite clearly. Bob Diamond and Jerry del Messier were the Chief Executive Officer and Chief Operating Officer of Barclays Bank, respectively, when the UK Financial Services Authority (FSA), the US Security Exchange Commission and the Department of Justice levied fines on Barclays. Up until present day, no senior executive has been charged with any criminal or civil offence. Additionally, the role of the Bank of England and Paul Tucker's[136] influence in regard to some of the decisions that Barclays took in terms of falsely submitting lower LIBOR rates at the point just before the financial crisis in 2007/2008 leaves prosecutors an uphill challenge when governments get involved for reasons of economic interest or precaution. In the LIBOR case, following Hayes' conviction over the LIBOR rate-rigging scandal,[137] after a four-month trial, the accused persons (all mid-level managers) were acquitted.[138] All argued that they were made scapegoats for decisions taken by the senior management. In a similar vein, the bribery allegations against the BAE in the El Yahamah case were dropped after political interference by the Saudi and British governments.[139] Yet, the perseverance of the US authorities eventually ended up with the BAE admitting to false accounting and making misleading statements in relation to allegations of corruption and agreeing to pay nearly £300 m in penalties.[140] However, not a single employee of the BAE has been charged with an offence.

Despite such a bleak picture, the Bribery Act 2010 can be welcomed as it clearly provides what the offences are, takes away the public official exclusivity as found in some of the other international conventions and introduces the commercial organisation offence of failing to prevent a bribe. This should not, however, lead us to the conclusion that it is beyond criticism. For example, the Section 7 defence of having adequate procedures in place for commercial organisations could provide a 'get out of jail card for organisations'. Combined with the DPAs,[141] that are available

come into force in 24 February 2014, companies can effectively continue to bribe as long as they can show strong anti-corruption controls and procedures in their organisations and be willing to pay a fine if they get caught. However, if a person pays a bribe on behalf of a UK company, the defendant could be liable under Section 1 of the Bribery Act 2010 if it takes place in the UK or anywhere else, provided that the briber has a close connection to UK. What is interesting here is if the demands of the 'identification doctrine' can be met, the organisation will be directly liable under Section 1 and cannot use the adequate procedures defence.[142] Effectively, what this means is that if the senior management were aware of the bribe or authorised it, then the company would be criminally liable. The question to be asked here is if the company enters a DPA, then would the criminal charges be dropped? Does the DPA also apply to the individual?

3.8.1 Anti-Corruption and Bribery Enforcement Agencies

The UK SFO, the Financial Conduct Authority (FCA)[143] and the economic crime units of the individual police forces (e.g. City of London Police – Overseas Anti-Corruption Unit) across the country are in charge of enforcing the Bribery Act.[144] In addition to ensuring that corruption and bribery are prevented, detected and countered, these agencies and particularly the FCA also aim to 'ensure that markets function well' and the integrity of the UK's economy is upheld[145] in a competitive environment.[146]

A number of publications by the FCA indicate that the agency puts great emphasis on businesses having adequate policy and systems in place to assess and prevent corruption and bribery risks within and beyond the organisation. The FCA also stated that it does not necessarily need to obtain evidence of actual corrupt activity to take enforcement action against a firm.[147] Accordingly, the firms with statutory duties to counter financial crime in general are bound to comply with the FCA's policy and guidelines.[148] Examination of these requirements indicates that firms shall adopt a risk-based approach to financial crime in all stages of their business activities, monitor and evaluate existing systems and their effectiveness regularly.[149]

Once described as a demoralised and ineffective agency, with 'inadequate management and leadership',[150] the SFO also has a key role in tackling corruption and bribery. This critical view by Grazia was arrived at by comparing it to its US counterparts (e.g. the FBI and district attorney in New York) which had over 200 years of experience in prosecuting financial crime.[151] The SFO is the national hub for collating the allegations and reports of bribery within and outside the UK. In light of intelligence and evidence obtained, the SFO investigates and, where appropriate, prosecutes cases of domestic or overseas bribery and corruption.[152] While reporting obligations pertaining to suspicious activities in the context of money laundering are well established,[153] there is no statutory duty to report bribery corruption. This creates problems for the SFO, as it relies on its own ability to detect bribery and corruption as well as information from willing whistle-blowers and tip-offs. Unlike the FCA, the SFO cannot impose regulatory sanctions to bring about compliance and ensure an effective reporting mechanism is put in place. This shortcoming creates one of the biggest risks for the UK anti-corruption framework.

Nevertheless, the SFO has issued numerous recommendations and guidelines for business conduct and operations within and outside the UK.[154] For instance, SFO's 'Approach to Dealing with Overseas Corruption' document provides industry-specific codes of practice as well as guidance on corporate hospitality.[155] Corporate hospitality or promotional or other legitimate business expenditure is recognised by the government as part of day-to-day business life, and SFO has not established rigid parameters as to what may constitute an unlawful activity in this regard.[156] The secretary of state for justice stated that taking clients to events such as Wimbledon and the Grand Prix would be acceptable even though the expense of attending these events is beyond the reach of majority of the UK society and, thus, could be considered as lavish.[157] The test, which will be applied, is one of reasonableness and proportionate hospitality, indicating that each case will be looked at on its own merits. It should be noted that the guidance clearly states that evidence of lavish expenditure for hospitality on its own will not amount to bribery, the intention to influence a public official (to gain a business advantage) via these rewards will need to be established for a successful prosecution.[158] Both the openness of the government in recognising hospitality

as 'normal' practice and the requirement of intention for prosecution weaken the UK's anti-corruption and bribery framework and as a consequence increases the risk in and vulnerability of the UK to corruption.

3.8.2 Sentencing and Enforcement

Since the Bribery Act 2010 hit the statute books, the number of convictions has remained relatively small. The SFO's archive indicates that the agency dealt with 14 cases.[159] Currently, it has about 30 cases, some of which involve corruption and bribery.[160] For example, the SFO charged Sweett Group PLC for failing to prevent the bribing of Khaled Al Badie by an associated person, namely Cyril Sweett International Limited, their servants and agents. It was held that the bribes offered were intended to obtain or retain business and/or an advantage in the conduct of business, for Sweett Group PLC, namely securing and retaining a contract with Al Ain Ahlia Insurance Company for project management and cost-consulting services in relation to the building of a hotel in Dubai, contrary to Section 7(1) of the Bribery Act 2010. The company pleaded guilty in December 2015.[161] Persons who are found guilty of an offence under Sections 1, 2 and 6 of the Bribery Act 2010 may face a maximum of ten years of imprisonment and/or an unlimited fine. For an offence under Section 7 of the Bribery Act 2010, there is no custodial sentence; however, an unlimited fine may be imposed.[162] For example, in the case of Standard Bank PLC, the bank was ordered to pay US$25.2 mn in fines for Section 7 offences.[163]

When it comes to the financial services and banking sector, the Financial Service and Markets Act 2000 has provided ample amount of enforcement and preventive measures to the disposal of the FSA (now the FCA). Indeed, to a certain degree, the FSA made use of these provisions in relation to money laundering and fraud offences by imposing penalty and sanctions for non-compliance. Ryder's analysis of these enforcement actions indicates that the 'credible deterrence' strategy of the FSA and later the FCA favours monetary sanctions/fines rather than criminal proceedings.[164] The risk this approach gives rise to is aptly explained by Peat and Mason, 'the FSA's policy of credible deterrence in enforcement cases involves bringing action not just against firms, but also against individuals'.[165]

In other words, a firm with sound capital backing can simply pay the fine and continue their business as usual, whereas for an individual, both the financial and career implications of a civil penalty would be dire. One of the other consequences of pursuing civil action against corruption and bribery is that a firm found guilty of an offence after a civil action would not be barred from taking on public service contracts which are subject to the EU Public Sector Procurement Directive 2004.[166]

By its own admission, the SFO is willing to engage in plea bargains[167] so as to minimise or avoid the time and cost of a trial. As the Approach of the SFO to Dealing with Overseas Corruption, alongside the Attorney General's Guidelines on Plea Discussions in cases of Serious or Complex Fraud,[168] indicates, seriousness of a corrupt act would be determined by determining at least two of the several attributes. The risk this regime poses is that in an event where the corrupt act (i.e. bribery) involves a small amount of money and takes place in a local/national context, that crime would not be caught and/or warrant SFO's specialised attention. Focusing on seriousness criteria undermines the fact that all corrupt acts (big or small, simple or complex) pose a threat to the socio-economic integrity of the society. The availability of plea bargains (in serious and complex cases) allows a negotiation of penalties, and encourage self-reporting and cooperation with the SFO, thus puts the companies first before the crime. This emphasis on 'carrot before the stick'[169] also paves the way for commercial interests overriding the rule of law.

As mentioned above, this fundamental weakness is clearly illustrated by the cases involving the BAE Systems Plc where the company was accused of corruption in its dealing with Saudi Arabia. On the back of an earlier case involving the BAE in 2008, namely the *El Yamamah* case,[170] the SFO was forced by the government (under Tony Blair's leadership) to abandon the case.[171] It was argued that if the case proceeded, it would have dire consequences for the national security and economy of the UK.[172] As a result, the reputation of the SFO was dented.[173] However, in a later case, initially pursued by the US Department of Justice (in relation to contracts with Saudi Arabia and central and eastern Europe), the SFO (in relation to contacts with Tanzania) managed to secure a conviction whereby the BAE admitted to false accounting and making misleading statements in relation to allegations of corruption[174] and was subsequently

fined nearly £300 million.[175] However, no individuals were identified and convicted as culprits of these crimes.

The BAE case was instigated in 2004; thus, the Bribery Act 2010 did not apply, and without the US Department Justice's robust enforcement action, there could not be any results.[176] When the SFO took an enforcement action, the judiciary has either criticised the SFO or amended its decision on a number of occasions. For example, in the Innospec case,[177] the Court of Appeal criticised SFO for 'usurping' the judge's authority by agreeing punishment and asserted that the SFO did not have any authority to enter into an agreement with an offender in regard to the penalty.[178] The judge made it clear that he did not agree with SFO's calculation of the penalty and would impose a higher fine. He opined, 'fines in cases of corruption of foreign government officials must be effective, proportionate and be dissuasive in the sense of having a deterrent element'.[179] The SFO was also criticised for using civil remedies where criminal proceedings and sanctions would be more appropriate.[180] In Dougall,[181] the judge rejected SFO claims for leniency[182] and emphasised that the 'responsibility for the sentencing decision in cases of fraud or corruption is vested exclusively in the sentencing court'.[183] These examples illustrate the tension between the judiciary and the SFO, which presents an additional hurdle for the SFO if and when it wishes to conclude a plea bargain. Subsequently, it should be noted that the SFO's guidelines published in 2012 encouraging self-reporting and cooperation need to be interpreted in light of the court judgements on plea agreements. The SFO does not have the competence to decide an agreed sentence, which results in uncertainty as to the exact scope of the sanctions if the SFO decides to pursue criminal charges. This aspect of the UK's enforcement regime is different than in the USA where, constitutionally, the court has the final discretion and power to pass a sentence; however, there is also an established practice whereby the courts approve the plea agreements entered into between prosecutors and defendants.[184] This lack of guarantee of the plea bargain being upheld by the courts may deter self-reporting and tip-offs and leaves the SFO in a difficult position.

The political interference and the discretion exercised by the SFO (in politically sensitive cases such as the BAE) remain as contentious issues and pose a real risk to the UK's anti-corruption framework and its success.

3.9 Risks and Banking Standards

Undoubtedly, the financial sector and banks are fundamental components of every developed economy, and economic development cannot be achieved without the services[185] and employment[186] that banks offer. With this importance also comes responsibility of countering crime, including bribery and corruption. Garland has described this trend as the 'responsibilisation strategy'.[187] Being experts, banks are also called upon to act to a certain extent as independent 'gate keepers' of surveillance and law enforcement agents of the state.[188] In tandem with this duty, they are required to be loyal to their customers who pay their fees. British Banking Association (BBA) stated that secrecy in banking has been reduced under pressure from governments trying to reduce malfeasant and illegal activities.[189] It is argued this has reduced the appeal of banking centres, including the UK, for which secrecy was an important selling point.[190] Furthermore, the cost of compliance[191] and rapid changes in anti-financial crime provisions may be seen as additional burdens. While the amount and benefit of prevented corruption and bribery are impossible calculate, the UK banks do look at their annual performance and competitiveness in comparison to their competitors in real and projected terms. In the face of this imagined and expensive benefit, the banks either trust in the benefit of compliance as part of their social responsibility, sustainability metrics, reputation and brand and genuinely believe that it is the right thing to do and good compliance is good business[192] or they toe the line in order to avoid sanctions and penalties by the regulatory and enforcement agencies of the state. Whatever the banks' drivers are, both the risks that bribery and corruption pose and the consequences of non-compliance to counter them are real and significant.

Given the volume and number of transactions conducted by the banks,[193] the anti-corruption and bribery regime under the Anti-Bribery Act 2010 recognises that banks and other financial institutions cannot prevent bribery at all times.[194] Accordingly, a risk-based approach is prescribed whereby differing levels of risk across jurisdictions, business sectors, business partners and transactions can inform practice.[195] Therefore, banks' compliance rests predominantly on its ability to adjust its practice in response to risks that each client or type of transaction may pose. The primary and minimum legal instruments on anti-bribery and corruption

which should inform UK banks' policy and practice are the UK Bribery Act 2010, the US FCPA 1977 and OECD Bribery Convention.[196]

There are numerous guidelines for banks in informing their anti-corruption policy: MoJ's Guidance,[197] SFO's Guidance,[198] FCA's handbook on 'Senior Management Arrangements, Systems and Controls'[199] and the BBA Anti-Bribery and Corruption Guidance 2014.[200] Informing the banks policy in light of these recommended practices is likely to mitigate most but not all risks posed by corruption and bribery.

A sound compliance regime should also evidence a strong commitment to bribery prevention across the organisation; an up-to-date and well-informed approach to risk mitigation; and a strategy for implementation. All these components need to correlate with the risks that the organisation (and associated persons) and its business at home and abroad encounter. The enabling environment in which disclosure and reporting can take place effectively must also adhere to the statutory standards of whistle-blower protection.[201] According to the FCA, an organisation does not need to be corrupt to face a sanction. Failing to put in place anti-bribery and corruption systems and controls effectively would suffice for the FCA to take action.[202] For the FCA, assessment of the risks of becoming involved in, or facilitating, corruption and bribery is paramount. Both the FCA and MoJ indicate that organisations need to periodically review the nature and extent of exposure to potential external and internal risks of bribery on its behalf by persons associated with it.

While the challenges and risks for failing to comply with the law are apparent and easier to identify, the assessment of the risks emanating from business activities is not straightforward as there are many variables that the banks have no control of. Nevertheless, there are a number of broad categories[203] which combine risk identification[204] and evaluation[205]:

- **Country risk** based on perceived levels of corruption highlighted by country reports, and corruption index provided by reputable organisations (e.g. FATF, TI); anti-bribery legislation and its implementation/enforcement therein; and the organisation's footprint in that country, including size, product and customer type/industry are some of the categories. A bank operating internationally may find itself having to comply with a number of legislations simultaneously. The US FCPA advises against a one-size-fits-all approach to compliance.[206]

- Risk management pertaining to **product and business opportunity** includes assessment of the service and product which may be more susceptible to corruption (e.g. real estate and construction); how the project is financed (private or public); merger and acquisitions; private equity and state-controlled or state-owned sectors such as extractive industries (e.g. oil, gas and mining), arms and defence; high-value projects involving a multitude of contractors and intermediaries; and commercial viability and the rationale of the project.
- **Business partnerships** may also pose a risk and thus require an assessment of type route to market; nature and remuneration of and commission structures for agents and third parties; the use of intermediaries in transactions with foreign officials; consortia or joint-venture partners; and politically exposed persons (e.g. a prominent public official or a politician).
- **The role and type of government** in business ventures may pose particular risks. Accordingly, it is important to ascertain and assess what role public officials play in the business activity concerned; the nature of government involvement and interaction between different levels of the state; licences and permits required; impenetrable bureaucracies; public procurement standards; existence of bond and equity issuance and underwriting or debt syndication; and lack of rule of law, democratic institutions and the extent of political lobbying.
- **Lack of access to or availability of data or limited data** can also be seen as red alerts in risk assessment at the operational level of business engagement. Therefore, it is desirable to assess and review the due diligence process and the results this creates. Enhanced due diligence may be required when regular methods and resources produce insufficient information that could inform an adequate risk assessment.

Since holistic and flexible approaches are necessary for risk-based anti-bribery and corruption practices for banks, and there is a degree of discretion (risk tolerance) available to banks, there are other elements which may be considered. These include, inter alia, the definition of bribery in a given jurisdiction; the scope of bribery offences (private vs. public and active vs. passive); types of payments (cash, cheque, etc.); extraterritorial application of the laws; the legality of facilitation payments (may be allowed under the US FCPA); transparency in transactions; the quality of

annual accounts/books and audit reports; relocation of third parties and contactors in jurisdictions with higher bribery risk; charitable or political donations and sponsorship; lobbying; procurement and sourcing; advisory and consulting activities; HR policies such as existence of disciplinary policies, remuneration structures and incentives, ethics and conduct for disclosure and whistleblowing, and deficiencies in employee training, skills and knowledge; limits on the value of gifts and entertainment and hospitality policies; travel expenses.

Responses to risk and how risk is assessed needs to be documented[207] and will depend on types of organisation and their activities. However, the overriding strategy ought to be risk reduction in response to bribery risk, and banks should ask the right questions such as 'what adverse events the organisation could reasonably be said to be exposed to by virtue of its activities, assuming no mitigating controls were in place. For example, wholesale banking is likely to focus greater attentions towards certain types of activities e.g. syndicated lending, soft dollar arrangements, sovereign wealth funds, M&A, real estate brokerage etc., whereas domestic based retail operations may be more concerned with introducing mortgage brokers. Private wealth banks may focus in particular on risks associated with Political Exposed Persons'.[208]

While a number of problems, which led to financial scandals, have been attributed to the business culture,[209] and psychological and biological peculiarities of bankers,[210] it is not easy to arrive at a definitive conclusion in this regard.[211] In any case, in the confines of this chapter, it is not possible to analyse these aspects in detail. Nevertheless, it may be worth noting that there is great emphasis on setting a robust compliance tone and commitment at the very top (at board and senior management levels) of the company. The ex-chairman of the FCA, Lord Turner, argued 'bank executives face the challenge of setting clearly from the top a culture which tells people that there are things they shouldn't do, even if they are legal, even if they are profitable and even if it is highly likely that the supervisor will never spot them'.[212] Indeed, this message transcends across all anti-bribery and corruption guidelines issued by the government. Accordingly, blind spots caused by weak compliance culture present a real compliance as well exposure to crime risks for the banks.

3.10 Findings and Conclusions

Corruption, bribery and illicit financial flows are global problems, transcending national borders and taking place in both public and private sectors. Accordingly, there is a need for a globally harmonised, holistic, collaborative and pragmatic approach to dealing with this phenomenon. NGOs such as TI and Global Witness have achieved a degree of success in highlighting the myriad of corruption offences by countries, companies and individuals, thus increasing public awareness and education. International organisations such as the UN, IMF and OECD on the other hand have achieved nearly universal agreement to counter corruption. However, the minimum standards and legal instruments they have created do not go far enough to make a material change to effective prevention and enforcement.

In the intergovernmental arena, the OECD has seemingly made some progress with the increase of its membership and the UK spearheading its anti-corruption agenda. Bringing strong economies such as the Russian Federation to the OECD and exerting diplomatic pressure on China and India to follow suit are evidence of its strong will to start the dialogue and coordination which are urgently needed. At the same time, the US focus exerted on China and Russia by the FCPA enforcement action is another evidence of the OECD agenda being carried out by some of its influential members. Furthermore, the Typology on Mutual Assistance in Foreign Bribery Cases draws on the experience and expertise used by the OECD Working Group on Bribery (WGB) in implementing the OECD Bribery Convention.[213] As a regional power, the EU recognises corruption as one of the biggest challenges it is facing.[214] Despite the 2003 Framework Decision on Combating Corruption in the Private Sector, there has not been the envisaged harmonisation across the EU nor a directly effective, stronger EU legal instrument. Having recognised the level of transposition as 'unsatisfactory', in June 2011, the EU set up a mechanism to assess its members' efforts to fight corruption and foster cooperation and exchanges of good practices and improve compliance with international instruments.[215] Depending on progress, the EU Commission intends to propose a Directive on anti-corruption to replace the Framework Decision of 2003.

It is fair to say that the UK has progressed well in creating a specific legal instrument that combats corruption (the Bribery Act). Across the Atlantic, the USA was the first country to invoke an anti-corruption law in 1977, in which the OECD followed suit for its member countries. It can be asserted that these three instruments form the main compliance standards across the world, and companies which comply with them are most likely to be in line with any other global and/or municipal anti-corruption instruments. It is unlikely that corruption will ever be eradicated or controlled completely; however, implementation of robust regulatory and international measures (also known as 'de-risking') is likely to minimise risk, mitigate liability arising from non-compliance and act as a deterrent. At the same time, with the increased enforcement and liability arising from anti-corruption regimes (i.e. the Bribery Act) financial institutions ought to be mindful of the consequences of 'wholesale' de-risking policies, whereby financial inclusion, access and competition may be negatively affected.[216] In addition to adopting a robust compliance regime within the company, as influential actors, the financial sector ought to support and instil the following building blocks (put forward by the IMF)[217] in the countries they operate:

- *Transparency is a prerequisite. Countries need to adopt international standards on fiscal and financial transparency. Because of the relative share of extractive industries in many economies, transparency in this particular sector is crucial. Governments need also to support international standards on transparent corporate ownership. A free press also plays a key role in exposing corrupt practices.*
- *To enhance the rule of law, a credible threat of prosecution must exist. Enforcement must also target the private sector. In certain cases, new specialised institutions must be set up where existing ones are corrupt. An effective anti-money laundering framework must be in place to minimise the laundering of proceeds of corruption.*
- *Excessive regulation creates rents which are allocated at the discretion of public officials and must be eliminated. Deregulation and simplification are cornerstones of efficient anti-corruption strategies. However, it is important to have an adequate institutional framework in place first when transitioning from state-controlled monopolistic markets (emerging economies in Eastern Europe).*

- *A clear legal framework is required. However, all of the best frameworks come to nothing, unless they are implemented. And implementation is all about effective institutions. In particular, a key objective is to develop a cadre of competent public officials who are independent of both private influence and political interference – and are proud of this independence. Finally, leadership plays a critical underlying role. Leaders must set a personal example and ensure decisive action is taken when needed.*

Having perused the general state of affairs and legal framework pertaining to anti-corruption, it is possible to conclude that almost all international and regional institutions emphasise the importance and necessity of a coherent and harmonised legal framework. The transnational and international nature of corrupt money and activities requires this strategy. In the absence of a supranational institution to determine the criminal law of a sovereign state, the realisation of this strategy depends on the actions of key public (politicians) as well as private actors (i.e. banks).

For the financial sector in the UK, the recent anti-corruption and bribery legislation has meant that risk-based and preventative measures are essential. Firstly, a company which suspects or uncovers a corrupt practice and/or bribery ought to report this (suspicious activity report) to the National Crime Agency (NCA) in order to avoid any liability for a money laundering offence. In addition, the FCA's Principles for Business[218] require that banks (and other regulated financial services) must conduct their business and relationship with regulatory bodies with openness and cooperation and disclose any relevant information to them without delay. In the context of corruption and bribery, the banks may also take the view that in addition to reporting to the regulatory bodies (e.g. the NCA and FCA), the SFO may also be informed as formal communication and information exchange channels exist between these agencies.

Since the enactment of the Bribery Act, it has become also evident that a bank disclosing information to the SFO may end up in a DPA. While there has not been any case law to clarify what sort of adequate procedures would suffice as a successful defence and diminishing liability, it is best to adhere to the guidance provided by the regulators and take self-reporting duties seriously and have clear plan of action if and when financial crime is discovered in the company. With the robust whistle-blower

protection in the UK,[219] it is very unlikely that a company will be able to contain the information leaking out to the public.

It is important to note that financial crime has truly become part of the UK criminal law landscape. It can be observed that the SFO no longer sees a civil settlement of cases involving financial crime as desirable. Accordingly, following the judgement in *R v Innospec*, there have been only two civil settlements (one in 2012 and another in 2014)[220] and the SFO felt compelled to state its rationale for civil action.[221] In *R v Innospec*, it was held that 'those who commit such serious crimes as corruption of senior foreign government officials must not be viewed or treated in any different way to other criminals. It will therefore rarely be appropriate for criminal conduct by a company to be dealt with by means of a civil recovery order; the criminal courts can take account of co-operation and the provision of evidence against others by reducing the fine otherwise payable. It is of the greatest public interest that the serious criminality of any, including companies, who engage in the corruption of foreign governments, is made patent for all to see by the imposition of criminal and not civil sanctions. It would be inconsistent with basic principles of justice for the criminality of corporations to be glossed over by a civil as opposed to a criminal sanction'.[222]

This judgement is likely to set the tone in relation to the prosecution of financial crime via criminal law procedures, consequences of which are dire for both individuals and companies.

Notes

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effective competition in the interests of consumers. The FCA states that its regulatory powers apply where firms fail to adequately address bribery and corruption risk, including, but not limited to, where these risks arise in relation to third parties acting on behalf of the firm'.

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Part 2

Financial Crime

4

The EU Sanctions and the Fight Against Financial Crime

E. Herlin-Karnell

4.1 Introduction

While the EU has for a long time had the power to require Member States to provide effective means for ensuring the enforcement of EU law, even if those meant the imposition of criminal law, enforcing EU law through criminalization at the EU level has always been a different question, given that the EU lacked a legislative competence prior to the Lisbon Treaty. However, despite the Treaty reformation and thereby the inclusion of criminal law in the Treaty (as part of the area of freedom, security and justice), as this contribution will show, that the EU legislator still

University Research Chair. This chapter was presented at the University of the West of England workshop on white collar crime July 2014, thanks go to Nicholas Ryder and the participants for helpful comments. The chapter was updated summer 2016. The usual disclaimer applies. The chapter draws to some extent on E Herlin-Karnell, "The Challenges of EU Enforcement and Elements of Criminal Law Theory: On Sanctions and Value in Contemporary 'Freedom, Security and Justice' Law" (Yearbook of European Law, 2016, 1–27), E. Herlin-Karnell "Constructing Europe's Area of Freedom, Security, and Justice through the Framework of 'Regulation': A Cascade of Market-Based Challenges in the EU's Fight Against Financial Crime", (2015), *German Law Journal* 171.

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N. Ryder (ed.), *White Collar Crime and Risk*,
https://doi.org/10.1057/978-1-137-47384-4_4

favors the administrative procedure in certain market related areas. In order to better understand the rationale of enforcement of EU law through use of criminal law, it is necessary to clarify the delicate debate regarding the characterization of the sanctions used in further detail. Administrative sanctions have always formed a crucial part of the EU's enforcement strategy, particularly with regard to competition fines and sanctions in the domain of EU agriculture and fisheries policies.[1] Yet with the entry into force of the Lisbon Treaty, and thereby the legislative competences granted in criminal matters, one would perhaps have thought that there was no further need for administrative law sanctions in the EU where there are already criminal law sanctions in place. With Lisbon Treaty in place, the framework has naturally changed as, alongside the EU's general enforcement armory, Articles 82 and 83 Treaty of the Functioning of the European Union (TFEU) specifically grant the EU a competence in criminal law matters with a cross-border dimension.

This chapter serves the purpose of critically examining EU regulatory efforts in the EU anti-crime and security domain, by focusing, in particular, on anti-money laundering legislation and the fight against market abuse as examples of recent financial crimes legislation in an EU context. The chapter starts by investigating the framework for understanding regulatory efforts in EU policy in the fight against financial crimes. Thereafter it looks at the sanction regime in the area of market manipulation and money laundering. It concludes by zooming in on the possible establishment of a European Public Prosecutor Office (EPPO).

4.2 Financial Regulation and EU's Fight Against Financial Crimes: Brief History

A majority of the current instruments adopted by the EU in the area of the suppression against financial crimes have been enacted on the basis and justification that there is a need for increased regulatory response to financial crises.[2] The occurrence of financial crimes has (since the early days of the EU) constituted the main criminal threat to the establishment of the internal market and has, until 9/11—when the fight against terrorism became a higher priority—been the core focus of the EU's approach to criminal law.[3] Therefore, there is an overlap—or hybridity in legal sources—here not

between EU internal market policies and the growing space of the Area of Freedom, Security and Justice, but a majority of the measures currently adopted to fight the financing of terrorism have an external dimension as well. While there have been many intriguing studies on the international impact on EU policies in the area of fisheries (and risk regulation/medicine[4] in particular), the AFSJ and its regulatory consequences remain largely unexplored with regard to the EU's fight against financial crimes.

In short, financial regulation is traditionally concerned with market efficiency, transparency, and integrity, as well as consumer protection.[5] In the EU internal market context, the importance of consumer protection and market efficiency has always been part of the EU legislator's vocabulary—particularly with regard to Article 114 TFEU.[6] Interestingly, market regulation and consumer confidence were not a focus of the EU's initial responses to the financial crisis nor were they reflected on the international agenda.[7] When discussing financial regulation, it is common to refer to different generations in the financial regulation life cycle. The first-generation instruments focused on institutional and systemic stability. The so-called second generation moved to a European self-styled architecture for regulatory design where anti-fraud rules are an imperative. Criminal law, as a policy tool for this kind of regulation, forms part of this second generation and is used to increase confidence and the enhancement of market integrity. For a long time, the EU has had preferences for relying on the slogan "confidence in the market" as an all-embracing justification for approximation under Article 114 TFEU and where criminal law has been used as a tool for boosting such confidence. The over-reliance on confidence as a justification for harmonization has long been observed (and criticized)[8] in the context of private law and more lately spilled over into the field of EU criminal law. In any case, the EU legislator has always claimed that one set of rules—a single rulebook—at the EU level is desirable and, where there are measures in place to fight irregularities, will boost investor confidence and contribute to market making. For example, in the Commission's communication on "driving European recovery",[9] the Commission referred to the high-level group, which stressed the importance of confidence, which had been taken for granted in a well-functioning financial system but had been lost in the present crisis.[10] The reorganization of this system focused on the importance of the

enhancement of market integrity and investor protection. The reformation of the sanctions system was seen as a crucial part of this strategy.[11] As part of the Lamfalussy process, and the legislative activity that followed at the EU level, several scholars have studied the process of European financial integration in terms of regulatory convergence that has been taking place since 2000.[12] Most of the discussion had concerned "hard core" financial regulation and processes, but has now been extended to cover the area of sanctions. The markets in financial instruments (MiFID) are the most important example in this regard as they reshaped the EU's share trading market place and were largely based on influence from various interest groups. Yet MiFID led to clashes between the stock exchange sector and the brokerage sector.[13] It is currently being renegotiated and largely influences current developments in the area of financial crimes. Thus, the EU's endeavors to stabilize and save the European market from financial turmoil is inexorably linked to the long-standing mission in the EU to increase investor confidence.[14] As noted, prior to the entry into force of the Lisbon Treaty, this fight was mainly fought through the internal market provision of Article 114 TFEU. Today we are faced with the classic choice-of-legal-basis question where Article 83 TFEU is *lex specialis* if the measure in question is primarily a criminal law measure. Therefore, under the present Treaty framework there are good reasons to believe that the center of gravity test will point in the direction of more general internal market powers. Thus, "mainstream" internal market powers, such as Article 114 TFEU, are still of crucial importance and are particularly significant with respect to the impact in the national arena as this provision also allows for the adoption of regulations—thereby having a direct impact on citizens. From a Member State perspective, there is merit with respect to engaging Article 83(2) TFEU as compared to action taken under Article 114 TFEU, in that this provision grants the possibility for the Member States to pull an emergency brake if a proposed measure appears to be too sensitive for the national criminal law system.

On that background, this chapter will now turn to some classic EU legal questions in the EU's fight against financial crime.

4.3 The Eternal Debate: Criminal or Administrative Sanctions?

Before the entry into force of the Lisbon Treaty, as indicated above, the question of what kind of sanctions the EU could impose on the Member States was subject to fierce debate and closely related to the development of the European Union project in general with regard to the general division of competences in the EU. The debate on sanctions in EU law has tended to focus on the controversial EU administrative sanctions system and on the question of whether these sanctions, contrary to their "administrative" label, should properly be viewed as falling under the umbrella of criminal law. Such an interpretation would, in accordance with the criteria laid down by the European Court of Human Rights (ECtHR) in the case law on Article 6 of the European Convention on Human Rights (ECHR), ensure the right to a fair trial and a subjective fault element.[15] The issue of whether the EU was entitled to create its own "quasi-penal system" was raised in C-240/90 *Germany* v. *Commission*,[16] where the Court of Justice of the European Union (CJEU) held that the measures were needed to secure the internal market and were therefore within the EU's competence.[17] This approach has been frequently reiterated, most recently in the *Bonda* judgment.[18] Prior to the competences granted in criminal law, the advantage of administrative sanctions was obviously that the fact these sanctions were not criminal sanctions meant that measures could be taken despite the EU's lack of an explicit criminal law competence. Nevertheless, administrative sanctions have been severely criticized for giving rise to a kind of "competence creep" into the sphere of penal law and in this way creating a supra-national system of sanctions through the EU legal back door and for breaching the general right of a fair trial.[19] Nevertheless, in line with mainstream EU law influence, the administrative sanctions regime has resulted in considerable harmonization of national criminal laws, with norms either being set aside by EU law or given extended scope in pursuit of European goals. Accordingly, while there was a presumption that criminal law was a matter for the Member States, this presumption could be rebutted (as in all other areas of EU law) if its operation affected the pursuit of Union policies such as

the smooth operation of the market. Clearly, competence boundaries have been easily blurred in this area and sanctions have played an important role in this process.

Moreover, recently in its *Taricco* judgment, which held that national, rules on prescription periods, which hinder prosecutions of VAT fraud against the national budget, infringe EU law.[20] The Court held that, "The provisions of Article 325(1) and (2) TFEU therefore have the effect, in accordance with the principle of the precedence of EU law, in their relationship with the domestic law of the Member States, of rendering automatically inapplicable, merely by their entering into force, any conflicting provision of national law."[21] The Court also asserted that this approach was in line with the Charter of Fundamental Rights. The case is largely in line with the new proposal for a VAT fraud Directive.[22]

One of the most clear-cut examples in the contemporary acquis of EU law of where sanctions not considered as belonging to criminal law are still being invoked is that of the sanctions being used in the fight against terrorism. The area of restrictive measures (or administrative sanctions) clearly has a significant internal-external dimension to it and been subject to debate on the protection of fundamental rights and the scope of the Court's jurisdiction in the famous *Kadi* saga.[23] While in *Kadi* the Court of Justice famously extended the jurisdiction of the EU to review, indirectly, UN measures and while that was a ground-breaking development in the context of sanctions, the adoption of the Lisbon Treaty means that the previous jurisdictional shortcomings have been resolved thanks to a specific legal basis in the Treaty. Accordingly, Article 75 TFEU provides for the competence to adopt restrictive measures in the fight against terrorism. A further question then arises as to which cases concerning the fight against terrorism are to be considered as falling within the scope of Article 75 TFEU, as opposed to Article 83 TFEU (which includes criminal law in its list), and the criminal law grid, and whether these articles are intended to complement each other. It seems as if the dividing line here is between administrative sanctions (freezing of funds) and criminal law, with the former being part of Article 75 TFEU and the latter forming part of Article 83 TFEU.[24] This confirms a rather broadly defined competence for the adoption of sanctions under Article 75 TFEU.

There is an additional layer of complexity with regard to enforcement of sanctions here. Specifically, there is a difficulty of distinguishing between the internal and external of EU action with regard to sanctions in the fight against terrorism is reflected in the recent judgment in *European Parliament v Council*.[25] In this ruling, the European Parliament challenged Council Regulation 1286/2009 amending Council Regulation 881/2002 imposing certain specific restrictive measures directed against targeted persons and entities associated with the Al-Qaida network.[26] The Parliament argued that, having regard to the aim and content of the Regulation, the correct legal basis should have been Article 75 TFEU and not Article 215 TFEU. Article 75 TFEU would guarantee a larger role in the legislative process for the Parliament and would also ensure the jurisdiction of the Court of Justice. It confirms a very scattered role of sanctions, which are located not only within the AFSJ, but also within the external relations competences. With regard to the contested regulation, the Court of Justice made it clear that this was based on a Security Council measure and intended to preserve international peace and security, which implies that the measure at stake had a clear Common Foreign and Security Policy (CFSP) character. In addition, the Court stated that the argument that it is impossible to distinguish between the combating of "internal" terrorism on the one hand and the combating of "external" terrorism on the other did not matter for the choice of legal basis and for the scope of Article 215(2) TFEU as the legal basis of the contested regulation. The Court therefore stressed the political considerations behind the drafting of the Lisbon Treaty and accepted that, when choosing between legal bases, it is not only the role of the European Parliament and the increased democratic input that are the decisive factors.[27] The Court did not specify what those critical factors entailed, but it seems reasonable to conclude that choice of sanctions, and thereby also legal basis, mattered at the political level as much as the effectiveness of the actual enforcement or the definition of a sanction. While the *European Parliament v Council* is a case which mainly concerns the dividing line between the internal and the external fight against terrorism, it is also a case which highlights the choice by the legislator to fight terrorism by means of the administrative model not the criminal law one. Therefore, this case is relevant for understanding the current practice of criminal law sanctions in the EU.

The area of administrative or restrictive measures in the fight against terrorism is not, however, the only area that borders on criminal law and that raises questions as to the exact definition of a sanction. The fights against money laundering and the financing of terrorism, for example, which are listed as crimes in Article 83 TFEU, are still on the agenda in connection with Article 114 TFEU, the internal market provision, just like before the Lisbon Treaty entered into force. This confirms an interesting hybrid dimension to AFSJ law as adjoining not only external relations law (as in the anti-terrorist laws), but also hard-core internal market law. This is also an area in which the EU's security strategy is widely felt to be the reason why the EU is adopting these measures.

4.4 EU Anti-money Laundering Action and Administrative Sanctions

The Money Laundering Directives offer a further interesting example with regard to the imposition of administrative sanctions and thus follows the international trend in the fight against dirty money and terrorist financing.[28] It should be remembered that the first EU Directive on anti-money laundering was adopted in 1991.[29] This Directive was subsequently amended in 2001[30] and then replaced by a third Directive in 2005,[31] while the Commission has now introduced a fourth Directive.[32] The fourth Directive illustrates an impressive and ambitious attempt by the Commission to address many of the challenges neglected in the previous Directives (for example the definition of a predicate offence).[33] The fourth Directive claims to follow the international trend by including a specific reference to tax crimes within the serious crimes that can be considered as predicate offences to money laundering. This marks a new development compared to the third Directive and is problematic as it involves administrative sanctions in a criminal law context such as the new offence of tax fraud, in this Directive. The Directive states that it is important expressly to highlight that "tax crimes" relating to direct and indirect taxes are included in the broad definition of "criminal activity" in this Directive, in line with the revised FATF Recommendations.[34] While no harmonization of the definitions of tax crimes in Member States'

national law is sought, Member States should allow, to the greatest extent possible under their national law, the exchange of information or the provision of assistance between EU Financial Intelligence Units. So while not directly requiring a tax crime competence at the EU level, it does so indirectly by allocating enforcement powers to the EU.[35]

In addition, the fourth Directive imposes an extended duty of risk assessment extended to the Member States, and raises the awkward question of whether the Member States are actually fit for this task and how the regime should be enforced. One of the arguments put forward in the fourth Money Laundering Directive is the classic claim that the EU is required to act because national action alone is not enough. The fourth Directive states that money laundering and terrorist financing are international problems and that efforts to combat them should be global. Intriguingly, the Directive also covers those illegal activities if they are committed on the internet.[36] But the relationship between the money laundering framework and the Cybercrime Directive in this regard is remarkably unclear.[37]

In tandem with the Directive, the EU has also adopted a Regulation, based on Article 114 TFEU, regulating the transfer of funds.[38] This is linked to the EU's internal security strategy and focuses on ensuring the payer's information is made immediately available to law enforcement and prosecutorial authorities. Curiously, while largely overlapping with the Directive, the Regulation points out that it may not always be possible in criminal investigations to identify the relevant data or the person concerned until long after the original transfer took place. Consequently, a preventive approach should be adopted and information stored to facilitate investigation. The Regulations affirms that information on the payer and the payee shall not be retained for longer than strictly necessary. Payment service providers of the payer and of the payee shall retain records of the information (Article 4–7 of the Regulation) for a period of five years.

Yet this raises several questions. Is the retention of data for five years proportionate? Would it stand a proportionality test on the necessity of keeping the data for that long?[39]

Finally, the fourth Directive on anti-money laundering adds an extra layer to the complexity of the EU's web of sanctions by requiring an evidence-based approach and by including European agencies such as the

European Supervisory Authorities (ESA) in the anti-money laundering scheme. The proposal contains several areas where work by the ESA is envisaged as raising crucial issues with respect to the relationship between this agency and AFSJ agencies such as Europol and Eurojust. This complex interaction of AFSJ policies and financial regulation at the heart of the internal market is intensified by the fact that the European Banking Authority has been asked to carry out an assessment of the money laundering and terrorist financing risks facing the EU. Yet the greater emphasis on the risk-based approach requires an enhanced degree of guidance for Member States and financial institutions on the factors to be taken into account when applying simplified and enhanced customer due diligence and when applying a risk-based approach to supervision. In addition, the ESAs have been tasked with providing regulatory technical standards for certain issues, such as those requiring financial institutions to adapt their internal controls to deal with specific situations.

4.5 Market Abuse Sanctions

The area of market manipulation (or market abuse) represents another sensitive area in which the boundary of sanctions has become blurred. While it is true that the new Market Abuse Directive[40] is based on Article 83(2) TFEU, which provides a more extensive competence than the areas listed in Article 83(1) TFEU for the effective implementation of a Union policy and so obviously involves criminal law, it also adds administrative sanctions to the picture. According to the Commission, market abuse can be carried out across borders and this divergence undermines the internal market, thus creating a certain scope for perpetrators of market abuse to carry such abuse into jurisdictions that do not provide for criminal sanctions for a particular offence. The Directive[41] is seeking to change this by adding criminal law to the discussion in order to fight market abuse more effectively. For this reason, we now face two instruments: one Directive and one Regulation that, in the ideal world, would complement one another.

The proposed Regulation[42] regulates the same area as the Directive, but its regime is stricter. Interestingly, it could be said that the Regulation brings competition law in through the back door by creating far-reaching

surveillance mechanisms and introducing "blacklisting" of companies, but without ensuring the full protection of criminal law procedure. The Regulation requires the publication of sanctions and by allowing competent authorities far-reaching powers similar to those of competition law raids and antiterrorism measures. Therefore, it could be argued that the Regulation brings us very close to the area of competition law, by imposing (as outlined in arts 12–15 of the Regulation) an obligation on issuers of financial instruments to issue so-called listing of companies or individuals engaged in market abuse. This Regulation is closely associated with reform of the MiFID (Markets in Financial Instruments Directive) and it has been suggested that it should become effective on the date that the MiFID review enters into application.[43] Hence the proposal follows the Commission Communication on "Ensuring efficient, safe and sound derivatives markets: Future policy actions", where the Commission undertook to extend relevant provisions of the MAD to cover derivatives markets in a comprehensive fashion.[44]

As for the legal basis of the Regulation, the Commission states, "There is a need to establish a uniform framework in order to preserve market integrity and to avoid potential regulatory arbitrage as well as to provide more legal certainty and less regulatory complexity for market participants."[45] Hence, the justification for adopting the Regulation is the same as for the Directive, albeit with a different legal basis, namely Article 114 TFEU and the establishment of the internal market. The Regulation aims expressly to contribute to the smooth functioning of the internal market. Most importantly, the Regulation establishes a new layer of sanctions: administrative sanctions regulating the same area as the Directive.[46] Why, then, the need for this dual approach, with both a Directive and a Regulation, to fight market abuse? More generally, the Regulation appears to confirm a new trend where "less is no longer more" and where the legislator is putting various back-ups into place. The explanation seems to be a lack of efficiency of the EU system and where the financial crisis has prompted the EU to act more vigorously, the effect of that the subsidiarity principle is not really considered.

Perhaps the most important lesson to be drawn here is that it can seriously be questioned whether dual regulation through criminal law sanctions and administrative sanctions, as proposed in various EU

Regulations and the proposed fourth Directive, respectively, breaches the principle of *ne bis in idem* or double jeopardy and thereby Article 50 in the Charter of Fundamental Rights. Article 50 states that, "No one shall be liable to be tried or punished again in criminal proceedings for an offence for which he or she has already been finally acquitted or convicted within the Union in accordance with the law." Considering the increasing use of administrative sanctions, it could be argued that such an approach leads to a fundamentally unfair system and that the proportionality principle has an important role to play here so as to avoid double procedures. A recent famous example of tensions between *ne bis in idem* and national administrative sanctions regimes was the recent case of *Åkerberg Fransson* concerning the compatibility with the *ne bis in idem* principle of a national system involving two separate sets of proceedings to penalize the same wrongful conduct and where the Court stipulated a general proportionality requirement.[47] But this would require a structured proportionality test, one which inserts a reasonableness check into the proportionality assessment. With Barak, "tests of causation and severity regarding the blow to the public interest should be balanced against tests of the limitation of the various human rights at issue".[48] Surely this must apply to the EU regime on sanctions, i.e. where the principle of proportionality could serve a tool for injecting quality into the legislative regime, and asks whether double systems of sanctions are strictly necessary in the area of financial crimes.

The final section of this chapter will turn to the question of the possible establishment a European Public Prosecutor Office.

4.6 The Proposal for a European Public Prosecutor Office

This section will try to briefly demonstrate the longstanding endavours of the EU to legislate against fraud against the EU budget by establishing a European Public Prosecutor Office (EPPO) and thereby lead the way for enhanced EU coopeartion in the fight aginst financial crimes. The idea of an EEPO has so far triggered two yellow cards with regard to the earlier drafted legislation and this has attracted a lot of attention and debate in EU law scholarship.[49] The striving for the creation of an

EPPO is perhaps one of the most contested EU criminal law measures in recent years and one which emanates from the longstanding idea of creating a comprehensive EU anti-fraud regime. This EU mission has lasted for over two decades, with the EPPO as representing something of a jewel in the crown and as such a follow- up to the previous Corpus Juris project. Many scholars thought that the only possibility for the EPPO project to survive was the enhanced cooperation mechanisms where some Member States (nine or more) could pursue flexible integration which by some people were considered as a subsidiary friendly alternative.[50]

Yet this sort of multi-speed cooperation has not happened, and the Council has once again redrafted the Regulation exactly so as to avoid this fragmented scenario to take place.

In sum, most arguments against the previous proposals for an EPPO concerned the inaccuracy of the figures presented by the Commission as well as the lack of added value of EPPO investigations. It was also argued that its establishment had a possible detrimental impact on the existing actors in the area and their future cooperation with non-EPPO Member States.[51] On the contrary, could one now say that the EPPO is a giant without powers?[52] In any case, the main argument as presented by the Commission is that Eurojust and Europol have a general mandate to facilitate the exchange of information and coordinate national criminal investigations and prosecutions, but lack the power to carry out acts of investigation or prosecution themselves. According to the Commission, action by national judicial authorities remains often slow, prosecution rates on the average low and results obtained in the different Member States over the Union as a whole unequal. Based on this track record, the judicial action undertaken by Member States against fraud may currently not be considered as effective, equivalent and deterrent as required under the Treaty.

There is however a fundamental flaw in the creation of a European Public Prosecutor. It is difficult to separate on the one hand rules relating to investigations and prosecutions, at the EU level, and on the other hand, trials at Member State level.[53] According to Peers, the Commission should have considered other possibilities of more limited measures to achieve the same objectives such as the harmonization of the national

prosecutions rules in this area. The main argument as presented by the Commission, is that Eurojust and Europol have a general mandate to facilitate the exchange of information and coordinate national criminal investigations and prosecutions, but they lack the power to carry out acts of investigation or prosecution themselves.[54]

Still the EPPO proposal has clearly far-reaching implications for the legal systems of the Member States in what is generally acknowledged to be the sovereignty-sensitive area of criminal law and procedure.

4.6.1 Does the EPPO Comply with the Idea of "Better Regulation"?

This section will tentativly ask to what extent the EPPO represents "better regulation" in the EU context. Let us start with Article 5 on "basic principles of the activities" in the proposed Regulation.[55] This article says that when a matter is governed by a Regulation and national law then the latter shall prevail. From EU law perspective, this is like stating the obvious. The article also states that the EPPO shall be bound by the principles of the rule of law and proportionality. This is hugely important. Yet this should apply without having to specify it but I believe it is important to have it as an extra assertion. And same goes for the statement that the EPPO should be governed by the Charter of Fundamental Rights. General EU law principles of transparancy and accountability are also important as the lack of any clear criteria has been a main concern among academics. However, this improvement may be weakened by the rules on judicial review. The Regulation says that only procedural matters can be challenged.

Still the EPPO proposal has clearly far-reaching implications for the legal systems of the Member States in what is generally acknowledged to be the sovereignty-sensitive area of criminal law and procedure.

As for enforcement powers, this seems the weakest part of the EPPO. Yet a key feature of the current proposal that the Commission identifies as catering to subsidiarity concerns, is that an EPP would operate within existing national criminal procedures.[56] Thus, an EPP would

use standard national methods of investigation and prosecution procedures. Yet a uniform treatment of crime is one of the main reasons given for the adoption of the EPPO in the first place. I am therefore far from sure if this is "better regulation".

4.7 Conclusion

The EU's fight against financial crimes is a longstanding struggle, one which has been intensified in the wake of the financial crisis that started in 2008. While measures such as the Fourth Money Laundering Directive and the Market Abuse Directive and Regulation confirm the complicated relationship between the internal market and the Area of Freedom, Security and Justice, they also affirm the future importance of sanctions as part of the recovery mechanism of the financial crises. The European Public Prosecutor Office is a huge step forward in the supranationalization of this area. The question is if it is a step far enough or offers too many half-based solutions at present.[57]

Notes

1. E.g. J Frese, *Sanctions in EU Competition Law* (Oxford, Hart Publishing, 2014).
2. Directive 2005/60, *supra* note 8.
3. *See,* e.g., Steve Peers, EU Justice and Home Affairs Law 1 (2011).
4. E.g., Giandomenco Majone, Dilemmas of European Integration: The Ambiguities and Pitfalls of Integration by Stealth (2009).
5. For on an overview what it means in the EU context, see Niamh Moloney, *The Legacy Effects of the Financial Crises on Regulatory Design in the EU*, *in* The Regulatory Aftermath of the Global Financial Crises 111, 111 (Elis Ferran et al. eds., 2012).
6. Niamh Moloney, *Confidence and Competence: The Conundrum of EC Capital Market Law*, 4 J. Corp. L. Stud. 44 (2004).
7. Ibid.

8. Thomas Wilhelmsson, *The Abuse of the Confident Consumer*, 27 J. Consumer Pol'y 317 (2004).
9. *Communication for the Spring European Council, Driving European Recovery,* COM (2009) 0114 final (Apr. 3, 2009).
10. *The High Level Group on Financial Supervision in the EU Report* (Feb. 25, 2009), http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf
11. *Directive of the European Parliament and the Council on Criminal Sanctions for Insider Dealing and Market Manipulation*, (Directive 2014/57/EU, L173/179).
12. Emiliano Grossman & Patrick Leblond, *European Integration: Finally the Great Leap Forward*, 49 J. Common Mkt. Stud. 413 (2011).
13. Guido Ferrarini & Niamh Moloney, *Reshaping Order Execution in the EU and the Rule of Interest Groups: From MiFID I to MiFID II*, 13 Eur. Bus. Org. L. Rev. 557 (2012). *See also* Elliot Posner, *The Lamfalussy Process: Polyarchic Origins of Networked Financial Rule-Making in the EU, in* EU Governance: Towards a new Architecture? 108 (Charles Sabel & Jonathan Zeitlin eds., 2010), Niamh Moloney, EU Securities and Financial Markets Regulation (OUP 2015, 3 edition).
14. Moloney ibid.
15. See e.g., *Engel and others* v. *The Netherlands*, Series A no. 22 [1979–1980].
16. C-240/90 *Germany* v. *Commission* [1992] ECR I-05383.
17. AG Jacobs stated in his Opinion of 3 June 1992 that "certainly EC law in its present state does not confer on the Commission, the CFI or the ECJ the function of a criminal tribunal. It should however be noted that that would in itself not preclude the EC from harmonizing the criminal laws of the Member States if that were necessary to attain one of the objectives of the Community".
18. For a strict interpretation of the "Engel test", see C-489/10 *Criminal Proceedings against Bonda*, CJEU, Judgment of 5 June 2012, confirming previous case law, including C-210/00 *Käserei Champignon Hofmeister* v. *Hauptzollamt Hamburg-Jonas* [2002] ECR I-6453.
19. See E. Herlin-Karnell, *The Constitutional Dimension of European Criminal Law* (Oxford, Hart Publishing, 2012), ch. 2.
20. Case C-105/14, *Tarico* delivered on 8 September 2015 nyr.
21. Para 52. See for more detail E Herlin-Karnell & N Ryder "The Robustness of EU Financial Crimes Legislation: A Critical Review of the EU and UK Anti-Fraud and Money Laundering Scheme", European Business Law Review (2017), issue 2 forthcoming.

22. Proposal for a Directive of the European Parliament and of the Council on the fight against fraud to the Union's financial interests by means of criminal law, COM(2012) 363 final, available at http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012PC0363&from=EN (last accessed 13 May 2016).
23. Court of First Instance (CFI), Case T-315/01, *Yassin Abdullah Kadi* v *Council of the European Union and Commission of the European Communities* [2005] ECR II-3649; European Court of Justice (CEJ), Case C-402/05 P, *Yassin Abdullah Kadi* v *Council of the European Union and Commission of the European Communities* [2008] ECR I-5351; General Court, Case T-85/09, *Yassin Abdullah Kadi* v *European Commission*, judgment of 30 September 2010, Kadi II, Joined Cases C-584/10 P, C-593/10 P and C-595/10 P, judgment of 18 July 2013 (not yet reported).
24. See Gazzini & Herlin-Karnell, 'Restrictive measures adopted by the EU against individuals from the standpoint of International and European Law' (2011) 36 *European Law Review,* 798.
25. Case C-130/10, *European Parliament v Council*, Opinion of AG Bot delivered on 31 January 2012.
26. Case C-130/10, *European Parliament v Council*, judgment of 19 July 2012 (not yet reported).
27. Case C-300/89 *Commission* v *Council* [1991] ECR I-2867.
28. Fourth Money Laundering Directive, Directive of the European Parliament and of the Council on the Prevention of the Use of the Financial System for the Purpose of Money Laundering and Terrorist Financing, Directive (EU) 2015/849. See also the European security agenda COM(2015) 185 final and proposal for a Directive on Combating terrorism and replacing Council Framework Decision 2002/475/JHA, COM(2015) 625 final. On money laundering see e.g. N Ryder, *Money Laundering—An Endless Cycle? A comparative analysis of the anti-money laundering policies in the United States of America, the United Kingdom, Australia and Canada* (Routledge 2012).
29. Directive 91/308/EEC OJ 1991 L 166/77.
30. Directive 2001/97/EC of the European Parliament and of the Council amending Directive 91/308/EEC on the prevention of the use of the financial system for the purpose of money laundering OJ L344, 28 December 2004.
31. Directive 2005/60/EC OJ L309, 25 November 2005.

32. Fourth Money Laundering Directive, COM/2013/045 final, **on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing. Now adopted as Directive (EU) 2015/849 and implemented by summer 2017.**
33. Money laundering is by definition based on another crime termed a predicate offence, which gives rise to the laundering in question.
34. Given that different tax offences may be designated in each Member State as constituting 'criminal activity' punishable by means of the sanctions as referred to in point (4)(f) of Article 3 of this Directive, national law definitions of tax crimes may diverge.
35. Article 57 states "Differences between national law definitions of tax crimes shall not impede the ability of FIUs to exchange information or provide assistance to another FIU, to the greatest extent possible under their national law."
36. On the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, COM (2013) 45/3.
37. Directive 2013/40/EU on attacks against information systems.
38. **Regulation (EU) 2015/847 on information accompanying transfers of funds.**
39. see e.g. *Case C-293/12 and C-594/12, Digital rights,* judgment of 8 April 2014 nyr and Case C-362/14, Schrems, judgment delivered on 6 October 2015, nyr.
40. Directive 2014/57/EU, Directive on criminal sanctions for insider dealing and market manipulation, OJ L 3/179.
41. Ibid.
42. Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.
43. Directive 2004/39/EC, Markets in Financial Instruments, OJ L 145, 21 April 2004.
44. European Commission Communication: *Ensuring efficient, safe and sound derivatives markets*, COM (2009) 332, 3 July 2009.
45. Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.
46. See Herlin-Karnell, 'White-Collar Crime and European Financial Crises: Getting Tough on EU Market Abuse' (2012) 37 *European Law Review* 487.
47. C-617/10, *Åkerberg Fransson,* judgment of 26 February 2013 (not yet reported).

48. A Barak, 'Proportional Effect: The Israeli Experience', (2007) University of Toronto Law Journal, 369.
49. G Conway, The Future of a European Public Prosecutor in Maria Fletcher, Ester Herlin-Karnell and Claudio Matera (eds), The European Union as an Area of Freedom, Security and Justice, (2016 Routledge forthcoming).
50. See *Presidency conclusions* Proposal for a Regulation on the establishment of the European Public Prosecutor's Office 2013/0255 (APP) Brussels 3 June 2016 available at http://eur-lex.europa.eu/procedure/EN/2013_255 (last accessed 13 July 2016). And *Proposal for a Council Regulation on the Establishment of the European Public Prosecutor's Office,* COM (2013) 0534 final (July 7, 2013). On corpus juris see M. Delmas-Marty & J.A.E. Vervaele (eds.), The Implementation of the Corpus Juris in the Member States (Intersentia 2000). See also discussion in E Herlin-Karnell, The Function of Subsidiarity in EU Area of Freedom, Security and Justice Law, Europarattslig tidskrift 2017 issue 1.
51. A Csuri, The Proposed European Public Prosecutor's Office—from a Trojan Horse to a White Elephant? Cambridge Yearbook of European Legal Studies, 1–30 (2016).
52. See C Gómez-Jara Díez *Federal European Criminal Law* (Intersentia, 2015).
53. See e.g. Katalin Ligeti (ed) *Toward a Prosecutor for the European Union Volume* 1 (Oxford, Hart, 2012), G Conway, The Future of a European Public Prosecutor in Maria Fletcher, Ester Herlin-Karnell and Claudio Matera (eds), The European Union as an Area of Freedom, Security and Justice, (2016 Routledge forthcoming) and Marianne Wade, *A European Public Prosecutor: Potential and Pitfalls*, Crime, Law & Social Change, 59, 439. (2013).
54. Steve Peers *EU Justice and Home Affairs Law* (Oxford, Oxford University Press, 2011) 858–860.
55. *Presidency conclusions* Proposal for a Regulation on the establishment of the European Public Prosecutor's Office 2013/0255 (APP) Brussels 3 June 2016 available at http://eur-lex.europa.eu/procedure/EN/2013_255 (last accessed 13 July 2016).
56. The EPP will not replace Eurojust, which will continue in its current role regarding all offences other than those against the financial interests of the EU.
57. See e.g. C Gómez-Jara Díez *Federal European Criminal Law* (Intersentia, 2015).

5

Tackling the Risks of Money Laundering

M. Michelle Gallant

Money laundering is ubiquitous in modern discourse because of its pervasive links to criminal activity. It bolsters terrorism, underpins much chastisement of financial institutions and their alleged links to drug cartels, expedites tax evasion, undergirds corruption and resonates in political wrangling over financial debacles. It stands accused of causing, or contributing to, any number of crimes shaped, in one way or another, by money.

Stringent anti-money laundering laws seek to tame this malevolence. The product of protracted global efforts, these norms establish an elaborate apparatus designed to detect, intercept and confiscate money connected to criminal activity. This chapter discusses the risks posed by money laundering, dividing these into two categories, associational-risk and non-derivative risk. It canvasses the main tenets of the taming exercise with a focus on the dismantling of secrecy, the central defining feature of money laundering. In concluding that this tempering project has merit, a glimpse of the laundering underworld suggests that much work remains.

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N. Ryder (ed.), *White Collar Crime and Risk*,
https://doi.org/10.1057/978-1-137-47384-4_5

5.1 Money Laundering

Money laundering conventionally refers to the cleansing or concealment of resources linked to criminal activity.[1] The earliest judicial acknowledgment of the term is claimed to be an American judicial decision although lore places its birth much earlier.[2] The association of the verb 'laundering' is also drawn from American origins, a reference to American criminal organizations using cash-intensive Laundromats to make illegal revenues appear as revenues of the washing business.[3]

First associated with cleansing or concealing wealth derived from criminal pursuits, money laundering grew to include resources associated with, or intended for, crime largely with the post-2001 'war' on terrorism.[4] Previous angst typically focused on profitable crimes and the circulation of criminal proceeds. Post-2001, the concept took fuller notice of resources destined for crime, in particular, for terrorist activities. A departure from previous conceptions, the criminal taint attaches to the destination, not necessarily the derivation, of money.

While money laundering had achieved some notoriety by the 1960s, the practice has fully entered the crime control lexicon over the past 30 years. Beginning largely in the 1970s and 1980s, the cleansing, concealment and disposal of resources linked to crime became identified as a virtual global pandemic. Allegedly billions of tainted resources were in circulation, derivative of any number of crimes although principally linked to the global trade in illegal drugs.[5] Such prodigious amounts posed a danger to financial stability as well as hindered the suppression of crime. Responsibility for the danger centered money laundering.

5.2 Risks of Money Laundering

Money laundering attracts condemnation because it poses risks. Loosely stated, those risks can be divided into two types. The most widely discussed are associational risks. These relate mainly to the criminal activities that underlie the laundering. The other type of risk arises not necessarily from the underlying crime but from money laundering in its own right.

In this latter case, it is the existence of tainted finance that menaces, rather than, or in addition to, its origin or destination.

5.2.1 Associational Risks

When money laundering first emerged as a global problem the principal source of tainted resources was the global trade in illegal drugs.[6] The elusive quality of resources, the disappearance or apparently lawful laundered character of drug revenues impeded efforts to control trafficking.[7] Adopting an analysis partly reliant on the theories of law and economics, the profits generated by the drugs business arguably outweighed any deterrence afforded by prohibition and conventional sanctions, sanctions that included lengthy prison terms and, in some states, the death penalty.[8] Deliberate attention to criminal finance became imperative, a means of grappling with a practice that nurtured the drugs trade.

Money laundering facilitates the trade in different ways.[9] It assists in placing drug money beyond the reach of national law. Using the global financial infrastructure, the process moves money to foreign jurisdictions, making it difficult for a state to enforce territorially bound drug laws. Putting earnings through a series of transactions obscures the link between property and the underlying offences. With trafficking, resources allegedly flow from peripheral players (i.e. drug couriers) into the pockets of more central players: laundering veils the latter's complicity. Money laundering eases re-investment of tainted earnings into the underlying enterprise, preventing the tying of the purchase of airplanes or speedy watercraft to transport drug shipments to the drugs trade. A veneer of legitimacy cloaks the origins of the payments. Such facilitative adeptness disturbs the balance between the risks of detection and prosecution and any profit motivations. Millions secured in foreign havens eclipses the costs of prosecution and sanction. Trafficking is a risk well worth taking.

For any trade-based, or business-oriented, crime, money laundering reduces the risk factor. It makes the underlying activity difficult to detect, abates the likelihood of prosecution and protects the profits. This diminishes the strength of prohibition. Capture, prosecution and sanctions pale in comparison to the riches safely sequestered in a foreign vault. Even with imprisonment, the abundance merely awaits release.

Another prime associational risk of money laundering is 'the abuse of public office for private gain', formally known as the crime of corruption.[10] Corruption impedes economic growth and denudes public infrastructure.[11] Corrupt officials divert resources otherwise destined for the development of public services, for healthcare or for educational facilities.[12] Money laundering helps secure the funds, conceals their trajectory and hides links to beneficiaries. The filtering of misappropriated resources through foreign jurisdictions constrains attempts by a subsequent administration to know the extent of the theft, to trace the funds and to obtain a financial remedy.[13] Again, while prosecution by successors may attach criminal liability, future access to riches weakens deterrence.

The trade in illegal weapons and nuclear arms, human trafficking and fraud—almost any crime with significant financial dimensions—are common culprits facilitated, or exacerbated, by money laundering. Lucidly obvious are the attendant physical, social and economic risks: the misery of the sale and enslavement of human beings, the death and destruction caused by a nuclear bomb and the chaos induced by vast fraud on the financial markets. Laundering blurs the link to crime, shelters profit and allows the wealth to masquerade as legitimate earnings.

Terrorism is a somewhat unique associational hazard. The association with money laundering differs from other crimes. Socio-logical considerations aside, corruption, trafficking, fraud and illegal arms dealing are profit-oriented activities. They can be analogized to lawful businesses. Similar motivations do not underpin terrorism. Resources facilitate, rather than motivate, terror. Money laundering does not necessarily cloak tainted earnings with legitimacy, although it certainly can. Rather, it covertly channels resources to terrorism, resources that may derive from legitimate sources.[14] This does not preclude the reliance of terrorist groups or networks funding from other criminal trades. With terror, however, money laundering assumes an important enabling function.

But the risk analysis differs too. While the probability of a terrorist attack may be extremely small, the damage to life, property and the social order can be exponential.[15] Strikingly randomly and unpredictably, it creates a climate of fear, a reaction certainly less acute in the context of other associational risks. Even though the likelihood of an attack may be

infinitesimally small, the magnitude of the consequences is immense. Money laundering's association with terror amplifies the risk: the consequences it facilitates more fearsome, more apt to command serious, sometimes troublesome, mitigation strategies.[16]

Tax evasion has a long acquaintance with money laundering. Its express integration into wider efforts, however, is of recent vintage, only becoming affixed to the international exercise in 2012.[17] Corruption, terrorism, drugs and others joined earlier. Tax crimes, together with drugs, securities fraud and other forms of 'white collar' crime, underpinned initial forays into money laundering regulation in the early 1970s.[18] Leaving aside the well-known story of Al Capone and his tangles with the Internal Revenue Service, initial American interest in countering money laundering involved glaring concerns over the disappearance of presumptively taxable earnings.[19] This agitation prompted pioneering US bids to unmask secrecy, a central ingredient of money laundering and a focal point of control strategies. Yet, four decades passed before tax crimes formally settled in global anti-money laundering law.

With deep formative roots to money laundering, explanations for this late inclusion remain ambiguous. It may be because tax matters conventionally belong to the domain of international trade and business rather than matters for the discipline of criminal law.[20] Tax features as a legitimate incident of global competition. Low to non-existent tax rates, differential tax treatment of foreign and domestically owned capital and rigid secrecy laws commonly help solicit foreign investment.[21] In the international political arena, this translates into fleeing untaxed dollars, constituting a problem for some states and an economic boon to others. Moreover, taxation aligns tightly with the concept of sovereignty, an aspect of statehood not lightly surrendered.[22] Finally, the belated arrival may reflect a prevailing tendency to characterize tax crime as a 'victimless' crime, a designation apt to provoke little empathy and even less political action. Given that vanishing public tithes atrophy state budgets and precipitate the languishing of public infrastructure, the latter is somewhat misconceived.

Regardless of the ambiguity in the lapse, tax evasion is now clearly acknowledged as a risk associated with money laundering.

5.2.2 Non-derivative Risk/Risk Exclusive to Money Laundering

In addition to facilitating or fueling any underlying criminal activity, money laundering allegedly poses a risk in its own right. That risk does not necessarily derive from the tainted source or tainted destination of money. It occurs mainly, although not exclusively, as a function of a reputation or knowledge that an institution or jurisdiction is implicated in laundering funds. It is, however, somewhat of an alleged risk. There is not a wealth of evidence of financial institutions shorn by an association with money laundering.

Posited as a serious hazard, this non-derivative risk stands accused of jeopardizing the health of the financial system and enterprises within that system.[23] Apprehension usually centers on reputation, that a connection to money laundering shreds public confidence, precipitates the withdrawal of deposits and erodes stability. The risk also relates to the corrosive influence of criminal money. The mere presence of tainted money shifts allegiances, leads to shady dealings or distorts the otherwise lawful ambitions of a financial institution.

The most regularly cited example of the non-derivative risks of money laundering is the demise of the Bank of Credit and Commerce International (BCCI).[24] In the late 1980s, BCCI acquired the identity of a 'dirty' financial institution because of its notoriety as an institution heavily involved in money laundering activity. Its ultimate financial failure allegedly arose from its infamous reputation. The death of BCCI exemplifies the evils of money laundering and serves to justify fears of this non-derivative risk.

The story of BCCI is conspicuous in money laundering literature. Stories of institutional failures consequence upon money laundering are otherwise rare. Although institutions and entire jurisdictions have been linked to money laundering, there is little real evidence that association induces collapse.[25] Most financial collapses appear to involve systemic regulatory breaches, shoddy management or bad investment decisions.[26] That does not mean that the close association of a financial institution with money laundering does not invite consequences. The seriousness of this risk, however, may be somewhat overstated.

5.3 Tackling Money Laundering Risks

Recognition of the risks posed by money laundering spawned countermeasures. The late 1980s witnessed the beginning of the construction of an edifice of anti-money laundering norms. Since international maneuvers are indispensable to successful concealment, the project is mainly a creature of international law.[27] A singularly influential actor in this initiative is the Financial Action Task Force (FATF), a body created to address global money laundering and the threat to the financial system.[28] Drawing upon the content of international conventions, this body issues recommendations on money laundering and terrorist finance governance that are widely acknowledged as the international standards.[29] States regularly respond to FATF dictates.

This coalescence of international law and FATF recommendations focuses on the criminal finance, the nucleus of laundering. Comprehensive in its remit, aspects of this apparatus range from the minting of new offences to the surveillance and monitoring of financial activity to enhanced international co-operation. While all aspects of this project are important, arguably some of the critical are the components that aspire to dismantle financial secrecy, the mechanics of which undergird global money laundering. These aim to increase the visibility of money laundering, to deny the concealment, cleansing and legitimatizing exercise, the principal tools of its trade. It is a dismantling venture that builds upon two basic parts of anti-money laundering regulation, the criminalization of money laundering and confiscation regimes.

5.3.1 Criminalization of Money Laundering and Confiscation Regimes

Prior to the contemporary awareness of the problem of money laundering, most states did not recognize a specific offence of money laundering. The deposit of bundles of cash or their exchange for other financial instruments attracted no particular criminal liability. It was not widely acknowledged that the engagement with the financial aspect of crime, *qua*, the laundering of proceeds linked to criminal activity, triggered criminal culpability.

A central tenet of anti-money laundering control is the criminalization of money laundering.[30] The international standard defines money laundering as:

> The conversion or transfer of property, knowing that such property is the proceeds of crime, for the purpose of concealing or disguising the illicit origin of the property or of helping any person who is involved in the commission of the predicate offence to evade the legal consequences of his or her action: the concealment of disguise of the true nature, source, location, disposition or movement or ownership of rights with respect to property knowing that such property is the proceeds of crime….the acquisition, possession or use of property, knowing, at the time of receipt, that such property is the proceeds of crime; participation in, association with or conspiracy to committee, attempts to commit, and aiding, abetting, facilitating and counseling the commission of any offences.[31]

This ample definition covers virtually any knowing engagement with property linked to criminal activity. Criminalization affixes liability to actions exclusively concerned with property, with finance. Significantly, prohibition attaches the prospect of a prosecution to the financial part of crime. This prospect does not derive from, nor is it necessarily predicated upon, complicity in the commission of any underlying offences. Tying liability to knowingly helping to cleanse or conceal the origins of property widens the scope of criminal liability. To invite criminal sanction, it is sufficient to engage with criminal finance.

The importance of this precept of anti-money laundering law cannot be understated.[32] The conversion or transfer of property, the disguising, acquisition or possession of property and participation in, or aiding, abetting or facilitating such activities captures a vast congregation. It exposes a broad range of individuals who knowingly facilitate money laundering to criminal liability. This extends from those who might transport large amounts of cash currency to those who might advise on the structuring of a laundering scheme to those who might ultimately acquire proceeds tainted by crime.

The second central tenet of anti-money laundering law is confiscation.[33] Confiscation laws usually connote the divestiture of assets upon conviction for a criminal offence. This process strikes directly at criminal property,

the subject of money laundering. Depending upon their configuration under domestic law, confiscation typically accomplishes a series of goals: it secures the recovery of tainted assets; it increases the odds of a successful divestiture; and it increases the scope of property liable to be confiscated. In securing the recovery of assets, confiscation permits the pre-trial seizure of property. This disables the capacity to hide or otherwise protect potentially forfeitable resources pending a criminal prosecution. Seizure interrupts the capacity to launder that rumors of a possible prosecution might otherwise encourage. Second, confiscation proceedings usually facilitate the taking of property. This is typically achieved either by incorporating the civil standard of proof, rather than the higher criminal standard, into the confiscation process or by requiring that, upon conviction, the burden of proof shifts to the convicted person to demonstrate the lawful origins of property liable to forfeiture.[34] A more conventional criminal process would impose all evidential burdens on the state and applies the criminal legal threshold of proof. Through the shifting of burdens or the lowering of thresholds, the process increases the probability that the state will succeed in its forfeiture bid. Of course, the conventional rules of criminal law govern any prosecution, a process that must usually yield a conviction to trigger confiscation.[35] Third, confiscation regimes may expand the sphere of property liable to be taken. This is often achieved by reliance on assumptions.[36] Again, while the precise form and content of confiscation is a matter for domestic law, confiscation regimes might provide that any assets acquired by a defendant during a defined period prior to the prosecution are assumed to derive from crime, with the burden lying with the defendant to disprove that assumption. Reliance on assumptions tends to significantly increase the scope of assets liable to be confiscated.

Despite the significant merits of confiscation to anti-money laundering governance, the global standards entertain reliance on a rather radical approach, non-conviction-based confiscation.[37] Under this approach, laundered property can be seized and forfeited without a prior criminal conviction. The non-conviction model, known in many jurisdictions as civil forfeiture, typically permits the forfeiture of property when it is shown, to the civil evidential standard, that assets are linked to criminal activity.[38] However, non-conviction models are controversial because they displace the substantive and procedural safeguards of a criminal trial.[39]

In attacking money laundering, in attacking the financial piece of crime, conviction-based and non-conviction-based confiscation appreciably affects the risk factor. Engaging in criminal activity incurs the obvious risk of prosecution and sanction. Seizure denies the ability to place assets in safe havens and facilitates the attachment and scope of confiscation increase the costs of crime. Non-conviction-based processes fasten liability more readily and make the preservation of tainted resources more challenging. When prosecution looms and the capacity to hold on to treasures shrinks, the profit motivations recede. The risk of crime holds less promise. Presumptively, the calculus gently shifts toward deterrence.

5.3.2 Dismantling Secrecy: Anti-money Laundering Regulation

Anti-money laundering regulations build on these twin tenets, supplementing the criminalization of money laundering and confiscation laws with the dismantling of financial secrecy. Attrition of secrecy aims to enable the detection of tainted transactions, to permit their interception, to deny their entry into the financial system, to assist in the imposition of criminal liability and, obviously, to permit confiscation.

Secrecy is the cornerstone of money laundering.[40] Any conduct of financial exchanges in obscurity inhibits the ability of law enforcement to identify criminal earnings, to trace laundered assets to their owners and to detect the underlying crimes. When secrecy cleaves to a transaction, the transaction escapes scrutiny. Legal doctrines such as confidentiality or financial privacy and vehicles of anonymity such as shell banks pile thick shrouds over financial activity.[41] Requests for financial information encounter silence. Detection of patterns of criminal activity is formidable. Anti-money laundering regulation seeks to shine a bright light on the financial environment, to enhance transparency, to modify the conventions of secrecy and to illuminate the trajectory of tainted finance.

A central pillar of secrecy reduction is the refusal to tolerate reliance on bank secrecy as a pretext for failing to comply with anti-money laundering regulation. Classically, bank secrecy prevents financial institutions from revealing information about their clients. Representative of the strength of this precept are early nineteenth-century Swiss laws that

imposed criminal liability on bankers who divulged confidential information.[42] British law has long acknowledged the primacy of the privileged relationship between bankers and their clients.[43] In the United States, early participants in the quest to suppress money laundering, the first piece of American anti-money laundering law targeted financial institutions and bank secrecy.[44]

In refusing to be beholden to secrecy, anti-money laundering controls provide that states cannot decline to act on the grounds of bank secrecy.[45] Local norms, conventions or doctrines that otherwise safeguard financial privacy cannot be used to justify refusals to comply with requests for information or refuse to enact protections against money laundering.

Anti-money regulation lends substance to the dismantling project by building resistance to secrecy. Discrete mechanisms aim to create financial transparency, to generate information essential to suppression efforts and to eliminate traditional vehicles of anonymity.

In constructing this resistance, anti-money laundering laws impose suspicious transactions reporting obligations on institutions and professionals, known as regulated entities, whose work intersects with financial activity. Should a transaction evoke suspicions, or provide reasonable grounds to suspect, that it involves proceeds of crime or terrorist financing, that suspicion must be reported.[46]

Enhanced due diligence norms continue this dismantling. Anti-money laundering standards demand that regulated entities exercise diligence in identifying their clients and maintain detailed records of financial activity.[47] Among others, diligence measures include verifying a client's identity using independent sources, identifying beneficial owners, securing information on the nature and purpose of a business relationship and scrutinizing financial activity over the course of the relationship.[48] Detailed record-keeping includes maintaining records of activities for at least a period of five years.[49] An ability to fully identify clients and a complete trial of financial conduct contribute an investigative aspect to anti-money law, providing the authorities the information needed to track money laundering. Moreover, regulated entities must also establish their own internal money laundering controls and create anti-money laundering programs.[50]

Reinforcing this assault on secrecy and building resistance, anti-money laundering regulation seeks to constrain the use of common vehicles of invisibility. Legal constructs such as trust arrangements and shell banks traditionally shield the identity of owners. The true orchestrators and beneficiaries of financial transactions are concealed beneath layers of artificial entities or nominees. Anti-money laundering law restricts interactions with shell banks and counsels their termination.[51] The beneficial owners of trusts and other artificial legal person must also be identified.[52] One of the most famous vehicles of secrecy, anonymous bank accounts, are also subject to prohibition.[53] Numbered bank accounts, popularized in copious works of literature, are felled by the dismantling exercise.

5.3.3 Other Aspects of Fortification

Criminalization, confiscation and the secrecy offensive form the core of the contemporary anti-money laundering framework. The broader apparatus within which they occur fortifies that core. The apparatus constructs a complete approach to the suppression of money laundering, one which commands a risk-based analysis to implementation, underscores the importance of national coordination, attends to additional avenues of laundering and addresses the supervision and operational management of the anti-money laundering strategy. Amid these, certain notable features pertain to the associational risks of terrorism and corruption. Other constitutive provisions aim to create a fluid international context capable of mimicking the context within which money laundering occurs.

Unorthodox origins contribute to notable features of terrorist finance regulation. The bulk of modern anti-money laundering law originates in international conventions. Laws aimed at terrorism have roots in conventions as well as in United Nations Security Council Resolutions.[54] These different roots reflect the fact that responses to terrorism developed separately from responses to money laundering. Discrete terrorist attacks repeatedly prompt UN intervention. That intervention contained measures specific to the financial aspects of terrorism.[55] Provisions related to corruption, drugs control and other associational money laundering crimes have remained confined to international treaties. Terrorist finance

and anti-money laundering regulation fused in the post-September 2001 period although components of earlier international edicts continued to be part of the anti-terrorism laws and were incorporated into anti-laundering law.[56] It is fusion that some invites controversy.[57] Moreover, the post-2001 focus on terrorist finance stimulated unique additions to the global approach.

A function of origins and the uniqueness of terrorism are offences related to the financing of terrorist organizations and the financing of individual terrorists in the absence of links to terrorist acts.[58] Also specific to terror are targeted financial sanctions. Sourced in UN instruments, these tie a modified version of confiscation to the assets of persons and organizations known to be involved in terrorist activity.[59] Equally triggered by terrorism is the application of anti-money laundering rules to not-for-profit institutions.[60] While not as rigorous as the regimes applicable to other regulated entities, these address post-September awareness that not-for-profit institutions risked abuse by terrorists, unwittingly used to channel resources to terrorist enterprises.[61] Latterly, that abuse expanded to acting as potential conduits for tax evasion.[62]

Terrorism also provoked the expansion of money laundering regulation to non-conventional financial conduits. Known as informal financial networks, or informal value transfer systems, these mediums of financial mobility typically fall outside the formal regulated sector.[63] To prevent abuse, anti-money laundering law requires that entities involved in such works be registered, licensed, monitored and required to adhere to anti-money laundering standards.[64]

Corruption attracts its own distinct anti-money laundering provision. This offence implicates a unique criminal clientele. Only those with public duties, those armed with state-based power and control, are positioned to engage in corruption. Anti-money laundering identifies and attends to the specific risks this collective poses. Named 'politically exposed persons', this collective comprises public authorities including Heads of State, senior government officials, politicians, and judicial and military officials.[65] Enhanced due diligence is imposed on financial institutions in conducting matters on behalf of this group.[66] Among others, this includes efforts to ascertain whether a potential client qualifies as a politically exposed person and to ascertain the precise source of wealth.[67]

Finally, in a global order rich in technological innovation, where financial interests can cross infinite national borders in a nanosecond, confronting money laundering demands heightened levels of international cooperation. Global integration seeks to replicate the seamless terrain of the villain it confronts. The centerpiece of global integration is obviously the endorsement and implementation of the series of conventions attentive to money laundering. Harmonized implementation, the ambition of a global project, establishes the essential legal framework for reducing the risks of money laundering.

To strengthen harmonization and to create a more fluid law enforcement domain, anti-money laundering law encourages better international collaboration. Better collaboration covers accelerating the pace of responses to foreign requests for assistance and information, assistance in facilitating extradition and a willingness to conclude additional formal agreements so as to facilitate speedy, well-ordered inter-jurisdictional cooperation.[68] Establishing fluid international operations includes a call to create national centers of financial expertise to organize and coordinate the global approach. This latter helps to negotiate the intricacies of parochial internal ordering.[69]

5.4 Risk, Merits and Appearances

This fortress of norms appears to solidify global defenses to the risks of money laundering. The act is prohibited, the ability to seize and confiscate laundered assets is eased, doctrines and vehicles of secrecy are banned, financial activity is subject to enhanced scrutiny and international collaboration is facilitated. Mere structural organization, the harmonization of domestic norms, assures some degree of consistency in harnessing a phenomenon built on the complete negation of law. However, the actualization of the strategy involves a vast assembly of participants, many of which are private actors, not law enforcement officials. The strategy depends upon knowledge of financial processes that can be difficult to acquire. It requires negotiation of international dynamics, and necessitates the timely sharing of information. It demands the expeditious seizure of assets and requires trust and a willingness to collaborate with

foreign states and institutions. Such underlying dynamics definitely pose serious enforcement challenges.

Assessing the merits of money laundering regulation is also challenging. Some dismiss the entire project as an exercise in futility, a waste of resources driven by the politics of appearances.[70] There is a penchant to point to money laundering's continued monopolization of the discourse on the profits of crime as evidence of the regulatory system's inadequacy. Certainly money laundering continues.[71] Money is a powerful motivator, for the lawful and the lawless alike. Confronting any wealthy industry has never been an easy task. It is to be anticipated that an industry alleged to involve billions in criminal finance would not readily yield to control. Moreover, any apparent structural resistance is apt to induce adaption. The endless chase for profits pushes the resourceful launderer to adapt to its environment. This means finding ways to circumvent the anti-money laundering mechanism.[72]

A very modest assessment is that this modern regulatory era constitutes a significant improvement upon its predecessor. Trite though it may seem, the previous era posed no barriers to an exchange of suitcases of dollars for anonymous gold bars. No reporting norms affixed to the architects of financial wizardry. Tainted money sailed smoothly from corrupt official to foreign shores. Secrecy obscured drug trafficking profits, invisible to the prying eyes of law enforcement. Moneys destined for terror were not detected. Criminal resources vanished. Taxable resources absconded. Slaves were bought and sold while traders feasted on the profits of human trafficking. Anti-money laundering law is a marked improvement on a chaotic era that posited no risk of prosecution and little risk of detection. Given anti-money laundering's manifestly worthy ambitions, some degree of structural interference is better than the preceding highly permissive era.

That this fortress of norms *appears* to solidify defenses invites a caveat. Glimpses inside the money laundering universe are rare. The universe covets murkiness and the unknowable. To effectively launder money is to remain out of sight, to avoid detection, to quietly conceal and cleanse. Scant glimpses into this netherworld are somewhat chilling.

In 2008, the US Senate conducted lengthy hearings into tax evasion.[73] In that year, a massive investigation into alleged tax evasion was triggered

by information disclosed by a Swiss private banker.[74] His disclosures precipitated criminal actions against UBS, a bank headquartered in Switzerland, for its role in facilitating tax evasion.[75]

The hearings reveal the complicity of UBS employees in laundering, work with US clients, and others, to evade US taxation laws. Letters from UBS to clients bluntly asserted that they would not disclose Swiss accounts held by US citizens even though UBS knew fully well that citizens were taxable under US law on those accounts. UBS bankers repeatedly traveled to the United States in search of wealthy clients, attending events known to attract 'High Net Worth' individuals, and stated on their US customs declarations forms that the travel was non-business related. While the bankers were in the United States selling securities without the proper licenses required under US law, company guidance advised employees that while on US soil, they should not use email, telephones, conclude agreements, issue reports or deliver documents, each of which is a substantive indicator of selling securities and investments. Bankers went to extraordinary length to encrypt or disguise account information, including reliance on numeric codes rather than any proper, formal client identification.[76]

The Senate hearings are instructive, and at the same time chilling, as they demonstrate the extent to which financial insiders, in this case bankers, were willing to assist in evading United States' tax laws. Some describe the actions of the Swiss bankers as 'routinely selling tax evasion services to Americans and other wealthy individuals'.[77] This depiction echoes wider sentiments about the legitimacy of financial institutions' interest in preventing money laundering.[78] The very institutions whose integrity anti-money laundering law seeks to protect diligently strive to elude those norms.

The glimpse highlights a relatively unexplored piece of money laundering terrain. Laundering constraints pre-suppose that the villains are drug traffickers, corrupt officials, traders in illegal arms, traders in human misery, terrorists and criminal tax evaders. Financial institutions are unwitting victims, caught in the vortex of money laundering. Leaks from insiders offer a twist on the narrative. Malignancy emanates from within the financial sphere. Receptiveness to servicing the money laundering creature, a degree of complicity in navigating legal constraints, exists within the financial industry.

It is a perspective that unsettles. While norms of old may have ceded to a new order money launderings continues to breed accomplices. Despite the disciplinary sting of regulation, the coveting of profit still reigns. An apparently mature and robust regulatory apparatus cannot reduce the risks of money laundering if its ambitions are under assault from within.

Notes

1. The Canadian definition of money laundering, for example, covers almost any handling of property knowing or believing that the property was obtained directly, or indirectly, from a criminal offence: Criminal Code, RSC 1985, c C 46, ss 462.31 (1).
2. *United States v $4,255,625.39* (1982) 551 F Supp 314 (S D Fla).
3. Brigitte Unger, 'Money Laundering Regulation from Al Capone to Al Queda' in Brigitte Unger and Daan van der Linde (eds), *Research Handbook on Money Laundering* (Edward Elgar, 2013) 19. Use of casinos to launder money continues: Financial Transactions and Reports Analysis Center of Canada, *Money Laundering Trends in Canadian Casinos* (November 2009).
4. Sue Eckert, 'The US Regulatory Approach to Terrorist Financing' in Sue Eckert and Thomas Biersteker (eds) *Countering the Financing of Terrorism* (Routledge, 2008) 210, 210–16.
5. William Gilmore, *Dirty Money: The Evolution of International Measures to Counter Money Laundering and the Financing of Terrorism* (4th edn, Council of Europe Publishing, 2011) 16–18. Most approaches to measuring money laundering lack robust theoretical underpinnings and are extremely variable: Brigitte Unger, *The Scale and Impacts of Money Laundering* (Edward Elgar, 2007) 29–56.
6. Gilmore (n 5) 16–18. The first treaty attentive to money laundering emerged in 1988, its content devoted to the drugs trade: Convention Against Illicit Traffic in Narcotics and Psychotropic Substances (adopted 20 December 1988, entered into force 11 November 1990).
7. Cherif Bassiouni, 'Critical Reflections on International and National Control of Drugs' (1990) 18 Denver Journal of International Law and Policy 311, 321–324.

8. Singapore has long imposed serious penalties for drugs offences, including caning and the death penalty: *Misuse of Drugs Act*, .c 185, Part III.
9. Roberto Durrieu, *Rethinking Money Laundering and Financing of Terrorism in International Law: Towards a New Global Legal Order* (Martinus Nijoff, 2013) 22–30; Robert Gross, *Drugs and Money: Laundering Latin American Cocaine Dollars* (Greenwood Publishing, 2001) 3–15: Guy Stessens, *Money Laundering: A New International Law Enforcement Model* (Cambridge University Press, 2003) 82–87; Pino Arlacchi, Introduction to the Panel Discussion, "Attacking the Profits of Crime: Drugs and Money Laundering" United Nations Office for Drug Control and Crime Prevention, New York 10 June 1998, (1998) Trends in Organized Crime 114 (Winter).
10. World Bank, *Helping Countries Combat Corruption: The Role of the World Bank* <www1.worldbank.org/publicsector/anticorrupt/corruptn/cor02> accessed 21 March 2016.
11. See generally, Susan Rose-Ackerman, *Corruption and Government: Causes, Consequences and Reform* (Cambridge University Press, 2009).
12. Ibid.
13. Attempts to recover funds appropriated by President Ferdinand Marcos of the Philippines exemplify this problem. During a 20-year reign, President Marcos stole billions from the Philippines, much of which was laundered through foreign accounts. Decades passed before a portion of this money was recovered: David Chaikin and Jason Sharman, *Corruption and Money Laundering* (Palgrave 2009) 153 (The Marcos Kleptocracy); Pieter Hoets and Sara Zwart, 'Swiss Bank Secrecy and The Marcos Affair' (1988) 9 New York Law School Journal of International and Comparative Law 75; Elizabeth Olson, 'Ferdinand Marcos's Swiss Bank Legacy: Tighter Rules for Despots and Criminal' *New York Times* (New York, 23 October 1998) <www.nytimes.com/1998/10/23/world/ferdinand-marcos-s-swiss-bank-legacy-tighter-rules-despots-and-criminals > accessed 21 March 2016.
14. The London Bombings in 2006, for example, were allegedly funded with legitimate earnings: *Report of the Official Account of the Bombings in London on 7th July 2005*, HC 1087, 11 May 2006, 23.
15. Tim Krieger and Daniel Meierrieks, "Terrorism: Causes, Effects and the Role of Money Laundering" in Brigitte Unger and Daan van der Linde (eds*), Research Handbook on Money Laundering* (Edward Elgar, 2013) 78, 81–83.

16. For a critic of this mitigation strategy, see generally, Nicole LaViolette and Craig Forcese (eds) *The Human Rights of Anti-Terrorism* (Irwin Law, 2008).
17. Financial Action Task Force, *International Standards on Combatting Money Laundering and the Financing of Terrorism and Proliferations: The FATF Recommendations,* February 2012, 113.
18. Elliot Stultz, 'Swiss Bank Secrecy and United States Efforts to Obtain Information from Swiss Banks' (1998) 21 Vanderbilt Journal of Transnational Law 63, 81–95.
19. James Eldridge, 'The Bank Secrecy Act: Privacy, Comity and the Politics of Contraband' (1987) 11 North Carolina Journal of International Law and Commercial Regulation 667, 668–69; Richard Bloch, 'Of Records and Reports: Bank Secrecy Under the Fourth Amendment' (1973) Arizona Law Review 39, 40–41.
20. The Organization for Economic Cooperation and Development, a body chiefly concerned with economic development, productivity, and global trade and investment, has a lengthy history of attending to tax matters including tax evasion: Allison Christians, 'Avoidance, Evasion and Taxpayer Morality' (2014) 44 Washington University Journal of Law and Policy 39, 43–5; Alexander Townsend, 'Global Schoolyard Bully: The Organization for Economic Cooperation and Development's Coercive Efforts to Control Tax Competition' (2001) 25 Fordham International Law Journal 215, 229–231.
21. International Monetary Fund, 'Tax Concessions and Foreign Direct Investment in the Eastern Caribbean Currency Union,' IMF Working Paper, WP/08/257.
22. Diane Ring, 'Democracy, Sovereignty and Tax Competition: The Role of Tax Sovereignty in Shaping Tax Competition' (2009) 9 Florida Tax Review 556.
23. Prevention of this particular risk is the foundational concern of the Financial Action Task Force. While this organization establishes the international standards for money laundering governance, its principal mandate is to prevent "threats to the integrity of the international financial system"; Financial Action Task Force <www.fatf-gafi.org/about/> accessed 23 March 2016; see also E P Ellinger, Eva Lomnicka and Richard Hooley, *Ellinger's Modern Banking Law*, 4th (Oxford University Press, 2009) 95.

24. Peter Trueli and Larry Gurwin, *BCCI: The Inside Story of The World's Most Corrupt Financial Empire* (Bloomsbury, 1992); James Adams and Douglas Frantz, *A Full Service Bank: How BCCI Stole Billions Around the World* (Simon and Shuster, 1992); Mark Potts, Nicholas Kochan and Robert Wittington, *Dirty Money: BCCI, The Inside Story of the World's Sleaziest Bank* (National Press Books, 1992).
25. Alldridge questions the harm money laundering poses to banks. He refutes the claim that BCCI failed because it laundered money, urging it closed because it became insolvent due to thefts: Peter Alldridge, *Money Laundering Law: Forfeiture, Confiscation, Civil Recovery, Criminal Laundering and Taxation of the Proceeds of Crime* (Hart Publishing, 2003) 35–39; Nikos Passas, 'The Genesis of the BCCI Scandal' (1996) 23 Journal of Law and Society 57.
26. For instance, the infamous Barings Bank failure resulted from the actions of a single trader, Nick Leeson, and the failure of his institution to adequately monitor his extraordinary revenue trajectory: Nick Leeson and Edward Whitley, *Rogue Trader: How I Brought Down Barings Bank and Shook the Financial World* (Little Brown and Company, 1996).
27. Convention Against Illicit Traffic in Narcotics and Psychotropic Substances (adopted 20 December 1988, entered into force 11 November 1990); Convention Against Transnational Organized Crime (adopted 15 November 2000, entered into force 29 December 2003 (*Palermo Convention*); Convention Against Corruption (adopted 31 October 2003, entered into force 14 December 2005 (*Corruption Convention)*; Convention for the Suppression of Terrorist Financing (adopted 15 December 1997, entered into force 23 June April 2001).
28. Established by the G-7 group of nations in 1988, the Financial Action Task Force (*FATF*) periodically releases recommendations on preventing the use of the banking system and financial institutions to money laundering. These recommendations, principally drawn from the content of the related international conventions, are generally acknowledged as the governing global standards of money laundering regulation: <www.fatf-gafi.org> accessed 23 March 2016.
29. It achieved this status partly through two unique strategies. The first consists of a mutual evaluation process, the periodic review of state laws for their compliance with its recommendations. The second is the invocation of a Non-Compliance Countries or Territories mechanism, a public shaming device used to coerce, or encourage, conformity with its standards: Guy Stessens, 'The FATF 'Black List' of Non-Cooperative Countries or Territories' (2001) Leiden Journal of International Law 12.

30. Palermo Convention, (n 27) article 6.
31. Ibid.
32. For a terse summary of the importance of criminalization, see Nicholas Ryder, *Money Laundering – An Endless Cycle: A Comparative Analysis of the Anti-Money Laundering Politics in the United States of America, the United Kingdom, Australia and Canada* (Routledge, 2012) 25–29.
33. FATF, (no 28) recommendations 4 and 38.
34. Palermo Convention, (no 27) art 12, s 7.
35. Some criminal regimes permit confiscation in the absence of a conviction in certain exceptional circumstances. The Canadian model, for instance, permits confiscation in the absence of a conviction if an offender has absconded or died pre-trial: Criminal Code 1985, c C 46 ss 462.38.
36. Financial Action Task Force, Best Practices on Confiscation (recommendations 4 and 38) and a Framework for On-going Work on Asset Recovery (FATF, October 2012) recommendations 22 and 23.
37. Financial Action Task Force, International Standards on Combatting Money Laundering and the Financing of Terrorism and Proliferation: the FATF Recommendations (*FATF*), February 2013, recommendation 3.
38. Proceeds of Crime Act 2002 (UK) c 29, Part 5 (civil recovery); Criminal Forfeiture of Property Act (Manitoba), CCSM c C306; Proceeds of Crime Act 1995 (Ireland) Number 30.
39. Reliance on non-conviction-based models raises serious constitutional, or human rights, concerns: Colin King, 'Using Civil Processes in Pursuit of Criminal Law Objectives: A Case-Study of Non-Conviction-Based Asset Forfeiture,' (2012) 16 International Journal of Evidence and Proof 337; Colin King, 'Civil Forfeiture and Article 6 of the ECHR: Due Process Implications For England and Wales and Ireland' (2014) 34 Legal Studies 371; Alexandra Rogin, 'Civil Asset Forfeiture and the Breakdown of Constitutional Rights' (2014) Drexel Law Review 45; Nkechi Taifa, 'Civil Forfeiture vs Civil Liberties' (1994) 39 New York School Law Review 95.
40. See generally, Ingo Walter, *Secret Money: The World of International Financial Secrecy* (George Allen and Unwin Publishers, 1985).
41. Shell banks are banks with no physical presence within a country in which it is incorporated or licensed, and which is not affiliated with a regular or financial supervisor: FATF, (no 37) 121.

42. Hans Bauer and Warren Blackman, *Swiss Banking* (Macmillan Press, 1988) 214–215; Sebastien Guex, 'The Origins of Swiss Banking Secrecy Law and its Repercussions for Swiss Federal Policy' (2000) 74 Business History Review 237, 234–244.
43. *Tournier v National Provincial and Union Bank of England* [1924] 1 KB 461: E Ellinger, Eva Lomnicka and Robert Hooley, *Ellinger's Modern Banking Law* (Oxford University Press, 2006) 165–175.
44. Robert Nuzum, 'The Bank Secrecy Act, the Fourth Amendment and Standing' (1976) 36 Louisiana Law Review 834, 834–85; John Villa, 'A Critical View of Bank Secrecy Act Enforcement and Money Laundering Statutes' (1988) 37 Catholic University Law Review 489, 491–92.
45. Palermo Convention, (no 27), article 12 (6) and article 18 (8); FATF (no 37), recommendation 9.
46. FATF, (no 37) recommendation 20. Suspicious transaction reporting applies to a litany of regulated entities who might be used as conduits for money laundering: FATF, recommendation 23. These provisions also protect against any civil or criminal liability arising from a disclosure.
47. Ibid. recommendations 10 and 22.
48. Ibid.
49. Ibid. recommendations 11 and 22.
50. Ibid. recommendation 18.
51. Ibid. recommendations 13 and 26.
52. Ibid. recommendations 25 and 26.
53. Ibid. recommendation 10.
54. UNSC Res 1267 (15 October 1999) UN Doc S/RES/1267; UNSC Res 1333 (19 December 2000) UN Doc S/RES/1333; UNSC 1373 (28 September 2001) UN Doc S/RES/1373; UNSC Res 1377 (12 November 2001) S/RES/1377; UNSC Res 1390 (28 January 2002) UN Doc S/RES/1390; UNSC Res 1438 (14 October 2002) S/RES/1438; UNSC Res 1440 (24 October 2002) UN Doc S/RES/1440; UNSC 1452 (20 December 2002) UN Doc S/RES/1452; UNSC 1455 (17 January 2003) UN Doc S/RES/1455; UNSC 1456 (20 January 2003) UN Doc S/RES/1456; UNSC Res 1526 (30 January 2004) UN Doc S/RES/1526; UNSC 1535 (26 March 2004) UN Doc S/RES/1535; UNSC 1566 (8 October 2004) UN Doc S/RES/1566; UNSC Res 1617 (29 July 2005) UN Doc S/RES/1617; UNSC Res 1730 (19 December 2006) UN Doc S/RES/1730; UNSC Res 1735 (22 December 2006) UN Doc S/RES/1735; UNSC Res 1787 (10 December 2007) UN Doc S/RES/1787; UNSC Res 1805 (20 March 2008) UN Doc S/RES/1805;

UNSC 1822 (30 June 2008) UN Doc S/RES/1822; UNSC Res 1904 (17 December 2009) UN Doc S/RES/1904.

55. The most curious is UNSC 1373 (28 September 2001) UN Doc S/RES/1373. Commanding specific laws against terrorist finance, this intervention has been described as tantamount to the United Nations Security Council acting as an international legislator: B Simma, ed. *The Charter of the United Nations: A Commentary* (Oxford University Press, Oxford, 2002) 741; G Guillaume, 'Terrorism and International Law' (2004) *International & Comparative Law Quarterly* 537.
56. Prior to 2001, the FATF has released 40 recommendations on money laundering regulation. In October 2001, the FATF released 9 additional recommendations specific to terrorist finance. The initial 40 and the 9 additional recommendations were collapsed and consolidated into a single set of 40 recommendations.
57. Ibrahim Warde, *The Price of Fear: The Truth Behind the Financial War on Terror* (University of California Press, 2007) 35–49.
58. FATF (no 37) recommendation 5. These amplify concerns about terror though they are arguably captured by more generic money laundering provisions.
59. The 'listing' process has proven problematic: Michelle M Gallant, 'Funds, Rights and Terror: Her Majesty's Treasury v Mohammed Jabar Ahmed and Others' (2010) 21 King's Law Journal 569.
60. FATF (no 37) recommendation 8.
61. Financial Action Task Force, FATF Report: Risk of Terrorist Abuse of Not-For-Profit Organizations, 14 June 2014.
62. Organization for Economic Cooperation and Development, Report on Abuse of Charities for Money-Laundering and Tax Evasion, <www.oecd.org/ctp/exchange-of-tax-information/42232037.pdf> accessed 23 March 2016.
63. Nikos Passas, Informal Value Transfer Systems, Terrorism and Money Laundering: A Report to the National Justice Institute, November 2003, <www.ncjrs.gov/pdffiles1/nij/grants/208301.pdf> accessed 23 March 2016.
64. FATF (no 37) recommendation 14.
65. Ibid. 119.
66. Ibid. recommendation 12.
67. Ibid.
68. Ibid.

69. For instance, in Canadian law, confiscation upon conviction is a matter for federal law whereas civil forfeiture falls under provincial law. Some regulated entities, lawyers for instance, are subject to provincial regulation rather than a national scheme. A national center of expertise facilitates the sharing of information and the coordination of the anti-money laundering strategy at the international level.
70. R. Thomas Naylor, *Wage of Crime: Black Markets, Illegal Finance and the Underworld Economy* (Cornell University Press, 2005).
71. Unger shows that there is no evidence of decline: Brigitte Unger, 'Can Money Laundering Decrease?' (2013) 41 Public Finance Review 658, 673.
72. A notable evasion tactic is known as 'smurfing', organizing financial activity so as not to attract reporting requirements: Courtney Linn, 'Redefining the Bank Secrecy Act: Currency Reporting and the Crime of Structuring' (2010) 50 Santa Clara Law Review 407.
73. United States Senate, Permanent Committee on Investigations, Tax Haven Banks and US Tax Compliance, Staff Report, 17 July 2008.
74. The Swiss banker in question, Bradley Birkenfeld, served a short sentence for his involvement in the tax evasion and, upon his release, received a US$104 million reward under US incentivized whistle-blower law: 'Whistle-Blower Awarded $104 Million by the IRS,' *The New York Times*, 11 September 2012 <www.nytimes.com/2012/09/12/business/whistle-blower-awarded-104-million-by-irs.html?_r=0> accessed 23 March 2016.
75. The criminal charges resulted in deferred prosecution arrangements wherein the bank agreed to pay almost US$800 million in fines and penalties: United States Department of Justice, 'UBS Enters into a Deferred Prosecution Arrangement' 18 February 2009, <www.justice.gov/opa/pr/ubs-enters-deferred-prosecution-agreement> accessed 23 March 2016.
76. United States Senate (n 72) 8–15.
77. Laura Szarmach, 'Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS Case' (2010) 43 Cornell International Law Journal 409.
78. Indira Carr and Robert Jago, 'Corruption, Money Laundering, Secrecy and the Societal Responsibility of Banks' 17 June 2014: <papers.ssrn.com/sol3/papers.cfm?abstract_id=2454934> accessed 21 March 2016.

Part 3

Market Manipulation

6

Market Abuse and the Risk to the Financial Markets

Andrew Baker

6.1 Introduction

Information is key in a wide variety of circumstances. Those that possess information are placed at a significant advantage over those that do not possess the same information (Baker 2011). This has been a particular point of debate with respect to the market for securities and now in a wider financial services context following the LIBOR (London Inter-Bank Offered Rate) and FOREX (Foreign Exchange) scandals. In the securities market information is one, if not the, most valuable commodity that a trader can possess and use. The interpretation of information can allow traders to make significant profits or avoid significant losses depending on the nature of the information, and the speed with which information can be obtained amplifies the outcome from the information. This is why some market participants are willing to use what is termed "inside information", that is information of a privileged nature that is not available to all participants, and therefore, such information places advantage on those in whose possession the information resides. The fact that this

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N. Ryder (ed.), *White Collar Crime and Risk*,
https://doi.org/10.1057/978-1-137-47384-4_6

information is not publicly available makes it privileged and prohibited from use; this is insider dealing and is a form of market abuse.

While insider dealing is a form of market abuse, market abuse is significantly wider term and covers a broader range of activities. A useful descriptor of market abuse can be gleaned from the UK's provisions dealing with such activity, namely Part VIII of the Financial Services and Markets Act 2000 (FSMA 2000), where in addition to insider dealing the legislation advances five other prohibited activities in relation to misuse of information, manipulation and distortion.

6.2 History and Background

Market abuse is an umbrella term that can be used to describe a range of activity and behaviour associated with market conduct, or maybe more accurately conduct on a market or in respect of securities traded on a market. The primary activity associated with market abuse has been insider dealing; however, improper market conduct goes much further than merely trading securities using non-public privileged information. The traditional approach has been to deal with such activity under the criminal law, through specific offences of insider dealing, misleading statements or fraud generally.

The UK's regime against insider dealing and market abuse is a relatively recent addition to measures dealing with financial aspects of criminal behaviour. The first real measure criminalising insider dealing was contained in the Companies Act 1980 later into the Company Securities (Insider Dealing) Act 1985. The evolution of the UK's approach to this offence came in the shape of Part V of the Criminal Justice Act 1993. In addition to the specific offence of insider dealing, misconduct by market participants was also dealt with via Section 47 of the Financial Services Act 1986 (FSA 1986), which made it an offence to make misleading statements, alongside the broader deception offences contained in the Theft Acts.

The real momentous change came with the enactment of the FSMA 2000 (Alcock 2007) when in addition to the criminal offences already on the statute book a civil remedy for market abuse was introduced. The civil offence covered a broader range of activities than the existing regime, mov-

ing beyond the mere use of information into market manipulation and distortion and to a wider range of actors, not just individuals, but corporate entities as well, and without the requirement of intent to commit the offence.

6.3 The Management of Risk

Regulation is undoubtedly a process of managing risk and the contemporary approach to regulation is to operate a risk-based approach. Baldwin et al. (2012: 281) note that this demands that "the regulator should clearly identify its objectives and the risks that the regulated organizations may present to the achieving of those objectives", and has become a "significant organising principle of government and a distinct unit of governance" (Black in Baldwin et al. 2010: 302). Risk-based approaches to regulation reflect the need to prioritise regulatory activity, that any authority tasked with control will have finite resources to meet the objectives set and therefore needs to target those resources in a way most likely to achieve set objectives. A second clear advantage to risk-based regulation is noted by Simonova (2015) who notes that risk-based regulation refers to "flexible regulation" (Ibid.) allowing rules to be tailored to fit the particular risk profile presented by a particular industry. It is clear to see the attraction of risk-based approaches in complex areas requiring regulators with finite resources with which to regulate.

The original FSMA 2000 created specific statutory objectives to be considered by the regulator, the FSA, a key objective being to reduce financial crime (Section 6 FSMA 2000). This objective and indeed all the objectives are at the core of managing risk and the risk of financial crime undermining positive economic activity received high priority in the formulation of the financial services regulation following the New Labour Election victory in May 1997. Section 6 of the FSMA clearly articulated the financial crime risk profile being targeted, focusing the regulatory authority on the three classes of financial crime that pose the greatest danger to the financial wellbeing of the UK, namely fraud or dishonesty (Section 6(3)(a)), misconduct in, or misuse of information relating to, a financial market (Section 6(3)(b)), or handling the proceeds of crime (Section 6(3)(c)). The second of the triumvirate has arguably proven to

be the most novel of the measures dealt with by the FSMA 2000, and identifies the risk evident in unclean financial markets.

The global financial crisis that emerged during 2007/8 has profoundly impacted the nature of regulation and has seen wholesale reform of the regulatory structure. The focus on principles-based regulation has made way for greater focus on outcomes of regulatory activity; however, the application of a risk-based approach remains central. Finite resources dictate that regulatory authorities cannot have eyes everywhere and so are forced into focusing those resources where risk is greatest. The previous statutory objectives provided for in the FSMA 2000 have made way for more focused objectives relevant to the regulatory roles of the new regulators, the Prudential Regulation Authority and the Financial Conduct Authority (FCA).

With regard to the old financial crime objective and in particular the control of market abuse the FCA is now the lead authority with the FSA's responsibility in this area transferring on the 1 April 2013. The FCA operates under a strategic objective of ensuring that the relevant markets function well, and is supported by operational objectives of ensuring consumer protection, market integrity, and competition, with a continuity objective added later.

The elements of the section are now operationalised within the integrity objective that states that the aim of the objective is protecting and enhancing the integrity of the UK financial system and includes that system not being used for a purpose connected with financial crime and not being affected by behaviour that amounts to market abuse. It is clear that that these elements pose significant risk to the orderly operation and integrity of the UK financial markets and thus require significant resources.

The FCA "expects the financial sector to manage risk" (FCA 2013), but that it is a key function that it manages risks as well, stating that they "will detect and act on risks" (Ibid.) and "identify potential problems early" (Ibid.) in order to meet their statutory objectives. With respect to this was the objective of the previous regime under the FSA, and the difference is that the FCA will intervene at an earlier stage and will generally be more intrusive now that the era of light touch regulation is over (Turner 2009). This move highlights the failure of regulators to apply regulations in the period preceding the global financial crisis.

The risks inherent in market abuse are clearly shown in the case of Fleurose v The Securities and Futures Authority [2001] EWCA Civ 2015.

To avoid payment under an options contract, traders at JP Morgan had engaged in large-scale selling of securities to move the market in a downward direction by 38 points in the last 6 seconds of trading. This was in breach of the London Stock Exchange rules, which prohibit a member firm from engaging in conduct, the sole intention of which is to move the value of the index in question, and is a clear example of market abuse.

By setting standards, the market abuse regime as contained in the FSMA 2000 and administered by the relevant authority is tasked with ensuring that such risk is reduced and that the markets are free from abusive practices, open and available to all users. The very real risk is that unclean markets will discourage investors into the market with significant impact on economic activity generally, and by setting the offence in broad terms it allows the regulatory authority to ensure that behaviour is that expected from market participants, leading to clean and efficient markets (Alexander 2013).

6.4 The Philosophical Difficulties

One of the key issues in relation to the wider subject of market abuse in particular has been the debate as to whether there should be an offence of insider trading in the first place. It is not universally recognised that the trading of securities on the basis of non-public privileged information should be prohibited, and to some it should be encouraged as a way of improving the information flow, and of remunerating insiders (Bainbridge 2008).

While the arguments against the prohibition have not found favour among law makers, there is a strong persuasive strand to the proposition. The seminal work on this was Professor Henry Manne's 1966 book *Insider Trading on the Stock Market* (Manne 1966). The argument is posited on a number of strands. A key element of his argument is that insider trading is a victimless crime (Manne 1985), that where insider dealing occurs there is no impact on the firm, the shareholders or wider groups; however, this is rebutted by others (Kripke 1985), and termed by others as an "abominable fraud" and "cheating" (Rider 2010). His other primary argument states that the price of a security will move in the same direction whether or not there is insider trading as the information has the character to move the security price up or down irrespective of the date

of information disclosure. In fact it is argued that insiders trading on inside information will in effect improve the flow of information to the market allowing other market participants to make more informed decisions in respect of a company's securities therefore "stimulating efficiency" (McGhee 1988). This undermines a major argument in favour of the prohibition that insider dealing creates information asymmetries with insiders at a distinct advantage over outsiders, further undermining argument that insider dealing is a risk to the financial system, the securities markets and those that use them. If it actually provides better information flow to markets, how can it add to the risk profile?

To illustrate his point Manne refers to the landmark US insider dealing case of SEC v Texas Gulf Sulphur where the shares in TGS were trading at around the US$18 per share, rising to US$31 per share following disclosure and jumping to US$58 per share thereafter. This would suggest, and as Manne's argument posits, that securities traded on the basis of inside information will move in the same direction as it would if the information were public, and that it would move in a more steady pattern instead of spikes associated with securities prices following information disclosure; thus, insider dealing actually improves information flow to the market (Bainbridge 2008).

While the arguments against the absolute prohibition are strong in certain respects and refuse to go away, it is clear that the arguments in favour of prohibition are stronger and have prevailed. From a shaky start the prohibition of insider dealing has developed through a proactive securities regulator and a general willingness of the US courts. From initial doubts as to whether the Securities and Exchange Act 1934 prohibited insider dealing, the US courts through a series of cases from SEC v Capital Gains Research Bureau, Re Cady Roberts, through Texas Gulf Sulphur and on to Chiarella and Carpenter, and subsequently Dirks and O'Hagan supported by the Securities and Exchange Commission ensured that the prohibition is clearly articulated to market participants in the United States (Sifuna 2012).

The fierce debate in this area suggests that, at least in cases of insider dealing, the risks to the financial sector are exaggerated and that allowing the use of information by insiders in advance of disclosure will provide an efficient method of disseminating such information to market participants. This, however, fails to get round the argument that trading on

restricted information is at its base unfair and is morally unacceptable (McVea 1995), that some market participants will be using information as a result of privileged positions with regard to the securities in question, such as in Texas Gulf Sulphur. A better approach could be to alter disclosure rules to encourage quicker release of price-sensitive information.

A further issue is that Manne's position can only really apply to pure insiders, those that are able to access or acquire the information directly through their position within the issuer of the security. Manne's position is arguably correct in respect of the entrepreneurs who generate the price-sensitive information themselves; however, the argument seems to weaken further away from the information originator when the trading takes place, and is weakened further when the entrepreneur passes that information to outsiders. The argument is eroded completely when that information is misappropriated in some way rather than acquired in the usual pursuit of their association with the security issuer.

6.5 The Criminal Provisions

After decades of piecemeal provisions to deal with insider dealing (see Davies 2015a), the legislation dealing with the offence in the UK is now contained in Part V of the Criminal Justice Act 1993, which gave effect to EU Directive 89/592. In essence the legislation creates three offences of insider dealing, punishable with a maximum sentence of seven years on indictment, namely an "insider" who deals in price-affected securities, encouraging another to deal in price-affected securities and an offence to disclose inside information to another otherwise than in the performance of their employment. The offence is relatively narrow in that the prohibition only applies to "insiders" who are in possession of "inside information" with the important point that the "inside information" has not yet been made public, and that they know that the information is inside information and that the information is from an inside source. It is arguable that keeping the required components of the offence within narrow confines showed a concern regarding the potential scope of the offence and a potential worry that an over-officious offence would negatively affect trading on the market. Alternatively the narrowness of the offence could indicate a worry that insider dealing was "rampant"

(Alexander 2013) and a comprehensive offence would catch a lot of market participants.

The key elements in respect of market abuse and inside information are the information itself, its possession and use. In Spector Photo Group NV v Commissie voor het Bank C-45/08 [2010] 2 CMLR 30, 822, CJEU the European Court of Justice gave judgement that a person in possession of inside information and deals in financial instruments creates a presumption that they use that information to commit the offence, subject to the ability to rebut the presumption (Ashe 2010). As noted above, information needs to be "inside information", meaning that the information has particular characteristics that bring it within the offence. The information needs to be in relation to particular securities or to a particular issuer or issuers of securities, excluding a more general approach. In addition, the information has to be specific or precise and has not been made public and if it were made public the nature of the information would have a significant effect on the price of the relevant securities. This is reinforced by the requirement that the information is "price sensitive information and the securities are 'price affected securities'".

Both the issues of specific and precise and made public are interesting. In respect of the former the use of "or" suggests an either/or position to be adopted and as such provides the prosecutor with a wider application where the inside information is not sufficiently specific, but is precise enough to form the offence. Lomnicka (1994) notes that this would allow an offence to succeed on the basis that information indicates that profits will exceed expectation and yet lacks the specificity of by how much, to focus on the latter would have placed too high a burden on the offence.

The offence is not committed where the information has been made public. The specifics are set out in Section 58 CJA 1993 in some detail and as such provide guidance on this issue. Timing is key in the context and it is not hard to understand why the offence has suffered some problems in terms of success when an assessment of this issue is made. To be made public, information does not have to be announced in a statement, and a better way is to see the information as being available to the public or in the public domain, which suggests that the information could be buried in a report, even an obscure report on a website of a company, and

picked up by a single investor, who on the strength of the reports content deals in the securities of the firm. In this respect the legislation does not penalise quality of research or quality of the researcher, as long as the information is available to everyone by some form of research then the offence will not be committed.

6.6 The Civil Regime and Market Abuse as a Wider Concept

It is clear from the preceding discussion that the criminal offences contained in the CJA 1993 are quite narrow and this resulted in few successful prosecutions (See Davies 2015a). Davies (2008) notes that the large-scale use of the criminal provisions "proved impossible" (Ibid.), with the criminal standard of proof required to prove the elements of the offence overly burdensome for prosecutors.

The answer lay in a new and innovative approach to the issue of the misuse of information and more generally in the actions and behaviour of market participants, although Davies (2015b) notes that civil actions were mooted prior to the enactment of the CJA 1993 and were an option open to US authorities for some time (Rider 2010). The action to "fill the regulatory gap" (Filby 2004) left by an unsuccessful criminal prosecution regime was the introduction of a wholly civil regime based on administrative sanctions rather than criminal ones, with a sanction of an unlimited fine for a breach of the provisions (Haynes 2007), designed to run in parallel and complement the existing criminal regime (Sykes 1999). The regime was contained in the FSMA 2000, Part VIII, and to be administered by the FSA. The new "regime" and the focus on the language of market abuse create a wider ambit of activity to be covered than the narrow offence of insider dealing, notwithstanding that the first element of the market abuse regime is insider dealing. What is clear is that the market abuse regime was created to provide the relevant authority a high degree of flexibility in respect of dealing with the risks that improper use of information and now improper actions of market participants could have on the market and wider economy. To achieve this, the FSMA 2000 gave significant rule-making powers to the FSA and more

significantly reduced the standard of proof to the civil standard for actions brought under Part VIII. It is therefore not surprising that the regime has attracted much attention described as "novel" (Linklater 2001), "controversial" (Alcock 2002) and a "new witchcraft" (Alcock 2001), at least in respect to the civil standard approach; maybe a more accurate description in respect of the use of powers in this area is a new alchemy in respect of market behaviour, although the idea of civil measures has been around for some time (Davies 2015a).

The provisions of the Act set the "outer limits" (Alcock 2002) of the regime; however, to support the primary provisions and the standard-setting rationale of the regime, the FSMA 2000 requires the relevant authority to create and maintain a Code of Market Conduct (MAR), a detailed list of rules and guidance that sets out the specifics of the regime, allowing market participants to clearly understand the aims and expected outcomes of the market abuse regime. The code is not exhaustive but does lay out a wide range of guidance in its attempt to set the required standard. MAR is arguably the embodiment of the risk-based approach regulation as it provides detailed guidance on what is expected of market participants, placing the burden on those individuals and firms to act in an appropriate manner.

The market abuse regime is much more focused on managing the risk profile of market abuse as compared to that of insider dealing as a criminal measure. The elements of the market abuse regime are essentially focused on dealing with those issues that present a risk to the integrity and proper functioning of the market and for the participants in the market (Hayes 2010). The civil market abuse regime concentrates on setting and managing the behaviour of market participants and the markets on which they participate (FCA 2008), thus allowing the market abuse regime to sit within a civil process, but not without controversy.

The original iteration of the market abuse regime focused on three categories of abuse (Burger & Davies 2005), namely misuse of information (S.118(2)(a)), creating false and misleading impressions (S.118(2)(b)) and distorting the market (S.118(c)(c)). It would seem clear that these three issues represent the most significant risk profile in respect of behaviour that could impact securities and securities markets. Indeed the FSA's successor the FCA specifically notes that they "work to reduce the risks posed by the spreading of false information that misleads the market" in addition to those posed by insider dealing (FCA 2013). The behaviour to

which the provisions apply needs to occur in relation to qualifying investments admitted to trading or requested for admission to trade on a prescribed market, with a very wide interpretation to this provision given by the Financial Services and Markets Tribunal in Jabre v FSA [2006] FSMT 035, where trades made on the Tokyo Stock Exchange were still held to amount to market abuse, focusing on the behaviour of Jabre (Alexander 2013), again proving the standard-setting nature of the legislation.

To support the application of the provisions, the market abuse regime introduced the regular user approach to assessing whether the behaviour amounted to market abuse so that the behaviour in question had to fall below the standards expected of a "regular user of that market who is aware of the behaviour as a failure on the part of the person or persons concerned observe the standard behaviour reasonably expected of a person in his or their position in relation to the market" (S.118 (1)(c)) (Swan 2004). The regular user test set a hypothetical and objective test based on the hypothetical market participant, a sophisticated version man on the Clapham Omnibus, against which the relevant authority and market participants can judge behaviour.

It is worth noting at this point that the language of the market abuse regime attempts to deliberately avoid connotations with criminal activity. The word behaviour is used to describe activity in contrast to the word "offence"; however, it is arguable that this is merely a matter of semantics as ultimately in at least one case the behaviour that is under scrutiny is insider dealing, which exists on both sides of the criminal/civil market abuse divide.

In 2005 the three original behaviours became seven (Conceicao 2006) by virtue of entering into force on 1 July 2005 of the Market Abuse Directive (MAD) given effect by the FSMA 2000 (Market Abuse) Regulations 2005 (SI2005/381). The broad elements of the original three forms of behaviour, misuse of information, false and misleading impressions and market distortion, are still identifiable; however, MAD outlines some specific issues in its recitals.

Under the banner of misuse of information the first of the behaviours caught by the regime is insider dealing and improper disclosure. The former catches an "insider" who deals, or attempts to deal, on the basis of inside information (Section 118(2)) with the latter catching the insider who discloses information to another person without some form of

permission (Section 118(3)). These provisions closely mirror the criminal provisions contained in the CJA 1993, but are broader in their overall remit.

The third behaviour (Section 118(4)) that was covered by the market abuse regime was relevant information not generally available (RINGA). This was an interesting provision as it is not one provided for by MAD and was one of the provisions retained by UK authorities when MAD was implemented. The provision goes further than the Directive requires and potentially catches a wider range of activity, referring to relevant information not generally available; this suggests that unlike the first two provisions the information need not be precise or have a significant effect on the price of a security, and it only needs to be relevant to the investor to form the offence; however, this is subject to the proviso that it is only usable where the MAD equivalents do not apply and is subject to the regular user test. This provision is termed super-equivalent and has been subject to a sunset clause originally to end on 30 June 2008 but has been extended on a number of occasions (see Sheikh 2008); however, the provision was repealed by statutory instrument effective on 31 December 2014.

It is arguable that the repeal of the provision weakens the available tools in respect of the misuse of information and increases the risk of abusive practices from slipping through the net. At the time the FSA noted that the retention of the RINGA provision gave the UK a flexible approach and "enabled action to be taken in relation to behaviour based on information which would be taken into account by investors but is not sufficiently precise to be inside information" (FSA 2004), and that this flexibility is now lost.

In common with the criminal provision under CJA 1993 the definition of inside information is key, needing to be information that is of a precise nature not generally available, relates to one or more issuers of qualifying investments or investments, and would, if generally available, be likely to have a significant effect on the price of those qualifying investments (S.118C FSMA 2000). The regulators' approach to this element was unsuccessfully challenged in Massey v Financial Services Authority [2011] UKUT 49 TCC, where Massey questioned whether the behaviour he was accused of had a significant effect on the price of a qualifying investment, and even though the Tribunal struggled with the interpretation of the stat-

ute in places, particularly in relation to the issue of precision, it still found that the information was "of a kind which a reasonable investor would be likely to use as part of the basis of his investment decisions" (Para 41), and therefore, Massey dealt on the basis of inside information (Para 42). It would seem clear from the Tribunal's decision that the legislation, while not perfect, is being applied in a manner that broadly supports the standard-setting and integrity maintenance aims of the promoter's intentions, although the decision in Massey is not universally popular (Davies 2015b).

The next behaviour classification caught by the regime moves away from the misuse of information elements and focuses on manipulating behaviour so as to give a false and misleading impression. The first deals with manipulating transactions (Section 118(5)) that give a false or misleading impression as to supply or demand of investments and the second deals with the use of manipulating devices (Section 118(6)) such as the employment of fictitious devices designed to deceive, for example giving false and misleading information following the purchase of shares with a view to increasing the value of those shares, thus giving a false impression to other investors regarding the true value of the shares.

The next behaviour caught by the regime is improper dissemination where false or misleading impressions (Section 118(7)) are presented regarding a security or issuer of security in the full knowledge that the information is false.

The final behaviour is the second of the super-equivalent measures retained from the Pre MAD market abuse regime making a breach to give false and misleading impressions of either the supply or demand of securities or behaviour that distorts the market in securities (Section 118(8)). This measure is subject to a sunset clause, which was to trigger on 30 June 2008 but has been extended on a number of occasions; it will now cease to operate when the Market Abuse Regulation enters into force on 6 July 2016. Like the now repealed super-equivalent provision in relation to RINGA, this measure utilises the regular user test to assess whether market abuse has been committed.

An interesting element of the civil market abuse regime is that the provision makes the definition of using and possessing inside information a subjective (Horan 2011) exercise and that no intent on the market participant is required unlike the obvious requirement for the criminal offence of

insider trading, suggesting that market abuse could be committed negligently, this being the case to ensure the focus is on the integrity of the markets (Ibid.). A challenge on this issue was dismissed by the Court of Appeal in Winterflood Securities v The Financial Services Authority [2010] EWCA Civ 423, and follows the line of argument posited during the FSMA 2000 transit through Parliament where the Law Society's concerns about the severity of outcomes as a result of no mental element but answered with reassurances that the proposal was not to prosecute persons for accidental breaches of the regime, emphasising that the rationale behind the measure is to set standards and not to make judgement on the "moral culpability of individual players in the market" (JCFSM 1999: Para 265), emphasising that "markets can be affected by the effects of a player's conduct even if this is not the players intention" (ibid.).

It is worth noting as a discussion point here the decision of Massey v Financial Services Authority where the Upper Tribunal struggled with the interpretation of the statute, and where it would seem that there is debate regarding the intention of Massey in committing market abuse.

6.7 The Difficulties of the Civil Regime

Just by calling something civil does not necessarily make it civil in nature, and this difficulty has proved problematic for the market abuse regime from the start, prompting Rider (2010) to call the introduction of the civil regime "half baked" and its implementation a "compromise". The rationale for the regime was to provide a workable alternative to the criminal regime, which was facing significant challenges in proving the elements of the crime to the criminal standard. A move to a civil standard will allow the regulatory authorities much more flexibility in cleaning up securities markets, setting higher standards and avoiding the types of scandals that emerged under predecessor legislation. However, the move to a lower standard of proof is replete with controversy, especially as the first of the civil offences is insider dealing.

The argument revolves around whether the bringing of an action in respect of insider dealing within Part VIII FSMA 2000 is the equivalent of bringing a new criminal charge. If this is the case then the defendants

will be able to avail themselves of the protections afforded under Article 6 of the European Convention on Human Rights (ECHR) as incorporated in the Human Rights Act 1998 (HRA98), which at its heart provides that anyone charged with a criminal offence has the right to a fair trial and due process of law. There is little difficulty with Article 6(1) ECHR which is clearly engaged; however, more difficulty is inherent with Articles 6(2) and 6(3).

This issue has caused considerable uncertainty in the application of the regime and continues to prove the greatest challenge, as it does for sibling legislation in respect of confiscation of criminally obtained assets. The primary challenge to this point came in the case of R (On the application of Fleurose) v Securities and Futures Authority [2001] EWCA Civ 2015, where the Court of Appeal dismissed a claim by Fleurose for judicial review of the decision of the disciplinary appeal tribunal of the forerunner of the FSA in respect of securities markets, the Securities and Futures Authority, holding that the proceedings had not involved the determination of a criminal charge and that proceedings against him were not unfair. The case affirms that the process under Part VIII is civil in nature and that the civil standard of proof is to be applied. A problem, however, emerged from the application of that civil standard in the Financial Services and Markets Tribunal, which seemed to struggle with how to actually apply the standard to specific market abuse cases (Alcock 2007).

In the Tribunal decisions in Davidson and Tatham and particularly in Parker the tribunal seemed to lay down a sliding scale standard of proof, concluding that while there is a single standard of proof, the balance of probabilities, it is flexible in its application so that where the more serious the alleged market abuse is the "stronger must be the evidence before we should find the allegation proven on the balance of probabilities" (Davidson and Tatham) with the Tribunal in Parker noting that "it is difficult to draw a meaningful distinction between the standard we must apply and the criminal standard" (Parker). This confusion in application creates a significant challenge for the regulator in that a simple interpretation of the two cases brings the conclusion that, depending on the severity of the alleged market abuse, the prosecuting authority may need to effectively prove to a criminal standard that the offence has been committed, notwithstanding that the allegation is brought under the Part VIII

provisions. If the civil market abuse regime was intended to act as a gap filler to complement a failing criminal regime, then the tribunal's decisions put significant restrictions on the regime to achieve its goals.

The issue of the standard of proof has now been resolved in the Upper Tribunal decision of Hannam v The Financial Conduct Authority [2014] UKUT 0233 (TCC), which reviewed the authorities on this issue including the House of Lords decisions in Re B [2009] 1 AC 11. In light of these authorities the Upper Tribunal concluded that "the approach which allowed for a 'sliding scale' in the civil standard, by which it varied according to the seriousness of what has to be proved, has been exposed as a heresy" (Para 153). The decision of the Upper Tribunal, citing binding authority, is a significant victory for the prosecuting authority. The decision in Hannam arguably resets the requirements placed on the FCA to a much more manageable limit, thus allowing the authority to implement the regime as intended, and the standard is the civil standard on the balance of probabilities.

6.8 The Market Abuse Regulation and MAD II

That European Union legislators are convinced that market abuse remains a significant risk to markets is evidenced by the upcoming legislative changes, and reflects the evolving nature of securities trading (Baber 2013), and shows a determination of the Commission to get tough on market abuse (European Commission 2011) and by framing the reforms with a Regulation shows a commitment to ensure European-wide harmonisation of anti-abusive practices. This Market Abuse Regulation along with other reforms (MiFID II, MiFIR and EMIR) evidence the concern that market abuse poses risks to the efficient running of the markets across the European Union and to ensure against regulatory arbitrage creeping in. The Market Abuse Regulation will come into force on 6 July 2016 across the member states of the European Union and will widen the scope of the market abuse regime to new trading platforms that had developed since the original directive. It is interesting that the original draft of the regulation contained a proposal that was very similar to the RINGA provisions contained in the pre-MAD UK regime, in which the necessity

of precision was significantly watered down; however, this did not make it through to the final version, ultimately narrowing the scope of the regime, but at the same time providing some greater levels of certainty.

In addition to the regulation the Commission has brought forward a second MAD implementing a range of criminal sanctions alongside the civil regime of the 2005 Directive; however, the UK government has taken the option to opt out of MAD II, more accurately termed Criminal Sanctions MAD, presumably on the basis that the UK already has a mature criminal sanctions regime in respect of market abuse.

6.9 Market Abuse Outside the CJA1993 and Part VIII FSMA 2000

As noted above, market abuse is an umbrella term for activity that covers a broad range of behaviour that is considered to pose risk to the efficient operation and integrity of securities markets. Prior to the enactment of the FSMA 2000 provisions the concept of a wider approach to market abuse existed beyond the scope of the insider dealing provisions within the CJA1993. It was an offence under Section 47 of the Financial Services Act 1986 to make misleading statements or give misleading impressions in order to induce others to deal in investments. This section clearly deals with a more general market abuse than insider dealing and looks much more into the general integrity of investments, and is clearly designed to tackle the same issues as the contemporary market abuse provisions, namely to protect market integrity (Barnett 1996). The section was replicated in the FSMA 2000 Section 397 to run parallel with the civil regime contained in Part VIII with sporadic use following enactment (Callaghan and Ullah 2013), and is now contained in Sections 89–90 of the Financial Services Act 2012.

The LIBOR manipulation scandal arguably placed the market abuse regime in the spotlight, and it is surprising that manipulation of a benchmark interest rate was not included either in the Section 397 offence or within the civil market abuse regime; presumably the prospect of manipulating such a fundamental (Callaghan and Ullah 2013) benchmark was not thought to be a risk factor during the debate and drafting of the

original provisions or following updates, but was dealt with as a breach of principles. The Wheatley Review (Wheatley 2012) into the LIBOR scandal identified a number of failings and presented recommendations to avoid repetition. On the sanctions side of the LIBOR scandal the lacuna presented by the lack of criminal or civil offences available against individuals was corrected by the addition of a criminal offence to manipulate a benchmark contrary to Section 91 of the Financial Services Act 2012, and while this was originally to apply only to the LIBOR benchmark, it has been subsequently expanded to cover a wider range of benchmarks (Anon 2015). This is in addition to the use of the common law conspiracy to defraud offence, which has been the only avenue of sanction against individuals in respect of LIBOR manipulation (Telegraph 2015).

6.10 Getting Tough

The global financial crisis has resulted in a refocus (Anon 2011) of the regulatory approach to financial services and financial markets. Adair Turner as Chairman of the FSA noted an "end to light touch regulation" (Turner 2009), and while the cross-hairs of this statement were aimed at the regulation of banks, the scope of the new regulatory engagement extended to the wider financial services sector. During the period since the enactment of the FSMA 2000 the focus had been on using the civil regime to clean up the markets, using the range of enforcement mechanisms to deal with abusive practices. Following the emergence of the banking crisis the FSA turned to its criminal prosecutorial powers increasingly to meet its financial crime objective and this has been continued by the FCA in meeting its integrity objective. In R v McQuoid [2009] EWCA Crim 1301 the FSA secured its first conviction under the CJA 1993 and since then the FSA and FCA between them have secured a further 26 convictions, the latest on 15 March 2016, with a number of further prosecutions yet to be tried (FCA 2016). Arguably the switch back to the criminal process is based on three primary assertions, firstly the whole regulatory process for financial services was stung by the breadth of the global financial crisis, and the public clamour to reign in the excesses of the financial services sector, in particular criticisms of the

FSA's approach (Haines 2008; Bosworth-Davies 2013). Secondly, the emergence of technology in the securities trading industry exploded in the latter part of the 1990s and into the twenty-first century. The use of electronic means of exchange and algorithmic trading has arguably made the task of the enforcement authority easier to track trades and then follow them back into the hands of the trader. The explosion in trading technology has made it harder for insiders to remain inside. Finally, it is arguable that the application of the sliding scale of proof resulting from decision in the Financial Services and Markets Tribunal forced the FSA and now FCA into using the criminal process on the basis that if they are going to have to prove guilt to a criminal standard they may as well try and get the criminal sanction as well. The rejection of the sliding scale in Hannam may now see the options open to the regulator widen in the future.

6.11 Conclusion

The subject of market abuse has generated much debate since the FSMA 2000 came into force. The creation of a civil regime to complement the existing criminal regime has added several layers of flexibility to the armoury of regulators in dealing with the risks posed by market abuse. The real issue is how that flexibility is applied in practice. The headline offence remains insider dealing supported by the other market abuse offences within Part VIII FSMA 2000 and the other offences both within the FSMA 2000 and within other Acts, such as The Financial Services Act 2012, The Fraud Act 2006 and the Proceeds of Crime Act 2002. With respect to insider dealing the application of the offence has seen changing priorities affect the way in which the offence is prosecuted from a wholly criminal processes until the FSMA 2000 came fully into force, followed by an almost wholly civil regime between 2000 and 2009, where, partly stung by the global financial crisis, the criminal process has again found favour. Hopefully following decisions in the Upper Tribunal and Court of Appeal, the regulatory authorities will embrace both processes in the future to ensure a flexible approach to the risks posed by market abuse so that they are eliminated to the fullest possible extent.

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7

Competition Law and LIBOR in Three Jurisdictions: The United States of America, the United Kingdom and the European Union

Richard Ball

The London Interbank Offered Rate, better known as LIBOR, has ridden turbulent times over the last decade. Major banks, either through the collusion of individual traders operating on a discrete basis or on the instructions from more senior personnel, but always trading across national borders and on a global level, fixed the rate for at least four years.[1] This resultant rigged market worked to limit competition and led to massive profits for the banks and individual traders. Furthermore, it enabled banks to be insulated from the shocks of the market during the financial crisis of 2007–2008 and the consequences of that crisis.

The USA and UK are currently the largest and most important financial markets in the world, markets where most of the LIBOR manipulation took place, with the EU setting competition law standards for the European region. Therefore, this chapter will investigate this market manipulation through the lens of competition law, and specifically price fixing, from the perspective of the three jurisdictions of the USA, the EU, and the UK. Part 1 will describe the LIBOR system and the manipulation that took place before Part 2 details the competition law requirements for each jurisdiction

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N. Ryder (ed.), *White Collar Crime and Risk*,
https://doi.org/10.1057/978-1-137-47384-4_7

for enforcements at the public level, both civil and criminal, and at the private level. Part 3 will document the competition actions in the three jurisdictions that have taken place so far. Finally in Part 4, the effectiveness of these actions will be examined, identifying problems and solutions for competition regulation of banking practices and questioning the current philosophical basis for competition regulation in general.

7.1 LIBOR and Manipulation

The London Interbank Offered Rate (LIBOR) was established in 1986 when the British Bankers' Association (BBA), the UK's trade association of banks, recognised that banks were trading with each other in many new financial instruments without any reference rate against which these trades could be assessed. It was considered that in a market of floating interest rates, the underlying principle of which was to allow the market to determine the borrowing costs,[2] a benchmark rate would allow banks to trade with one another with relative market certainty thereby ensuring the stability of the global interbank trading system. LIBOR is the benchmark interest rate as determined in London, which over time became the average market rate, against which the largest and ostensibly safest banks in the world can borrow from, or lend to, each other on the global market. This London interbank market has enabled banks in need of cash to obtain US Dollar deposits (known as Eurodollar deposits) either overnight or for fixed terms from banks with excess cash. Consequently LIBOR, over time, came to be utilised by major banks as a tool to enable large corporate loans to be referenced to a collective interest rate objectively accepted by multiple banks and parties in such deals. These LIBOR-based interest rates were incorporated into financial contracts, the value of which grew significantly until LIBOR was eventually given the dubious epithet as the "world's most important number".[3]

At the time of the LIBOR scandal, the rate was constructed under the umbrella and ownership of the BBA, though it was Thomson Reuters who gathered the information, calculated the rate and published it. During the scandal time period, each day LIBOR was set for 15 maturities in 10 different currencies. Banks were selected by the BBA to make up panels of banks for each currency (known as Contributor Banks), on the basis of the scale

of market activity, credit rating and perceived expertise in the currency concerned. Purported rules for the conduct of LIBOR and Contributor Banks were published by the BBA,[4] to which Contributor banks had to agree in order to remain on the LIBOR panels. Each Contributor Bank had to submit its contribution by answering the question, "At what rate could you borrow funds, were you to do so by asking for and then accepting inter-bank offers in a reasonable market size just prior to 11 am?" and without reference to rates contributed by other Contributor Banks, determined by the Contributor Bank's staff primarily responsible for management of that bank's cash rather than its derivative trading book, without reference to the pricing of any derivative financial instrument, and that represented the rates it could borrow unsecured inter-bank funds in the London money market.[5] These rates were tabulated, the top and bottom sections (normally between the top and bottom 15–25%) excluded and the remaining figures averaged to create a mean rate published as the LIBOR fixing at about 1130 each day.

Regulation of the LIBOR setting process by the BBA and Thompson Reuters was highly limited. As a consequence LIBOR manipulation could be instigated by one of two different levels of market players, for two different purposes. The first market player was at the trader level, where individual traders could collude with other traders for Contributor Banks to submit rates conducive to the individual traders stock and trade portfolios (known as "trader manipulation"[6]). The purpose here was to fix prices with the sole motivation of profit by seeking to benefit the bank's trading positions. When the bank was operating alone to manipulate LIBOR then the bank and traders involved benefitted materially by this misconduct at the expense of other traders, banks and market participants. Where the bank colluded with other market operators, profit was maximised at the expense of those banks and traders that were not a party to this collusion.

The second market player was at more senior management level, where instructions were given to traders to submit artificially lower LIBOR submissions (known as "lowballing"[7]). The purpose here was to fix prices in order to increase market confidence in the banks and thus either sustain or increase profits. Liquidity of banks was a central concern during the 2007–2008 financial crisis and it was considered that if a bank over a period of time submitted higher than average assessments for LIBOR then this indicated an issue with liquidity and an inability to raise funds. This would then be reported in the media, undermining confidence in

the bank and its trading position on the market, and thereby reducing bank profits. A further problem could occur if it became clear that some Contributor Banks were submitting higher than expected rates for LIBOR, thereby leading to claims that these banks were afraid to lend to one another, reducing confidence in those banks and diminishing profits. Therefore manipulation of submission rates, and consequently LIBOR itself, through collusion between banks would again fix prices at the expense of other market operators.

7.2 Competition Law Provisions and Regimes of the United States of America, the European Union and the United Kingdom

Competition law is a relatively simple concept,[8] although the policy that underpins it is more complex and vague. In a perfectly competitive market, there are a large number of buyers and sellers with perfect information, producing homogenous goods and services, and with no barriers to entry or exit to or from the market.[9] The market under perfect competition provides optimum allocative and productive efficiency,[10] with consumer welfare maximised, a measure aimed specifically at the limited group classified as consumers rather than the wider society in general.

Unfortunately perfect competition and the resultant perfect market are for the most part illusions, never to occur in the real world. The assumptions are theoretical and unlikely to be replicated practically,[11] where human intervention and behaviour can lead to distortions in competitive conditions leading to market failure and imbalance, and subsequently concerns over fairness and harm to consumer welfare. It is at this point of failure of the market that the law steps in. The result of leaving the market to function devoid of legal and regulatory control is clearly demonstrated by the "Robber Barons"[12] of the nineteenth century that led to the adoption of the Sherman Act in the US.

There are three possibilities for the law to regulate competition through legal regimes and enforcement: civil public; criminal public; and, civil private.

7.2.1 The United States of America

7.2.1.1 Civil Public Enforcement

In the USA the principal legislative instrument dealing with price-fixing is Section 1 of the Sherman Act 1890, which states, "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal." To establish infringement four elements must be proved: an agreement, between separate parties, an unreasonable restraint of trade, and that operates inter rather than intrastate. The Antitrust Division of the Department of Justice (DoJ (AD)) has exclusive jurisdiction to enforce Section 1 of the Sherman Act, although the Federal Trade Commission (FTC) can investigate non-hard core cartel violations under Section 5 of the FTC Act 1914.[13]

The most important element of any Section 1 infringement is the establishment of an agreement.[14] This can be formed either horizontally, between competitors or vertically, between companies operating on different levels of economic activity. At the horizontal level, it must be established that there was a meeting of minds between the parties,[15] which can be proved by either primary, direct proof or secondary evidence, made up primarily of circumstantial evidence from which an agreement can be inferred.

The second element comes into play when a corporate entity trades with a subsidiary. If that subsidiary is whole owned by the corporation, then there is not enough separation between the two entities for there to be meaningful trade on which Section 1 can bite, and so the parent and subsidiary companies are a single enterprise.[16] However, the Supreme Court in *Copperweld* left open the situation where the subsidiary was less than wholly owned by the parent company. As such the legal position of parent and subsidiary remains ambiguous, not helped by equivocal Supreme Court judgments on the matter.[17]

The unreasonable restraint of trade requirement has been split up into two possible categories by the courts—agreements deemed per se illegal and agreements considered to be unreasonable after examination under the rule of reason principle. It is enough for present purposes to state that

horizontal price fixing is the classic per se Section 1 violation,[18] which requires no further investigation once proven.

Finally, the need for intrastate violation requires the Sherman Act, like all federal statutes, to comply with the Commerce Clause of the US Constitution.[19] Section 1 does so explicitly but also provides for an international dimension by including agreements that restrain trade with foreign nations.

7.2.1.2 Criminal Public Enforcement

The latest updated version of Section 1 of the Sherman Act 1890 continues with, "Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding US$100,000,000 if a corporation, or, if any other person, US$1,000,000, or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court." The DoJ(AD) has exclusive authority for criminal enforcement at the federal level.

The effect of Section 1 is that all abuses of the antitrust laws are criminal violations. However, in practice, the DoJ only instigates criminal action against hard-core cartels, which includes price-fixing, and will prioritise criminal enforcement for these activities over civil enforcement.[20]

In September 2015, the Deputy Attorney General, Sally Quillian Yates, sent a memorandum[21] to all DoJ attorneys instigating a DoJ initiative to hold individuals responsible for corporate misdeeds, both criminal and civil. Although it was suggested that this was a new initiative, it actually simply reinforced previous policy, and this was emphasised by Deputy Assistant Attorney General Brent Snyder of the Antitrust Division in a conference speech at Yale School of Management in February 2016.[22]

7.2.1.3 Civil Private Enforcement

The third strand of antitrust enforcement is that by private litigants. Section 4 of the Clayton Act 1914 allows the recovery of damages by "any

person injured in his business or property by reason of anything forbidden in the antitrust laws," with a successful litigant being able to claim three times the damage (treble damages) and costs. Section 4A enables the US to act as a private litigant and to also claim treble damages. To prove a claim, the claimant must establish both constitutional and antitrust standing. For the former, a mere showing of harm will establish the necessary injury. The latter, however, is more complex.

Two strands must be proven for antitrust standing. The first is an infringement of the antitrust laws, which follows the principles above (antitrust violation). The second is the actual establishment of antitrust standing. This antitrust standing itself contains two requirements: that the claimant suffered a special type of antitrust injury; and, the claimant is a suitable candidate to pursue the alleged antitrust violations and thus is an 'efficient enforcer' of the antitrust laws.[23] In *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*,[24] the Supreme Court held that for the claimant to prove an antitrust injury then it must be an "injury of the type the antitrust laws were intended to prevent"[25] and that the antitrust laws were designed to protect competition rather than competitors. As such this question is one of causation[26] in which the claimant must prove the particular injury was caused by the proven anti-competitive activity of the defendant. In *Illinois Brick Co. v. Illinois*,[27] the Supreme Court identified a number of factors when considering this issue including inter alia: the causal connection between the alleged antitrust violation and the plaintiff's harm; the defendant's motive; the nature of the alleged injury; and, "the directness or indirectness of the asserted injury." For the efficient enforcer, a number of factors are taken into account: the directness or remoteness of the violation and cause of injury; the identifiable other class of persons whose self-interest would normally lead them to sue for the violation; the speculative nature of the injury; and, the possibility to identify further claimants who could recover duplicate damages and the difficulty in apportioning damages to actual and potential victims.

A party suffering an antitrust injury as the result of an antitrust infringement that is a per se violation, such as price-fixing, would be highly likely to satisfy the necessary elements to establish liability.

7.2.2 The European Union

7.2.2.1 Civil Public Enforcement

The EU equivalent to Section 1 of the Sherman Act is Article 101(1) TFEU. This holds that "The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which: (a) directly or indirectly fix purchase or selling prices or any other trading conditions…". To establish infringement there are three elements: an agreement between undertakings, decisions by associations of undertakings or a concerted practice; the impact of which affects trade between Member States; and, has the object or effect to prevent, restrict or distort competition within the internal market. The Directorate-General for Competition of the European Commission is responsible for investigation and enforcement of the competition law provisions.[28] Any agreements or decisions found to infringe Article 101(1) TFEU are automatically void.[29]

The first, and most important, element is the requirement for an agreement, a decision of an association of undertakings or a concerted practice. For an agreement, there must be "the existence of a concurrence of wills between at least two parties, the form in which it is manifested being unimportant so long as it constitutes the faithful expression of the parties' intention".[30] As with the situation in the US, agreements can be either horizontal or vertical with the Court of Justice of the European Union (CJEU) holding that the standard of proof, as set out above, is applicable to both.[31] If a cartel is coordinated through decisions of a trade agreement then these can also come within the scope of Article 101(1) TFEU in so far as their own activities or those of the undertakings affiliated to them are calculated to produce the results which the association aims to suppress.[32] The third situation that comes within the scope of Article 101(1) TFEU is that of concerted practices. The aim of the term "concerted practices" is to extend the prohibition of Article 101(1) TFEU to "a form of coordination between undertakings which, without having reached

the stage where an agreement properly so-called has been concluded, knowingly substitutes practical cooperation between them for the risks of competition".[33] The CJEU further developed this so that Article 101(1) TFEU strictly prohibits "any direct or indirect contact between such operators, the object or effect whereof is either to influence the conduct on the market of an actual or potential competitor or to disclose to such a competitor the course of conduct which they themselves have decided to adopt or contemplate adopting on the market."[34]

The second element requires inter-Member State trade, which defines "the boundary between the areas respectively covered by [EU] law and the law of the Member States".[35] With the introduction of Regulation 1/2003,[36] the "Europeanisation" of most Member States' competition laws and the introduction of the European Competition Network[37] this delineation takes on greater importance with the Commission issuing "Guidelines on inter-State trade."[38]

The third and final element requires there to be an object or effect of preventing, restricting or distorting competition. As the CJEU has made clear, this is to be read disjunctively rather than conjunctively.[39] Article 101(1) TFEU provides a non-exhaustive list of examples of hard-core cartels, one of which is price-fixing. This effectively means that price fixing is a per se violation and the Article 101(3) TFEU defence would not apply.

7.2.2.2 Criminal Public Enforcement

Competences of the European Union are outlined in Title I, TFEU and do not include criminal enforcement of EU laws. Therefore the Commission has no powers to bring a criminal enforcement action against a cartel.

7.2.2.3 Civil Private Enforcement

As with criminal enforcement, once again there is no option for individuals to bring an action for damages in the CJEU or General Court. However, the CJEU has given guidance over private actions in national courts for the enforcement of rights under the competition laws when the national courts are acting as European courts. Indeed as Articles 101 and 102

TFEU are directly applicable and thus produce direct effects, any individual can bring an action in a domestic court to enforce the right to damages.[40] In *Manfredi*,[41] the CJEU stated that to ensure the total effectiveness of Article 101(1) TFEU "any individual can claim compensation for the harm suffered where there is a causal relationship between that harm and an agreement or practice prohibited under Article [101(1) TFEU]".[42] The difficulty though is to determine whom to include as "any individual." In the 2014 Damages Directive[43] Article 3 requires Member States to ensure that "any natural or legal person who has suffered harm caused by an infringement of competition law is able to claim and to obtain full compensation for that harm." Full compensation must be available for direct and indirect purchasers from an infringer,[44] although the infringer may claim a partial defence of the passing on of overcharge compensation.[45] However, the injured party must still be fully compensated and so this provision seeks to regulate compensation levels between multiple parties, with full compensation being equated with actual damage and devoid of augmentation by "punitive, multiple or other types of damages."[46]

7.2.3 The United Kingdom

7.2.3.1 Civil Public Enforcement

The central provisions of the UK's Competition Act 1998 were designed to mirror two central competition laws of the EU, namely Articles 101 and 102 TFEU. As such the Chapter I prohibition[47] in section 2(1) matches the wording of Art 101(1) TFEU albeit applicable just to the UK with similar elements to those outlined above for Article 101(1) TFEU. At the time of the LIBOR scandal, the UK's national competition enforcement agency was the Office of Fair Trading (OFT), although this has now been replaced by the Competition and Markets Authority (CMA).

7.2.3.2 Criminal Public Enforcement

In 2002, the UK introduced the Cartel Offence[48] into criminal law in section 188 of the Enterprise Act 2002, with a maximum sentence of five

years imprisonment on indictment.[49] For the Cartel Offence to be successful, it must be proved that an individual dishonestly agreed, the agreement being necessarily reciprocal,[50] with one or more other persons that undertakings would engage in conduct as specified in the legislation.[51] That conduct includes direct and indirect price-fixing[52] but only for horizontal agreements,[53] with proceedings only able to be conducted by the Director of the Serious Fraud Office or the OFT.[54]

7.2.3.3 Civil Private Enforcement

The UK has been at the forefront of the drive in the EU to enable individuals to claim damages for harm caused by infringements of Articles 101 and 102 TFEU.[55] Although the Competition Act 1998 does not specifically provide for a right to bring an action to claim damages under the Act, there is no doubt that damages are available.[56] A claimant can either bring a direct standalone action in the High Court, without a previous anticompetitive finding by the Commission or OFT, or a follow-on action where there has already been a decision finding of competition infringement.

For the former, the claimant would have to prove anticompetitive infringement. As there is no specific measure enabling a private action, the cause of action must be founded in tort, be that breach of statutory duty[57] or conspiracy,[58] and as such the rules of the specific tort must be followed. Unfortunately these tortious rules can be restrictive and, according to the CJEU in *Courage v Crehan*,[59] procedural rules of a domestic tortious action must not be employed to prohibit a party suffering damages to be able to recover. However, the right to damages is purely compensatory with no possibility of restitutionary damages being awarded[60] where compensatory damages would be sufficient,[61] thereby prohibiting the possibility of double or treble damages. Indeed as Longmore LJ notes, restitutionary damages can be awarded outside of the regular categories in exceptional cases but cartels are not exceptional as it would be difficult to see how one cartel could be more exceptional than another.[62] This does not mean that exemplary damages for particularly serious anti-competitive behaviour cannot be awarded,[63] so long as

no penalty had already been ordered by a public competition authority.[64] These are in addition to compensatory damages and are only awarded if the original sum is not adequate to punish the defendant.[65]

Follow on actions are regulated by section 47A and 47B of the Competition Act 1998, with the procedural aspects of such regulation, at the time of the LIBOR scandal, set out in Part IV of the Competition Appeal Tribunal's 2003 Rules (CAT Rules).[66] Follow on actions can be started in the CAT or High Court, with individual action covered by section 47A and collective actions through specified consumer bodies on behalf of consumers by section 47B.

7.3 Competition Law Actions

7.3.1 The United States

7.3.1.1 Civil Public Enforcement

The DoJ has focused on criminal public enforcement rather than civil public enforcement, especially over infringement of the Sherman Act. However, the Commodity Futures Trading Commission has fined six banks a total of US$2605 million and two interdealer brokers a total of US$66.2 million for non-antitrust infringements of the Commodity Exchange Act 2006.[67]

7.3.1.2 Criminal Public Enforcement

The DoJ has been proactive in enforcing section 1 of the Sherman Act against the banks involved in the LIBOR scandal with prosecutions of five banks. The DoJ accepted a guilty plea agreement for both Royal Bank of Scotland Plc (RBS) and Deutsche Bank AG for one count of wire fraud and one count of price fixing, which led to deferred prosecution agreements (DPAs) and fines totaling US$150[68] and US$775[69] million, respectively. UBS, Barclays and Rabobank pleaded guilty to one charge of wire fraud and in their DPAs were fined US$500,[70] US$160[71] and US$325[72] million, respectively. UBS were subsequently found to have violated their DPA and

were fined a further US$203 million.[73] The total fines against banks for LIBOR manipulation now amounts to US$2113 million. Although the elements of the antitrust action were not tested in court, it can be inferred that there was an agreement between banks, their employees or traders operating under their instructions, operating as individual corporate entities on the international stage by price fixing, that antitrust practice being a per se illegal restraint of trade. However, this only applied to RBS and Deutsche Bank.

The DoJ has also been proactive in bringing criminal proceedings against individual bank employees and traders, but these are for wire fraud rather than for price fixing. The first two Rabobank employees, Anthony Allen[74] and Anthony Conti,[75] were convicted on 5 November 2015 after a jury trial. After an unsuccessful appeal to the District Court on Fifth Amendment grounds,[76] they were sentenced to 24 months and 12 months and a day of imprisonment, respectively in March 2016. They have both petitioned the US Court of Appeals for the Second Circuit appealing both their conviction and sentence. A further three defendants, Paul Robson, Lee Stewart and Takayuki Yagami, pleaded guilty through a plea bargain arrangement and await sentencing in June 2017, whilst a further two, Tetsuya Motomura and Paul Thompson, await trial.[77]

7.3.1.3 Civil Private Enforcement

Unsurprisingly customers of the banks involved in LIBOR manipulation and other parties suffering subsequent losses have commenced actions to claim damages for antitrust actions. These antitrust claims focused on losses through contracts for interest rate swaps that were tied to LIBOR, debt securities that paid interest tied to LIBOR (mainly individual pension accounts), futures contracts where the price paid at the settlement date was again fixed to LIBOR, and individuals who purchased or held LIBOR-based financial instruments (frequently mortgages where loans were overpaid). The first court case came before the Southern District of New York District Court in 2012[78] but Buchwald J did not allow the case to progress far. She first correctly identified the need for an antitrust injury for there to be antitrust standing,[79] but then found that a per se violation of section 1 of the Sherman Act would not necessarily establish

antitrust injury.[80] For that to happen, she claimed, there would need to be competition. However, LIBOR itself was a benchmark standard, not intended to be competitive and not itself tradable.[81] In effect this narrowly defined the market where an antitrust injury needed to occur as LIBOR was, by its very definition, without a competitor.

Buchwald J went on to find that the claimants could have suffered harm under normal conditions of free competition.[82] She based this finding on two judgments of the US Supreme Court. The first, *Brunswick Corp v Pueblo Bowl-O-Mat Inc.*,[83] involved a bowling equipment company purchasing failing bowling centres, which rival centres claimed caused losses through antitrust injury. The Supreme Court held that even if rival bowling centres were injured by the continued operation of the failing centres after the takeover, that injury was not by reason of anything forbidden in the antitrust laws. In the second, *ARCO*,[84] the defendant oil company supplied petrol to its own dealers and franchised dealers that operated under its name. It conspired with these dealers to implement a vertical price-fixing scheme, setting below-market prices and forcing many independent discount dealers out of business. The Supreme Court found that cutting prices to above cost price would not involve anti-competitive activity but was in fact the very essence of competitive activity. Only by cutting prices below cost price and therefore engaging in predatory pricing would there be a possibility of antitrust injury. These cases demonstrated that injury suffered under normal conditions of free competition was not antitrust injury.[85] In the LIBOR situation, Buchwald J found the harm could have occurred under normal conditions of free competition because banks acting independently could have rationally submitted manipulated LIBOR figures.[86] The rationality of these submissions lay in the fact that the LIBOR submission-process was not competitive.[87] Therefore collusion would not have allowed them to do anything that they could not have done already.[88] Indeed Buchwald J found that in both Brunswick and ARCO there was more harm to competition than in the LIBOR situation.[89]

This judgment came under sustained criticism from academic and judicial sources. Foster[90] identified the root of the problem to be Buchwald J's holding that manipulating LIBOR was not a competitive process,

which is not a recognised antitrust injury requirement. The authority used to support this finding, namely *Brunswick* and *ARCO*, were not horizontal price-fixing cases, whereas the LIBOR manipulation situation was straightforward horizontal price-fixing, with consumers rather than competitors suffering harm.[91] Indeed as Foster noted,[92] the LIBOR scenario is analogous to a situation where competitors with significant market power set and manipulate unregulated industry standards. This results in harm to competition and harm to consumers, which establishes antitrust injury without any need to consider whether the benchmark setting constituted a competitive process.

In the same District Court of the Southern District of New York, but with different judges, two cases have commented on *In re LIBOR*. In *In re FX*,[93] a number of major banks had colluded to manipulate benchmark rates in the foreign exchange markets but this benchmark rate, distinguished from *In re LIBOR*, was not a cooperative endeavour but set by transactions in the foreign exchange market.[94] Schofield J in an *obiter dictum* went out of her way to disagree with the findings of Buchwald J in *In re LIBOR*, predominantly on the basis of the difficulties with *Brunswick* and *ARCO* described above.[95] In the more recent *Alaska Electrical Pension Fund,* et al. *v Bank of America Corp.*, et al.,[96] the benchmark being manipulated was the US Dollar ISDAfix, a benchmark interest rate incorporated into a broad range of financial derivatives. Furman J declined to follow *In re LIBOR* for two reasons.[97] The first was that although the two situations were similar, in that the ISDAfix was formulated in a similar way to LIBOR, the traders in this case also conspired to move prices for swaps in the inter-dealer market by acting as a trading bloc, so distinguishing the cases. This was the very essence of anticompetitive behaviour that the antitrust laws were intended to prevent.[98] Second, it was found that a lack of competitive process in a cooperative endeavour did not insulate otherwise competing entities from antitrust liability to parties harmed by that manipulation. Furman J gave four reasons for this. First, the Supreme Court had long held that the machinery employed by a combination for price-fixing is immaterial to the antitrust laws. Competing entities acting together as part of a cooperative endeavour meant that there should be greater scrutiny not less,

and was definitely not a basis for absolute immunity from antitrust liability.[99] Second, the gravity and level of harm alleged was on the basis of a horizontal price-fixing conspiracy, the quintessential antitrust injury.[100] Third, courts had long held that collusion in the setting of a benchmark rate (or its functional equivalent) that was then used as a component of price, resulted in antitrust injury.[101] Finally, most antitrust collusions involved misrepresentations or deliberate falsehoods and it would be perverse to grant such parties immunity from liability merely on the basis of taking steps to conceal such activity, as well as engaging in it.[102]

The rejection of the antitrust claims of *In re LIBOR* was appealed to the Second Circuit of the Federal Courts of Appeal but was itself rejected before arguments were heard on the grounds that the case was ongoing and a final order had not yet been made.[103] The Supreme Court ordered the Second Circuit to hear the cases as the rejection of the claims in their entirety left the claimants with no recourse of action.[104] In May 2016, the Second Circuit overturned Buchwald J's judgment.[105] They were critical of her approach, finding that she had blurred the necessary procedural distinction of first determining antitrust violation, before then considering antitrust standing, which requires consideration of antitrust injury and an efficient enforcer inquiry.[106] The court found that horizontal price-fixing constituted a per se antitrust violation with the claimants alleging that LIBOR was an inseparable part of the price, and the fixing of a component of price violated the antitrust laws.[107] Examining antitrust injury the court held that a claimant did not need to plead harm to competition, or any further inquiry made, as horizontal price fixing was per se unlawful.[108] This was because of, as the Supreme Court emphasised in *Socony-Vacuum*, horizontal price fixing's actual or potential threat to the economy,[109] particularly one based on the free market's interaction between supply and demand.[110] Thus a consumer who paid a higher price on account of that horizontal price-fixing suffered antitrust injury. The case was remanded to the District Court to determine the efficient enforcer element of antitrust standing, which had not been considered by Buchwald J at first instance, with considerable guidance provided.[111]

7.3.2 The European Union

7.3.2.1 Civil Public Enforcement

The Commission conducted surprise investigations of banks to commence the investigation into manipulation of the European equivalent to LIBOR, the Euro Interbank Offered Rate (EURIBOR) beginning on 18 October 2011.[112] This resulted in full investigations by the Commission into the manipulation of Swiss Franc LIBOR (and the market for Swiss Franc interest rate derivatives (CHIRDs)) and of Yen LIBOR (and the market for Yen interest rate derivatives (YIRDs)), along with the market for European interest rate derivatives (EIRDs). Currently, only three Decisions have been published.[113] The first involved anti-competitive activity on Swiss Franc LIBOR (CHF LIBOR) which then impacted on the CHIRD market, addressed to RBS and JPMorgan with the latter being fined €61.676 million and RBS granted leniency immunity under the Leniency Notice[114] for total cooperation with the Commission's investigation. In the second and third Decisions, Barclays, Deutsche Bank, RBS and Société Générale (EIRD cartel) and UBS, RBS, Deutsche Bank, Citigroup, JPMorgan and the broker RP Martin (YIRD cartel) were fined a combined total of €1.494 billion after agreeing a settlement over the operation of two cartels to fix the EURIBOR, Yen LIBOR and Euroyen TIBOR (Tokyo interbank offered rate) which then impacted on the market for interest rate derivatives where prices were also fixed. The Commission continued proceedings against Crédit Agricole, HSBC and JPMorgan under the standard, non-settlement, cartel procedure,[115] which is ongoing. Third RBS, UBS, JP Morgan and Crédit Suisse were fined €32.355 million for operating a cartel on bid-ask spreads of CHIRDs[116] but this did not involve any benchmark interest rate manipulation. Finally in connection with the YIRD cartel, the broker Icap was fined €14.9 million[117] but a Decision has yet to be published and Icap has appealed.[118]

In the benchmark cartels, the Commission established that there were agreements or concerted practices between the parties from direct evidence, notably through online chat rooms messages, emails and phone contacts. The collusive arrangements constituted an interrelated string of

occurrences united by the common objective of the restriction and/or distortion of competition that constituted a single and continuous infringement of Article 101 TFEU. That common objective meant that there was no need to demonstrate the anticompetitive effect of the agreements. As the benchmark interest rates were utilised extensively on the international money markets by international banks, brokers and traders then the anticompetitive practices were capable of appreciably affecting trade between Member States.

7.3.2.2 Criminal Public and Civil Private Enforcement

Neither of these two options were open to either the Commission or private parties at the EU level. It should be noted, however, that the Commission's press releases invited and encouraged private parties to bring actions for private redress in their domestic civil courts.

7.3.3 The United Kingdom

7.3.3.1 Civil Public Enforcement

The OFT first became aware of concerns over LIBOR rigging and anti-competitive practices in November 2008.[119] Indeed both the OFT and the Competition Commission expressed their opinion to the FSA of possible collusive activity by submitting banks that could be harmful to consumers and other banks.[120] The OFT was urged not to launch an investigation into LIBOR manipulation by the head of the FSA as it was felt that the BBA was already improving the process of LIBOR setting and an investigation could pose potential risks to the stability of the financial markets.[121] The result of this is that no UK public authorities investigated any manipulation of LIBOR for anti-competitive practices and even though the FSA and its successor, the Financial Conduct Authority (FCA), have penalised banks, traders and brokers with significant financial penalties, none of these were found in competition law.

7.3.3.2 Criminal Public Enforcement

There have been three prosecutions of traders involved in the LIBOR scandal. The first was successful with the UBS and Citibank trader sentenced to 14 years for fraud,[122] reduced to 11 on appeal.[123] In the second, six traders were found not guilty of fraud. In the latest case, four Barclays traders were given sentences ranging from two years and nine months to six and a half years for fraud,[124] with a further two traders facing retrial, and eventually being acquitted.[125] It should be noted that no action was brought under the Cartel Offence.

7.3.3.3 Civil Private Enforcement

Just as in the USA, clients and customers of the banks involved, and third parties economically affected by the LIBOR manipulation, sought to recover damages in the UK courts. Before the cases began, the claimants were already facing some difficulty as any action, unless based upon the Commission's Decisions examined previously, would have to be standalone as the OFT had not conducted a cartel investigation and so they would need to prove all the elements of Article 101 TFEU or a Chap. 1 Prohibition of the Competition Act 1998.

The only case so far to come before the courts is *Deutsche Bank v Unitech.*[126] Here Unitech argued that the anticompetitive manipulation of LIBOR meant that the contracts for the bank loan of US$150 million and interest rate swap of US$11 million should be void as they were calculated on the basis of LIBOR. Before Teare J at first instance and in the Court of Appeal, with Longmore LJ delivering the judgment of the court, it was held that the agreement was vertical between bank and customer. As such although the customer could obtain damages for anticompetitive infringement, following *Courage v Crehan*,[127] the contracts could not be held void. Indeed misrepresentations as to Deutsche Bank's submissions to LIBOR could not lead to an implied term excluding such LIBOR manipulation being read into the contracts, although Teare J appeared to be sympathetic to this if dishonesty could be proved. If the contracts had been between banks then these would have been horizontal agreements and thus capable of being declared void.

7.4 Competition Law's Impact on LIBOR and Post-LIBOR

7.4.1 How Effective Was Antitrust Regulation of Banking Activity?

In the aftermath of the LIBOR scandal, it was claimed that competition law could undergo regulatory scope creep and surpass specific financial sector regulation.[128] However, it must be questioned how effective competition law has actually been in regard to the LIBOR price-fixing collusion. The UK's Independent Commission on Banking, established to provide recommendations for banking regulation after the 2008 global financial crisis, contained a significant section on competition law.[129] However, although recommendations were made to improve supply- and demand-side competitiveness in the sector, and to create a primary duty of the new FCA to promote effective competition, no mention was made of the LIBOR scandal. There is now a primary mandate in the Financial Services and Markets Act 2000 (FSMA2000)[130] to promote competition, such that the FCA must act in a way that is compatible with its strategic objective and advances one or more of its three operational objectives. The strategic objective is to ensure that the relevant markets operate well,[131] and the operational objectives are consumer protection, integrity and competition.[132] The FCA now has a competition duty to discharge its general functions in a way, which promotes effective competition in the interests of consumers.[133] The FCA's competition duty is empowered through the provisions in the FSMA s234I-O,[134] though it is notable that the cartel offence is not part of its remit.

The result of this in the UK so far has been minimal use of competition law against the banks. Despite numerous investigations, identifying dishonest behaviour by banks,[135] bank traders[136] and brokers,[137] no competition law enforcement action has been instigated by the FCA or the CMA. This can also be seen on the criminal side, with no prosecution of any banks or brokers, and no use of the cartel offence against individuals involved in LIBOR manipulation. Furthermore, after the clear and precise decisions of the European Commission finding horizontal price-

fixing in the benchmark cartels, UK courts have been reluctant to allow private parties to advance their cases.

There are some parallels with the situation in the USA. Although individuals have been found criminally liable for LIBOR manipulation, the prosecutions have been for wire fraud and not antitrust violations. This is mirrored in the criminal actions brought against financial institutions, with only RBS and Deutsche Bank pleading guilty to a charge of price fixing. For private antitrust actions, there are considerable hurdles yet to overcome before any actions can claim success.

It may have been that enforcement agencies were communicating effectively with one another to ensure that over enforcement was avoided, be that within a single, overarching or global jurisdiction as suggested by Huizing.[138] However, the wholly ineffectual enforcement of competition law provisions to police the blatant horizontal price fixing of the LIBOR benchmark by financial institutions and their employees cannot be explained by this fear of over protection. There must therefore be policy reasons for a lack of antitrust action by the competition authorities, with the notable exception of the European Commission, and a reluctance to allow private antitrust enforcement.

7.4.2 Why Was the Cartel Offence Not Used in the United Kingdom?

It is clear from the actions of the public regulatory authorities that the US criminal enforcement of antitrust is stronger than that in the UK, with the EU having no competence in this area. There are a number of reasons for this. The first is that section 1 of the Sherman Act is centred on the crime of cartel activity, and prosecution is reinforced in such instruments as the Yates Memo. This can be compared to the Cartel Offence in the UK that was an 'add on' to the main competition provisions in the Enterprise Act 2002. The second is the length of time of the existence of the two criminal competition regimes. The UK's regime is considerably younger than that in the USA and therefore the culture of antitrust criminalisation will need time to take hold. Indeed competition culture is a relatively new aspect to enterprise in the UK, beginning with a highly

politically controlled regime in the 1950s and only developing into a modern and effective system from the start of the twenty-first century.[139] The third is the perceived weakness of the UK's Cartel Offence. When it was introduced, it was necessary to prove that an individual had acted with dishonesty, which commentators considered to have introduced a moral element into competition law.[140] The test for dishonesty was the normal criminal two-stage test set out in *Ghosh,*[141] consisting of both an objective and subjective standard, both of which were jury questions. First was the defendant acting dishonestly according to the standard of reasonable and honest people and then, if the answer to the first question was in the affirmative, did the defendant realise that what she or he was doing was dishonest according to those standards. Unfortunately, since the introduction of the Cartel Offence there has only been one successful prosecution,[142] and one failed prosecution,[143] where the prosecution offered no evidence due to issues concerning disclosure of evidence. As a result, the Cartel Offence was amended, through the Enterprise and Regulatory Reform Act 2013, by removing the dishonesty requirement,[144] reducing the scope of the Cartel Offence by outlining circumstances when the Cartel Offence would not be applicable,[145] and by introducing three specific defences.[146] The result is a seriously diluted action, which has yet to be tested before the courts, but with defences so easily satisfied that liability should be easily avoided.[147] Indeed in the case of the LIBOR manipulation offences, prosecution under the Cartel Offence was not even considered. As Michels points out, this is almost certainly the result of a lack of both public support, particularly over the moral wrongdoing of cartel formation, and political support.[148]

The difficulties with the UK's Cartel Offence mean that we must question the policy considerations behind it. However, this should not just be reserved to the UK, as there appears to have also been significant reluctance in the USA to utilise criminal law to bring the white-collar crime of the financial institutions and their employees to account. Indeed the question of policy goes further, questioning why the financial institutions were not investigated for competition law violations swiftly and with zeal. It is further suggested that the very basis for competition law itself needs investigating, with an attempt to establish the philosophical underpinning of the concept.

7.4.3 What Policy Considerations Led to Limited Antitrust LIBOR Regulation?

The policy considerations behind antitrust or competition legislation as set out earlier are relatively straightforward[149] and indeed Steuer spells them out as combatting bullying and ganging up. Underneath that though there are, as set out in this chapter, three specific enforcement regimes to ensure compliance—civil public, criminal public and civil private. It could be argued that each of these enforcement regimes has its own set of policy considerations but this ignores the fact that all three are directed at serving the public interest, and as Yeong points out,[150] competition law is a form of public law that aims to protect that public interest. It is how that public interest is defined that determines the policy considerations. Since the late 1970s, the Chicago School of Economics has come to dominate the debate over competition law's public interest, with the sole aim being the protection of consumer welfare as determined through a mathematical analysis of the economic data, and the justification for consumer welfare being economic efficiency.[151] This has resulted in a narrow and very strict containment of antitrust focused almost entirely on markets and consumers operating in those markets, to the exclusion of the wider society. This is most clearly stated by Hovenkamp that "antitrust is an economic, not a moral, enterprise."[152] That wider society is also affected by antitrust activity, as clearly demonstrated in the LIBOR manipulation scenario, but the neoliberal Chicago School account does not take this into consideration when investigating anticompetitive activity. From this perspective, the market is mainly self-righting and as such the State should intervene only on specific and rare occasions.

If consumer welfare was the sole aim of competition law then the competition authorities and financial regulators totally abrogated their responsibilities over the LIBOR scandal as consumers were undoubtedly damaged by financial institutions' horizontal price fixing. What interests then overruled those of consumer welfare? Two can be identified. The first was the interests of the banks as drivers of national economies. Following the financial and economic crisis of 2008, it was undoubtedly

in the banks and bankers' interests to avoid a deep antitrust inquiry and subsequent criminal convictions. The lowballing behaviour of the banks was certainly influenced by the financial crisis, though the true motivation may have been personal profit rather than the larger picture of safeguarding a bank's existence. This interest then, although possibly wider than consumer welfare as a public interest, appears weak and undermined by the financial institutions' self-interests and trader manipulation. The second was the national interest that meant that full prosecution of competition law violations could have significantly impacted on the bank's ability to survive and strive competently in the global market following the financial crisis. If this full antitrust prosecution had resulted in the collapse of a bank then this could have had significant national and global consequences. This appears at first blush to be a valid interest but on closer inspection is shallow and lacks justification. The US Second Circuit has raised the possibility of triple damages creating such a problem for the banks[153] but the evidence would suggest that it is rare for triple damages to apply[154] and that the banks are likely to settle civil private actions.[155] This then undermines the national interest argument.

So the limited competition law investigation remains unjustified, particularly for the UK. In the EU, benchmark manipulation was prosecuted to the maximum effect by the Commission, but in the USA, and even more in the UK, there has been very limited action. It could possibly be explained by an over-complicated and over-crowded regulatory environment where the competition law violations took place within multiple jurisdictions. As such, liaison between different agencies and across borders meant that competition matters slipped between the investigatory cracks. This would appear to be supported by the lack of LIBOR commentary in the UK Independent Commission on Banking's Report, and the lack of competition law commentary in the Wheatley Report on LIBOR.[156] However, the use of DPAs and limited antitrust criminal charges in the USA, coupled with no horizontal price fixing investigation or Cartel Offence charges in the UK, suggest that the financial service industries were regarded as being too delicate for further competition law scrutiny.

7.4.4 Justifications for Competition Law

The final part of this chapter is to consider briefly[157] the philosophical underpinning of antitrust on a broader spectrum. It is clear from the discussion above that the weak competition regulatory response to LIBOR manipulation did not protect consumer welfare. If consumer welfare was not protected then it must be questioned if it can satisfactorily underpin an antitrust regime.[158] A number of commentators have started to question this consumer welfarist, constricted approach with the quite significant emasculation of competition law as a tool of public policy. Black[159] suggested in 2005 that he would analyse competition law through a philosophical approach, but on closer inspection this was merely based on economics and not philosophy. Atkinson[160] has suggested that antitrust policy should be adjusted to include objectives based on distributive justice. This is an interesting approach but has yet to be further developed. Whelan[161] investigates the justificatory theory of the Cartel Offence, but this is more directed towards the philosophy underpinning criminal punishment rather than competition law per se. Similarly, Wardhaugh[162] uses the philosophy of JS Mill and John Rawls to establish a normative liberal justification for criminal law as it applies to antitrust, rather than as a justification for competition law. This demonstrates much of the literature where philosophy is used to justify part of the enforcement mechanism of competition law, descends into an alternative disciplinary justification of antitrust, or makes a suggestion for change without any justificatory argument.

One of the more interesting attempts to fashion a new theory of antitrust justification is that of Ayal[163] in which he identifies societal goals,[164] economic efficiency predominantly, and individual goals, based on fairness.[165] Fairness comes into play, as there has to be a balancing exercise[166] conducted between the rights of victims of monopolists, predominantly consumers,[167] and the rights of monopolists.[168] Consumer welfare therefore is an element of the balancing exercise and not the justification for competition law. That is the idea of fairness, built on the notion of distributive justice and considered through the lens of Rawls' Theory of Justice,[169] which is probably the moral underpinning of antitrust, though

this is never fully spelt out. This is a credible attempt at an alternative approach to that of consumer welfare but it is submitted it only goes partially to the heart of the question, with only a spartan consideration of the tools of legal philosophy to justify a legal discipline.

How then may a rational justification for antitrust be established, that cuts across jurisdictions and gets beyond the shallow skirmishes relating to the purpose of competition law, to provide a deeper and defensible anchoring of competition law? The starting point must be that the law only steps in when conditions of perfect competition fail and the impact of that failure falls on society and natural or legal persons in that society.[170] Legal enforcement then is a public interest as it ensures the protection of societal interests, where those interests also reflect relationships between individuals. Those societal interests could be limited to economic efficiency and fairness, as suggested by Ayal, but it is submitted that the public interest must extend further than this as competition law impacts other interests, rights and public policies.[171] These areas include the environment, intellectual property, consumer protection, employment, industrial policy, non-discrimination and human rights. With such impact on different public interests, and the interaction of antitrust law on relationships between natural and legal persons, then the value-laden nature of the law means that any justification needs to go further than just consumer welfare. It is here that we have to turn to legal philosophy but this is outside the constraints of a book chapter and will be a matter for future research.

7.5 Conclusion

The LIBOR manipulation scandal was a deeply shocking event, in which market-players manipulated the self-regulated market, and where outside regulation, particularly over competition law concerns, failed to adequately investigate and prosecute the blatantly infringing banks and traders. This serious white-collar crime undoubtedly has significant implications for financial institutions, their regulation and competition law in general, some of which have been examined by the authorities and changes implemented. It is clear, as the Bank of England's Governor, Mark Carney, has recently stated in a letter to the G20 Meeting in

Hangzhou,[172] "financial sector misconduct has risen to a level that has the potential to create systemic risks by undermining trust in both financial institutions and markets." The institutional, systemic, procedural and jurisdictional failings by USA and UK national competition authorities to investigate financial institutions' antitrust violations undoubtedly had a negative impact on the welfare of consumers, and thus calls consumer welfare into question as the basis for competition law. It is hoped that in the UK especially, where competition law violations were not investigated by any regulatory authority, the new competition law duties and powers for the FCA will see a significantly more robust approach by FCA investigators in any future similar scenario.[173]

Notes

1. For comprehensive and entertaining accounts of the scandal, see L Vaughan, G Finch, *The Fix: How Bankers Lied, Cheated and Colluded to Rig the World's Most Important Number* (Bloomberg Press, Chichester 2017) and D Enrich, *The Spider Network* (Harper Collins Press, London 2017).
2. J Macey, 'LIBOR: Three Scandals in One' https://www.foreignaffairs.com/articles/2012-07-20/libor-three-scandals-one last accessed 1 April 2016.
3. D MacKenzie, 'What's in a Number?' (2008) 30 LRB 11, "The British Bankers Association's London Interbank Offered Rate matters more than any other set of numbers in the world."
4. At the time these were published on the website http://www.bbalibor.com/explained/the-basics, not now available. They can still be accessed at http://www.bbatrent.com/explained/the-basics last accessed 1 April 2016.
5. At the time these were published on the website http://www.bbalibor.com/technicalaspects/setting-bbalibor, not now available. They are set out in the US Department of Justice's Letter, Reference USB AG, http://www.sec.gov/Archives/edgar/data/1114446/000119312513106100/d497201dex43.htm, dated 18 December 2012 Appendix A, paragraph 7 last accessed 1 April 2016.
6. Financial Service Authority, Internal Audit Report: A review of the extent of awareness within the FSA of inappropriate LIBOR submissions'

March 2013, http://www.fsa.gov.uk/static/pubs/other/ia-libor.pdf last accessed 5 April 2013, 3.

7. Ibid.
8. R Whish, D Bailey, *Competition Law* (8th edn OUP, Oxford 2015) 4. See also RM Steuer, 'The Simplicity of Antitrust Law' (2012) 14 University of Pennsylvania Journal of Business Law 543 where antitrust law is summarised as combating bullying and ganging up.
9. Whish, *Competition Law* (n 7) 4.
10. Ibid., 5.
11. Indeed as Whish points out (ibid., 8), perfect competition will lie at one end of a scale with monopoly at the other.
12. For a layman's account see T McNeese, *The Robber Barons and the Sherman Antitrust Act* (Chelsea House Publishers 2009). For a more robust legal account see WD Collins, 'Trusts and the Origin of Antitrust Legislation' (2013) 81 Fordham Law Review 2279.
13. Section 5(a)(2) empowers the FTC to enforce the prohibition of unlawful "Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce" set out in Section 5(a)(1). See FTC Statement of Enforcement Principles Regarding "Unfair Methods of Competition" Under Section 5 of the FTC Act dated 13 August 2015 https://www.ftc.gov/system/files/documents/public_statements/735201/150813section5enforcement.pdf last accessed 1 April 2016.
14. D Broder, *US Antitrust Law and Enforcement* (2010 OUP, Oxford) 37.
15. *Copperweld Corp v Independence Tube Corp.* 467 US 752, 771 (1984).
16. Ibid., 771–777.
17. For example, *American Needle, Inc. v. National Football League* 560 US 183 (2010)—see JM Schmitten 'Antitrust's Single-Entity Doctrine: A Formalistic Approach for a Formalistic Rule' (2012) 46 Columbia Journal of Law and Social Problems 93 for a highly critical analysis.
18. (n 13) 46.
19. Article 1, Section 8, Clause 3 of the US Constitution.
20. US Department of Justice, "Antitrust Division Manual" (5th edn Department of Justice, Washington 2015) III-12.
21. Deputy Attorney General Sally Quillian Yates' Memorandum 'Individual Accountability for Corporate Wrongdoing' dated 9 September 2015 https://www.justice.gov/dag/file/769036/download last accessed 12 August 2016.

22. Deputy Attorney General Bent Snyder 'Individual Accountability for Antitrust Crimes' dated 19 February 2016 https://www.justice.gov/opa/file/826721/download last accessed 12 August 2016.
23. *Gatt Comm., Inc. v. PMC Assocs., LLC*, 711 F.3d 68, 75 (2d Cir. 2013).
24. 429 US 477, 489 (1977).
25. Ibid.
26. 431 US 720 (1977).
27. Ibid., 536–545.
28. First granted powers under Regulation 17/62 the First Regulation implementing Articles 85 arid 86 of the Treaty [1962] OJ 204/62, now updated by Council Regulation (EC) 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty [2003] OJ L1/1.
29. Article 101(2) TFEU.
30. Case T-41/96 *Bayer v Commission* [2000] ECR II-3383 para 69—see O Black, 'Agreement: Concurrence of Wills, or Offer and Acceptance?' (2008) 4 European Competition Journal 103.
31. Case C-260/09 P *Activision Blizzard German GmbH v Commission* [2009] ECR I-419.
32. See Joined Cases 96–102, 104, 105, 108 & 110/82 *IAZ International Belgium NV v Commission* [1983] ECR 3369 para 20.
33. Case 48/69 *ICI v Commission* [1972] ECR 619 para 64.
34. Joined Cases 40–48, 50, 54–56, 111 & 113–114/73 *Suiker Unie v Commission* [1975] ECR 1663 para 174.
35. Case 22/78 *Hugin Kassaregister AB and Hugin Cash Registers Ltd. v Commission* [1979] ECR 1869 para 17.
36. (n 27).
37. See the Commission Notice on cooperation within the Network of Competition Authorities [2004] OJ C101/43.
38. Commission Guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty [2004] OJ C101/81.
39. Case 56/65 *Société Technique Minière v Maschinenbau Ulm* [1966] ECR 235, 249.
40. Case C-453/99 *Courage Ltd. v Crehan* [2001] ECR I-6297 para 26.
41. Joined Cases C-295-298/04 *Vincenzo Manfredi and Others v Lloyd Adriatico Assicurazioni SpA and Others* [2006] ECR I-6619.
42. Ibid., para 61.
43. Directive 2014/14/EU of the European Parliament and Council on certain rules governing actions for damages under national law for

infringements of the competition law provisions of the Member States and of the European Union [2014] OJ L349/1.

44. Ibid., Article 12(1).
45. Ibid., Article 12(3).
46. Ibid., Article 3(3).
47. As labeled in section 2(8).
48. For comprehensive analysis of the Cartel Offence see M Furse, S Nash, *The Cartel Offence* (Hart Publishing, Oxford 2004) and for a more theoretical examination see P Whelan, *The Criminalization of European Cartel Enforcement: Theoretical, Legal, and Practical Challenges* (OUP, Oxford 2014).
49. Enterprise Act 2002 section 190(1).
50. Enterprise Act 2002 section 188(3)(a).
51. Enterprise Act 2002 section 188(1).
52. Enterprise Act 2002 section 188(2)(a).
53. Enterprise Act 2002 section 189(1).
54. Enterprise Act 2002 section 190(2).
55. *Garden Cottage Foods v Milk Marketing Board* [1984] AC 130 (HL).
56. Whish and Bailey (n 7) 328.
57. *Garden Cottage Foods* (n 54).
58. *WH Newson Ltd. and Others v IMI plc and Others* [2014] Bus LR 156 (CA).
59. (n 39), and recognised by the Court of Appeal in the same case, *Crehan v Inntrepreneur Pub Company CPC* [2004] EuLR 693.
60. *Devenish Nutrition Ltd. v Sanofi-Aventis SA (France)* [2009] Ch 390 (CA) para 109.
61. Ibid., para 104.
62. Ibid., para 148.
63. *2 Travel Group Plc v Cardiff City Transport Services Ltd.* [2012] CAT 19.
64. *Devenish Nutrition Ltd. v Sanofi-Aventis SA (France)* [2008] 2 WLR 637 (Ch) para 52.
65. *Rookes v Barnard* [1964] 1 AC 1129, 1228 (HL).
66. SI 2003/1372, now replaced by the 2015 Rules, SI 2015/1648 Part IV for section 47A and Part V for section 47B. The CAT has also provided a more comprehensive Guide to Proceedings with, rather confusingly, Section 5 dealing with Part IV of the CAT Rules and section 47A, and Section 6 dealing with Part V and section 47B.
67. See http://www.cftc.gov/PressRoom/PressReleases/pr7159-15 last accessed 25 April 2016. The banks were Deutsche Bank, UBS, Rabobank, RBS,

Barclays and Lloyds, and the traders Icap Europe Ltd. and RP Martin Holdings Ltd. & Martin Brokers (UK) Ltd.

68. There were two actions, one brought against the parent company (RBS AG) and one against the subsidiary (RBS Securities Japan). The former received a fine of US$150 million for wire fraud and price fixing (see *USA v RBS* dated 5 February 2013 https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2015/05/22/04-12-13the-royal-bank-of-scotland-dpa.pdf last accessed 25 April 2016) whilst the latter in a Connecticut District Court judgment received a fine of US$50 million for wire fraud that was incorporated in the total US$150 million fine of the parent company (see *USA v RBS Securities Japan* dated 6 January 2014 https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2015/05/22/01-13-14the-royal-bank-of-scotland-securities-japan-limited-judgment.pdf last accessed 25 April 2016).
69. Like RBS there were two actions, one brought against the parent company (Deutsche Bank AG) and one against the subsidiary (Deutsche Bank Group Services UK Ltd.). The former received a fine of US$625 million for wire fraud and price fixing (see *USA v Deutsche Bank AG* DPA dated 23 April 2015 https://www.justice.gov/sites/default/files/opa/press-releases/attachments/2015/04/23/db_dpa.pdf last accessed 25 April 2016) whilst the latter received a fine of US$150 million for wire fraud (see *USA v Deutsche Bank Group Services UK Ltd.* Plea Agreement dated 23 April 2015, https://www.justice.gov/sites/default/files/opa/press-releases/attachments/2015/04/23/dbgs_plea_agreement.pdf last accessed 25 April 2016).
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Part 4

Technology and White Collar Crime

8

The Financial Crisis and Digital Currencies

Clare Chambers-Jones

8.1 Introduction

Digital currencies are mainly known for their part in illegal activities such as money laundering or terrorist financing. However, the purpose of this chapter is to explore whether digital currencies could have a potential benefit for countries that are in financial crisis. Since 2007, the global financial crisis has affected many different countries and no more so than Greece, where austerity measures and fiscal issues have caused an enormous social and political upheaval. The global economy has been hit by the lack of trust and confidence the ordinary person has for banks, financial intuitions and in some countries, the governing body. Banks were created in the 1400s in Florence to ensure that society could trust that their money or currency at the time would be safe. Following the global crisis, this trust and confidence in banks and financial institutions has been eroded. This chapter considers whether a digital, decentralised cryptocurrency, where

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N. Ryder (ed.), *White Collar Crime and Risk*,
https://doi.org/10.1057/978-1-137-47384-4_8

peer-to-peer transactions and lending takes place, could replace the trust and confidence that was once found in banks.

The chapter is therefore divided into several parts. The chapter begins by examining what digital currencies are and how they differ from other platform-based currencies, which could not be used at the present time as a form of currency within countries. The chapter then moves onto explore Bitcoins and how they are the leading digital currency currently and whether they have the potential to act as a States' currency. This then leads the chapter into discussing the financial crisis and digital currencies as an alternative to the sovereign currency of a State. In particular, the chapter uses Greece's tumultuous journey through the financial crisis as an example of a State exploring advantages and disadvantages of a cryptocurrency as an alternative currency. The chapter concludes by opining whether digital currencies have a future in financial crisis management and whether the law or State can intervene.

8.2 Digital Currencies

The financial crisis of 2007–9 demonstrated how, we as a global society, rely on money, access to, and the supply of money. However, when we really sit and think about what money is, we are often left confused. Is money the coins and papers in your purse or pocket? Is money the cash we deposit in the banks? Is money the card we hand over in the shop to purchase our morning coffee? Or is money just something that we exchange for something else, something that we collect and amass either tangibly or intangibly? Money, or the legal tender in a country, is determined and controlled by the country or governing body in the case of any monetary unions, such as the European Union. However, money's evolution has demonstrated that money in its truest form could be anything. It could be the grain that is bartered to get the turnips your family wants. It could be the gold that you use to buy property; it could even, in this modern technological society, be codes within a computer which allows you to purchase goods to facilitate your modern life. Money therefore could be considered to be a digital currency and if a digital currency is money, a parallel currency to the national currency within a country, it

could be used as an alternative economy. The question to ask if digital currencies are money is what is their value?

A piece of computer code which makes up a Bitcoin has no intrinsic value unlike gold. However, the bank notes in your pocket are not valuable in their own fungible right, but they are the promise of the sum of gold (cash) on the front of the note. As Casey and Vigna denote, "in the broadest sense money is… an all-encompassing, society-wide system for keeping up with who owns or owes what".[1] Does this make Bitcoins less valuable than gold? The essence of value is linked to the trust between transacting parties and also the state and its people, if the money is state controlled. As will be discussed later in this chapter, Bitcoins are a decentralised currency with no central authority regulating or controlling them per se. This is not to say there is no structure to the currency, but rather it is controlled by those people who mine code to release Bitcoins and the developer who has set a definitive number of Bitcoins to be mined. Bitcoins are digital obligations[2] much like paper notes are physical obligations. For each of these to be worth any value, the person receiving or holding the money needs to trust that the obligation will be fulfilled. If this is the case, then as Keopsell states, "Bitcoins are as real as money in banks".[3] In order for each form of money as discussed above to be useful within a country, the people of that country needs to trust that their intangible commodity representing money will be honoured once presented. What has happened in many countries during the financial crisis is that the states cannot fulfil their obligations and therefore the money that is held by the person is now worthless. The trust has gone. Alternative solutions to ensure solvency within a country and for its people needs to be sought. Digital currencies may just be able to bridge the gap.

Digital currencies have received a lot of negative attention since its creation. There are different digital currencies and some of which will be considered within this chapter. However, the main emphasis within this chapter is on the use of the digital currency, Bitcoin as a medium of money within a financial crisis–hit country, and whether this could be a potential way forward for these countries.

A digital currency is one which has been defined by the Financial Action Task Force in 2014 as:

> [A] digital representation of value that can be digitally traded and functions as (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status (i.e., when tendered to a creditor, is a valid and legal offer of payment) in any jurisdiction. It is neither issued nor guaranteed by any jurisdiction, and fulfils the above functions only by agreement within the community of users of the virtual currency. Virtual currency is distinguished from fiat currency (a.k.a. "real currency", "real money", or "national currency"), which is the coin and paper money of a country that is designated as its legal tender; circulates; and is customarily used and accepted as a medium of exchange in the issuing country. It is distinct from e-money, which is a digital representation of fiat currency used to electronically transfer value denominated in fiat currency. E-money is a digital transfer mechanism for fiat currency—that is, it electronically transfers value that has legal tender status.[4]

A digital currency as mentioned above can also encompass other virtual currency, such as platform-based currency, which will be discussed below. Digital currency and virtual currencies are often used interchangeably[5] and will also be done within this chapter. There are more than 500 different digital currencies but Bitcoin is by far the most used and common.[6]

Digital currencies are either convertible or non-convertible, meaning whether they can be converted from the virtual world into the real world and into real legal money, or not. Digital currencies are also classified as either being centralised or non-centralised. All convertible currencies are centralised and are administered by one central body. Decentralised currencies are not regulated by one administrative body but are rather peer-to-peer, open-source, math-based currencies. These are also known as cryptocurrencies.[7]

8.3 Countries' Regulation of Digital Currencies

It is interesting to note how different jurisdictions view and deal with digital currencies. For some countries, digital currencies should be regulated and deemed part of the financial system, others take the view that they should be banned and excluded from financial regulation. Within

the section below, jurisdictional oversight of Bitcoins and other virtual currencies in a few selected countries will be discussed.

Since 2013 until 2015, Bitcoins and other digital currencies were examined by the Australian Tax Office and as such, issued no guidance or regulation. In October 2013, the Australian Bitcoin bank was hacked, causing a loss of over US$1 million of Bitcoins.[8] Following this criminal activity, Australia issued a guidance paper, which stated that Bitcoins are not money or a foreign currency, but rather it is similar to the barter system and will be treated as such in terms of tax compliance.[9] Australia in 2015 has deemed that Bitcoins and other digital currencies will be for all intents and purposes considered "money" under Australian law.[10]

Although Canada does not view Bitcoins or digital currencies as money[11], they have taken a view that Bitcoin transactions will fall under the countries' taxation regime.[12] Similarly in 2014, the Government decided that Bitcoins and other digital currencies would be subject to anti-money laundering and anti-terrorist financing regulations. These came into effect under Bill C-31, including an amendment to the Proceeds of Crime (Money Laundering) and Terrorist Financing Act. This amended law regulates Bitcoins through the definition of "money service providers."[13]

China has taken a robust approach to digital currencies and has issued a Notice on Precautions against the Risks of Bitcoins.[14] The notice informs the people of China that Bitcoins do not possess the characteristic of legal tender and does not have real meaning as currency.[15] The notice continues to say people may not use Bitcoins as a means of payment or pricing for goods or services. Furthermore, the notice indicates that if websites or exchanges are operating with Bitcoins, they need to register, according to the Telecommunications Regulations of the People's Republic of China, and the Internet Information Services Managing Guidelines, register with the Telecommunications Bureau.[16] Additionally, they must also comply with the country's Anti-Money Laundering regulations.[17]

Cyprus, a country which has suffered economically during the most recent financial crisis, does not regulate the use of Bitcoins or digital currencies in the country. However, the Central Bank of Cyprus has issued a statement stating that the use of virtual currencies is dangerous as it is not regulated.[18]

The European Union has passed no specific regulations or legislation that confirms the status of Bitcoins or virtual currencies. The report Virtual Currency Schemes in 2012 explores the possibility of whether virtual currencies are money,[19] with some debate as to whether it falls under the Electronic Money Directive 2009/110/EC. Under this Directive, electronic money is categorised as being: (a) electronic storage; (b) issuance upon receipt of funds; and (c) acceptance as a means of payment by a legal or natural person other than the issuer.[20] The report finds that Bitcoins meets the first and third criteria but not the second.[21] Similarly, the Payment Services Directive 2007/64/EC was also seen as a possible legal avenue for Bitcoins but the EU report rejected this claim as it does not deal with electronic money.[22]

Greece has issued no legal definition of Bitcoins or virtual currencies and there have been no statements from the National Bank of Greece. Currently Greece has taken no legal stance on the legal status of Bitcoins. Yet during the recent financial crisis, Bitcoins aided the financial infrastructure.

Another country which suffered during the latest financial crisis is Iceland, which prohibited the use of Bitcoins, and the Central Bank of Iceland has stated that trade in the currency is prohibited as trade may be violating the Foreign Exchange Act.[23]

Russia has no legislation which regulates the use of Bitcoins but the use of the currency can be restricted under article 140 of the Russian Civil Code. This code only recognised the Rouble as a legitimate currency in the country. However, in 2014, the Central Bank of the Russian Federation stated that virtual currencies and the use therefore is considered a "dubious activity" associate with money laundering and terrorist financing and that the people of Russia should not engage in the use of virtual currencies.[24] Developments during 2014 and 2015 see that the Russian Government is working to ban the use of Bitcoins completely within the country.[25]

Within the United Kingdom, there has been no official statement from the Bank of England as to the status of Bitcoins.[26] In 2013, a review was undertaken and determined that Bitcoins would remain unregulated.[27] Although they may be unregulated in 2013, Her Majesty's Revenue and Customs office has deemed Bitcoins to be subject to Value Added Tax of 10–20%[28] as Bitcoins could be "single purpose vouchers".[29]

The United States' approach to digital currencies is based on state not federal laws, although federal regulators are issuing guidance on Bitcoins. In 2013, the Financial Crimes Enforcement Network (FinCEN) published guidance[30], which stated when Bitcoin users could be considered as money services businesses. These businesses have to follow anti-money laundering and know your client regulations. Two other government regulators, the US Commodity Futures Trading Commission (CTFC) and the US Securities and Exchange Commission (SEC), have not published guidance but both have indicated that it is not thinkable that guidance would be issued.[31] State guidance has been much more forthcoming with New York issuing business licences to Bitcoin exchanges in 2015. Similarly, New Jersey has followed New York's steps and has also tried to push through legislations which will regulate the use and taxation of Bitcoins.[32]

As with the decentralised nature of the currency, its regulatory guidance is also gaining attraction from the decentralised sphere. Coin Centre[33] issued in 2015 a State Digital Currency Principles and Framework guide, which outlines the basic elements of sound digital currency laws to aid law makers in the work.[34]

Globally, regulators are opposed to providing legislation focused on the use of digital currencies but more and more governments are realising that the use of Bitcoins could and will generate taxable income for their countries. As such, most of the legislation which is coming into play is based on the regulation of taxation and also anti-money laundering and counter terrorist financing regulations. As Emery & Stewart state, "there is a legal basis to treat digital currencies as money based on their function as a medium of exchange".[35]

8.4 Platform-Based Digital Currencies

Platform-based digital currencies (PBDC) are those which are connected to centralised currency systems such as the pound or dollar, unlike digital currencies, such as Bitcoins, considered above. PBDC are issued by internet-based companies such as Facebook,[36] Amazon[37] or Linden Labs.[38] Within these platforms, digital currency can be bought or exchanged for centralised currency through credit card or PayPal transactions. PBDC are not

normally centred on a physical unit of money such as a pound or dollar but have their own unit of value. Although digital currencies are gaining some traction, in terms of legislative oversight, PBDC have not appeared on legislator's agendas. Due to the nature of PBDC being able to be moved from the internet platform into the physical world, its potential for criminal misuse is enormous.[39] However, little is being done to monitor and regulate the increase of the market place use of PBDC. Their use outside the internet platform for non-criminal activity is minimal and therefore within the remit of this chapter, not a pertinent currency to discuss for financial crisis hit countries.

8.5 Bitcoin

Houben argues that Bitcoins are already a "social phenomenon with legal relevance"[40] but to what extent can it be used for social good rather than the negative connotations that it attracts in the media? Bitcoin is a decentralised digital currency and came into existence in 2009, following the financial crisis. Bitcoins are divisible to eight decimal places[41], meaning that they can take part in any financial transaction regardless of value. The Bank of England describes how the process of Bitcoin works:

> A user, wishing to make a payment, issues payment instructions that are disseminated across the network of other users. Standard cryptographic techniques make it possible for users to verify that the transaction is valid—that the would-be payer owns the currency in question. Special users in the network, known as "miners", gather together blocks of transactions and compete to verify them. In return for this service, miners that successfully verify a block of transactions receive both an allocation of newly created currency and any transaction fees offered by parties to the transactions under question.[42]

Each Bitcoin transaction is linked to an address which is traceable and therefore the notion that Bitcoin transactions are always anonymous is not factually correct. These addresses are added to the public ledger (blockchain) itemising the expenditure of Bitcoins.[43] Transactions are anonymous when users conduct transactions via Bitcoin exchanges, which require no proof of identification.[44] Bitcoin transactions are also irrevocable and users

do not need to identify themselves to each other or a third party. This then also leads to an issue of anonymity.[45]

Bitcoins, being a decentralised monetary system, are also characterised by deflation. Bitcoins have been programmed so that it cannot generate in total more than 21 million Bitcoins. They increase geometrically by 21,000 blocks roughly every four years. During this time span, Bitcoins will encounter deflation due to a lack of new supply.[46]

If a person wanted to create new Bitcoins rather than purchase them through a Bitcoin exchange, then, given that their computer was powerful enough to allow the running of the free downloadable software to generate Bitcoins, the process is relatively simple. Mined Bitcoins must be stored in a virtual wallet, whether this is either on the hard drive of the computer or within a Bitcoin exchange, located outside of the person's computer.

Bitcoin has been at the forefront of people's minds recently due to its links with illicit crime. However, Bitcoins are not just used in illegal ways and Bitcoin's unidentified creator or the consortium of creators depending on what theory you adhere to,[47] released the document which described the coding and theory behind Bitcoin in the aftermath of the financial crisis. The financial crisis caused an enormous amount of distrust among consumers, states and bankers. The potentially unidentified creator,[48] Nakamoto, provided a unique solution to this lack of trust emanating from the financial crisis. Nakamoto provided a decentralised currency which lacked state interference or third party interactions. The currency is peer-to-peer with the aim of cutting out the distrust of banks and financial intermediaries. However, in 2015 Warren Buffett stated that people should "stay away" from the digital currency due to its association with criminal activity.[49]

The value of Bitcoins fluctuates greatly,[50] and its lack of identity checks allows criminals to use the currency via third party currency exchange for illegal means. However, the idea and the technology provide a safe, unhackable (due to its blockchain ledgers)[51] currency, which could be used in situations where the national or state currency has become unusable. As Casey & Vigna state, "No digital currency will soon dislodge the dollar, but Bitcoin is much more than a currency. It is a radically new, decentralised system for managing the way societies exchange value. It is, quite simply, one of the most powerful innovations in finance in 500 years".[52] Houben states that Bitcoins are virtual currency and a virtual currency is

defined by the European Central Bank as a form of unregulated digital money, usually issued and controlled by its developers and used and accepted among the members of a specific virtual community.[53]

Koepsell also argues that Bitcoins should be treated like money despite the lack of intuitional guarantees. He states that "a Bitcoin is as own-able as a dollars are when they are deposited in a bank…Bitcoins exist by virtual of their representations in a ledge in cyberspace".[54] Koepsell links money and digital currencies by the trust the consumer places with the banks and the digital exchanges or wallets that keep their money. There is an obligation in terms of physical or digital records that the customer has X amount of currency deposited in the bank, exchange or wallet. He therefore concludes that "Bitcoins are as real as money".[55]

Houben, like Koepsell, also argues that Bitcoins are currencies because people have accepted them to be as such. Houben states that "this shows that money is a concept that evolves along with an evolving society".[56] Houben further opines that "from a dogmatic point of view Bitcoins seems to comply with all of the components of the legal concept of money".[57] However, he also points to an interesting Dutch case[58] which decided that Bitcoins were not money from a legal perspective due to the fact that the Dutch Civil Code does not apply to Bitcoins.[59]

Contrary to this Dutch decision, Bitcoins were considered to be legal tender in an America Case, where an East Texas federal judge[60] decided that the currency could be regulated under American law.[61]

It is therefore still unclear in any given jurisdiction as to whether Bitcoins are money, regulated or part of the legal financial system. What is pertinent legally speaking is that Bitcoins have been used as part of criminal activities and have also been used for social benefits. The next part of this paper will consider the benefits of using digital currencies in countries that have suffered economic crisis.

8.6 Financial Crisis and Digital Currencies

Within Bitcoins, in some instances being credited as being money, it is interesting to explore how Bitcoins or other digital currencies could be used for the social benefit of the world. Bitcoins, it is argued, have their

origins linked to the financial crisis of 2007–9.[62] Commentator Negurita has orated that the existence of Bitcoins could be linked to the global economic crisis, promulgated by many challenges to the stability of national banking systems.[63] Negurita continues to explain why the growth of Bitcoin is related to the global economic crisis, and states that the natural occurrence of Bitcoins is understandable when central governments are causing ordinary people to lose deposited or investment money in safe and centralised financial intuitions.[64]

Similarly, Sablik also highlights the importance of the role of the global financial crisis on the creation of the Bitcoin. He states that "some individuals looking for alternatives to government-issued currencies".[65] Discussing the idea of the perception of money, Sablik opines that as long as people believe that the currency being exchanged for goods is a real currency, then it is money and useable as money.[66] However, he continues to look at the issue of regulation and argues that digital currency is like the inception of the internet. Legislators and policy makers are unsure as to how to legally treat it. On one hand, we could apply existing laws or we could come up with new laws which would fit better.[67] What is clear is that it offers social potential but that there are legal obligations which must be addressed such as money laundering rules to ensure the safe and legal use of the currency.[68]

Former Greek finance minister, Yanis Varoufakis, has been a vocal supporter of using Bitcoins as an alternative for national currency, where financial crisis has crippled economies. On his website,[69] he believes that Bitcoins "can be used profitably in order to help the Eurozone's member states create euro-denominated electronic payment systems that help them…overcome the asphyxiating deflationary pressures imposed by the Eurozone's Gold Standard-like auterian design".[70]

8.7 Greece

The Great Financial Crisis of 2007–9 affected most countries around the globe. However, within the Eurozone, several countries were affected greatly. These countries, Greece, Ireland and Iceland, saw enormous strain on their domestic economy due to the crisis. Greece is, some six years after

the crisis, still struggling to maintain solvency. the former Greek finance minister, Yanis Varoufakis, is an advocate of using a digital currency as a parallel to the Euro to help "delay the moment of default on the loans". As Mason opines about the Greek financial problem,

> The Greek debt is unpayable; the austerity required to pay it down is socially unbearable. So whether it's this week or in six months' time, there will come a point when Athens cannot meet conditions acceptable to the European Central Bank. Then, the normal sequence would be: bank closures, capital controls, an angry standoff and ultimately a Greek default.[71]

Varoufakis's idea is that the digital currency would be similar to Bitcoins but it would be issued by the state and would, like Bitcoins, be exchangeable for Euro's. The other difference would be that if, once you had the new digital currency, you retained it for more than two years, you would get a profit back on it paid for by taxes. Varoufakis termed the idea a "future-tax coin".[72]

The reasoning behind Varoufakis' proposal was that Greece would have a currency, which was outside the reach of Brussels and that it would give the people of Greece an opportunity to live within the reaches of austerity. Varoufakis is seen as an anti-establishment economist and should a digital currency actually come into being in Greece, it would support his, and many others', ideas, that it should be the state and not markets that create money.[73]

The argument is further developed by the anti-establishment economists stating that taxing and spending creates money and not buying and selling in the market place. By the state taking an active role in regulating and taxing money within their system, they can create more money. This modern monetary theory is as Mason argues, not a theory any more.[74]

This belief in the state and that the state will exist in the future is what drives this modern monetary theory forward. If people believe in the currency, then it is real and the economy can regain its cogs once more. If this happens, the state can pay people, and it can create more jobs and can ensure the economy is running despite running at a deficit. In other words, a state that controls its own monetary system will always be solvent as it can always create more. This is an inherent problem for countries within the Eurozone which do not have control over their national

monetary systems and as we can see from the Greek problem, can lead to severe monetary solvency issues for countries.

During the financial crisis when ATM machines were running out of cash, there was a rise in the use of Bitcoins and in fact the first Bitcoin ATM was set up in one of the Greek Islands so that people could access money.[75] On the island of Agistri, a test case for the digital currencies, a local loyalty scheme has been created (drachmaeconnect.com) which allows people and tourists to use a digital currency when conducting financial transactions on the island.[76] It has been argued[77] that the use of the digital currency can be likened to the use of M-Pesa in Africa, which is a mobile phone-based money transfer and micro-financing initiative.[78]

The Greek financial crisis and the use of digital currencies by ordinary people, as a short term means of accessing money, demonstrated the social benefit of the decentralised peer-to-peer system. The Eurozone has been severely disabled during the recent financial crisis and its people turned to non-government-controlled money. It allowed people to have access to the basic necessities that money facilitates. However, the appeal and awareness of what Bitcoins or other digital currencies could offer people in austerity or financial crisis, is limited. By regulating the digital currency, awareness would rise but with regulation comes governmental control. The people of Greece have demonstrated throughout the years since the financial crisis, their mistrust of those in charge of their financial system. Regulation by the government or national banks may not be the right legal and social position but it would enable the digital currency to become more mainstream and facilitate an economic growth, which the Euro is not able to do currently. Regulation, in some shape or form, would allow for the currency to be used in a legal way and to ensure the safety of its users, but perhaps it would diminish the appeal of its maverick nature.

8.8 Advantages and Disadvantages of Using a Digital Currency for a Crisis-hit Country

The financial crisis has allowed economists and legal academics to look into the benefits and disadvantages of using Bitcoins, or other digital currencies as a means of alternative finance. In the next section of this

chapter, an exploration of these will be undertaken to argue whether an alternative currency could be beneficial to those countries inflected by global financial crisis measures.

8.8.1 Disadvantages

There are many disadvantages to using Bitcoins or other digital currencies but these are not insurmountable. One of the issues with Bitcoins is the lack of a financial institution's involvement and therefore it falls outside the legal remit of banking.[79] There are no safeguards in place to protect the consumer if a digital currency is not linked to a bank. If the digital currency stops being in existence or suffers a financial crisis, then it is not backed by the bank and government, and the customer will not have any recourse.[80] Digital wallets and also credit and debit cards used in financial transactions of digital currencies will also not recompense a customer who has suffered a loss through the use of digital currencies.

Bitcoins are very volatile and customers can lose vast amounts of money very easily and quickly without government or institutional backing and safeguards.[81]

Another disadvantage is that there are a limited number of goods and services available for exchange of Bitcoins or digital currencies.[82] The digital currency phenomenon is relatively new and not all vendors accept digital currencies as a means of payment. This is changing however, and in cases of financial crisis, evolution and development are quick to set in to accommodate supply and demand.

There is a lack of national and international regulation, which means that any unregulated digital currency can be used for criminal purposes, such as money laundering and terrorist financing.[83] However, more countries are now viewing the financial transactions of digital currencies as being applicable to national anti-money laundering rules. Although it does not protect the currency itself, it can protect the consumer and society in general.

Tax evasion is also a disadvantage (or advantage) of using digital currency and has been seen as a means of avoiding paying national taxation.[84]

In light of this, the USA and Germany has taken the stance that Bitcoins are subject to capital gains tax and retail transactions are subject to sales tax. In Denmark, casual sales of Bitcoins are not subject to taxation but Norway follows the German taxation system.[85]

Bitcoins themselves have issues, where they have been stolen or lost, thus rendering the owner unable to seek recompense or recourse for their return. Virtual wallets can be hacked with the result of the theft of Bitcoins[86]; they can also be lost or erased from an owner's computer.[87]

Bitcoins can also be used to pay for unregulated gaming activities on the internet. Consumers using unregulated gaming sites have a mistrust of mainstream financial providers and as such use alternative means of financing for their activities. This can lead to the increase of criminal activities stemming from gaming.

8.8.2 Advantages

One of the most notable advantages for countries within a financial crisis is that Bitcoins are non-governmentally controlled. Thereby government, unless through legislation, cannot control the use of the currency, if the country is gripped in a financial crisis. People would be able to access their finances through the internet, thus allowing spending and consumption of goods. In countries such as Greece, Cyprus and Iceland where banks saw enormous runs on their deposits, people with access to Bitcoins would still be able to have access to their accounts.

The cost and speed of the transaction is also a benefit to the currency. The irrevocable transaction is faster than a normal electronic transfer as it does not need to go through a third party for authentication. The process is peer-to-peer lending.[88] This also means that the cost of the transaction is considerably lower, depending on the type of transaction being made. This will also benefit and encourage the growth of micropayments, thus increasing the number of people who have access to finance globally.[89]

Financial privacy is both an advantage and a disadvantage of the currency system.[90] Although transactions are not completely anonymous due to the Bitcoin unique address being recorded in the blockchain ledger,

there is more privacy associated with the financial transaction than with traditional payment systems. A disadvantage would be that the levels of anonymity create a criminal undertone where criminal activities can be traced back to.[91]

Access is also a huge advantage of a digital currency.[92] A digital currency is based on the internet and therefore can be accessed by any population that has access to the internet but perhaps does not have access to other systems of finance. This may the case not only in rural developing countries but also in countries where financial crisis has led to the collapse of the traditional banking system.

8.9 Conclusion

In this chapter the idea that Bitcoins or other new forms of digital currency can be used as a new form of currency in economies is discussed. In particular it is discussed agsainst the background of financial crisis in countries where the digitial currency is used as a means of continuing commerce. Also witihn this chapter it is discussed that these unregulated digitial currencies can pose serious criminal issues. There is much merit in the idea that a parallel digital currency could mean a lesser effect of austerity measures in times of financial crisis. A digital currency may also mean that more of the unbanked population being bought into the financial environment through an alternative mechanism. To regulate the digital currency in comparison to the traditional forms of finance would mean that the possibilities of the currency are curtailed. Not regulating digital currencies in light of traditional crimes effecting finance will allow the criminal underbelly of society an avenue to flourish. A bespoke set of national and international laws directing legislation and guidance to where digital currencies can achieve benefits are greatly sought after. This is only achievable through a careful and considered debate between policy makers and users/developers of digital currencies. Digital currencies can offer much hope for a fairer and more equal financial system but if the regulators get it wrong, they will be forever confined to criminals and those who are rich enough to dabble in innovative finance.

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9

Financial Crime in the Twenty-First Century: The Rise of the Virtual Collar Criminal

Alan S Reid

In the twenty-first century, individuals, corporations and governments are becoming increasingly exposed to the risk of becoming victims of financial crime. The rise in white collar crime can be largely attributed to modern society's increasing reliance on electronic communications systems to control, monitor and deliver fundamental services. Schools, hospitals, companies, governments and households all rely on electronic communication networks to function properly. The exponential rise in ownership of powerful smartphones, tablets, portable gaming consoles, wearable computers and smart TVs, allied with the growing availability of Wi-Fi hotspots and the phenomenon of the Internet of Things, have coalesced to revolutionise mobile computing and internet access. People are accustomed to working, playing, relaxing and socialising remotely and, as such, are constantly exposed to the danger of financial cybercrime.

Beyond the present, the future offers infinitely more opportunities for financial crime, as people's lives will be lived increasingly in the ether, through ubiquitous computing. The general phenomenon of cybercrime, although a relatively recent occurrence, is undergoing a paradigm shift in

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N. Ryder (ed.), *White Collar Crime and Risk*,
https://doi.org/10.1057/978-1-137-47384-4_9

its modalities. Cybercrime is rapidly evolving to encompass increasing virtuality. Virtual money and financial systems, virtual representatives such as avatars, virtual memory and virtual imagery are just some examples of the increasing dimensions of electronic communications. Virtual money can be stolen or used to launder real-world money, avatars can be attacked, destroyed or controlled by others and virtual intellectual property can be misappropriated. Further, virtual imagery that is illegal or offensive may be used and distributed for the purposes of blackmail and extortion. Virtual memory and resources hosted in the cloud can be stolen, modified or erased. Such virtual operations are often conducted anonymously or at least semi-anonymously and thus they embolden the perpetrators of these white collar crimes that they can remain hidden in cyberspace, thus fuelling the preponderance of this type of crime. Thus, virtuality is promoting the rise of a new phenomenon, coined by the author as virtual collar crime.

This chapter outlines the rise of opportunities for virtual crime directed at individuals, corporations and governments, and discusses what can be done to counter virtual financial cybercrime.

9.1 Introduction: White Collar Crime

The notion of white collar crime is well established and well documented. However, its definitional scope is incredibly fluid, porous, changeable and contestable. Historically, its classic exposition was espoused by the American criminologist Edwin Sutherland, in his famous book from 1949.[1]

For Sutherland, the defining features of white collar crime were the nature of the perpetrator and of the crime. It was a

> crime committed by a person of respectability and high social status in the course of his occupation.

The perpetrators invariably relied on their high occupational status, exemplified by the wearing of a white collar[2] and business suit, to inveigle their victims into suffering financial losses. The crime required a high level of trust dependency on the part of the victim towards the perpetrator

and directly resulted in a loss of money or money's worth. The trust would be 'earned' by the perpetrator on account of their occupation, high position in society or high level of experience and skills and thus extended to business people, politicians and celebrities and not just middle and higher management employees of an organisation. This position of high status, high skill or high reputation enabled the perpetrator to engage in sophisticated abuses of that trust and position, without resorting to violence or threats of violence.[3] In terms of victims, the notion of white collar crime encompassed both individual victims who were overcome by the skills, position and reputation of the supposed trustworthy white collar operative and multifarious collective, innominate and diffuse victims such as legal corporations, local and national government, taxpayers and even abstract incorporeal notions such as the environment.

Traditional white collar crime encompassed financial crimes such as bribery, embezzlement, money laundering, unfair competition, obstruction of justice and perjury, tax evasion and regulatory violations in fields like health and safety law, environmental law and food safety law.

Sutherland's definition came under increasing attack as being too simplistic, over-broad and undefined.[4] Nevertheless, the phenomenal rise in internet use globally has breathed new life into the general phenomenon of white collar crime.

The growth in general and specific cybercrimes, intellectual property infractions and novel crimes like health care fraud have required a new definitional approach to white collar crime. Further, the author posits that the growth of the internet has even created the possibility of a new definitional paradigm, that of virtual collar crime.

9.2 The Lure of the Internet

Criminologists have argued that criminal offenders typically base their decision to engage in criminal activity on five variables: The effort that needs to be expended in committing the crime; the risk of detection; the rewards of the crime; the conditions that provoke criminal action; and the ease of justifying or rationalising their behaviour.[5]

Thus cyberspace is a particularly attractive criminal space. For virtual collar criminals, cyberspace is an important enabler, which reduces these barriers and helps to promote criminal behaviours and activities. The effort to be expended in committing crimes on the internet is low. Perpetrators no longer need specialised computing skills to perform cybercrimes, the crime can be conducted from the comfort of your own home, workplace or office anonymously and the crime can be conducted at any hour of any day, any day of the year. The rise of Virtual Private Networks (VPNs), TOR[6] browsers and end-to-end encryption mean that the risks of being identified during and after the cybercrime have been lowered. The rewards in cybercrime are potentially substantial, although the increasing incidence of cybercrime has had a deflationary effect on the price achievable for stolen identities and other easily traded digital information. The atomised nature of online communications and crime allow for individuals to be actively encouraged to commit crime and thereafter to easily rationalise it as a victimless, small-scale crime.

Academics have identified four locations around which criminal activities coalesce. According to Felson, Hammer, Madensen and Eck,[7] criminals obviously require a crime site itself, in order to perform the crime. This is the first place for crime – the crime site (*locus delicti*). Frequently, criminals will require the assistance of fellow conspirators in order to commit the crime and thus require a space to both interact with fellow criminals (Zone 2, identified as the convergence space setting) and a site to hide in and prepare for future criminal enterprise (Zone 3, the comfort space). The fourth zone is the corrupt spot, namely the place where further crime is encouraged from elsewhere.

In the real world, the *locus delicti* would be the home, the office, the workplace, the bank. Zones 2 and 3 would be the pub, the home, the gym or the car. Zone 4 would be places like recycling centres that incentivise the theft of valuable scrap materials.

The nexus of virtual collar crime is cyberspace itself and as such lends itself to a wide range of activities. Indeed, virtual collar crime is so appealing because all four zones of opportunity can be situated in cyberspace. The *locus delicti* (Zone 1) of the crime is the internet: for example, stolen e-money, online services not paid for or theft of intellectual property. Zones 2 and 3 are similarly positioned in the ether: the e-games hub,

social media sub-groups, special interest sites and the Dark Web. Zone 4 Corrupt Spots may also occur online: members of social media sub-groups, special interest sites and populations of the darkest reaches of the web may facilitate, support, encourage and create a market for the acquisition of illicit goods and materials and commission of online crime.

9.3 The Power Balance and the Changing Conception of White Collar Crime

The concept of white collar crime is predicated upon an imbalance in power between the perpetrator and the victim. In particular, the trust the victim places in the perpetrator rests on a certain level of ignorance and/or dependence on the part of the victim and a particular skill or attribute of the offender. The recent history of cybercrime has closely matched this white collar paradigm: the virtual victim has tended to be middle aged or older, be a newcomer to technology and thus under-skilled and under-prepared to defend themselves against the online threat; the virtual perpetrator has tended to be young, male and an enthusiastic adopter and user of new technologies and thus inordinately tech savvy and the online crime could only be committed by deploying specialist software or technological skills, for example, through the creation and execution of malware, ransomware or computer viruses.

In the second decade of the twenty-first century, this paradigm no longer holds true. Victims of online crime are getting younger as technology becomes an established, all pervasive fact of life at an earlier and earlier age; victims in their teens or in their early twenties are digital natives and therefore tech savvy, not ill-prepared and unskilled in the digital environment; malware, ransomware and computer viruses are no longer bespoke, targeted complex computer programme codes beyond the reach of all but the best computer experts; generic programmes can be purchased off the shelf, via an online marketplace, or as an online crime application for smart phones and tablets; perpetrators no longer need a degree in computer science to create or execute online crime programmes and applications; in short, the imbalance between the victim and the perpetrator has narrowed considerably.

This phenomenon is documented as 'Crime as a Service'.[8] Thus, the specialist skill required can now be outsourced and cascades downwards to the lower levels of criminals, who would have traditionally been thought of as blue collar criminals.

Blue collar crime is known as street level crime, frequently perpetrated by low-skilled males and encompasses physical attacks, threats of physical attacks and is highly visible and impactful. This type of criminal activity has a more direct bearing on people's quality of life, particularly physical attributes and as such society has tended to prioritise its resources on this type of overt criminal activity. White collar crime, by contrast, was relatively hidden, from the point of view of the victim, the harm caused and its societal impact and as such was given a much lower priority by law enforcement and the machinations of the state.

The future challenge for society is the increasing democratisation of white collar crime, such that these crimes can be committed by an increasing range of unskilled individuals and organised criminal gangs.[9]

9.4 Future Virtual Collar Crime

In common with cybercrime generally the move to an online life has revolutionised the opportunity for criminal activity. Old crimes can be committed with increasing frequency and novel crimes are proliferating. Both the scale and scope of cybercrimes is increasing. Indeed the notion of 'crime as a service' means that the ability to successfully engage in online criminal activity is lucrative in itself, that is the virtual collar criminal can monetise his skills and knowledge in the virtual marketplace, selling his expertise to the online criminal masses. The greater propensity for humans living their lives online generates greater opportunities for virtual collar crime, as exemplified by a number of examples discussed below.

9.4.1 The Internet of Things

Internet-connected laptop computers, tablets and smartphones are ubiquitous in the twenty-first century, featuring in millions of homes, offices, factories and retailers across the globe. As such, the public is aware of the

risks of going online and thereafter becoming a victim of cybercrime. However, the Internet of Things[10] looks set to magnify this risk by many factors in the coming years. As an example, within the European Union, research conducted by the European Commission estimates that there will be over 6 billion Internet of Things connections in Europe by 2020.[11]

The term 'Internet of Things' refers to the widespread deployment of Radio Frequency IDentifier 'RFID' enabled devices, products and furniture. RFID technology allows inanimate objects, previously seen as simply passive accoutrements of life, to actively collect and communicate information about their environment, position and status, remotely to servers and computers located anywhere in the world. Wide scale deployment of this technology posits an intelligent, ambient, fully controllable future. Thus, these passive objects are transformed into smart, active, technological computer devices and in so doing, liberate the internet, freeing it from its computer-based shackles. In so doing, the car, the fridge, the lightbulb, the oven, the toilet seat, the shower, the carpet, the cupboard, the desk, the door, the clothes on your back, the pacemaker and cybernetic enhancement[12] devices become receptors and repositories of valuable information.

This integrated seamless automated nirvana belies a serious criminal undercurrent, with this valuable information ready to be intercepted, modified, stolen or withheld by the virtual collar criminal. The risks associated with this technology are well documented.

At present, the increasing use of internet-enabled apps to control vehicles or indeed to order taxis[13] mean that personal transportation is already vulnerable to criminal attack. The electronic systems that control battery and engine power, heating and air-conditioning and the alarm and the door openings could be controlled remotely and therefore could be controlled by someone other than the driver or owner. Drivers or owners of electric cars could amend the power supply software so that they are charged less for their energy when plugged into the grid. Power to the engine and the controls could be switched off, making the car inherently dangerous, with the speed being increased to dangerous levels. Records of vehicle journeys could be made readily available online, much to the chagrin of the adulterer, the drug seeker or skiver.

In the future, autonomous vehicles[14] will negate the need for humans to be in control of a vehicle at all, with every aspect of the car being

controlled via artificial intelligence software. The car will select the most appropriate route and navigate through streets and motorways independently, avoiding other road users using anti-collision software.

Such ability to access critical information about the vehicle and to assume control of critical decision making software leaves the vehicle owner, the driver and passengers and the car manufacturer vulnerable to financial crime such as theft, blackmail, extortion and spurious personal injury claims.[15]

In the medical field, pacemakers, defibrillators or ventricular assist devices can be interrogated remotely by medical devices or can transmit their data via Wi-Fi, notifying the physician that it or the heart are not working properly. In the future, cybernetic enhancements such as bionic limbs, exoskeletons[16] and even brain augmentation implants will enable people to run and walk faster, lift and carry very heavy objects and receive and process information in the brain faster than is possible at present. In the field of entertainment, virtual reality games will increasingly rely on EEG[17] headsets to allow players to control the movement of avatars and control vehicles.[18]

The risk of a Wi-Fi enabled cyber-attack against a pacemaker, defibrillator or ventricular assist device, making the heartbeat or blood flow dangerously irregular, is not just a fantastical storyline for television drama, it is a realistic threat vector for opportunistic virtual collar criminals.[19] In a similar vein, in the future, bionic limbs and exoskeletons could be susceptible to hacking attacks, rendering them inoperable or working at levels dangerous to human health. The deployment of brain augmentation implants may leave individuals vulnerable to the threat of psychological trauma. As the technology to read brainwaves through EEG headsets advances, hackers, using specialist algorithms, may even be able to accurately guess the passwords used by e-gamers to access the site, leaving them vulnerable to online theft and blackmail.[20]

Everyday items are and will be transformed by increasing deployment of the Internet of Things. The smart lightbulb, the smart carpet and smart heating thermostat controls can inform building owners of the number of people left in the building and alter the heating, lighting and security requirements of the building according to the fluctuating levels of occupancy over the course of the day in real-time, thereby achieving efficiency gains by saving energy, resources and money. Increased reliance upon

software means that the building itself becomes vulnerable to hacking and remote control[21] by unauthorised individuals and groups, who can gain easy access to the building to steal or cause damage to the building.

More specifically, the ramifications for the power station,[22] air traffic control,[23] nuclear submarine defence,[24] care homes, water treatment plant or hospital[25] are immense. Critical infrastructure can be held to ransom, services can be disabled and utility services can be contaminated.

Smart fridges can interrogate RFID-enabled food and drink receptacles inside, notifying the owner that the milk has gone off or that the stock of white wine is critically low. The smart fridge can place an online order for milk or wine to be delivered, interrogate the smart door lock, causing the door lock to the house to open, ready for the supermarket delivery driver to enter and restock, all under the watchful eye of the CCTV. The internet retailer Amazon has even invented the Amazon Dash button, a Wi-Fi enabled button allowing the replenishment of toilet rolls, razor blades and beer, which, in the future, could be delivered by drone.[26] This level of consumer immediacy and simplicity is a boon for busy households but could also be a mechanism for fraud. Smart fridge owners may hack the system to gain more supplies than they are actually invoiced for and neighbours may intercept deliveries by drone.

9.4.2 The Sharing Economy

The phenomenal rise in online commerce, particularly consumer to consumer transactions (C2C) has resulted in a significant rise in the risk of opportunistic online financial crime. The twenty-first century has also seen the rise of what has been called the Sharing Economy.[27] The Sharing Economy[28] refers to People to People (P2P) networks whereby people connect over the internet to share human, physical and intellectual resources, typically on a reciprocal, non-monetary basis.

Sites like AirBnB,[29] Uber,[30] eBay,[31] Amazon Marketplace[32] and Craigslist,[33] have revolutionised commerce conducted via cyberspace. They have disrupted traditional commerce models such as Business to Business (B2B) and Business to Consumer (B2C). They are based on the principle of connecting buyers and sellers on a many to many basis. As such, they reduce the professional and commercial links of traditional B2C business and replace

this with a horizontal transactional relationship between private individuals. This change in relationship promotes riskier behaviour and a greater exposure to fraudulent activity. The main laws on consumer protection do not apply to C2C transactions.

Consumer to consumer fraud is multifarious. Examples include online sellers sending their products to the buyer, only for the buyer to claim that no such product arrived.[34] It appears that unscrupulous sellers are able to substitute the real goods with other inferior or cheaper objects and then claim that the goods never arrived or were damaged in transit. Under the contractual terms of eBay, the buyer is arguably more strongly protected than the seller under the terms of the Money Back Guarantee[35] and therefore unscrupulous buyers can invoke the redress system before the seller has had an opportunity to tell their side of the story and therefore receive reimbursement from eBay, which then seeks recompense from the seller.[36]

9.4.3 Cryptocurrencies

The exponential rise in interconnected computer networks and the concomitant rise in online transactions globally, created a desire for a truly online method of payment, freed from the shackles of the traditional banking system. Thus, the past few years has seen the rise of alternative payment systems like PayPal but also the creation of virtual currencies, based on peer-to-peer technology.[37] The most famous crypto-currency is that of Bitcoin. These decentralised systems of exchange offer tremendous advantages over traditional transfers of money's worth that require the involvement of financial service providers acting as third party intermediaries, which charge a fee and inevitably cause a delay in transferring the funds, adding to the overall cost of the transaction. Involving a third party in the transaction also increases the risk of the underlying transaction not being fulfilled, due to delay, misplacement of the funds or the financial service provider refusing to authorise the transfer.[38]

Nevertheless, reliance on crypto-currencies is not without significant risk of becoming a victim of virtual collar crime. In the case of new, emerging currencies, there is always a nascent phase in their development in which the currency is pre-mined, in order to generate enough critical

mass of the currency to trade in.[39] Once the currency is established, users of cryptocurrencies face the risks of extreme volatility in the real world value of currency, the lack of convertability into real world currencies, and the general cybercrime risks of malware, ransom requests and theft.

9.4.4 The Dark Web (and the Light Web)

The anonymous dark web has now entered the public consciousness and is utilised for both legal and illegal means. The privacy afforded by the use of technology such as TOR emboldens internet users, in a positive sense, to criticise their repressive government, expose illegal activity of their politicians, organise legitimate protests and demonstrations and to communicate with like-minded individuals, free of governmental surveillance.

This privacy is clearly also highly attractive for more negative applications over the internet. The Dark Web facilitates significant trade in controversial products and services such as legal and illegal drugs, child abuse imagery, weaponry,[40] pirated intellectual property, endangered animals and their by-products[41] and looted art and artefacts, of dubious provenance.[42]

However, even the World Wide Web itself is a vector in the sale of such prohibited goods and services. The sheer scale and scope of the membership of social media sites[43] means that like-minded individuals and organisations can easily find one another and arrange the exchange of contraband across borders, with the management of social media sites simply overwhelmed with the task of identifying, monitoring and enforcing criminal law violations taking place on their networks.

9.4.5 Online Dating, Companionship and Revenge Porn

In the cash rich, time poor twenty-first century, the quest for love and human companionship has gone virtual, with a tremendous uptake of social media sites and apps like Tinder,[44] Ashley Madison[45] and Grindr[46] and online dating sites like match.com[47] and eharmony.com.[48] Naturally, the scope for falsity in virtual/remote relationships is immense, since in order to improve the prospects of successful dating and friendship, people

will invariably want to paint themselves in the best light and may decide to cut corners by posting pictures of other people on their profile, embellishing their interests and achievements or creating absolute falsehoods.[49] There is also an enhanced risk of becoming the subject of blackmail, extortion, identity fraud and identity theft. Blackmail and extortion are a real risk where the individual is in a long-term relationship of marriage or civil partnership and actively seeking sexual partners outside of that long-term relationship or where the individual is seeking a sexual partner online, who is different to their known sexual preference(s). Identity fraud and theft are a risk simply because the dating apps and sites, by definition must collect, retain and use sensitive personal data of their users in order to provide the dating service itself. The hacking of the Ashley Madison site, exemplifies the range and nature of this risk.

The atomised, distant nature of online interaction facilitates such behaviour. However, recent developments have augmented this activity. The process of relationship finding online can now be outsourced for a fee, with companies and individuals offering to organise and operate an individual's online dating account.[50]

If finding a real-life partner is too complicated, or a person is under familial pressure to be in a long-term relationship, technology offers a solution in the shape of a virtual girlfriend or boyfriend. Apps like Virtual Girlfriend and KARI, allow people to interact with an artificial intelligence computer system. The virtual companion will respond to the user's communications and can even send messages to friends and family that convincingly appear to come from a real person.

Internet connectivity in the bedroom may result in a loss of libido and/or physical intimacy in a relationship, however adult toys that are Wi-Fi enabled can lead to more serious problems of a legal nature. Beyond the obvious privacy concerns[51] that may arise from usage data being stored in the cloud by the toy manufacturer, users may be susceptible to hackers resorting to blackmail or extortion.

The video capture technology in the palm of everyone's hand has led to the modern phenomenon of revenge porn. The ability to easily record high-quality images and sounds in a compact smartphone or tablet means that amateur pornography has gone mainstream. Self-made pornography, consensual recording of intimate bodily areas or activities or surreptitious non-consensual filming of such activities, all share one

characteristic: the ability to be uploaded and shared online by the ex-lover, the stalker, the voyeur and the hacker. The phenomenon of revenge porn does not squarely fall within the broad definition of white collar crime. Nevertheless, the consequences of such actions do clearly fit the definitional matrix. An online industry has developed whereby, for a not inconsiderable fee, websites hosting this material will gladly take down the offending images.[52] Indeed, the commercialisation and professionalism of the websites exhibit the classic white collar paradigm.

9.4.6 Algorithms

This utopic (or dystopic) online environment relies heavily upon complex algorithms to work. At present, individuals are accustomed to automated decision making, particularly when they apply for a loan or a mortgage. Artificially intelligent entertainment services already allow people to talk to devices that can suggest recipes to cook, TV shows and films to watch, games to play and music to listen to. Social media sites use algorithms to direct content to users that is exciting, entertaining and enticing, according to their demographic. In the future, algorithms will control the driverless car and the conversation with a virtual assistant will be indistinguishable with interactions with humans.

Altering the algorithm offers significant scope for financial crime. The applicant could secure a better loan rate for themselves or hackers or financial service employees could force the applicant to accept an artificially worse loan rate, with the virtual criminal pocketing the monetary difference. Entertainment service and social media algorithms could be modified by individuals to direct and monetise traffic to content and websites controlled and operated by that individual or their associates.

9.5 Virtual Collar Crime Solutions?

As this overview of the near future provides, increased online living is accompanied by an increased risk of being a victim of virtual crime. The UK's National Audit Office has recently grappled with this phenomenon and has highlighted significant deficiencies in the country's preparedness.[53]

The report found that in 2016, in England and Wales, there was estimated to have been 1.9 m separate cyber-related fraud events, equating to 1 in 6 adults experiencing fraud, making online fraud the most commonly experienced crime.[54] However, recorded fraud incidents for the same period only totalled 623,000, indicating a massive problem with under-reporting.[55] Collectively, these individual cyber-frauds are calculated to cost individual victims a loss of £10 bn and businesses £144 bn.[56] Crime of this magnitude, scale and scope should be one of the highest priorities for law enforcement within the UK. However, according to the National Audit Office, only 1 in 150 police officers have, as their main function, the investigation of economic crime.[57] Further, more than a third of Police and Crime Commissioners in England and Wales omitted to mention online fraud at all in their annual plans for 2017.[58]

Individuals and organisations, who wish to be proactive and minimise their exposure to online fraud, are faced with a bewildering array of advice sites, creating the risk that the educational message is lost, contradictory or out of date.[59]

The fragmented, disparate and individualised nature of virtual collar crime means that it is difficult to coordinate, plan and enforce the law in a coherent way. The victims, offenders, modalities, scale and effect of virtual collar crimes are extremely heterogeneous. Thus, a one-size-fits-all approach to tackling the phenomenon will not work. This diversity is also replicated in the approach taken to these crimes by the police in England and Wales, exacerbating the discrepancy in approach across the country, with pockets of best practice not being rolled out across the entire UK. The City of London police, with their geographical location in the heart of the UK's financial district, are in a privileged position to take the lead in the fight against online crime, alongside the National Fraud Intelligence Bureau and the National Crime Agency.[60] However, even with only three bodies involved, there is scope for gaps to appear, contradictory approaches, for best practice to remain localised and for duplication of effort. The international nature of many virtual collar crimes means that cooperation between law enforcement, prosecuting authorities and the judiciary needs to be maintained and enhanced with the UK's partners both within the EU and with the rest of the world. At the level of prosecutions and sentencing, there is also wide divergence in the

rate of prosecutions and the sentences handed out across England and Wales.[61] In the past, these discrepancies could be dismissed as being the result of crime being a localised or regional phenomenon that did not take place uniformly across the country and sentence diversity simply reflected the multifarious permutations of fraud. However, in the twenty-first century, no village, hamlet, town or city is immune from the risk of virtual collar crime and the diversity of the typologies of virtual collar crime do not justify a corresponding diversity in sentencing. Stolen intimate photographs, the theft of a Bitcoin, inflated loan repayment schedules or a non-existent holiday apartment booked and paid for online all share the same basic white collar characteristics: a betrayal of trust and significant financial and non-financial damage to the victim and as such, sentencing should reflect the level of individual and societal harm caused, societal opprobrium of the conduct and a proportionate deterrent effect.

9.6 Conclusion

A perfect storm of increased internet penetration and pervasiveness, reduced complexity in the creation and operation of internet apps and services, and the growing realisation of the profitability of the 'Crime as a Service' model and of assisting criminal activity online, has transformed the concept of white collar crime.

The history of white collar crime is replete with examples of technological developments being used to incorporate facets of what can now be termed virtuality. The telegraph, the phone, the cheque, the fax, the credit and debit card and the computer, all provided increasing physical distance between the white collar criminal and the victim. However, twenty-first century technology has been truly transformative. Digitisation means that virtually all physical and non-physical crimes classified as being of the white collar genus can be committed in cyberspace. The defining characteristic of white collar crime has been that it is committed by a person who is in possession of technical expertise or skills and is therefore in a position of trust. That trust forms the basis of an imbalanced power relationship, which is then abused to commit financial crime. However, white collar crime has transcended these limitations.

The expertise and skill of the white collar criminal is now easily obtainable and sophisticated computer programmes and algorithms offer the authenticity, professionalism and competence required to engender trust.

The growing usage of online horizontal commercial, business, social and professional platforms, the rise of the Internet of Things, the simplification and ease of access of internet apps creation and their deployment and the development of the 'Crime as a Service' model has created the phenomenon of Virtual Collar Crime.

The law needs to be more attuned to these dangers. Small scale, individual virtual crimes must be aggregated to highlight the collective, cumulative danger to society. As developed societies are driven towards ever more online dependency, these virtual risks will only increase exponentially. Legal developments also need to go hand in hand with an upscaling of digital skills for the general population so that individuals and organisations can better defend themselves and prevent them from becoming victims. Otherwise, the society faces an unprecedented reversal of technological advancement as we lose all semblance of trust in the internet: A Winter of Disconnect.

Notes

1. *White Collar Crime*, E. Sutherland, 1949, New York: The Dryden Press.
2. Hence the *modus operandi* and nomenclature of the crime.
3. See, for example, A. Wright, *Organised Crime*, 2005, Willan Publishing, at p. 63.
4. See, for example, the various critiques discussed by Hazell Croall – *Understanding white collar crime*, Croall, 2001, OUP, at pp. 6–7 and the discussion in Chapter 4, Computer Crime and White Collar Crime, Grabosky and Walkley, in *International Handbook of white-collar and corporate crime*, Pontell and Geis (eds.) Springer, 2007.
5. See, for example, *Opportunities, Precipitators and Criminal Decisions: A Reply to Wortley's Critique of Situational Crime Prevention*, Cornish and Clarke, Crime Prevention Studies, 16 (2003), 41, *Understanding white collar crime*, Croall, OUP, 2001, and *The Oxford Handbook of White-Collar Crime*, van Slyke, Benson and Cullen (eds.), OUP 2016, particularly Chapter 19 by Tamara Madensen, entitled *Opportunities for White Collar Crime*.

6. Otherwise known as The Onion Router. TOR browsers allow internet users to surf the internet with a significantly enhanced level of privacy, akin to almost complete anonymity. The browser software, through a system of relays and encryption, routes connection information in a more private way such that it is incredibly time-intensive and difficult to trace individual users. The browser software is available at; https://www.torproject.org/download/download-easy.html.en
7. As identified by Tamara Madensen, in chapter 19 '*Opportunities for White Collar Crime*' of *The Oxford Handbook of White-Collar Crime*, van Slyke, Benson and Cullen (eds.), OUP 2016, particularly.
8. See Chapter 3 of the Europol Internet Organised Crime Threat Assessment 2014, available at; https://www.europol.europa.eu/iocta/2014/chap-3-1-view1.html
9. See for example the EUROPOL SOCTA report 2017, available at; https://www.europol.europa.eu/activities-services/main-reports/european-union-serious-and-organised-crime-threat-assessment-2017
10. See for example, *RFID Tags and the EU: Really Free Internal Distribution?* Alan S. Reid *(2005) JITLP 4, 1–30,* at page 5.
11. See *European Commission Report: Definition of a Research and Innovation Policy Leveraging Cloud Computing and IoT Combination*, 2014, ISBN 978-92-79-47760-7, available at: https://ec.europa.eu/digital-single-market/en/news/definition-research-and-innovation-policy-leveraging-cloud-computing-and-iot-combination, at page 10.
12. The term cybernetic enhancement refers to medical implants and devices that are inserted or attached to the human body, either to replace missing parts of the body or to enhance the functionality of existing body parts. See for example the discussion of this topic in; *The Future of Human Augmentation and Performance Enhancement*, Tracinski, 4th April 2017, Real Clear Science, http://www.realclearscience.com/articles/2017/04/04/the_future_of_human_augmentation_and_performance_enhancement.html
13. Via companies such as Uber, available at www.uber.com
14. That is driverless cars, controlled by artificial intelligence software. See, *Street Wars 2035: can cyclists and driverless cars ever co-exist? Laura Laker, 14th June 2017*, https://www.theguardian.com/cities/2017/jun/14/street-wars-2035-cyclists-driverless-cars-autonomous-vehicles
15. See for example: *Nissan Leaf electric cars hack vulnerability disclosed*, Leo Kelion, BBC News, 24th February 2016, http://www.bbc.co.uk/news/technology-35642749; *Mitsubishi Outlander hybrid car alarm 'hacked'*, BBC

News, 6th June 2016, http://www.bbc.co.uk/news/technology-36444586 and http://www.bbc.co.uk/news/technology-35841571

16. Exoskeletons are external skeletons that are attached to human bodies. They allow disabled people to walk and pick up objects and for soldiers and other professionals to carry heavy loads over a distance. See for example, *Rise of the human exoskeletons*, Neil Bowdler, BBC News, 4th March 2014, http://www.bbc.co.uk/news/technology-26418358
17. The term electroencephalograph, or EEG, refers to a machine placed on the head which can record electrical activity in the brain.
18. See for example the commercial website of Neurosky, available at; http://neurosky.com/2015/09/eeg-games-top-5-list-playing-with-your-brainwaves/
19. The ex-vice president of the United States, Dick Cheney, reportedly requested that his pacemaker have no Wi-Fi capability after watching an episode of the American TV show Homeland: *Dick Cheney feared assassination by shock to implanted heart defibrillator*, Richard Luscombe, Guardian News, 19th October 2013, https://www.theguardian.com/world/2013/oct/19/dick-cheney-heart-assassination-fear
20. See for example, *Study Finds Hackers could use brainwaves to steal passwords*, Tiffany Westry Womack, June 29, 2017, Phys.org, available at; https://phys.org/news/2017-06-hackers-brainwaves-passwords.html
21. *Tomorrow's Buildings: Help! My building has been hacked*, Jane Wakefield, BBC Technology reporter, 20th April 2016, http://www.bbc.co.uk/news/technology-35746649
22. See the discussion in; *Hackers behind Ukraine power cuts*, says US report, BBC News, 26th February 2016, http://www.bbc.co.uk/news/technology-35667989
23. Remote and Virtual Tower control allows air traffic to be controlled remotely rather than from the control tower at the end of a runway. National Air Traffic Services, Press Release, 19th May 2017, available at; http://www.nats.aero/news/london-city-airport-and-nats-to-introduce-the-uks-first-digital-air-traffic-control-tower/. However, it could be argued that such a system may be more susceptible to hacking than pre-existing computer navigation systems.
24. See the report, *Hacking UK Trident: A Growing Threat*, Stanislav Abaimov and Paul Ingram, British American Security Information Council, 1st June 2017, available at; http://www.basicint.org/publications/stanislav-abaimov-paul-ingram-executive-director/2017/hacking-uk-trident-growing-threat

25. The UK's National Health System computer system was taken down by the WannaCry ransomware worm on the 12th of May 2017: *What is WannaCry ransomware and why is it attacking global computers?* Alex Hern and Samuel Gibbs, 12th May 2017, Guardian online, https://www.theguardian.com/technology/2017/may/12/nhs-ransomware-cyber-attack-what-is-wanacrypt0r-20
26. See the Amazon website: https://www.amazon.co.uk/Andrex-Dash-Button/dp/B01I29IZQ6
27. See the definition adopted by The People who Share website: http://www.thepeoplewhoshare.com/blog/what-is-the-sharing-economy/
28. For an overview of some of the contractual risks associated with the Sharing Economy, see *Digital Revolution: Challenges for Contract Law in Practice*, Schulze and Staudenmeyer (eds.), Nomos/Hart Publishing 2016.
29. The website for Airbnb is https://www.airbnb.co.uk/
30. The website for Uber is https://www.uber.com/
31. The website for eBay is http://www.ebay.co.uk/
32. Information on Amazon.co.uk Marketplace is available at http://www.amazon.co.uk/gp/help/customer/display.html?nodeId=3149141
33. The website for Craigslist is https://www.craigslist.org/about/sites
34. *It's seller beware as eBay's buyer guarantee is exploited by scammers*, Anna Tims, 25th April 2016, http://www.theguardian.com/money/2016/apr/25/ebay-seller-beware-buyer-guarantee-exploited-scammers?CMP=share_btn_link
35. The Terms and Conditions of the eBay Money Back Guarantee in the United Kingdom are available at: http://pages.ebay.co.uk/help/policies/money-back-guarantee.html#receive
36. See the discussion in the Guardian Online article: *It's seller beware as eBay's buyer guarantee is exploited by scammers*, Anna Tims, 25th April 2016, http://www.theguardian.com/money/2016/apr/25/ebay-seller-beware-buyer-guarantee-exploited-scammers?CMP=share_btn_link
37. For an overview of crypto-currencies, see *Chapter 9: Virtual currency in a virtual world: virtually unstoppable?* Alan S. Reid, in *Fighting Financial Crime in the Global Economic Crisis,* Ryder, Turksen, Hassler (eds.), Taylor and Francis, 2014.
38. See *Chapter 9: Virtual currency in a virtual world: virtually unstoppable?* Alan S. Reid, in *Fighting Financial Crime in the Global Economic Crisis,* Ryder, Turksen, Hassler (eds.), Taylor and Francis, 2014, at p. 172.
39. See *Chapter 9: Virtual currency in a virtual world: virtually unstoppable?* Alan S. Reid, in *Fighting Financial Crime in the Global Economic Crisis,* Ryder, Turksen, Hassler (eds.), Taylor and Francis, 2014, at p. 176.

40. *Online retail boom helping criminals smuggle guns into UK, says police chief*, Vikram Dodd, 28th February 2016, Guardian Online, http://www.theguardian.com/uk-news/2016/feb/28/online-shopping-boom-criminals-smuggle-guns-uk-police-chief?CMP=share_btn_link
41. See *Wildlife Smugglers using Facebook to sell ivory and rhino horn*, Jeremy Hance, 14th November 2016, Guardian News, available at; https://www.theguardian.com/environment/2016/nov/14/wildlife-smugglers-using-facebook-sell-ivory-rhino-horn
42. See *How Western art collectors are helping to fund Isis*, Leila Amineddoleh, 26th February 2016, Guardian News, available at; https://www.theguardian.com/artanddesign/2016/feb/26/western-art-funding-terrorism-isis-middle-east
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44. The website to download the app is available at; http://www.gotinder.com
45. The website is available at; http://www.ashleymadison.com
46. The website is available at; http://www.grindr.com
47. The website is available at; http://www.match.com
48. The website is available at; http://www.eharmony.com
49. *Tinder nightmares: man scams two women out of $26,000*, Julia Carrie Wong, Guardian Newspaper, 17th February 2016, http://gu.com/p/4gz7n/sbl
50. Virtual Dating Assistants and Invisible Girlfriends. *Invisible Girlfriends: a dubious service for dubious customers*, Eleanor Robertson, Guardian Newspaper, 29th August 2014, http://www.theguardian.com/commentisfree/2014/aug/29/invisible-girlfriend-a-dubious-service-for-dubious-customers
51. See the article, *Sex Toy Maker Pays $3.75 Million to Settle 'Smart' Vibrator Lawsuit*, Jeff John Roberts, March 10, 2017, Fortune, available at; http://fortune.com/2017/03/10/sex-toy-maker-settlement-smart-vibrator-lawsuit/
52. *Revenge porn: the industry profiting from online abuse*, Dan Tynan, Guardian Online, 26th April 2016, https://www.theguardian.com/technology/2016/apr/26/revenge-porn-nude-photos-online-abuse?CMP=share_btn_link
53. *Online Fraud*, National Audit Office, 30th June 2017, ISBN: 9781786041241.

54. *Online Fraud*, National Audit Office, at p. 2 of the executive summary.
55. *Online Fraud*, National Audit Office, at p. 2 of the executive summary.
56. *Online Fraud*, National Audit Office, at pp. 2 and 3 of the executive summary.
57. *Online Fraud*, National Audit Office, at p. 2 of the executive summary.
58. *Online Fraud*, National Audit Office, at p. 2 of the executive summary.
59. *Online Fraud*, National Audit Office, at p. 2 of the executive summary. The report found that there were at least 10 campaigns live in March 2017, dedicated to education and awareness raising as regards online fraud.
60. *Online Fraud*, National Audit Office, at p. 8 of the executive summary.
61. *Online Fraud*, National Audit Office, at p. 8 of the executive summary.

Part 5

The Financial Crisis and White Collar Crime

10

Is 'This Time' Really 'Different'?: Reflections on 'Risk' in Financial Impropriety and Criminal Liability Past and Present in Looking to the Future

Gary Wilson and Sarah Wilson

> Fraud shames our financial system. It undermines the credibility of the economy, ruins businesses and causes untold distress to people of all walks of life … For too long, there has been too little understanding of the problem and too great a reluctance to take steps to tackle it.[1]

In attaching so much significance to the aphorism of 'this time is different', there is much which must be explained about it, and the intendment of its authors in its coining, and the different 'plays' which have been made on it following the publication of Carmen Reinhart and Kenneth Rogoff's now iconic text.[2] This requires explaining how this text's iconic qualities have arisen from the impact of the work itself, but also from how it has captured a mood amongst those responsible for managing and reconfiguring the aftermath of the global financial crisis: a mood purveying interconnectedness between past and present—and

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N. Ryder (ed.), *White Collar Crime and Risk*,
https://doi.org/10.1057/978-1-137-47384-4_10

indeed future—which had only started to reveal itself when the text was published in 2009. In the first instance, the significance of 'this time is different' is directed towards factual context and temporal reality. This is that now in 2017, a decade has now passed since the onset of the global financial crisis, which promoted the observation that periods of crisis engender insistence that 'this time is different'. This focus on relationships subsisting between the crisis, white-collar/financial crime and risk now adds to the multitude of different accounts of the events leading to the crisis and its aftermath. Here, it is well known that events widely regarded as a 'once-in-a-lifetime' crisis[3] had roots in the US sub-prime mortgage crisis, and which then transcended into a global squeeze on credit, and ultimately the 'first crisis *of* globalisation'.[4] Whilst there *are* already numerous narratives of these events, and their aftermath, the premise of this analysis is very much to suggest that far more emphasis should be placed on the prism provided by 'risk', and where the proposition of 'this time is different' responds to this by looking at different dimensions which can be brought within the rubric of risk.

10.1 Background and Context

There are of course many more dimensions capable of being brought within the rubric of risk than can be considered in this analysis. And within what is considered, some are very obvious in the light of narratives of the global financial crisis and its aftermath, whilst others are less so. From what is firstly obvious, attention will of course be paid to how risk is regarded in key discourses as a central factor in shaping the high profile of the crisis, underpinned by its severity and longevity. This can be seen in extensive castigations of 'extremely risky' conduct,[5] particularly on the part of financial institutions, most readily associated with wide-spread use of debt finance. The analysis explains how examining 'extremely risky' conduct itself also reveals a distinct discernible link between the crisis and what is considered financial impropriety regarded as 'financial crime'. Here the analysis shows how the crisis is a reference point for multiple types of risk associated with financial crime specifically; ones which are obvious and also less so alike. For the former, attention is paid to the risks embodied in the prevalence of

financial crime in the UK, for the economy and within a wider society. Alongside this, the analysis also considers risks which can arise from seeking to 'manage' and actually curtail the commission of financial crime, which it is suggested should have greater prominence in discourse on white-collar crime and its associated perceptual and enforcement challenges.

There are of course complexities entailed in even defining financial crime in absence of an internationally agreed definition for it, and which alongside continuing academic and policy travails involved in aligning 'financial crime' with Sutherland's classic definition of white-collar crime[6] and his classification of activities found here into two broad typologies,[7] should not be underplayed. This is particularly so in the light of how, although much criticised since its introduction,[8] Sutherland's framework continues to provide the building blocks for respected commentaries which have followed for three quarters of a century. The imperative for continuing to acknowledge Sutherland's work becomes more powerful still in the light of an evident 'Sutherland revival' underpinning some of the most influential texts of the past decade,[9] positing that alternatives to his highly contested concepts have failed to unite disciplinary and linguistic practices,[10] and even that Sutherland is 'rightly remembered and venerated' for his critique of criminological theory and for highlighting the existence of structural inequality in criminal justice responses, and hypothesising on the causes and implications of failing to address this.[11] These classic and more novel critiques and adulations of Sutherland's work can be found explored elsewhere within a deeply divided literature on white-collar crime,[12] which has become an intellectual battleground for debate set in motion by Sutherland's work, and almost a century later shows little sign of subsiding. Indeed contention continues to prevail as to whether white-collar crime is deserving of its special labelling by being qualitatively 'different' from (what Sutherland himself termed) 'traditional' crime, or whether purported differences have been socially constructed,[13] with this scholarship also on occasions noting the irony of the continuing use of the white-collar crime 'label' in the light of Sutherland's aspiration for bringing the unlawful behaviour of business and professional people within the 'scope of the [general] theories of criminal behaviour'.[14]

In noting these general parameters of the literature on white-collar crime, and Sutherland's initial and continuing significance within this,

this current exploration of financial crime and risk channels its interest into the concept of 'finance crime', which embodies 'large-scale illegality that occurs in the world of finance and financial institutions'.[15] Applying this to multiple dimensions of risk arising in the sphere of financial impropriety does of course involve drawing upon the significance of 'catastrophe' for Ulrich Beck's seminal work,[16] and this is focused on the UK in particular, notwithstanding consideration elsewhere of the hypothesis of a global movement of change in responding to financial crime.[17] In Beckean terms, this requires engaging with the constructs of risk itself and also underpinning ones of methodological nationalism[18] and the cosmopolitanism[19] configured for his take on global communities of risk,[20] but these more theoretical aspects are considered only to the extent of their importance for supporting a key proposition for this analysis. This is that the importance of engaging with 'risk' in terms of how it pertains to the challenges presented by financial crime is highly timely, and necessitates highlighting the multi-dimensional aspects of risk found in this context. Indeed, it will be explained that not only are there multiple faces of risk arising from the commission of financial crime in the twenty-first century, but these different facets of risk can have highly complex relationships with one another, and are even capable of conflicting with one another.

It is argued that looking at risk arising from financial crime in the twenty-first century is particularly important where financial conduct is actually or potentially subject to criminal sanctions. This is also what makes this analysis particularly timely, in the light of forces suggesting that a global movement towards increasing recourse to criminal enforcement is currently taking hold, together with the reality that many financial wrongs subsisting as crimes also do so as non-criminal offences, in the UK and beyond.[21] As it has been suggested elsewhere, recent policy trends in the UK exemplified in the criminalisation of benchmark manipulation and 'reckless banking',[22] are also evident in a number of key jurisdictions, including the US, Australia, and Hong Kong, and are indicative of such a movement. And whilst other occurrences might cast doubt on this, such as the outcomes of the HSBC-Suisse and 'Lux-Leak' scandals, support for such a movement is also to be found in European policymaking, and in the publications of transnational standard-setters such as the International

Organization of Security Commissioners (IOSCO).[23] Framing these considerations with the 'this time is different' aphorism is undertaken for the most part through presenting this as a question asking 'is "this time" really 'different"? This is an interesting take on how Reinhart and Rogoff initially coined 'this time is different', which was how the authors framed humanity's historic reaction to periods of crisis.

For Reinhart and Rogoff, this underpins breaking an 800-year cycle of 'financial folly', which has been sustained by delusion. For the authors '"this time is different" syndrome' has been responsible for our inability to protect ourselves against future shocks by learning from periods of financial instability from our past, because we always find explanations for new instances which ignore that there are 'usually remarkable similarities with past experiences from other countries and from history', enabling us to convince ourselves that 'this time is different'.[24] There are of course critiques which can be made of this proposition, and ones which can be made through the dimensions of risk which are herein explored. Here attention is paid to how Reinhart and Rogoff's proposition acts as an entreaty to take a closer look at financial instability in Britain's past as we try to assess future challenges, in this instance by drawing on primary research undertaken on nineteenth-century reactions to financial crises directly concerned with financial crime. This also draws on the perceived benefits of undertaking long-timeframe analyses for current societal challenges, as these are understood by the discipline of History. Most significantly, it also identifies the appeal of such approaches amongst regulators and enforcement communities who are formulating and operationalising 'front line' responses to financial crime.

10.2 Tackling the Time and the Aphorism Head On: This Time *Is* Different

As suggested above, the attention which is paid to Reinhart and Rogoff's iconic proposition embodies its critique alongside how it might provide a valuable reference point for considering the financial crisis and its aftermath, and particularly the relationships subsisting between the crisis and current discourse on financial crime. Here a very obvious point of critique

is how the events of 2007–8 have attracted very highly profiled reflections on producing a 'once-in-a-lifetime' crisis,[25] and indeed no less than the 'first crisis of globalisation', with such novelty also being alluded to in the Bank of England's insistence that the global financial crisis had 'demonstrated the need for fundamental reform of the financial system' and necessitated re-evaluation of the 'underlying structure of the international financial and monetary system'.[26] And in furthermore insisting that a new regulatory framework must enable 'financial institutions to fail without imposing unacceptable costs on the rest of society',[27] this reflection from the Bank of England also mirrors closely the view that one element operating to ensure that 'this time' is 'different', was how this financial crisis has borne witness to 'a formerly relatively prudent banking culture' being 'replaced with a new and aggressive financial culture wholly privileging profit-maximization over all other objectives'.[28]

That this new culture of high finance is considered to be 'inherently criminogenic'—in promoting 'harmful conduct that either is in violation of the criminal law or ought to be'[29]—is interesting for the connections which are now being made between the financial crisis and financial crime, on which more is said shortly. In the first instance this, together with the references above, presents a series of perspectives, which might point to the limited value of the 'this time is different' syndrome thesis. However, even if 'this time' *is* different, in terms of identifying the causes and underlying architecture of the crisis, does it necessarily follow from this that what we might be able to glean from it as we look to react to it and think to the future is also thereby limited? In thinking about why this might actually be a question of some importance, the essence of Reinhart and Rogoff's thesis of using delusion to convince ourselves it is 'OK' to continue 'as usual' *can* be seen in early post-crisis reflections. It aligns plausibly with perceptions that notwithstanding continuing economic downturn,[30] regulatory reform was advancing slowly, and where the opportunity for this to be extensive was already becoming obscured in a setting more oriented around 'business as usual' than putting in place a new agenda for framing 'the questions about economics and what we value'[31]; and also with views that we look set to move from one 'exhausted grazing pasture' to the next,[32] as it does with more recent lament that 'nothing has been learned'.[33]

10.3 Financial Crisis and Financial Crime: New Directions and Perspectives on 'This Time' Being 'Different'

The nuances of the 'this time is different' hypothesis do not preclude it being both a syndrome and a truism of our time, and it is an aphorism for our time which is likely to remain widely used. This is likely to be so on account of how, 'this time' *is* arguably distinctive, in terms of how the events associated with the 'global meltdown'[34] have precipitated very extensive change in how periods of financial instability are analysed, even if this contrasts with perceptions of regulatory change in its aftermath. This includes greater emphasis being placed on a 'conscious coupling'[35] in which understandings of periods of crisis, in terms of cause and effect, and severity and longevity, are being sought through focusing on 'financial crime' specifically.[36] Applying this to different perspectives on the question of '*is* this time *really* different?' this discussion also looks to open and explore connections which can be made between the 2007–8 crisis and financial crime specifically, and which can be classified in terms of likely consequences and causes of this period of turbulence. Here a swathe of academic commentary has pointed to the aftermath of these events as being likely to bring about new impetus and vigour in responding to financial crime, and has even more contentiously suggested that the causes of the financial crisis can be found in the commission of financial crime.[37]

Whilst this analysis is focused on different dimensions of risk associated specifically with financial crime, more generally much of this new strand of financial crisis-financial crime coupling is engaging with the essence of 'this time' being 'different'. Alongside the proposition of an entirely new culture of high finance, which is 'inherently criminogenic',[38] as intimated above, academic scholarship has also predicted that the events of 2007–8 are likely to mark a 'turning point' in financial crime enforcement, such as through the widely-anticipated demand for tough new sanctions actioned through new regulatory bodies.[39] The crisis has also been credited with creating the opportunity for and the conditions necessary to bring about 'transformative' understandings of crime, which would allow for the harms emanating from financial dealings to be

properly recognised through societal acceptance of financial misconduct as criminal behaviour.[40] Beyond academic analysis, and notwithstanding views that post-crisis reform is widely regarded as being both painfully slow, and unlikely to be far-reaching, connections being made between the crisis and financial crime specifically in the policy sphere *do* point to an appetite for applying the 'this time is different' aphorism. This can be seen for example in the publication of a Proposal for a Directive on Criminal Sanctions for Market Abuse, which subsequently became the CSMAD 2014, which was part of a raft of new legislation seeking to respond to generalised concern about the enhanced opportunities for committing market abuse created by greater financial interconnectivity, increasingly porous jurisdictional boundaries, and rapid technological innovation. However, reference was made to the Libor scandal of 2012 explicitly together with more generalised allusion to the novelties of the global financial crisis by the European Commission in framing its insistence that criminal enforcement demonstrated 'social disapproval of a qualitatively different nature compared to administrative sanctions or compensation mechanisms under civil law'.[41]

The connection made between financial *crime* and a 'this time is different' configuration of the financial *crisis* is more direct and explicit in former Chancellor of the Exchequer George Osborne's Mansion House Speech from 2015. In mirroring closely the sentiments expressed by Governor of the Bank of England, Mark Carney in his own Mansion House address of 2015, highlighting the importance of protecting financial markets from instability arising from impropriety,[42] Mr. Osborne explained the importance of taking a tough line on those who commit financial crime. For Mr. Osborne, a setting which demanded that competitiveness would not be achieved at the expense of propriety, required that 'after so many scandals, and such cost to the country', those who committed financial crime would be 'treated like the criminals they are'.[43] Notwithstanding his insistence that the message of intolerance for financial crime was a 'clear one', Mr. Osborne's take on so-called 'entrepreneurial risk' can be added to a growing anthology of perspectives proposing that responding to financial crime is highly complex. This can be illuminated through drawing on the maelstrom of the crisis and its aftermath, with this becoming more apparent still from adopting a long timeframe analysis of financial crime and risk.

Following this very brief introduction to how different dimensions of 'risk' might arise in discourse on financial crime, it will be suggested that risk occupies an important place within analyses of financial crime, but that far greater emphasis should be placed upon it within this sphere. As this is explored, the purported importance of risk for current discourse on financial crime can follow on very naturally from illuminating an analytical approach, which is very much in the spirit of the 'this time is different' aphorism as it was coined by Reinhart and Rogoff. For them our ability to convince ourselves that 'this time is different' not only justifies carrying on as usual, but actually renders doing so the rational course of action. Reference has already been made to forces attaching to the events of 2007–8 supporting critics of Reinhart and Rogoff who insist that this period of financial instability is unprecedented, and 'this time' *is* 'different', but whilst allusions to the distinctive features of this crisis—in relation to cause, as well as effect—can be found in UK policy discourse on what is required to move from 'crisis to recovery',[44] a very different perspective is also readily apparent amongst regulators who are actually fashioning this.

10.4 Financial Crime and the Potential Benefits of 'Risk' and Long Timeframe Analyses

In ways which mirrored how the collapse of Northern Rock in September 2007 marked the very arrival of the global financial crisis in the UK, it was the subsequent House of Commons Treasury Committee Report into *The run on the Rock*, which set in motion two key tenets for this analysis. Most obviously it forms part of subsequent discussion of the connections which can be made, and actually should be made between 'financial crime' and 'risk'. Its highly publicised insistence that the affairs of Northern Rock—which had necessitated the institution's seeking of emergency financial assistance and resulted in it being taken into partial public ownership—must result in different approaches to banking regulation of the future, also arguably challenged regulators to look beyond the temptations of stating simply that 'this time is different'. Indeed the Report noted that the most notorious 'run' on British banks had occurred

a century and a half earlier following suspension of payment by the prominent city finance house, Overend, Gurney & Co.[45] Reference made to '1866 and all that' was part of the preamble for lessons which had to be learned in recognising the importance of systemic stability,[46] but more explicit connections being made between past and present would follow on numerous occasions prior to recommendations made by the Parliamentary Commission on Banking Standards in 2013 that the Bank of England should institutionalise its ability to learn from the past.[47]

In between these points in time, in 2012, then Bank of England Governor Mervyn King lamented that the Bank of England should have paid greater attention to 'lessons from history' for identifying the likely onset of periods of financial instability,[48] with key speeches from two further Bank of England executives earlier in 2009, also alluding to what we might and indeed should learn from history in building a more stable and resilient regulatory framework for the future.[49] Arguably though, this sentiment was perhaps most tellingly captured by the now defunct Financial Services Authority (FSA), which was of course so heavily criticised for being 'asleep on the job' in regulating banks in the lead into the crisis.[50] In 2009, then head of Wholesale Sally Dewar insisted quite directly that the 'cyclical nature of scandals that continue to rock the financial system to its very core', ensured that regulators 'must learn from the past'.[51] Interestingly, these remarks were made in relation to financial crime directly, and in making them, Ms. Dewar also alluded to views that history has no relevance for the present, albeit in her insistence of the contrary position; namely the manifest importance of rejecting the view that, 'If history teaches us one thing, it's that history teaches us nothing'.[52] Although Ms. Dewar's comments lacked reference to intellectual debate, they do have a basis in the emphasis currently being given in the discipline of history to 'historical awareness'.[53]

For historians, 'historical awareness' is a phenomenon by which a sense of future direction can be crafted for societies from being able to understand themselves and where they have come from. Here regulators' enthusiasm for 'historical awareness' can be aligned with receptiveness to it evident in discourse on white-collar crime. Here, in conceptualising the so-called 'paradox of lenience and severity'—namely the tensions at

play in sentencing white-collar offenders—Wheeler et al.'s work regarded this as being part of a 'broad cultural pattern with deep historic roots'.[54] This work has always stood out within the discipline of Criminology's strong chronocentric tendencies, where a more typical approach is to configure that 'we live in 'new times' … that demand new concepts, ideas, understandings'.[55] Here the assertion from criminologists themselves that chronocentricism 'tends to suggest a rupture with the past and hence effaces historic continuities'[56] is very much in the vein of John Tosh's now classic statement on benefits of embracing historical continuities:

> Because our species depends more on experience than on instinct, life cannot be lived without the consciousness of a personal past … As individuals we draw on our experience in all sorts of different ways- as a means of affirming our identity, as a clue to our potential, as the basis for our impression of others, and as some indication of the possibilities that lie ahead. Our memories serve as both a data bank and as a means of making sense of an unfolding life story. We know that we cannot understand a situation without some perception of where it fits into a continuing process or whether it has happened before. The same holds true of our lives as social beings. All societies have a collective memory, a storehouse of experience which is drawn on for a sense of identity and a sense of direction.[57]

For Tosh, history is a vital cultural resource for society, and whilst it is not to be regarded as a 'blue print' for the future, it is particularly useful in situations which are unfamiliar or alien to us, and in times of challenge.[58]

Tosh's proposition that societies are empowered through being able to draw on experiences outwith their own is also attractive in the light of how financial crimes are considered to be 'among the most difficult crimes for the legal system to deal with, let alone control'.[59] Given this, there would appear to be much potentially to gain from exploring how the past can enrich our capabilities for understanding why this might be so, and what might be done in response. For historians, the practice of exploring what has been 'thought and done in the very different contexts of the past',[60] is capable of generating an 'inventory of alternatives' from the multiple ways which can be found for 'interpreting a predicament or responding to a situation'.[61] This can now be also applied to how Criminology itself perceives the importance of correctives for 'the

mistaken idea that white-collar crime is a product of the twentieth century'.[62] And as a small but burgeoning literature base is being developed within it and alongside it by Historians (of Business and Crime), emphasis is now placed on what research conducted on nineteenth-century Britain's experiences of financial crime can reveal about the importance of risk for current discourses on financial crime.

Ahead of identifying and embracing continuities in perceptions of risk in the setting of financial crime, as signposted the meaning given to risk is very strongly influenced by the classic work of Ulrich Beck. For Beck being 'at risk' is 'the way of being and ruling in the world of modernity'[63] and that being at global risk is the 'human condition at the beginning of the twenty-first century' by virtue of encounters with risk being an 'an inescapable structural condition of advanced industrialization'.[64] This is what makes the discourse of 'risk society' global rather than national, and for Beck risks are characterised as such by virtue of being 'historically unprecedented in terms of their spatial and temporal reach, their potential catastrophic effects'.[65] For Beck, the nexus between 'risk' and 'catastrophe' arises from how risk is the anticipation of catastrophe; once a catastrophe has occurred, it ceases to be a 'risk', and thereby 'risk' is shifted to a different location, such as the anticipation of further or ancillary catastrophe.[66] Beck's insistence that 'risks exist in a permanent state of virtuality, and become topical only to the extent that they are anticipated'[67], illuminates how for Beck these risks are also invisible, and would acquire visibility through social definition within knowledge or fora where knowledge is developed and processed, such as science, the legal system and the mass media.[68]

Clearly Beck's classic work clusters around risks of an environmental-ecological nature, and centrally toxins and pollutants, but the language of 'catastrophe' has been applied to the financial crisis extensively.[69] Beck himself has also engaged with the financial crisis as it unfolded, examining how the 'revolutionary power of global financial risks' had challenged the central ideals of Anglo-Saxon laissez-faire capitalism, evident through how capitalist actors themselves were 'demanding state intervention to support their losses'.[70] Furthermore, Beck has even aligned so-called 'ecological and financial dangers' conceptualising these as 'side effects', and which for modern civil society could be distinguished from the deliberate

exploitation of vulnerability by 'intentional catastrophes' by terrorism.[71] In this regard, the very high levels of scrutiny of finance following the global financial crisis—through 'Public enquiry', the legal process and mass media—suggests that in Beckean terms, 'financial risks' have acquired visibility and requisite social definition. This can and should be regarded as important in observing heightening awareness of financial crime, and potentially for increasing societal acceptance of financial misconduct as criminal behaviour as envisioned in Sutherland's hypothesis of the circular relationship between law and social mores and 'mutual reinforcement' achieved through enforcement,[72] and more recently in Friedrichs's thesis of transformation.[73]

But in observing this, and insisting that risk analysis is very important for formulating and articulating responses to financial crime, it will also be suggested that some risks which do arise in this setting are far less visible than others. And in suggesting the importance of balanced discussion of risk in responding to financial crime, there are ways in which Victorian Britain can persuasively be regarded as a 'risk society', through its evident appreciation of and occupation with 'debating, preventing and managing risks that it itself has produced'.[74]This was a time of dynamism and curiosity which both embraced the view 'that nothing was impossible',[75] and also acute consciousness of the anxieties arising[76] from being an age 'radically different from what had come before'.[77] In this setting, financial crime was not new when Victorian society encountered the 'whole new world and vocabulary of ingenious crime, which could only be perpetrated by business men and by large, prominent, wealthy or at least credit-worthy business men at that' during the 1840s,[78] but this would result in reactions to 'large-scale illegality that occurs in the world of finance and financial institutions' which are recognisable today.

10.5 Financial Crime and Risk: Perspectives Across Time

Victorian contemporaries did appreciate that financial wrongdoing had been a characteristic of life since 'time immemorial',[79] and had a very strong consciousness of previous financial catastrophes arising from the

South Sea Bubble in the early eighteenth century, and the Tulipmania earlier still when reacting to '"High art" crime' from the 1840s.[80] Interestingly, in the light of a strengthening financial crisis-financial crime 'coupling' being developed following the 2007–8 crisis, Victorian contemporaries attributed this 'whole new world' to exposures from the 1840s 'railway crisis', themselves mirroring new financial opportunities characterising the burgeoning 'enterprise economy'.[81] Continuing contemporary interest in what was even termed 'financial crime'[82] would also be strongly defined by the 'commercial distress' of the 1850s, and the panic triggered by the suspension of Overend and Gurney in 1866—in a century which was characterised by significant economic instability on account of 'severe trade cycles and a stock market crash roughly every ten years'.[83] From these 'mid-century' crises, a clear narrative started to emerge that financial impropriety was capable of presenting risk of catastrophe, and constituting a threat to the economy and to wider society, and also to the reputation of the nation. It was from this that views that financial impropriety would in some instances require public rebuke started to concretise.

For instances where financial infractions were to be viewed otherwise than as 'between man and man' and as ones which could not be 'made good' out of a wrongdoer's 'own property',[84] Victorian society reacted with new legislation[85] and pioneering criminal proceedings designed to test old laws and new in a context of rapid and extensive financial innovation,[86] and one where considerable reliance was being placed upon business and commerce for generalised economic and wider societal progress and advancement.[87]Victorian criminalisation of financial misconduct appeared to reflect contemporary belief that this mode of enforcement demonstrated 'social disapproval of a qualitatively different nature'[88] from private law action. But this was coupled with insistence that not all alleged financial impropriety would amount to being unlawful let alone criminal, apparently underpinned by a strong belief—here expressed in 2010—that 'criminal prosecutions [should] be reserved for the most serious offences'.[89] It is also interesting that distinguishing 'things which are not crimes in themselves'[90] in order to ensure punishment for 'real frauds' and not '… fictitious ones'[91] would involve using the criminal process not only to castigate deliberately fraudulent conduct, but also conduct regarded in current parlance as 'extremely risky'.

This terminology was coined in the wake of conclusions drawn in respect of Royal Bank of Scotland that existing law may not be capable of 'reaching' behaviour resulting in RBS's request for emergency assistance and in the institution being taken into partial public ownership.[92] Clearly RBS was a very important trigger for new criminal liability premised on recklessness—that is taking risks considered to be unacceptable—with this embodied as the so-called 'reckless banking' offence.[93] Whilst this is considered to be an offence of narrow application and intended to be used exceptionally,[94] the importance of reckless behaviour for mapping criminal liability is manifest across time from earliest reactions to '"High art" crime'. The new offence was conceived from the attractiveness of a recklessness standard for financial misconduct, making liability potentially easier to establish and more widely cast than in traditional approaches requiring dishonest/intentional conduct, and also the strong messages of societal determination 'to prevent and deter' that conduct communicated through the 'egregious character' of recklessness.[95] In this light, the new offence can be seen as a departure from a lengthy tradition of attaching liability to deliberate wrongdoing, and one actually dating back to how nineteenth-century reactions to financial crime insisted that criminalisation would be confined to 'deliberate transgressions' from 'ordinary business'; namely ones accompanied by fraudulent intent.[96]

However, in the light of how the 'reckless banking' offence is regarded as a legal landmark, it is also the case that in seeking to punish 'real frauds' and distinguish these from 'fictitious ones', Victorian reactions sought also to discourage 'extremely risky' conduct. Clearly well acquainted with and deeply troubled by deliberately fraudulent behaviour on the part of business people, concern about 'excessive' or 'over' trading reflected contemporary understanding that temptations to engage in a range of transgressions from 'ordinary business' would arise in the course of prima facie legitimate activities of 'prominent, wealthy or at least credit-worthy business men'.[97] In ways recognisably analysed today as crime which is secondary in time and proximity to lawful business,[98] concerns about pressures arising from intense competition for investor and consumer interest leading to misrepresentations became manifested in castigations of so-called 'excrescent trade', even where liability itself was attached to deliberate transgression. This was on account that where

the ability of third parties—investors, customers, and creditors—to locate and assess risk was compromised, risk became inseparable from profit, and 'the line between fair trade and foul' impossible to draw.[99]

In 1858, directors of the Royal British Bank were convicted of offences relating to balance sheet falsification, where false representations made concerning the bank's financial health were alleged to have originated in a reckless and imprudent approach to lending. In an address which could have been written for any one of the three UK bank scandals of the global financial crisis—Northern Rock and RBS and HBOS—it was alleged that 'Wide-spread ruin has been scattered over the whole of the country, houses have been brought to destruction, families have been plunged from affluence into poverty, the hard earnings of industry, collected by long labour, have been entirely lost'.[100] Indeed, if read without its very twenty-first-century referencing to groups of financial institutions, this case along with City of Glasgow Bank trial in 1879, could quite easily be textbook applications of the reckless banking offence created in 2013, to confer liability for a 'decision causing a financial institution to fail', where this decision is made by/agreed to by a senior manager of a financial institution concerning, with awareness of the risk that implementation may cause failure.[101] Like the new offence, both these nineteenth-century cases can be read as warnings of the risks attendant to not responding to the worst instances of financial impropriety.

Closer examination of concern about financial crime across time reveals how perceptions of risk attach to costs which are associated with financial crime. For many costs to the economy and to society, both justify and necessitate more extensive and tougher regulation and enforcement. Within this, there is of course extensive referencing to pecuniary costs arising from this 'invisible'[102] crime, and in the UK context, this was estimated as being an eye-watering annual cost of £73 BN in 2011 by the now defunct National Fraud Authority.[103] This speaks credibly to long-standing assertions in the academic literature of costs which 'dwarf' those incurred as a result of 'conventional' crime,[104] and most recently pecuniary risk is found effectively and succinctly presented in then Home Secretary, Theresa May MP's insistence that, 'Our economy relies on the financial system and everyone in this country benefits from its global success' and her accompanying concern that 'the scale and volume of financial activity

also brings serious risks of economic crime and real opportunities for criminals to defraud hardworking taxpayers of their savings and earnings'.[105] During the nineteenth century, the risks to the embedding of industrial capitalism presented by financial impropriety were also much appreciated and understood by contemporaries, with this articulated strongly in reference to high levels of investment confidence from amongst the expanding middle classes required to achieve this, and through the risks attaching to what has recently been termed 'investment avoidance'.[106] Such considerations are evident in how responses to financial crime manifested that capitalist activities must be undertaken responsibly as well as boldly in order to be regarded as proper and legitimate, and that what was regarded as 'irresponsible venturing' would be punished.[107]

Other powerful reference points for nineteenth-century insistence on responsible behaviour in undertaking enterprise, or in financing enterprise, embodied in reactions to financial crime included the risks attendant to individuals incurring poverty as a result of impropriety (as also observed by Theresa May in 2016). Indeed, in 1858, anxiety about families who were affluent, and by contextual implication prudent, was regarded as part of a calculus of 'wide-spread ruin', suggesting parallels with Mrs. May's concerns for the safety of the assets of 'hardworking' people. This concern across time for the risks presented to individuals' personal finance by financial crime also resonates with how academic literature configures victims of a wide range of financial impropriety, including more diffuse types arising from market abuse and tax offending etc. as well as frauds targeting individuals more directly.[108] These considerations of risks associated with not responding to financial crime adequately during the nineteenth century also drew attention to reputational risk, as is the case today. Regarding the UK as a 'safe' place to 'do business' is a clear theme running throughout domestic policy on financial crime from the last quarter of the twentieth century to the present, and clearly does speak to the implications of not doing so in an increasingly globalised world,[109] but acute anxiety about Britain's place as the 'great commercial community'[110] at the centre of the world is also evident in nineteenth-century reactions to financial crime.

Alongside these risks associated with financial crime and which can be identified with the economy, and with the wider societal consequences of economic functionality, there are also others configured as non-pecuniary

ones. In policy literature and academic study, financial crime is commonly associated with differential criminal process responses,[111] and also policies showing disproportionate concentrations of enforcement energy on 'conventional' offending.[112] Bequai's powerful warning in 1979 that a society segregated on grounds of justice was as much of a segregated society as one segregated by race[113] is clearly part of the same trajectory as Sutherland's assertion of differential enforcement and its capacity for undermining the egalitarian nature of law,[114] and risks presented by justice-oriented divisions in society are also embedded in UK enforcement discourse. Here prosecutors directly concerned with financial crime have long purveyed views that 'soft options' for 'suits'[115] are not acceptable, with this mapping closely onto judicial insistence that 'a man's wealth and power' must not 'put him beyond punishment'.[116] Whilst much in George Osborne's 2015 Mansion House speech concerning the apparently 'clear' position of intolerance of financial crime does merit and require closer scrutiny, his insistence that there is public interest in ensuring that those who commit financial crime should be exposed to punishment commensurate with the fate of those 'in any other walk of life'[117] has arguably brought messages of the risk to social cohesion of segregated justice into mainstream policy discourse.

Earliest reactions to nineteenth-century financial crime also reveal the perceived importance of exposing those whose financial misconduct deserved 'public contumely'[118] to 'condign punishment'.[119] The comparisons which were made between those of 'unquestioned honour and integrity' and considered incapable 'of the offence with which they are now charged'[120] and 'common felons' was a recognisable trope of criminal proceedings brought against businessmen, appearing to reflect a determination to punish those who were accustomed to the 'elegances of life'[121], who were considered to have violated the expectations of 'high office'.[122] At a time when it was uncertain whether establishing financial misconduct as 'infamous crime' where absence of punishment would be a 'disgrace'[123] would actually 'carry public opinion',[124] nineteenth-century reactions to financial crime do appear to manifest concern about risks for society of not ensuring appropriate criminal process responses for those who did not 'conform to the popular stereotype of "the criminal"'[125] alongside those who clearly did by virtue of being part of the 'criminal classes'.[126]

10.6 Concluding Thoughts

This analysis has shown that a number of manifestations of determination to respond to financial impropriety using criminal enforcement which are evident in current discourse can also be located across a wider timeframe of 150 years or more. In doing so, it has also shown how reactions to financial misconduct past and present can also be configured as responses to risk. The prism of risk is particularly useful in this context on account that financial crime attacks a range of societal interests notwithstanding that it 'may not attract the immediate moral outrage' of other types of crime,[127] whilst a long timeframe approach is able to present a distinctive perspective on how risk also underpins concerns about the complexities entailed in criminalising financial wrongdoing. Today these complexities are strongly identifiable with the 'crime of ambiguity' trope,[128] found extensively across academic and policy discourse, reflecting perceptual and even legal ambiguities attendant to regarding 'financial impropriety' as crime. The importance of guarding against criminalising activities which 'are not crimes in themselves'[129] does of course go to the heart of the integrity of the criminal law, but Victorian contemporaries appeared also to be appreciative of implications beyond this of criminalising financial misconduct, even when believing that doing so should be able to 'carry public opinion'.[130] This is evident in how attempts made to distinguish 'real frauds' from 'fictitious frauds' also carried warnings of the risks of erring in doing so, as contemporaries sought to grapple with the worst excesses of capitalist activity whilst warning that 'honest men' should not be deterred from participating in business and enterprise.[131]

One hundred and fifty years later, and notwithstanding that financial crime 'shames our financial system' by undermining 'the credibility of the economy, ruins businesses and causes untold distress to people of all walks of life', because of how 'everyone in this country benefits' from the global success of the British economy,[132] it would be wise to keep in mind Victorian conceptions of risks for the economy and to wider society of striking the wrong balance in castigating business persons and their conduct in seeking 'propriety'. Indeed, that interactions between competi-

tiveness and propriety might be more complex than as apparently presented by George Osborne in 2015 was tellingly proposed by the Treasury some time earlier in 2012. Here remarks made specifically in the context of banks readily and recognisably capture how business more generally 'inevitably involves taking risks':

> Business and investment decisions of all kinds are always forward looking and involve a degree of judgement about future developments that is necessarily less precise than … the kinds of prediction that are possible under the laws of the natural sciences or engineering. It would be inherently more difficult, therefore, to decide whether someone ought to have been aware of a risk that occurred, or that they were aware of a risk but wrongly decided that it was not significant, or to judge whether it was reasonable or unreasonable to take a particular risk.[133]

Bearing this in mind is important for attaching any legal liability to alleged financial misconduct. It is also arguably most important where the use of criminal sanctions is being sought; as it appears to be the case now as 150 years ago, that criminal enforcement is being identified with 'social disapproval', which is qualitatively different from that connoted through 'administrative sanctions or compensation mechanisms under civil law'.[134] Here criminal enforcement has a long association with harm perceived capable of emanating from financial impropriety, but examining reactions to financial impropriety across a timeframe of 150 years through the prism of risk makes not only a powerful case for tough responses, but also for the care which is required in their formulation.

At the same time as examining how the perceptual and enforcement challenges associated with financial crime can profitably be viewed through reference to risk, this analysis has sought also to point to how much more such work could usefully be undertaken. Here examining the problematics identifiable with financial crime with reference to risk and across a long timeframe reveals that a number of risks have actually been identified with financial crime over a period of 150 years or more. Whilst this might plausibly be regarded as prima facie support for Reinhart and Rogoff's thesis of 'this time is different syndrome', the work of historians suggests that the dynamics between past and present and continuity and change are more appropriately characterised as complex and multi-faceted

than simple and linear. With key discourses suggesting that the global financial crisis is likely to represent a precipice for important choices to be made about how to continue to react to financial crime, as the tenth anniversary of its onset approaches, we would be wise to keep in mind the value of risk for understanding its origins and antecedence, and what might be required in response. In returning once more to Ulrich Beck, his theory of cosmopolitanism asks whether there is an enlightenment function of being in a constant state of risk; and where opportunities might arise from being so. For Beck, that global risk conflicts serve an enlightenment function through destabilising existing order and being capable of enabling the first steps to be taken towards the construction of new institutions could usefully be applied directly to reactions to financial crime. As there is at least some evidence of a global criminal enforcement movement taking hold in this context, looking at the complexities arising from financial crime through the prism of risk suggest that this is a moment of utmost importance for fashioning future directions.

Notes

1. See Home Office and The Rt Hon Theresa May MP 'Home Secretary launches new joint fraud taskforce' Gov.UK (10 February 2016) https://www.gov.uk/government/news/home-secretary-launches-new-joint-fraud-taskforce
2. C M Reinhart and K S Rogoff *This Time Is Different: Eight Centuries of Financial Folly* (Princeton: Princeton University Press, 2009).
3. A Haldane and V Madouros 'The Dog and the Frisbee' (Federal Bank of Kansas Economic Policy Symposium, Jackson Hole, Wyoming, 31 August 2012), 24.
4. G Brown, *Beyond the Crash: Overcoming the First Crisis of Globalisation* (London: Simon & Schuster, 2010).
5. HM Treasury *Sanctions for the directors of failed banks* (London, July 2012), 5–6, para 2.2 and Box 2A.
6. Expressed classically as unlawful activity committed by persons of respectability and high social status in the course of his/her employment; see E H Sutherland, *White-Collar Crime* (New York: Dryden Press, 1949), 9.
7. With these comprising activities which could be classified as misrepresentations of asset values, approximating with fraud or swindling, or

duplicity and manipulation of power; see E H Sutherland 'White-Collar Criminality' (1940) 5 American Sociological Review, 3.

8. See e.g. D Nelken 'White Collar Crime', M Maguire et al. (eds) *The Oxford Handbook of Criminology* (Oxford: Oxford University Press, 1994, 1st edn), 355.
9. See e.g. S P Green *Lying, Cheating and Stealing: A Moral Theory of White-Collar Crime* (Oxford: Oxford University Press, 2006) and M L Benson and S S Simpson *White-Collar Crime: An Opportunity Perspective* (London: Routledge, 2009).
10. S P Green, *Lying, Cheating and Stealing*, n 9 above, 9–10.
11. M L Benson and S S Simpson, *An Opportunity Perspective*, n 9 above, 7; 87–88.
12. See the analysis set out in S Wilson *The Origins of Modern Financial Crime: Historical foundations and current problems in Britain* (Abingdon: Routledge, 2014).
13. With both perspectives extensively explored and illustrated in D Nelken 'White Collar Crime', n 8 above.
14. Per E H Sutherland 'Is "White Collar Crime" Crime?' (1945) 10 American Sociological Review, 132; 132, with the irony dimension noted in S P Shapiro 'Collaring the Crime, Not the Criminal: Reconsidering the Concept of White-Collar Crime', (1990) 55 American Sociological Review, 346; 347.
15. D O Friedrichs *Trusted Criminals: White Collar Crime in Contemporary Society* (Belmont: Thomson Wadsworth, 1996), 156.
16. With capacity for potentially catastrophic effects being a central pillar for Beck's configuration of risks produced in late modernity and presented for society: see e.g. U Beck *Risk Society—Towards A New Modernity* (London: Sage, 1992).
17. See for example S Wilson 'Financial Crises and Financial Crime: conscious coupling and "transformative understandings" of crime past, present and future' in N Ryder et al. *The Financial Crisis and White Collar Crime—Legislative and Policy Responses* (Abingdon: Routledge (Law), 2017).
18. See U Beck 'Living in the world risk society' (2006) 35(3) Economy and Society, 329; 342.
19. Ibid., 343.
20. Ibid. and see also U Beck 'Risk Society's "Cosmopolitan Moment"' Lecture at Harvard University (Harvard, November 12th, 2008).

21. For example 'market abuse' offences which are criminalised, and bearing of non-criminal state enforced administrative penalty, and also possible equitable private law action.
22. Respectively s 91 Financial Services Act 2012 and s 36 Financial Services (Banking Reform) Act 2013.
23. With all of these reference points considered extensively in S Wilson 'Financial Crises and Financial Crime: conscious coupling and "transformative understandings" of crime past, present and future' in N Ryder et al. *The Financial Crisis and White Collar Crime—Legislative and Policy Responses* (Abingdon: Routledge (Law), 2017).
24. C M Reinhart and K S Rogoff *This Time Is Different*, n 2 above xxv.
25. A Haldane and V Madouros 'The Dog and the Frisbee', n 3 above, 24.
26. Bank of England, *The Role of Macroprudential Policy: A Discussion Paper* (London, 2009), 3.
27. Ibid.
28. D O Friedrichs 'The Financial Crisis as White Collar or Economic Crime and the Criminogenic Architecture of Wall Street', Paper, Economic Crime and the State in the Twentieth Century: A German–American Comparison conference, German Institute of Historical Research, Washington DC, 14 April 2011, cited with permission.
29. D O Friedrichs 'Wall Street: Crime Never Sleeps' in S Will et al. (eds) *How They Got Away With It: White Collar Criminals and the Financial Meltdown* (New York: Columbia University Press), 2012, 20; 15.
30. J Stiglitz *Freefall: Free Markets and the Sinking of the Global Economy* (London: Penguin, 2010).
31. See R Williams, speech accompanying the launch of R Williams and L Elliott (eds) *Crisis and Recovery: Ethics Economics and Justice* (Basingstoke: Palgrave, 2010), 28 September 2010, at http://rowanwilliams.archbishopofcanterbury.org/articles.php/941/crisis-and-recovery-book-launch-28th-september
32. Z Bauman, *Living on Borrowed Time* (Cambridge: Polity, 2010), 17.
33. See e.g. E Dunkley 'Banker bashing draws to an end as watchdog scraps review' *Financial Times* (London, 31 December 2015), reporting the views of John Mann MP.
34. A central trope for the analyses across academic analyses of the events of 2007–8, alongside ones which have emerged from policy and political reactions to this period of turbulence.
35. See S Wilson 'Financial Crises and Financial Crime: conscious coupling and "transformative understandings" of crime past, present and

future' in N Ryder et al. *The Financial Crisis and White Collar Crime—Legislative and Policy Responses* (Abingdon: Routledge (Law), 2017).

36. See S Wilson, Review of N Ryder *The Financial Crisis and White-collar Crime: The Perfect Storm*? (Abingdon: Routledge, 2014), (2015) Rutgers School of Law and School of Criminal Justice *Criminal Law and Criminal Justice Books*: see http://clcjbooks.rutgers.edu/
37. E.g. D O Friedrichs, 'Wall Street', n 29 above, 9.
38. Ibid., 20; 15.
39. R Tomasic 'The financial crisis and the haphazard pursuit of financial crime' (2011) 18(1) Journal of Financial Crime, 7; 7–8.
40. D O Friedrichs 'Wall Street', n 29 above, 16–20.
41. See European Commission Memo 'European Parliament's endorsement of the political agreement on Market Abuse Regulation' Brussels, 10 September 2013 http://europa.eu/rapid/press-release_MEMO-13-774_en.htm?locale=en. This incorporated Frequently Asked Questions, including one (Q15) on 'Proposal for a Directive on Criminal Sanctions for Market Abuse', for which the quoted text formed part of a response.
42. Mark Carney 'Building real markets for the good of the people', Mansion House Speech (London, 10 June 2015).
43. Rt Hon George Osborne MP, Mansion House Speech (London, 10 June 2015).
44. R Williams and L Elliott (eds) *Crisis and Recovery: Ethics Economics and Justice* (Basingstoke: Palgrave, 2010).
45. House of Commons Treasury Committee Report on Northern Rock: *The run on the Rock*, HC 2007–8, 56–1, 8.
46. Ibid., especially 3–8.
47. Whilst the resulting recommendation that a historian should be appointed to the Financial Policy Committee has yet to be fulfilled, the Bank has instituted other educative initiatives, such as the Learning from Previous Financial Crises Seminar Series.
48. Mervyn King BBC Radio 4 *Today* Lecture 2012 (2 May 2012).
49. See for example P Tucker 'Redrawing the Banking Social Contract', British Bankers Association Annual International Conference (London, 30 June 2009), and A Haldane 'Credit is Trust', Association of Corporate Treasurers Speech (Leeds, 14 September 2009).
50. *The run on the rock*, n 45 above, 22, para 37, footnote 119.
51. S Dewar 'Tackling financial crime in the current economic climate', FSA Annual Financial Crime Conference, 27 April 2009.

52. Ibid.
53. J Tosh, *The Pursuit of History: Aims, Methods and New Directions in the Study of Modern History* (London: Longman, 2010), especially 1–12.
54. S Wheeler et al. 'Sentencing the White-Collar Offender: Rhetoric and Reality' (1982) 47 American Sociological Review, 641; 658.
55. P Rock, 'Chronocentrism and British criminology' (2005) 56 British Journal of Sociology, 473; 474.
56. Ibid.
57. J Tosh, *The Pursuit of History*, n 53 above, 1–2.
58. Ibid., 33.
59. R Tomasic 'The haphazard pursuit of financial crime', n 39 above, 7.
60. J Tosh, *The Pursuit of History*, n 53 above, 1–2.
61. Ibid.
62. Per Michael Benson, reacting to the analysis offered in S Wilson *The Origins of Modern Financial Crime: Historical foundations and current problems in Britain* (Abingdon: Routledge, 2014).
63. U Beck 'Risk Society's 'Cosmopolitan Moment", n 20 above.
64. U Beck *Risk Society, Towards a New Modernity*, n 16 above.
65. S Cottle 'Ulrich Beck, "Risk Society" and the Media: A Catastrophic View?' 13(1) European Journal of Communication, 5; 8.
66. U Beck *Risk Society, Towards a New Modernity*, n 16 above, 22–23.
67. S Cottle 'Ulrich Beck, "Risk Society" and the Media', n 65 above, 8.
68. Ibid.
69. For example D O Friedrichs 'Wall Street', n 29 above, 20.
70. U Beck 'Imagined Communities of Global Risk', Lecture for the Risk Conference in Shanghai, September 2009.
71. U Beck 'Living in the world risk society', n 18 above, 329.
72. E H Sutherland 'Is "White Collar Crime" Crime?', n 14 above, 139.
73. D O Friedrichs, 'Wall Street', n 29 above, 16–20.
74. U Beck 'Living in the world risk society', n 71 above, 332.
75. C Stebbings 'Benefits and barriers: The making of Victorian legal history' in A Musson and C Stebbings (eds), *Making Legal History: Approaches and Methodologies* (Cambridge: Cambridge University Press, 2012), 72.
76. Ibid., 73.
77. J Black and D Macraild, *Nineteenth-Century Britain* (Basingstoke: Palgrave, 2002), xvii.
78. H Perkin *Origins of Modern British Society 1780–1880* (London: Routledge and Kegan Paul, 1969), 442.

79. D M Evans *Facts Failures* and *Frauds Revelations Financial Mercantile Criminal* (first published 1859, reprinted New York: Augustus M Kelley, 1968), 5.
80. Ibid., see especially 1–5; and a more detailed analysis in S Wilson *The Origins of Modern Financial Crime: Historical foundations and current problems in Britain* (Abingdon: Routledge, 2014).
81. S Wilson *The Origins of Modern Financial Crime*, n 12 above.
82. D M Evans *Facts Failures and Frauds*, n 79 above, especially 1–5.
83. M Lobban, 'Nineteenth-Century Frauds in Company Formation: *Derry v Peek* in Context' (1996) 112 Law Quarterly Review 287; 287–288.
84. See *Hansard*, series 3, 46, HC 8 June 1857, col. 1363, Serjeant Kinglake.
85. Centrally the Punishment of Frauds Act 1857.
86. See S Wilson *The Origins of Modern Financial Crime*, n 12 above.
87. Ibid.
88. See European Commission Memo 'European Parliament's endorsement of the political agreement on Market Abuse Regulation' Brussels, 10 September 2013, n 41 above.
89. Law Commission *Criminal Liability in Regulatory Contexts* CP No 195 (London: The Stationary Office), para A39.
90. Parliamentary Papers VIII 419 (1877) *The Report of the Select Committee on the Companies Acts 1862 and 1867*, para 2174.
91. Ibid., para 2189.
92. FSA Board *The Failure of the Royal Bank of Scotland* (RBS Report, London 2011), Lord Turner's Chairman's Foreword, 6.
93. Pursuant to s 36 Financial Services (Banking Reform) Act 2013.
94. Matthew Hancock MP, 'The right are right to challenge rewards for failure', Policy Exchange speech (London, 12 January 2012, full text available on Mr. Hancock's MP's Home Page).
95. H M Treasury *Sanctions for directors of failed banks*, n 5 above, 14, para 4.11.
96. *The Report of the Select Committee on the Companies Acts 1862 and 1867,* n 90 above, para 2174.
97. Per Perkin *Origins of Modern British Society 1780–1880*, n 78 above.
98. D Nelken 'White-Collar Crime', n 8 above, 374.
99. B Hilton, *The Age of Atonement: The Influence of Evangelicalism on Social and Economic Thought 1785–1865* (Oxford: Clarendon, 1989), 122.
100. Address for the prosecution in the trial of the Royal British Bank directors 1858, cited in D M Evans, *Facts, Failures & Frauds*, n 79 above, 289.

101. Here liability also reflects how and that in all the circumstances conduct relating to the taking of the decision falls below what could be reasonably expected from a person in such a position, and implementation causes failure, with definitional amendments relating to insolvency added by s 26 Bank of England and Financial Services Act 2016.
102. P Davies et al. (eds) *Invisible Crimes: their victims and their regulation* (Basingstoke: Macmillan, 1999), especially the excellent summary of this conceptualisation given in P Davies et al. 'The Features of Invisible Crimes', 3–28.
103. As summarised in Press Release 'Cost of fraud revealed in new report' (London, Home Office, 29 March 2012).
104. Friedrichs, 'Wall Street', n 29 above, especially 4–5, 8–9, and 16–20.
105. See Home Office and The Rt Hon Theresa May MP 'Home Secretary launches new joint fraud taskforce', n 1 above.
106. Dr. Mark Carney 'Uncertainty, the economy and policy' Policy Speech, (London, Bank of England, 30 June 2016).
107. D M Evans *Facts, Failures & Frauds*, n 79 above, 128.
108. See the general orientation of for example Nelken 'White-Collar Crime' (n 8 above) and Friedrichs 'Wall Street' (n 29 above).
109. With the themes of globalisation readily apparent in Lord Irvine's remarks in the context of the Law Commission's publication *Fraud and Deception: A Consultation Paper* CP No 155 (London: HMSO, 1999), para 1.4. and even in Lord Roskill's *Fraud Trials Committee Report* (London: HMSO, 1986).
110. D M Evans, *Facts, Failures & Frauds,* n 79 above, 145, citing Baron Alderson's reflections on the conviction of Strahan, Paul and Bates in 1855.
111. As proposed by Sutherland (in 'Is "White-Collar Crime" Crime?', n 14 above, 136), and disputed in S Wheeler et al. (in 'Sentencing the White-Collar Offender'), n 54 above, 641.
112. This being a key thread within D O Friedrichs, 'Wall Street', n 29.
113. A Bequai *White Collar Crime: A 20th Century Crisis* Massachusetts (Lexington Press, 1978), 4.
114. E H Sutherland 'Is "White-Collar Crime" Crime?', n 14 above, 137.
115. For example R Wright 'Fighting Fraud in the UK- the interaction of the criminal and the regulatory process' to the Financial Regulation Industry Group Reception, (London, 25 May 2000).
116. Henry J cited in M. Levi 'Sentencing White-Collar Crime in the Dark?: Reflections on the Guinness Four' (1991) 28(4) Howard Journal of Criminal Justice, 257–279; 268.

117. Per George Osborne MP, Mansion House Speech, 2015.
118. D M Evans *Facts, Failures & Frauds*, n 79 above, 3.
119. Ibid., 209.
120. Ibid., 126.
121. Ibid., 108–109.
122. Ibid., 145.
123. Ibid., 384–5.
124. *Hansard,* series 3, 146, HC 26 June 1857, col. 502, Mr. Wigram.
125. Sutherland 'Is "White-Collar Crime" Crime?', n 14 above, 136; and reflected on in T M Ashe and L Counsell, *Insider Trading*: *The New Law* (London: Tolley, 1993), 178–9.
126. See C Emsley *Crime and Society In England 1750–1900* (London: Longman, 2010).
127. M Cole 'The FSA's approach to insider dealing', American Bar Association Speech (Chicago, 4 October 2007).
128. V Aubert 'White-Collar Crime and Social Structure' (1952) 58 American Journal of Sociology, 263.
129. *Report of the Select Committee on the Companies Acts*, n 90 above, para 2174.
130. *Hansard* series 3, 146, HC 26 June 1857, col. 502, Mr. Wigram.
131. *Report of the Select Committee on the Companies* Acts, n 90 above, para 2175.
132. See Home Office and The Rt Hon Theresa May MP 'Home Secretary launches new joint fraud taskforce' Gov.UK (10 February 2016).
133. HM Treasury Sanctions for directors of failed banks, n 5 above, 14–15, para 4.12.
134. See European Commission Memo 'European Parliament's endorsement of the political agreement on Market Abuse Regulation' Brussels, 10 September 2013, n 41 above.

11

Corporate Crime and Corporate Culture in Financial Institutions: An Australian Perspective

Roman Tomasic

I am not so much concerned with the content of a corporate governance model as with the culture of the organisation to which it attaches. For me, the key to good corporate governance lies in substance, not form. It is about the way the directors of a company create and develop a model to fit the circumstances of that company and then test it periodically for its practical effectiveness.

Justice Owen, HIH Royal Commission Report, 2003

When a corporation takes a calculated risk by intentionally or recklessly failing to disclose material information to the market, it may be inferred that there is a corporate culture which encourages or, at least, tolerates or permits decision-making which expressly or implicitly weighs the benefit of non-compliance against the risk if non-compliance is detected. For such deliberate conduct, the risk associated with re-offending must be set at a high level by high penalties.

Justice French, *ASIC v Chemeq Limited*, FCA 936, 2006

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N. Ryder (ed.), *White Collar Crime and Risk*,
https://doi.org/10.1057/978-1-137-47384-4_11

11.1 Introduction[1]

The corporate culture of banks and financial institutions has been subject to much criticism in Australia, the UK and the United States following the global financial crisis (GFC). This led to taxpayer-funded bail outs of many banks in the UK and the USA although the toxic culture of banks has been slow to change, as illustrated by the subsequent Libor[2] and cross-selling scandals in the UK and the substantial payments made by banks which saw them settle claims against them for fixing foreign exchange markets.[3] The largest US banks have reportedly paid about US$110 billion in fines because of their role in the financial crisis.[4]

Despite massive government support, banks have been slow to change their corporate cultures after the GFC, as was evident from hearings into the cross-selling of different products in the USA by Wells Fargo bank between 2012 and 2014; Wells Fargo is the third largest US lender by assets. In hearings before the US Senate Banking Committee, criticisms were made by both Republican and Democrat senators who looked at the bank's culture and went on to query the responsibility of the Wells Fargo CEO, John Stumpf, for these failings.

Republican Senator, Patrick Toomey, argued that "cross-selling" as a business strategy was fraudulent; this involved Wells Fargo employees setting up new accounts for large numbers of bank customers, even though the customers knew nothing about these products.[5] Senator Toomey noted that whilst Wells Fargo had dismissed some 5300 of its employees for engaging in cross-selling, it was unlikely that they had acted independently as the bank had claimed in its defence. Senator Toomey exclaimed to the bank's CEO:

> You state unequivocally that there are no orchestrated effort or scheme, as some have called it, by the company….But when thousands of people conduct the same kind of fraudulent activity, it's a stretch to believe that every one of them independently conjured up this idea of how they would commit this fraud.[6]

Like other banks, Wells Fargo had made massive profits from cross-selling activity, leading Democrat Senator, Elizabeth Warren, to call for

the resignation of the bank's CEO and return of money that he had earned during the sales scandal; Senator Warren added: "[y]ou should resign … and you should be criminally investigated."[7] As one report noted, the senators accused the CEO "of fostering a culture where low-paid branch employees were pressured to meet impossible sales quotas to keep their jobs, and so signed up customers for products without their knowing."[8]

Instead of criminal actions against senior officers, the bank has been fined US$185 million and, without admitting or denying wrong-doing, it settled allegations that its employees had secretly opened over two million unauthorised deposit and credit card accounts for customers so as to meet the bank's sales goals.[9] Wells Fargo CEO, Stumpf, did however accept some limited responsibility and highlighted the central role of the bank's corporate culture when he stated:

> I accept full responsibility for all unethical sales practices in our retail banking business, and I am fully committed to doing everything possible to fix this issue, strengthen our culture, and take the necessary actions to restore our customers' trust.[10]

However, this has meant that personal legal liability was not assumed by the CEO or any of his senior management team, such as the Wells Fargo head of retail banking who was retiring with almost US$125 million in stock and options.[11] Calls for a "claw back" of such payments had for a time fallen on deaf ears.

Similar concerns have been raised in regard to the culture of Australia's four main banks. Whilst the strength of Australian banks has been such that these banks escaped any significant damage during the GFC,[12] in more recent times they have begun to be subject to similar criticisms that have undermined trust in banks in other parts of the world and they have faced calls for further inquiry into their operations.

However, the shadow banking system did work to create significant risks, such as through the A$625.6 million in securities sold to Australian local government councils and community groups by Lehman Brothers.[13] The report of the Australian Financial Systems Inquiry subsequently

reminded banks and other financial institutions in Australia that they were not immune from global forces and were subject to global regulatory rules, calling for a strengthening of domestic regulatory institutions monitoring banks and financial institutions.[14]

Australian banks and regulators have been slow to recognise these regulatory problems and it was left to the Australian Prime Minister, Malcolm Turnbull, on the occasion of the 199th birthday of Australia's oldest bank, Westpac, to warn that banks should fix their cultures; Turnbull noted that there had been "too many troubling instances" and that the banks' social licence could be harmed by their pursuit of profit over values.[15] What we have seen is a clash between older bank cultures and the newer and very different cultures that were to be found in the wealth management and investment arms of banks as a result of increasing liberalisation of markets.[16]

This has seen the Australian Opposition Leader, Bill Shorten, call for a Royal Commission inquiry to be held into banks after actions by "cowboys" at Westpac manipulated benchmark interest rates.[17] Banks were of course quick to dismiss these calls,[18] whilst trust in bank-based financial planners continued to fall following a number of other Australian banking scandals.[19]

Despite the HIH Royal Commission report three years earlier,[20] similar concerns have continued to be expressed regarding the culture of Australian insurance companies, especially where such insurance was sold by banks through cross-selling products. The Australian Financial Systems Inquiry had noted that the Australian "…Senate Economics References Committee report on ASIC's performance highlighted that resource constraints affect ASIC's capacity to conduct surveillance across regulated entities."[21] After some years of concern by the corporate regulator over poor funding, the Australian Government in 2016 allocated an additional AU$127 million to better police banks, although this occurred after some years of reduced funding for the corporate regulator.[22]

However, it should not be forgotten that a clash between different bank cultures was also evident in the years leading up to the GFC when UK and US banks moved from the traditional business model of writing mortgages so as to hold them until their maturity, to the new derivatives-based model, which saw these mortgages repackaged or securitised and resold.

The Treasury Committee of the UK House of Commons described this as a "transition from the 'originate to hold' model of banking to the 'originate to distribute' model."[23] This took place in the context of the increasing liberalisation of financial regulation, facilitating the development of financial products such as derivatives that significantly multiplied risks in an increasingly globalised and inter-connected world. These changes in the organisation of banking and finance in the UK followed the so-called Big Bang of 1986 which allowed mergers to take place between banks and securities firms introducing competition that saw the takeover of small stockbroking firms and the subsequent diversification and expansion of banks.[24] A consequence of these mergers was the emergence of diversified financial institutions, creating conflicts of interests that could not be simply controlled by the use of conceptual architecture such as Chinese Walls within these large firms.[25]

In the USA, a similar change in banking business models had occurred in 1999 following the repeal or dismantling of the 1933 Glass-Steagall Act by the Clinton administration at the behest of the big banks; this Act had long separated commercial and investment banking since reforms enacted after the 1929 Great Depression.[26] Its relaxation allowed commercial banks to once again engage in securities trading as well as normal commercial banking and thereby to compete with the shadow banking system.

From this point, traditional banks began to use shadow banking and were forced to rely upon rating agencies to provide assurance that they were assuming acceptable levels of risk. However, this was far from a reliable system of risk control as the rating agencies were subject to intense conflicts of interest which led them to underestimate the risks that were inherent in new securitised financial products that they were rating.[27]

Some have argued that the repeal of the Glass-Steagall Act was a key factor in creating the market bubble that led to the GFC in 2008.[28] Nobel Laureate Professor Joseph Stiglitz has reminded us of the significant role that this legislation had played in restraining financial misconduct in the USA:

> In the aftermath of the Great Depression, an event preceded by similar excesses, the country enacted strong financial regulations, including the Glass-Steagall Act 1933. These laws, effectively enforced, served the country well: in the decades following passage, the economy was spared the kind

> of financial crisis that had repeatedly plagued this country (and others). With the dismantling of these regulations in 1999, the excesses returned with even greater force: bankers quickly put to use advances in technology, finance, and economics. The innovations offered ways to increase leverage that circumvented the regulations that remained and that the regulators didn't fully understand, new ways of engaging in predatory lending, and new ways to deceive unwary credit card users.[29]

As the Australian economist Ross Garnaut has added: "The liberalisation of financial transactions seems to have left more scope for the herd to gain momentum in a boom, as well as in a panic, when the herd changes its course."[30] Professor Garnaut added that, in the period leading up to the GFC, the resort to financial innovations, such as derivatives and securitisation, had:

> …allowed imbalances in the global economy to be much greater than would have been the case under the old rules. They enabled banks to dramatically increase their leverage and gave individuals and businesses access to credit they could never repay…When the breaking of the old rules reached its inevitable conclusion, the world was left with shattered trust in its financial system.[31]

The legitimacy of business organisations often depends greatly upon the degree to which they are trusted.[32] As trust is often seen as a bank's most precious resource, the diminution or loss of trust that followed the financial crisis led to a new interest in enhancing the culture of banks and other financial institutions.[33]

11.2 The Problem of Corporate Culture

Much has been said about problems with corporate culture in Australia and elsewhere, especially in regard to banks and insurance companies. However, it is a general problem that applies to all public companies. In a 2006 continuous disclosure case before the Federal Court of Australia, French J (as he then was) stressed the importance of a "culture of compliance" in corporations and added that:

> Compliance policies and procedures will not be effective unless there is, within the corporation, a degree of awareness and sensitivity to the need to consider regulatory obligations as a routine incident of corporate decision-making. This kind of general sensitivity to the issues underpins what is sometimes called a 'culture of compliance'. It does not require a risk averse mentality in the conduct of the company's business, but rather a kind of inbuilt mental check list as a background to decision-making.[34]

A number of leading corporate regulators and business leaders have also stressed the importance of a healthy corporate culture.[35] The Australian Securities and Investments Commission's (ASIC) Chairman, Greg Medcraft, has been a leading international voice in focusing attention on corporate culture issues. Medcraft had previously worked for Société Générale, a large French bank, before taking on the job as Chair of ASIC and presiding over International Organisation of Securities Commissions (IOSCO).

Although Medcraft is not a lawyer, he has pushed for an extension of liability based on corporate culture, from Pt 2.5 of the Criminal Code, to apply to other areas of law to which it is not currently applicable; this includes Chap. 7 of the Corporations Act, dealing with the regulation of financial markets. Not surprisingly, Medcraft has encountered some resistance to this proposal from conservative legal commentators.[36]

Medcraft has perhaps been an unusual regulator in that he has often taken up academic ideas and sought to use them as regulatory tools; these have included placing a stress on the importance of corporate gatekeepers (like lawyers, accountants, auditors, liquidators, etc.) and more recently, championing the idea of corporate culture. He is also unusual in that he has been prepared to be publicly critical, sometimes to his own disadvantage; for example, he is reported to have said that Australia was a "paradise" for white-collar criminals.[37] This did not endear him to some senior members of the Liberal National Party coalition government and he was lucky to have his term extended before the 2 July 2016 national election.[38]

Medcraft also drew upon the socio-legal work on corporate culture that had been published by John Braithwaite and Brent Fisse.[39] This work has had international significance, but it has been slow to take root in regard to corporate culture in financial institutions.

Medcraft argued that many corporate problems can be traced back to prevailing corporate culture in organisations and noted that ASIC was now incorporating culture into its risk-based surveillance system. As he has repeatedly said in recent years, culture was "a key driver of conduct" with the consequence that good outcomes lead to good outcomes for investors and customers; the converse also applies with poor culture and poor conduct having negative outcomes.[40]

He added that cultural change was likely to be "better for business than constantly having to remove bad apples – and cultural change will have a more enduring and positive impact than simply addressing isolated instances of misconduct."[41] The Commission's rationale for focussing upon culture was further explained by ASIC's Deputy Chairman, Peter Kell, when he pointed to the link between culture and trust in the financial system:

> Culture, and its links to conduct and regulation, has become central to discussions of how business operates, particularly in the finance sector. Given the massive global costs of misconduct arising out of poor finance sector culture, this should not be surprising. ASIC has been highlighting the importance of culture in financial firms. Our aim is to promote trust and confidence in the financial system, and poor culture clearly undermines that trust and confidence.[42]

Kell noted that other financial market regulators, such as the Australian Prudential Regulatory Authority and the UK's Financial Conduct Authority (FCA) had also stressed the importance of culture as a measure of integrity in firms.[43] The FCA has seen this new focus as "encouraging a culture of personal responsibility" as culture has been seen as being vital to the regulation of conduct.[44] However, given that it is such a "nebulous concept," culture has not proved to be a reliable tool to assist in corporate prosecutions because, as Dixon has argued, "[p]rosecuting based on corporate culture involves the onerous task of proving that culture. One of the primary difficulties of this task is that the culture must relate to the physical act and be evidenced at the point in time that the physical act took place."[45]

In the UK, the FCA's Director of Supervision saw culture as being shaped by four facts; these were firstly, the "tone from the top"; he noted that senior managers were "responsible for setting the tone in the firm."[46] Secondly, this was supported by "tangible practices and cues which tell people what they need to do to be successful" in the firm and this can be illustrated by critical factors such as patterns of recruitment, promotion and compensation within the firm.[47] Thirdly, culture was seen to be shaped by "narratives that circulate in the firm that explain what the firm is trying to achieve" and whether the resources that have been allocated to achieve these goals will place pressure upon employees "to deliver against tough targets."[48] Finally, the FCA argued that the "capabilities of an organisation" will also shape its culture.

Of course, as is evident from the magnitude of the cross-selling scandal in Wells Fargo bank in the USA, cultural problems may sometimes be systemic and not merely a reflection of the actions of a few "bad apples." This general point was recognised by the Australian Treasury Secretary, John Fraser, when he observed in 2016 that:

> Time and time again, we have seen firms blaming it on a few bad apples driving bad outcomes for consumers, rather than taking responsibility for looking more closely at their organisation.[49]

In an address to the Law Council of Australian in November 2015, Medcraft added that:

> Culture matters to ASIC because poor culture can be a driver to poor conduct. Culture has been at the root of some of the worst misconduct we've seen in the financial sector…We think improved culture in the industry we regulate will have a long-lasting positive impact on the industry in a broader way than deterring or disrupting isolated misconduct.[50]

The ASIC Chairman concluded a 2015 speech by reminding his audience that "[c]ulture is important to us because it drives conduct."[51] Medcraft noted in a later speech that "poor culture has been at the root of some of the worst misconduct we saw during the global financial crisis."[52] He went on to identify what he saw as several key drivers of good

culture, with the first of these being the role of the board and senior management in leading by example and "demonstrating the conduct that supports the organisation's values."[53]

This of course assumes that there is a clear dividing line between virtuous and criminal corporations, illustrating what Fiona Haines describes as "the essential ambiguity of white collar crime…"[54] and the "blurred boundaries between 'criminal' and 'normal' business behaviour."[55]

Medcraft saw the enhancement of a firm's culture being achieved by the use of peer pressure, the use of whistle-blowers and by fostering individual and corporate accountability. In regard to the third of these tools, he noted that the UK had introduced an enhanced accountability mechanism for corporate managers. Medcraft, who has been the chair of the IOSCO, noted that:

> In the United Kingdom, the Senior Managers Regime has recently been developed to hold individual managers accountable for poor conduct occurring in businesses for which they are responsible. The regime involves firms mapping out responsibilities for senior managers and having them pre-approved by regulators.[56]

The operation of the UK's Senior Managers Regime (SMR) has been seen as an important means of ensuring accountability within financial firms.[57] Davidson has noted that there are three essential ideas underpinning this regime:

> First,… senior managers are clearly accountable for decisions and conduct that falls within their areas of responsibility and that the responsibility for conduct does not fall through the cracks or become shared so widely that no one feels accountable for it…The second idea is that senior managers are clearly accountable for ensuring that they have taken reasonable steps, for example, through governance and control frameworks, to ensure that the decisions made by individuals in their areas are appropriate.…The third idea is that all senior managers are clearly accountable for ensuring that individuals working at all levels in their areas of responsibility meet appropriate standards of conduct and competence.[58]

The UK's SMR is seen by the FCA as the most significant of mechanisms for embedding an accountable corporate culture in financial

firms.[59] It is too early to assess the effectiveness of this new regime; the failure of the principles-based system of light touch regulation that was previously used to regulate the financial services industry in the UK[60] suggests that SMR will need to be credible. Often soft law regimes lack credibility; on the other hand, legalistic or formal criminal prosecutions have also proved difficult to apply in regard to well-resourced and complex financial institutions, especially those that are perceived to be "too big to fail."[61]

ASIC Chairman, Medcraft, concluded a 2015 speech by arguing that "[c]ulture is important to us because it drives conduct."[62] Medcraft noted in a later speech that "poor culture has been at the root of some of the worst misconduct we saw during the global financial crisis."[63] In is also clear that bad corporate culture may have systemic consequences, as was evident recently from an ASIC report into the Australian funds management industry, based on a review of 12 Australian financial services licence holders from 1 July 2013 to 30 September 2015.[64] In responding to cultures that have produced questionable conduct, ASIC launched a series of legal action against Australia's leading banks in connection with rate rigging of Australian Bank Bill Swap rates.[65]

Echoing statements coming from the UK's FCA, ASIC Chairman, Medcraft, identified what he saw as key drivers of good culture, with the first of these being the role of the board and senior management in leading by example and "demonstrating the conduct that supports the organisation's values."[66] This of course assumes that there is a clear dividing line between virtuous and criminal corporations[67] and the "blurred boundaries between 'criminal' and 'normal' business behaviour."[68]

11.3 Theorising About Corporate Culture and Corporate Crime

Too often cultural leadership from the top in corporations has been lacking. Professor John Braithwaite has noted that:

> While it is middle management who perpetuate the criminal acts, it is top management which set the expectations, the tone, the corporate culture that determines the incidence of corporate crime.[69]

He added that in these circumstances, responsibility for illegalities is attributed to senior managers who are often "wilfully blind to the creation of a criminogenic corporate culture."[70] At this stage, it may be appropriate to look briefly at some of the academic literature on these issues.

The question whether white-collar crime was a crime has troubled criminologists at least since the 1950s when Edwin H Sutherland considered this matter.[71] Others such as Christopher Stone took a different approach and wondered whether the large corporation was "where the law ends."[72] This is because large corporations are largely systems of private governance.[73] Fisse and Braithwaite noted that corporate justice mechanisms within the corporation may be more effective in finding out what occurred and in so doing "reflect the culture of the organisation, and be perceived as fair by those subjected to investigation or sanctions.".[74]

They added that the problem with this was that "private justice systems have weaker safeguards of procedural fairness."[75] Nevertheless, they went on to highlight the advantages of private justice systems and the capacities of inside investigators to better understand the culture of an organisation and more quickly establish who might be responsible; as they explained: "[p]rivate justice systems have a superior capacity to finger the culpable partly because of their capacity to trap unsuspected wrongdoers."[76]

However, internal systems of private governance may have greater difficulty in dealing with misconduct by powerful actors in senior management positions and on corporate boards. Not surprisingly, in regard to responsibility for banking failures leading up to, or since, the GFC, few if any senior executives or board members of major banks have been subject to criminal actions or been subject to financial sanctions.[77] At the same time, since 2009, it has been reported that some US$190 billion was paid by 49 financial institutions in fines and settlements with governments and private individuals.[78] However, this money has been paid out of what might otherwise be shareholder funds and not by individual bankers.

Professor MacNeil has noted that "the financial crisis did not lead to a significant rise in public enforcement actions in either the USA or the UK…"[79] The failure to bring successful criminal actions personally against senior bank executives after the GFC has been explained by the claim that it is often difficult to prove misconduct by senior corporate officers; the effect of statute of limitations clauses has also prevented actions being

brought against wrongdoers.[80] As a result, governments have often been content to see massive fines being paid by banks in the settlement of claims raised, without any admission of liability. This suggests that it is necessary to look more closely at new laws and improved regulatory mechanisms, as well as issues of corporate culture and the attribution of criminal liability upon the basis of a toxic corporate culture.

It is often argued that organisations have a distinctive culture which may tolerate violations of the law when this is done for the benefit of the firm.[81] However, this does not mean that there is no room for corporate criminal liability, even if many cases of corporate misconduct can be handled by the use of civil or administrative remedies.[82] Indeed, the use of corporate law remedies need not always involve imposing criminal sanctions as a range of other less coercive remedies may often be more appropriate, as Fisse and Braithwaite have argued when they advanced their accountability model which used their well-known pyramid of enforcement.[83]

There has been a decrease in the number of successful corporate crime prosecutions in recent decades. Laureen Snider has argued that this can be attributed to three broad forces; firstly, in the context of neo-liberalism, we have seen a deregulation of some areas; secondly, we have seen a trend towards decriminalisation of corporate misconduct and finally, we have seen a downsizing of the machinery of corporate crime enforcement.[84] She attributed these changes to the influence of hegemonic groups in encouraging governments to reform laws and ease the regulatory burden on business (such as the movement against "red tape"). In this context, the political influence of large banks is often such that they are able to neutralise punitive regulatory action.

It is remarkable that there have been almost no successful criminal prosecutions of individuals following the GFC when a comparison is made with the number of prosecutions after the Savings & Loans crisis in the USA between 1983 and 1992. This crisis arose during the Reagan era as a result of competitive pressures that flowed from the deregulation of financial institutions, such as thrift banks.[85] Despite academic findings that those involved in the S&L crisis received more lenient sentences than would be applied in "normal" street crime,[86] it has been reported that the S&L crisis saw 1100 criminal prosecutions of individuals in major S&L fraud cases out of a total of 5490 criminal investigations, with 839 convictions of individuals being recorded in the USA.[87]

Similarly, there were more criminal prosecutions of senior executives after the collapse of Enron and other dot com companies than occurred after the GFC; this outcome was helped by resources being made available and dedicated task forces being set up to prosecute these cases.[88] However, it has been noted that the outrage at the use of securitised special purpose vehicles by Enron, and the convictions that were recorded at this time, had little impact upon the financial sector where similar practices continued to evolve.[89] As one observer remarked:

> …many of the same financial vehicles tested by Enron became institutionalized on Wall Street in the years after the company's collapse…While Enron and the reforms it spawned may have been sufficient to change behaviour at some companies, it barely seemed to register in the financial sector. To avoid low returns, the big banks embraced risky business models ultimately built around trading. Trading was Enron's Achilles heel as well.[90]

The collapse of HIH in Australia has many parallels with the failure of Enron. In Australia, limited action took place after the collapse of insurance company HIH, which was only made possible by the allocation of additional resources by government to fund the HIH prosecutions. However, as Haines noted from her review of the HIH case, the line between corporate criminality and normal business behaviour is often ill defined and industry leaders may at times be celebrated for their risk-taking business behaviour but at other times such behaviour may be seen as criminal.[91]

But a decade on, for a variety of reasons, there has been a reluctance to pursue senior executives in failed or failing major banks and financial institutions; to some degree this hesitation was attributed to perceptions that markets were too fragile and needed to be calmed so as to avoid "contagion."[92] Added to this was the realisation gained from experience with earlier prosecutions, such as with Enron, that criminal cases can be lengthy and expensive and that their complexity was often difficult for juries to understand; often, well-resourced litigants were able to have their convictions overturned on appeal.[93] Others have argued that the GFC was caused by regulatory failures or poor prudential supervision and risk management and not by criminality on the part of senior banking officers. Such reasons have been used to justify a search for other remedies.

It is well known that a lack of adequate resources is also a fundamental cause of the failure to prosecute securities market abuses.[94] Unlike the response to earlier market crises, after the GFC there was a reluctance to set up working groups and task forces (as occurred after earlier failures) to organise prosecutions of senior executives, and banking regulators were generally more reluctant to refer cases to prosecutors to pursue through the courts; some regulatory bodies, such as the US Securities and Exchange Commission, were also constrained by the fact that they were only empowered to bring civil and not criminal cases.[95]

After a decade of minimal market regulation during the boom years prior to 2008, bodies such as the SEC were induced to see the regulation of financial markets as something that should best be left to markets themselves. This was well illustrated by the failure to deal with massive Ponzi schemes such as the scheme organised by the highly regarded US securities trader, Bernard Madoff.[96]

In seeking to make some sense of these failures, US criminologist, Henry N Pontell, was quoted in *The New York Times* as saying:

> When regulators don't believe in regulation and don't get what is going on at the companies they oversee, there can be no major white-collar crime prosecutions…If they don't understand what we call collective embezzlement, where people are literally looting their own firms, then it's impossible to bring cases.[97]

One reason for the reluctance of the US Government to act more robustly against Wall Street bankers was the belief that the Obama Administration itself had become dominated by former Wall Street bankers and lawyers.[98] Such concerns over political interference were also raised in the earlier response to the Savings and Loans Crisis in the USA.

In the UK, it has been shown that regulators preferred to rely upon non-enforcement-led compliance promoting strategies in their regulation of disclosure of finance and corporate governance matters.[99] Iain MacNeil has concluded that in the UK:

> The financial crisis has drawn attention to the potential for individual as opposed to entity responsibility to act as an accountability mechanism as

> well as a deterrent. It has also acted as a driver for increasing criminalization of regulatory offences so as to harness the reputational sanctions associated with regulatory contraventions.[100]

After the GFC in the UK, actions against individual senior bankers in failed banks had been stymied by inadequate legal remedies, as occurred when action was taken against individuals in the failed Royal Bank of Scotland.[101] This eventually led to the enactment of new provisions in 2013 to remedy this defect in the law.[102] Neo-liberal proponents have often seen markets as self-disciplining or self-regulating and have therefore urged governments to stay out of business. The GFC demonstrated the ideological nature of these claims as Government bail-outs and quantitative easing by Central Banks became the order of the day. This was also illustrated after the failure of UK banks after 2007, when an official inquiry headed by Sir David Walker concluded by arguing that further legislation was not required and that problems could be resolved by introducing a self-regulatory Stewardship Code to monitor banking activity.[103] This code has been criticised by many academic commentators.[104] A somewhat more critical view of the professional standards and culture of banks was subsequently taken in 2013 in the report of the UK Parliamentary Banking Standards Commission.[105] As the Commission's Report explained:

> Too many bankers, especially at the most senior levels, have operated in an environment with insufficient personal responsibility. Top bankers dodged accountability for failings on their watch by claiming ignorance or hiding behind collective decision-making. They then faced little realistic prospect of financial penalties or more serious sanctions commensurate with the severity of the failures with which they were associated. Individual incentives have not been consistent with high collective standards, often the opposite.[106]

The Banking Standards Commission went on to argue that:

> A more effective sanctions regime against individuals is essential for the restoration of trust in banking. The current system is failing: enforcement action against Approved Persons at senior levels has been unusual despite multiple banking failures. Regulators have rarely been able to penetrate an

> accountability firewall of collective responsibility in firms that prevents actions against individuals. The **patchy** scope of the Approved Persons Regime, which has left people, including many involved in the Libor scandal, beyond effective enforcement.[107]

The Commission was critical of the FCA's Approved Persons Regime arguing that it had created a largely illusory impression of regulatory control over individuals.[108]

The rise of non-binding corporate social responsibility codes, or soft law, is an illustration of the effects of a widespread reluctance to use criminal sanctions or governmental regulatory mechanism. We have also seen efforts to avoid criminal convictions by the use of negotiated arrangements, such as deferred prosecution agreements[109] and negotiated settlements which avoid the need for a guilty plea. However, MacNeil has argued that "[i]nformal settlements have attracted some criticism for their role in exculpating offenders but can be justified as a means to make efficient use of scarce enforcement resources."[110]

For example, in 2016, Goldman Sachs negotiated a settlement with the US Justice Department to pay US$5.06 billion as a penalty for its actions in marketing mortgage-backed securities between 2005 and 2007.[111] However, although negotiated settlements have long been used in countries such as Australia,[112] courts have not always been comfortable with them.[113] In these circumstances, a space has been created for a new focus upon improving internal corporate cultures in financial institutions rather than expending massive resources on complex criminal prosecutions. In 2013, the UK's Parliamentary Banking Standards Commission argued that a significant cultural change was required to restore trust in banks at all levels:

> the weakness in standards and culture that has contributed to the loss of public trust in banks has not been confined to isolated parts of a few substandard banks. It has been more pervasive. Trust in banking can only be restored when it has been earned, and it will only have been earned when the deficiencies in banking standards and culture, and the underlying causes of those deficiencies, have been addressed.[114]

Westbrook argues that regulators have turned to the idea of culture in frustration.[115] Campbell and Loughrey also suggest that "the regulatory retreat to a critique of something so amorphous as culture follows from an acknowledgment that previous regulation was a deplorable failure…"[116] The inadequacy of conventional regulation of markets has also been seen as explaining the resort to culture and ethics in seeking to deal with market failure.[117]

Whilst lawyers may imagine culture as being law-like and economists imagine culture as being like a market, Westbrook argues that these are both very shallow understandings of culture and points out that the term culture is impossible to define objectively and externally.[118] He argues that culture needs to be seen as a web of understandings and needs to be seen as being "internal to the individuals, institutions, modes of interaction that constitute financial markets."[119] Three theoretical problems with the current effort to draw upon culture in enhancing financial regulation are identified by Campbell and Loughrey when they note:

> [T]o direct regulatory effort at a change of culture has at least three debilitating shortcomings. First, it leaves the nature of the regulatory effort to be mounted extremely vague…This leads to the second shortcoming, for it is not as if attempts to indirectly produce a change of culture have not been made; it is that they did not work…And it is here that we would seek to identify the third and most important regulatory shortcoming that led to the crash. The culture that is being criticised undoubtedly is a culture of self-interest…[120]

They argue that the type of self-interest that caused financial markets to crash was "not market self-interest, but very substantially its opposite."[121] Drawing upon Adam Smith rather than Amartya Sen, Campbell and Loughrey argue that a culture of market self-interest must remain an essential driver of markets.

11.4 Using Corporate Culture as a Legal Tool

In 2006, the Australian Law Reform Commission (ALRC) recommended that the Australian Government should expand the range of penalties that were applicable to corporations to include such mechanisms as cor-

rective action, community service and the publication of information about the offence that had been committed. The ALRC also recommended that s 16A(2) of the Crimes Act (Cth) be amended to include:

> [T]he type, size, circumstances and internal culture of the corporation; [and] the existence or absence of and effective compliance program designed to prevent and detect criminal conduct.

A 2008 report by the law firm Allens Arthur Robinson (now merged with Linklaters) noted that these recommendations have not been implemented.[122] The Allens report also noted that:

> Unlike the US, and despite having a nuanced model of organisational liability, Australia has not developed corresponding systematic principles of sentencing to deal with organisational liability.[123]

The Allens report notes that the final report of the Standing Committee of the Attorney-General's Department that recommended the change "drew on academic writing to outline the justification for corporate culture provisions."[124] This included a number of papers written by Professor Brent Fisse.[125]

The Australian Criminal Code Bill was introduced in 1994 and the Criminal Code Act (CCA) was amended in 2000.[126] Section 12 of the CCA (in Pt 2.5) defines Corporate Culture as:

> an attitude, policy, rule, course of conduct or practice existing within the body corporate generally or in the part of the body corporate in which the relevant activities takes place.

In proving the fault element of an offence Art 12 also states that this can be done by:

> (c) proving that a corporate culture existed within the body corporate that directed, encouraged, tolerated or led to non-compliance with the relevant provision; or
> (d) proving that the body corporate failed to create and maintain a corporate culture that required compliance with the relevant provision.

Section 769A of the Australian Corporations Act 2001 provides that Pt 2.5 of the Criminal Code does not currently apply to Chap. 7 of the Corporations Act (dealing with Financial Services and Markets); Also, s 12GH(6) of the ASIC Act 2001 limits the application of Pt 2.5 to the financial services provisions found in Div 2 of Pt 2 of the ASIC Act; this therefore does not currently allow the corporation's culture to be used in proceedings as evidence of intention or recklessness.[127]

In this way, Dixon has noted that Australia has extended the breadth of its corporate liability regime "far beyond any other jurisdiction."[128] Clough and Mulhern have described the Australian Criminal Code in similar terms.[129] However, there has been a "prosecutorial reticence in relying upon the corporate culture provisions of the Criminal Code as a basis of liability."[130] She adds that these "provisions have not been tested in a criminal prosecution, although, in the United States, corporate culture has often been referred to in regulatory offences as a factor in sentencing."[131]

Corporate culture has long been the subject of academic discussion by lawyers and criminologists. Culture has also been studied extensively by business-related disciplines.[132] The language of Section 12 is based on work done by Fisse and Braithwaite in their 1993 study of *Corporate Crime and Accountability*. This has been an on-going theme in academic debates.[133] Essentially, the concept of corporate culture was being used as a way of proving intention. However, these provisions do not seem to have been effective in an organisational context.

Fisse and Braithwaite noted that "an organisation has a culture which is transmitted from one generation of organisational role incumbents to the next."[134] They added that any "strategy for allocating responsibilities should be in harmony with the varieties of structures, cultures, [etc.] in large and small organisations."[135]

In considering the problem of disharmony between corporate culture and the law, Fisse and Braithwaite considered various solutions,[136] but noted that this presents problems as corporate culture will inevitably vary significantly between different organisations, making it difficult to standardise the application of law to corporate culture. They turned to the idea of the pyramid of disciplinary action as a way of obtaining "commit-

ment from corporations to comply with the law" and allowing regulators to "back up their negotiations with credible threats about the dangers faced by defendants if they choose to go down the path of non-compliance."[137]

However, the fuzziness of the concept of corporate culture has led critics to argue that its inherent uncertainty as a concept provides a poor basis upon which to rest legal arguments concerning criminal liability. Because some have argued that culture is a "moving target," Colvin and Argent argued that:

> …there are significant difficulties in attempting to regulate something as uncertain as corporate culture. In order to impose liability on directors, officers and the company, there must be an identifiable 'offence' – the culture of the organisation must fall short of some legal standard. It is, however, extremely difficult to define that standard.[138]

They go on to argue that the extension of Pt 2.5 of the Criminal Code to Chap. 7 of the Corporations Act:

> [W]ould be a significant intrusion into the internal governance of corporations. The provisions are 'vague and provide little guidance to companies and their lawyers about what is required' to comply with Pt 2.5 of the Criminal Code.[139]

Arguably, one of the problems with corporate legislation in many Western countries is the excessive reliance on detailed provisions, rather than general provisions. It is interesting to note that the former Governor of the Bank of England, Mervyn King, has called for simpler more robust rules for the regulation of financial markets.[140] A similar argument was made by Andrew Haldane of the Bank of England when he argued that the excessive complexity of the Basel process of banking regulation had become counterproductive.[141] This is because detailed provisions are often able to be avoided by lawyers acting for corporate clients. It could be argued that corporate culture is such a simpler rule. Moreover, it is a matter that would largely be left to corporations themselves in a more sophisticated model of regulation than that espoused by industry advocates.

11.5 Conclusions

Recent financial market and corporate collapses have led to a loss of faith in many traditional legal regulatory tools used in regard to the control of financial markets. The failure to successfully pursue criminal actions against senior officers in banks and financial institutions following the GFC has raised questions regarding the utility of criminal prosecutions. A number of explanations for the declining use of criminal prosecutions and the use of other remedies, such as commercial settlements, were considered.

This has caused a significant loss of trust in banking and financial institutions. Over the last decade, we have seen a renewed interest in the idea of corporate culture and its value as a regulatory tool. Regulatory authorities have been keen to draw upon it in the regulation of financial institutions, although the fuzziness of the concept has made it a difficulty tool to use as a legal mechanism, such as in criminal prosecutions. Some efforts have been made to develop a legal model of corporate culture, but it has yet to be applied widely and not at all to the financial services industry. It is unlikely to provide the "quick fix" that some regulators had hoped for.

Nevertheless, the provisions of the Australian Criminal Code dealing with corporate culture have provided an important focus to the ongoing reform debate, even if it is clear that the existence of an inadequate corporate culture is unlikely to be an effective means of proving criminal misconduct in financial institutions. This debate will no doubt continue as the managerial aspects of corporate culture may well serve as an interim mechanism for achieving greater accountability in corporate governance.

Notes

1. A similar paper was presented at the annual conference of the Corporate Law Teachers' Association, held on the Gold Coast, Qld, Australia in 2017. A revised version will appear in the conference papers published in (2017) 32(2) Australian Journal of Corporate Law.
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3. Trotman, B, "UK investors could start forex lawsuits after banking trio settle for $1bn in US", *The Telegraph*, 22 October 2015.
4. Rexrode, C and Glazer, E, "Tough act tracing billions in bank fines", *The Australian*, 11 March 2016 at p. 25.
5. See further, Glazer, E and Rexrode, C, "Well boss grilled over bank's accountability", *The Australian*, 22 September 2016 at p. 25.
6. Chappell, Bill, "'You Should Resign': Watch Sen. Elizabeth Warren Grill Wells Fargo CEO John Stumpf," National Public Radio, 20 September 2016. Available at: http://www.npr.org/sections/thetwo-way/2016/09/20/494738797/you-should-resign-watch-sen-elizabeth-warren-grill-wells-fargo-ceo-john-stumpf
7. Ibid.
8. Glazer and Rexrode, above at p. 25.
9. McCallister, D, "Well Fargo CEO Discusses Secret-Accounts Scandal in Senate Hearings", National Public Radio, 20 September 2016; available at: http://www.npr.org/sections/thetwo-way/2016/09/20/494680201/wells-fargo-ceo-to-address-accounts-scandal-before-senate-panel
10. Ibid.
11. McCallister, above at p. 3.
12. As to why Australia managed to survive the GFC see further: Sykes, T, *Six Months of Panic – How the Global Financial Crisis Hit Australia*, Crows Nest, Allen & Unwin, 2010; Hill, JG, "Why did Australia fare so well in the global financial crisis?", (pp. 203–300) in Ferran, E, N Moloney, JG Hill and JC Coffee, *The Regulatory Aftermath of the Global Financial Crisis*, Cambridge, Cambridge University Press, 2012.
13. See further, Garnaut, R with Llewellyn-Smith, D, *The Great Crash of 2008*, Melbourne, Melbourne University Press, 2009, at p. 48. For a Federal Court case which subsequently dealt with these transactions see: *Wingecarribee Shire Council v Lehman Brothers Australia Ltd.* (in liq) [2012] FCA 1028.
14. Financial Systems Inquiry, *Final Report*, December 2014; see further at: http://fsi.gov.au/publications/final-report/chapter-5/recommended-actions/
15. Quoted by White, A, "Banks face rising risk from conduct breach, says Fitch", *The Australian*, 8 April 2016 at p. 22.
16. For a discussion of this point see: Bartholomeusz, S, "Labor politicians should curb the urge to bash banks", *The Australian,* 13 April 2016.

17. Eyers, J, "Shorten uses Westpac 'cowboys' to justify royal commission call", *The Age,* 17 May 2016, p. 7.
18. See for example, Williams, P, "Ex-CBA chief Norris backs bank culture", *The Australian Financial Review*, 2 May 2016 at p. 17.
19. Patten, S, "Trust in financial planners still falling", *The Australian Financial Review*, 27 May 2016.
20. In many ways the collapse of HIH may be seen as Australia's Enron.
21. Financial Systems Inquiry, "Strengthening Australian Securities and Investments Commission's funding and powers" available at: http://fsi.gov.au/publications/final-report/chapter-5/strengthening-asic/
22. McCauley, D et al., "Policing the bank 'will cost more than $127 million' consumer advocates warn", news.com.au, 20 April 2016, available at: http://www.news.com.au/finance/business/banking/policing-the-banks-will-cost-more-than-127-million-consumer-advocates-warn/news-story/b2243dd1482fea205a5b253d9f4aafba
23. Treasury Committee, House of Commons*, The Run on the Rock,* Fifth Report of Session 2007–08, *Volume I* at p. 12. Available at: https://www.publications.parliament.uk/pa/cm200708/cmselect/cmtreasy/56/56i.pdf
24. See further, King, M, The End of Alchemy – Money, Banking and the Future of the Global Economy, London, Little Brown, 2016 at pp. 23–24. Also see generally, Augar, P, *The Death of Gentlemanly Capitalism – The Rise and Fall of London's Investment Banks,* London, Penguin Books, 2000; and Poser, NS, *International Securities Regulation – London's "Big Bang" and the European Securities Markets*, New York, Little, Brown & Co, 1990.
25. See generally, Australian Securities and Investments Commission, "Culture, conduct and conflicts of interest in vertically integrated businesses in the funds-management industry", Report 474, March 2016; available at: http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-474-culture-conduct-and-conflicts-of-interest-in-vertically-integrated-businesses-in-the-funds-management-industry/. In regard to Chinese Walls, see generally: Tomasic, R, "Chinese Walls, Legal Principle and Commercial Reality in Multi-Service Professional Firms", (1991) 14 *University of New South Wales Law Journal* 46–72.
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12

The Financial Crisis and Mortgage Fraud: The Unforeseen Circumstances of the War on Terrorism and the Financial War on Terrorism, a Critical Reflection

Nic Ryder

12.1 Introduction

The 2007/2008 financial crisis has attracted a great deal of research, debate and conjecture on the identification of its contributory factors. Many government-commissioned reports have attempted to identify the root causes of the financial crisis and have ascertained an embarrassment of complex and interwoven financial, legislative and regulatory factors that contributed to the largest financial collapse since the Wall Street Crash in 1929. For example, the United States (US) Financial Crisis Inquiry Commission Report (Financial Crisis Commission) concluded that there were several factors that caused the financial crisis. This included weak financial regulation, the collapse of corporate governance and risk management, unwarranted borrowing combined with precarious investments, ill-equipped governments, a complete breakdown of accountability and ethics, collapsing mortgage lending standards, mortgage securitisation, over-the-counter derivatives and the failures of Credit Rating Agencies (CRAs; Financial

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N. Ryder (ed.), *White Collar Crime and Risk*,
https://doi.org/10.1057/978-1-137-47384-4_12

Crisis Enquiry Report 2011, pp. xv–xxviii). Additionally, the US Department of Treasury (2008) stated that there were five elements: a complete breakdown in underwriting standards for subprime mortgages, a significant erosion of market discipline, flaws in CRAs, risk management weaknesses at many large financial institutions and ineffective banking regulation. The Federal Reserve identified more components that included a generalised run on global financial institutions, the dependence of many financial systems on short-term funding, a vicious cycle of market-to-market losses driving fire sales of asset-backed securities, the realisation that financial firms were pursuing flawed business models and were subject to similar risks, and global swings in risk aversion supported by instantaneous worldwide communications and a shared business culture (2010, p. 6). In the United Kingdom (UK), the Financial Services Authority (FSA) concluded that "the origins of the greatest post-war financial crisis can be traced back to a combination of macroeconomic factors and financial market developments. The resulting exuberance in pricing credit and volatility risk developed into a self-reinforcing cycle, exacerbated by a failure to develop appropriate macro-prudential policy responses" (FSA 2009, p. 5). In particular, the FSA identified six factors that included the macroeconomic imbalances increasing the complexity of the securitised credit model, the rapid extension of credit and falling credit standards, the property price boom, increasing leverage in the banking and shadow banking system, underestimation of bank and market liquidity risk, and self-reinforcing cycle of irrational exuberance (ibid., pp. 7–12). Other well-documented influences that triggered the financial crisis included the spectacular collapse of the US subprime mortgage sector (European Commission 2009), weak and ineffective banking regulation models (Hutchins 2011, p. 293), high levels of consumer debt and related over-indebtedness (Dickerson 2009, p. 395), the sale of toxic debts (Arsalidou 2010, p. 284), securitisation (Nwogugu 2008, p. 316), deregulation of banking legislation (Levitin 2009, p. 399), ineffective macroeconomic policies (Gevurtz 2010, p. 113), weak consumer credit regulation (Schaefer 2012, p. 741), the deregulation of consumer credit legislation (Choi and Papaioannou 2010, p. 442) and the culture of some banking practices (Tomasic 2011, p. 7). However, one of the most significant developments in the aftermath of the financial crisis has been the increasing recognition

that white-collar crime either triggered the financial crisis or was a significant contributory factor (Ryder 2014; Huisman 2012; Deflem 2011; Herlin-Karnell 2012; Hardouin 2011; Creseney et al. 2009; Eng and Nuttal 2009; Posner and Vermeule 2009). It is not the purpose of this chapter to identify the different types of white-collar crime that caused the financial crisis, instead, it will uniquely concentrate on how the instigation of the 'War on Terrorism' and the 'Financial War on Terrorism' contributed towards the inability of US authorities to tackle the most prominent type of white-collar crime to be associated with the financial crisis – mortgage fraud. The chapter begins by providing a brief overview of the instigation of the 'War on Terrorism' and the 'Financial War on Terrorism' by President George Bush, in September 2001. It then outlines and highlights how the al Qaeda terrorist attacks resulted in the transformation of the US white-collar crime strategies to include the ill-considered merger between its anti-money laundering (AML) and counter-terrorist financing (CTF) strategies, and how this metamorphosis had a catastrophic impact on their ability to tackle mortgage fraud. The next section of the chapter illustrates the link between the financial crisis, subprime mortgages and mortgage fraud before moving to identify and critically considering the impact of the alteration in policy towards mortgage fraud that was introduced by President Barak Obama.

12.2 The War on Terrorism and the Financial War on Terrorism

It is the hypothesis of this chapter that an unforeseen factor that contributed towards the financial crisis was the instigation of the 'War on Terrorism' and the 'Financial War on Terrorism'. Both of these were introduced by President George Bush, following the terrorist attacks in September 2001. It has been suggested that the President associated the 'War on Drugs' with the 'War on Terrorism' after it was insinuated that the terrorist attacks, in 2001, were partly financed by the profits of sale of illegal narcotics (Kenney 2003, p. 187). On September 15, 2001, President George Bush declared that the US was at 'war', and on September

18, Congress permitted the president to "use all necessary and appropriate force against those nations, organisations, or persons he determines planned, authorised, committed, or aided the terrorist attacks…or harboured such organisations or persons, in order to prevent any future acts of international terrorism against the United States" (Public Law 107–40). The 'War on Terrorism' began on October 7, 2001 when UK and US forces conducted the first of many aerial bombardments of selected al Qaeda and Taliban targets in Afghanistan (The White House 2001a). These attacks were soon followed, in January 2002, by the deployment the North Atlantic Treaty Organization (NATO)-led International Security Assistance Force, that became involved in armed conflict with the Taliban and al Qaeda. The US ended its use of the phrase 'War on Terrorism' in April 2009, when the Department of Defence replaced it with 'Overseas Contingency Operations' (US Government Accountability Office 2009). It has been suggested that President Barak Obama declared an end to the 'War on Terrorism' in a speech in May 2013, when he stated that "every war has come to an end…we must define our effort not as a boundless 'global war on terror', but rather as a series of persistent, targeted efforts to dismantle specific networks of violent extremists that threaten America" (The White House 2013). However, the Director of the Central Intelligence Agency, John Brennan, stated in 2015 that the 'War on Terrorism' would never end:

> If we were not as engaged against the terrorists, I think we would be facing a horrendous, horrendous environment…it's a long war, unfortunately. But it's been a war that has been in existence for millennia…so this is going to be something, I think, that we're always going to have to be vigilant about. (Harvard University 2015)

The most significant part of the US response to the terrorist attacks in September 2001 that would have a catastrophic effect on its ability to tackle mortgage fraud was the decision to pursue the development and implementation of a national strategy for homeland security. This was propelled by the announcement, in 2002, for the creation of the Department of Homeland Security. In June 2002, President George Bush declared that his most important responsibility was to "protect and defend the American

people" (Department of Homeland Security 2002, p. 2). The Department of Homeland Security stated that "the President proposes to create a new Department of Homeland Security, the most significant transformation of the US government in over half a century by largely transforming and realigning the current confusing patchwork of government activities into a single department whose primary mission is to protect our homeland" (ibid.). The Department of Homeland Security was established via the Homeland Security Act 2002 (Public Law 107-296, November 25, 2002), and its creation has been described as the biggest "reorganization of the federal government since World War II" (Thompson 2010, p. 277). When the Department of Homeland Security was launched in March 2003, it represented the merger and integration of 22 different government agencies and departments. Indeed, it has been suggested that prior to its creation, there were over 100 government organisations that were undertaking the responsibilities of the Department of Homeland Security (Department of Homeland Security 2002). The Homeland Security Act provides the Department of Homeland Security with three objectives, including the prevention of terrorist attacks (Home Land Security Act 2002, s. 101(b)(1)(a)), to reduce the vulnerability of the US to terrorism (Home Land Security Act 2002, s. 101(b)(1)(b)), and to minimise the damage and help in the recovery from terrorist attacks (Home Land Security Act 2002, s. 101(b)(1)(c)). In order to achieve these objectives, the Department of Homeland Security was given a considerable annual budget and an extensive array of rulemaking powers. For example, in 2002, the budget was US$19.5bn (Department of Homeland Security 2003, p. 9), US$37.7bn in 2003 (ibid.), US$36.2bn in 2004 (Department of Homeland Security 2004, p. 1), US$40.2bn in 2005 (Department of Homeland Security 2005, p. 3), US$41.1bn in 2006 (Department of Homeland Security 2006, p. 5), US$42.7bn in 2007 (Department of Homeland Security 2007, p. 5), US$46.4bn in 2008 and (Department of Homeland Security 2008, p. 7) US$50.5bn in 2009 (Department of Homeland Security 2009, p. 7). At the time of writing this chapter, the proposed annual budget is US$41.2bn (Department of Homeland Security 2015, p. 10). The Department of Homeland Security is able to perform its duties by issuing regulations under its six operational components which include the US Citizenship and Immigration Services, the US Coast Guard, the US Customs and Border

Protection, the Federal Emergency Management Agency, US Immigration and Customs Enforcement, and the Transportation Security Administration. The creation of the Department of Homeland Security and the prevention of terrorism became the top priority for the Bush Administration and resulted in sweeping changes to how the Federal Bureau of Investigation (FBI) tackled white-collar crime, and, in particular, mortgage fraud. The impact of this policy change following the terrorist attacks in September 2001 is further explored and analysed in a later section of this chapter, but it now turns its attention to how the 'Financial War on Terrorism' also contributed towards the inability of the US to tackle mortgage fraud.

On September 24, 2001, President George Bush famously declared "we will starve terrorists of funding, turn them against each other, rout them out of their safe hiding places, and bring them to justice" (The White House 2001b). The 'Financial War on Terrorism' had begun, and this announcement was followed by frequent declarations of the freezing of the financial assets of terrorists and their supporters. The 'Financial War on Terrorism' resulted in a seismic shift in the white-collar crime strategies of the international community away from money laundering towards the financing of terrorism (Harrison and Ryder 2013, p. 39). This is a view strongly asserted by Alexander who stated that "terrorist financing only became of international concern following the al Qaeda attacks" (2003, p. 200). Therefore, as argued by Eckert, "the events of 11 September precipitated a sea change in the manner with which regulators and financial institutions approached the issue of terrorist financing" (2008, p. 229). Until the terrorist attacks in September 2001, the international community had directed its resources and legislative provisions towards tackling the proceeds of drug-related crimes, a point clearly illustrated by the remit of the United Nations (UN) Convention against Narcotic and Psychotropic Substances, the early AML legislative measures introduced by the European Union (EU) and the scope of the 40 Recommendations of the Financial Action Task Force (FATF). The international community responded to the declaration by President George Bush and introduced a series of CTF legislative provisions. However, it is essential to note that the foundations of the 'Financial War on Terrorism' were contained in the 1999 International Convention for the Suppression of the Financing of Terrorism, before the terrorist attacks in 2001 (54/109 of December 9, 1999). The aim of the

International Convention was to "enhance international co-operation among States in devising and adopting effective measures for the prevention of the financing of terrorism" (Abeyratne 2011, p. 57). It is important to note that prior to the terrorist attacks, "only four States had acceded to the Convention" (O'Neill 2012, p. 31). However, at the time of writing, the International Convention has been implemented by 186 nation states. Terrorist financing was defined by the International Convention as including "assets of every kind, whether tangible or intangible, movable or immovable, however acquired, and legal documents or instruments in any form" (International Convention for the Suppression of the Financing of Terrorism (1999) Art. 1 para. 1). Terrorist financing has also been referred to as 'reverse money laundering', which is a practice, whereby 'clean' or 'legitimate' money is acquired and then funnelled to support acts of terrorism. Supplementary, the UN-issued Security Council Resolution 1267 in 1999, which generated a sanctions regime that applied to people or entities that were associated with the Taliban, Osama bin Laden and al-Qaida (United Nations 1999). This was followed by fulcrum of the 'Financial War on Terror', UN Security Council Resolution 1373, which was unanimously adopted by UN on September 20, 2001 (United Nations 2001). The scope and remit of Security Council Resolution 1373 has been amended by Resolutions 1390 (United Nations 2002), 1456 (United Nations 2003) and 1566 (United Nations 2004).

Additionally, the EU "adopted a framework decision on combating terrorism" (Brent 2008, p. 114). For example, in December 2001, the European Council adopted the Common Position on combating terrorism, which was the legal instrument that implemented UN Security Council Resolution 1373 ([2002] OJ L164/3). Furthermore, Council Resolution 2580/2001 required members of the EU to freeze the funds, financial assets and resources of people, and named groups ([2001] OJ L344/93). Additionally, Council Resolution 881/2002 included a 'black list' of names that were identical to the list determined by the UN Sanctions Committee. The Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime and on the Financing of Terrorism was authorised in December 2005 in Warsaw (Abeyratne 2011, p. 57). Importantly, in 2005, the Convention amended the scope of the 1990 Convention on Laundering, Search,

Seizure and Confiscation of the Proceeds from Crime to include the financing of terrorism (European Commission 2005). However, it is important to note that prior to the terrorist attacks in September 2001, the EU had directed its white-collar crime efforts on money laundering and not the financing of terrorism, thus adopting an identical stance to that of the UN. For example, the EU has implemented three Money Laundering Directives, the first of which concentrated on tackling the laundering of proceeds of drug trafficking through the financial system, and not the financing of terrorism (Council Directive 91/308/EEC). At the start of the new Millennia, it became clear that the scope of the First Directive was too narrow and ineffective (Mitsilegas and Gimlore 2007, p. 119). Therefore, the EU introduced a broader Second Money Laundering Directive (Directive 2001/97/EC) which increased the list of predicate offences for which the suspicious transaction reports were compulsory from just drug trafficking offences to all serious criminal offences and extended the scope of the Directive to a number of professions and non-financial activities. However, the Second Money Laundering Directive did not include the financing of terrorism. In 2004, the European Commission determined that it was necessary to introduce a Third Money Laundering Directive, which included the financing of terrorism (Directive 2005/60/EC). The European Commission published a Fourth Draft Money Laundering Directive in February 2014, the terms of which were agreed and approved by the European Council in February 2015, and it took effect from June 26, 2015. Member States of the EU are required to implement the Directive by 2017 (The Law Society 2015).

These legislative measures are supported by the expansion of the remit of the FATF to include the financing of terrorism in October 2001. The FATF was originally mandated to focus on the prevention of money laundering, and this was evident by the publication and scope of its '40 Recommendations' (Financial Action Task Force 2003). In October 2001, the FATF broadened its remit and included, at the time, an additional 'Eight Special Recommendations' to tackle terrorist financing. This was extended to the 'Nine Special Recommendations' and resulted in the Recommendations becoming referred to as the '40+9 Recommendations' (Sykes 2007, p. 236). The objectives of the 'Special Recommendations' were to "detect, prevent and suppress the financing of terrorism and

terrorist acts" (Financial Action Task Force 2001, p. 2). These were further amended in February 2012, and are now referred to as the International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation (Financial Action Task Force 2012). Therefore, the extension of the remit of the international legislative measures to tackle the financing of terrorism would have both a long-term and fundamental impact on the white-collar crime strategies of nation states. The next section of the chapter demonstrates the evolution of the US CTF legislation and how they were mistakenly based on its existing AML measures. It then moves on to explain how this would limit efforts to tackle mortgage fraud associated with the financial crisis in the US.

12.3 The Evolution of the US Counter-Terrorist Financing Strategy

It is important to note that prior to the terrorist attacks in September 2001, the US had concentrated its white-collar crime resources on fraud and money laundering. For example, a wide range of fraudulent activities were originally criminalised by the Mail Fraud Statute in 1872 (18 U.S.C. Chapter 63). This was followed by a glut of fraud-related legislation including the Wire Fraud Statute 1952 (18 U.S.C. § 1341), the Comprehensive Crime Control Act 1984 (Public Law 98–473, S. 1762, 98 Stat. 1976, enacted October 12, 1984), the Major Fraud Act 1988 (Public Law 100-700), the Financial Institutions Reform and Recovery Act 1989 (Public Law 101-73), the Sarbanes-Oxley Act 2002 (Public Law 107–204) and the Fraud Enforcement and Recovery Act 2009 (Pub.L. 111–21, S. 386, 123 Stat. 1617). The US AML policy originated in the 1960s when its Department of Treasury became alarmed at the link between criminal behaviour and offshore bank accounts (Doyle 2002, p. 279). The legislation that has become inherently associated with the US AML policy is the Currency and Foreign Transactions Reporting Act 1970, or as it is more commonly referred to the Bank Secrecy Act 1970 (Pub, L. 91-507-OCT. 26, 1970). The Bank Secrecy Act (BSA 1970) imposed a plethora of reporting obligations on a wide range of financial institutions,

including currency transaction reports. The next notable development in the evolution of the US AML policy was its association with the 'War on Drugs' in the 1970s and 1980s (Ryder 2012, p. 2). The AML policy was largely supported by a series of legislative measures that criminalised money laundering, expanded the scope of US forfeiture powers, expanded the currency transaction reporting requirements of the Bank Secrecy Act 1970 and introduced the use of suspicious activity reports (SARs). These legislative measures included the Money Laundering Control Act 1986 (Public Law 99-570), the Anti-Drug Abuse Act 1988 (Public Law 100-690), the Anti-Money Laundering Act 1992 (Public Law 102-276) and the Money Laundering Suppression Act 1994 (Public Law 99-570).

There are three legislative provisions that the US CTF legislative and regulatory framework is constructed on: the Trading with the Enemy Act 1917, Anti-terrorism and Effective Death Penalty Act 1996 and the Bank Secrecy Act 1970 (Donohue 2008, p. 147). The Trading with the Enemy Act 1917 (12 U.S.C. §§ 95a–95b) provides the US president with the power to supervise and/or constrain trade between the US and its enemies in times of war. Additionally, the Trading with the Enemy Act 1917 criminalises conduct for any person in the US to trade with an enemy nation state (Aufhauser 2009, p. 22). Therefore, the overarching aim of the 1917 Act is to enable US to "exert control over financial transactions or impose sanctions against foreign countries and/or nationals" (Savage 2001, p. 21). The second piece of legislation was the Anti-terrorism and Effective Death Penalty Act 1996 (Pub. L. No. 104-132, 110 Stat. 1214). The purpose of the 1996 Act is to enable the US government "to prevent persons within the United States…from providing material support or resources to foreign organizations that engage in terrorist activities" (ibid.). The Act was signed in April 1996, a year after the bombing of the Oklahoma City federal building by Timothy McVeigh. The legislation contained two important statutory provisions that permitted the victims of terrorism to sue state sponsors of terrorism and prohibited fundraising in the US by terrorist groups (§ 303(a), 110 Stat. at 1250). The aim of the Anti-terrorism and Effective Death Penalty Act 1996 was to "hold terrorist nations accountable and to create a civil remedy for victims of foreign terrorism" (Conway 2002, p. 735). Furthermore, the Anti-terrorism and Effective Death Penalty Act 1996 amended the foreign state immunity

provisions of the Foreign Sovereign Immunities Act 1976. By virtue of the 1996 Act, the US government is authorised to designate an organisation as a foreign terrorist organisation if they determine that "(a) the organization is a foreign organization (b) the organization engages in terrorist activity…(c) the terrorist activity or terrorism of the organization threatens the security of United States nationals or the national security of the United States" (8 U.S.C. §1189(a)(1) (Supp. IV 1998)). Additionally, the Anti-terrorism and Effective Death Penalty Act 1996 "created two lists of entities against which financial structures applied: state sponsors of terrorism and designated foreign terrorist organisations" (Donohue 2008, p. 148). The first list was created under the International Emergency Economic Powers Act 1977 and the second by designation of foreign terrorist organisations (See 50 U.S.C. § 1702(a)(1)(B)). The aim of the legislation was to provide "the President authority in national emergency situations to prohibit dealings by any person subject to the jurisdiction of the United States with designated foreign persons and parties" (Kelley 1992, p. 167). The powers under the 1977 Act have been used against several countries including Libya, Iraq, Haiti, Iran South Africa, Nicaragua, Panama and Kuwait (ibid., p. 173). Indeed, it has been argued that these powers have been used to deal with a wide range of matters including "national emergencies as the Iranian hostage seizure, Sandinista activities in Nicaragua, apartheid in South Africa, terrorist activities in Libya, Iraq's invasion of Kuwait, and the crisis in Haiti" (Gantz 1995, p. 1). The International Emergency Powers Act 1977 has been described as "one of the primary tools used in fighting the financial war on terror. Although the [Act]…existed prior to the terrorist attacks of September 11…it provides the legal framework to block assets of organizations that are deemed to be aiding and abetting foreign terrorist groups" (Ferrari 2005, p. 205). The second type of terrorist-related list was introduced by the Anti-terrorism and Effective Death Penalty Act 1996 (Donohue 2008, p. 149). Warneck took the view that the 1996 Act "prevents funds from ever reaching the organization by…forbidding contributions to groups that the Secretary of State has classified as terrorist organizations" (1998, p. 177). The powers under the Anti-terrorism and Effective Death Penalty Act 1996 was first utilised in October 1997 by the then Secretary of State Madeline Albright (Department of State 1997). Under this legislation, it

is possible for the US government to designate individuals and groups as foreign terrorist organisations. Specifically, the 1996 Act permits the Secretary of State, to liaise with the Secretary of the Treasury to "designate an organisation as a foreign terrorist organisation" (8 U.S.C. §1189(a)(1) (Supp. IV 1998)). It is possible for a body that has been designated as a foreign terrorist organisation to challenge this description within 30 days of its publication in the Federal Register (8 U.S.C. § 1189(6)(c)(1)). The final area of legislation was the BSA 1970, which "focused on creating a paper trail to help the state detect an investigate violations of tax and criminal law" (Donohue 2008, p. 151).

It is important to note that from the early AML measures spawned the untimely and ill-advised merger of the US AML and CTF strategies by virtue of the Money Laundering and Financial Crimes Act 1998. This legislation required the US government to publish and deliver its National Money Laundering Strategy and also to "coordinate the efforts of law enforcement agencies and financial regulators in combating money laundering" (General Accounting Office 2003, p. 1). Under the Act (31 USC § 5341(a)(1)–(2)), the Department of Treasury and the Department of Justice were required to produce five reports, which have yielded the publication of five National Money Laundering Strategies (Department of Treasury 1999, 2001, 2003). The final National Money Laundering Strategy was published in 2007, (Department of Treasury 2007) as a direct response to the publication of the Money Laundering Threat Assessment (Department of Treasury 2005). The extension of the money laundering legislative framework to include terrorist financing must be questioned because the 'AML model' is based on tackling the proceeds or profits of criminal activity, where acts of terrorism do not generate a profit. The financial process adopted by terrorists to accumulate funds can be contrasted with that adopted by money launderers. For instance, terrorist financing has been referred to as 'reverse money laundering', which is a practice whereby 'clean' or 'legitimate' money is acquired and then funnelled to support terrorism (Ryder 2013, p. 767). Conversely, money laundering involves the conversion of 'dirty' or 'illegal' money into clean money via its laundering through three recognised phases. The extension of the money laundering model to include terrorism must be queried because terrorism is not a profit-based crime.

The first part of the chapter has discussed the impact of the 'War on Terrorism' and the 'Financial War on Terrorism' on US white-collar crime strategies. The creation of the Department of Homeland Security resulted in an unprecedented reorganisation of how US authorities tackled terrorism, with approximately 40 per cent of its special agents being reassigned to protect homeland security. Ultimately, this decision would cripple the FBI's counter mortgage fraud efforts in the build-up to and during the financial crisis. The second section of the chapter moves on to highlight the link between the financial crisis and mortgage fraud.

12.4 The Financial Crisis and Mortgage Fraud

The origins of the financial crisis can be traced to the collapse of the US subprime mortgage sector in 2007 (Financial Crisis Enquiry Report 2011). A subprime mortgage has been defined as a "non-traditional, higher risk loans that frequently carry above market interest rates" (Slevin 2007, p. 18). Many commentators have concluded that the collapse of the US subprime mortgage market contributed towards the financial crisis (Singh and LaBrosse 2010, p. 55). The spectacular collapse resulted in financial institutions reporting record losses (International Monetary Fund 2008, p. 10), a large number of corporate insolvencies, significant losses for investors and banks (Wen 2011, p. 325), record number of property repossessions (Marshall 2009, p. 2) and record levels of consumer debt (Ruben 2009). Additionally, several studies have determined that the collapse of the US subprime mortgage sector highlighted an underlying association with mortgage fraud. For example, Nguyen and Pontell stated that their "investigations have found that the growth of nonprime lending attracted a great deal of [mortgage] fraud" (2011, p. 12). These authors cited research by Black (2010) and Costello et al. (2007) which "found that fraudulent misrepresentation existing in almost every [mortgage application] file" (Nguyen and Pontell 2011, p. 12). These studies were supported by the Federal Financial Institutions Examinations Council which stated that "industry experts estimate that up to 10% of all residential loan applications have some form of material misrepresentation, both inadvertent and malicious" (2009). The FBI

stated that during the subprime mortgage crisis "mortgage fraud perpetrators…[took] advantage of industry personnel attempting to generate loans to maintain current standards of living" (2004). Therefore, the FBI concluded that the "subprime mortgage issues remain a key factor in influencing mortgage fraud directly and indirectly" (ibid.). This is a view supported by McCann who noted that "mortgage fraud perpetrated by these unregulated private mortgage brokers may have contributed to the instability and loss in the residential lending market that contributed to the mortgage crisis" (2010, p. 352). Therefore, mortgage fraud became the most prominent white-collar crime to be associated with the financial crisis. It has been described as "the fastest growing white collar crime in the US" (FBI 2006) and "one of the most pervasive problems in lending" (Jacobus 2008, p. 188). Mortgage fraud has been defined as "the intentional misstatement, misrepresentation, or omission by an applicant or other interested parties, relied on by a lender or underwriter to provide funding for, to purchase, or to insure a mortgage loan" (Federal Bureau of Investigation 2004). It also includes providing misleading information when making a mortgage application (Vacco 2008, p. 248). There are two types of mortgage fraud – fraud for property and fraud for profit (O'Donnell and Planer 2008, p. 54) which are associated with property flipping, straw buyers, equity skimming, builder bailout, buy and bail, chunking, double selling, phantom sales, property flip fraud, reverse mortgage fraud and short sale fraud (Federal Financial Institutions Examinations Council 2009, p. 8). Prior to the onset of the financial crisis, the FBI estimated that extent of mortgage fraud in 2006 was US$4.2bn (Federal Bureau of Investigation 2007). It was declared to be an "escalating problem" in 2007 (Federal Bureau of Investigation 2008), and in 2008, the reported losses from mortgage fraud increased by 83 per cent to US$1.4bn (Federal Bureau of Investigation 2009a). In 2009, the FBI citing 'Core Logic', estimated that the total amount of losses related to mortgage fraud had increased to US$14bn (ibid.). 'Core Logic' estimated that the extent of mortgage fraud, in 2011, was US$12bn (2011, p. 1). In its 2011 mortgage fraud report, 'Core Logic' projected that that the level of mortgage fraud had increased to US$13bn (ibid.).

Further evidence of the association between the financial crisis and mortgage fraud is illustrated by the significant increase in the number of

related SARs submitted to the Financial Crimes Enforcement Network (FinCEN). For example, between 1996 and 2006, FinCEN received 82,851 mortgage-fraud-related SARs (FinCEN 2006, p. 4). During this period, the number of suspected instances of mortgage fraud reported to FinCEN increased by 1400 per cent (Mahallati 2010, p. 712). In 2008, FinCEN reported that between 2006 and 2007, it received 37,313 mortgage fraud SARs (2008, p. 4). This figure represented 45 per cent of the total mortgage-fraud-related reports it received between 1996 and 2006. In 2010, the number of mortgage-fraud-related SARs received by FinCEN numbered 70,472 (FinCEN 2011, p. 2). The number of SARs significantly increased to 92,028 in 2011 (FinCEN 2012, p. 3). It was reported that in 2011, FinCEN received 93,508 mortgage-fraud-related SARs, an increase of 33 per cent (Lexis Nexis 2012, p. 3). However, FinCEN reported, in 2012, that there was a 25 per cent drop in the number of mortgage-fraud-related SARs (FinCEN 2013). This position was succinctly summarised by Smith who noted "the past decade has witnessed an explosion of mortgage fraud, with reports…rising by a magnitude of over eighteen times from 2000 to 2008" (2010, p. 473). However, it has been argued that the figures from FinCEN only represent a small percentage of the true extent of mortgage fraud. For example, Black took the view that "the total SARs figure is only a faint indication of the true incidence of mortgage fraud" (2011, p. 597). It is also interesting to note that "mortgage fraud, far from abating, has only expanded since the foreclosure crisis began" (Fisher 2009, p. 121). The association between mortgage fraud and the financial crisis is also illustrated by an increase in the investigative and enforcement activities of the FBI. For example, since the start of the financial crisis, we have witnessed a 400 per cent increase in the number of mortgage fraud investigations undertaken by the FBI (Heroy 2008, p. 322). In response to the increasing levels of mortgage fraud and related SARs submitted to FinCEN, the FBI established 84 mortgage fraud task forces; there are approximately 2000 ongoing investigations, over 1000 indictments and over 1100 convictions have been obtained. Moye summarised the overall impact of mortgage fraud from a law enforcement perspective:

> From 2007 through 2010, the number of federal mortgage fraud cases increased from 1,200 to over 3,000. Almost 70 per cent of those fraud cases involved losses exceeding $1m. In June 2010, the Department of Justice announced the results of Operation Stolen Dreams, the largest mortgage fraud sweep in history. The sweep lasted three and a half 422 months, involved 1,517 defendants, 863 indictments, 525 arrests, and involved over $3.05bn in losses. (2011, p. 421)

Nonetheless, the reliability of the figures provided by the FBI has been questioned by the Department of Justice's Inspector General's Office which concluded that the total number of mortgage-fraud-related prosecutions could be less than expected (Richman 2014, 265). Black was also very critical of the response from the FBI and stated that "the elite frauds that drove the current crisis have not even been subjected to a serious investigation" (2012, p. 987).

12.5 An Alteration of Policy

The declaration of the 'War on Terrorism', the instigation of the 'Financial War on Terrorism' and the prioritisation of Homeland Security had an adverse impact on the ability of the FBI to tackle mortgage fraud. The impact of the 'War on Terrorism' on the Department of Justice was recognised by the then Attorney General who noted that the "war on terrorism became *the* [author's emphasis] overriding focus of the Department of Justice and my mission as Attorney General became clear: to transform a peacetime Justice Department ill-prepared for the challenges of 9/11, into wartime Justice Department" (Ashcroft 2009, p. 813). As a result of this alteration in priority, the FBI and a large number of US Attorneys' officers became responsible for "fighting the domestic portion of the War on Terror" (Richman and Stuntz 2005, p. 583). This decision was questioned by commentators who argued that the Department of Justice "led by organized-crime prosecutors, [became]…an extension of the Defence Department in the 'War on Terrorism', as the USA Patriot Act [2001] provides a new role for law enforcement in fighting terrorism. The boundaries between war and law enforcement are now very blurry" (Baker 2004, p. 310). It is very

interesting to note that despite the necessity to promote Homeland Security and the related extension of the remit of the FBI and Department of Justice, the threat posed by mortgage fraud *was* recognised by many commentators before the start of the financial crisis. For example, the FBI warned that "if fraudulent practices become systemic within the mortgage industry and mortgage fraud is allowed to become unrestrained, it will ultimately place financial institutions at risk and have adverse effects on the stock market" (Federal Bureau of Investigation 2009b). Furthermore, an assistant director of the FBI described the threat posed by mortgage fraud in 2004 as having "the potential to be an *epidemic* [author's emphasis]", and that "we think we can prevent a problem that could have as much impact as the Savings and Loans crisis" (Federal Bureau of Investigation 2004). These statements were also used by other media outlets including *Reuters* who warned that the FBI "after years spent focusing on national security, is struggling to find agents and resources to investigate wrongdoing tied to the country's economic crisis" (Michaud 2008). Furthermore, the Los Angeles Times reported that "a massive shift of FBI agents to anti-terrorism and counter intelligence duties has *undermined* [author's emphasis] the work of fraud investigators, who are taking on fewer scam artists and corporate miscreants and taking longer to complete cases" (Eckard 2004). Lichtblau et al. stated that:

> Since 2004, FBI officials have warned that mortgage fraud posed a looming threat, and the bureau has repeatedly asked the Bush administration for more money to replenish the ranks of agents handling non-terrorism investigations, according to records and interviews. But each year, the requests have been *denied* [author's emphasis], with no new agents approved for financial crimes, as policy makers focused on counterterrorism. (2008)

This was a view supported by Black, one of the most vociferous critics of the US approach towards mortgage fraud, who famously declared that "an expanding epidemic of mortgage fraud existed. The Federal Bureau of Investigation…warned Congress…in September 2004 that an 'epidemic' of mortgage fraud was developing and predicted that it would produce an economic 'crisis' if it were not contained". Black added that despite this forthright statement from the FBI, "no one in the industry, including regulators, ranks of investors or creditors, or law enforcement personnel took effective action against the epidemic" (2011, p. 597).

A clear link between the instigation of the 'War on Terrorism' and the benign neglect by the Bush administration towards mortgage fraud was the diversion of significant resources away from the FBI's whitecollar crime team towards tackling terrorism and maintaining Homeland Security. The reduction in white-collar crime by FBI agents was recognised by the Financial Crisis Enquiry Commission Report, which stated that the number of assigned agents towards white-collar crime dropped from 2342 to less than 2000 (Financial Crisis Enquiry Commission 2011, p. 5). The Commission added that, in 2007, only 150 agents were available to investigate over 54,000 mortgage-fraud-related SARS filed with the FinCEN. The direct association between the redistribution of its special agents and mortgage fraud was highlighted by Creseney et al. who described this process as becoming an "obstacle" that adversely affected the ability of the FBI to investigate allegations of mortgage fraud (2009, pp. 238–239). Indeed, Creseney et al. concluded that by 2007, "the number of FBI agent's nationwide pursuing mortgage fraud had shrunk to about 100, in sharp contrast to the roughly 1,000 agents that were deployed on banking fraud during the Savings and Loans crisis of the 1980s and 1990s" (ibid.). Similarly, Podgor condemned the decision by President George Bush to promote Homeland Security and stated that "the reduction in [FBI] agents likely resulted in the reduced number of white-collar prosecutions" (2010, p. 205). The diversion of resources resulted in the *New York Times* concluding that "the FBI is struggling to find enough agents and resources to investigate criminal wrongdoing tied to the country's economic crisis" (Lichtblau et al. 2008). Despite numerous pleas by law enforcement agencies and the Mortgage Bankers Association for more federal funding to tackle mortgage fraud, it was *consistently* and *incorrectly* rejected by President George Bush. This was acknowledged by Robert Mueller, the Director of the FBI, who informed the Financial Crisis Enquiry Commission Report that he had asked for more resources to tackle mortgage fraud but "didn't get what we had requested" (Financial Crisis Commission 2011, p. 163). Additionally, it has been argued that the Bush Administration disregarded the threat posed by mortgage fraud, and that they provided hardly any financial support for the FBI (ibid., p. 164). However, the former Attorney General Alberto Gonzales argued that "I don't think anyone can credibly argue

that [mortgage fraud] is more important than the war on terror. Mortgage fraud doesn't involve taking loss of life" (Financial Crisis Commission 2011, p. 163). This statement is another example of the negligent attitude towards mortgage fraud that was afforded by the Bush Administration. It is abundantly clear that despite warnings and requests for additional funding from the FBI, President George Bush adopted an apathetic stance towards mortgage fraud.

However, the strategy towards mortgage fraud gained significant momentum when President Barak Obama came into office in January 2009. One of the first legislative measures introduced to tackle white-collar crime associated with the financial crisis was the Fraud Enforcement and Recovery Act 2009 (Pub.L. 111–21). The origins of this legislation are to be found in an initial, but abortive legislative attempt to combat mortgage fraud that was tabled, in April 2007, by then Senator Barack Obama and Senator Dick Durbin. The Bill was entitled "Stopping Mortgage Transactions which Operate to Promote Fraud, Risk, Abuse, and Underdevelopment Act". The Bill sought to amend fraud legislation by imposing tougher criminal sanctions upon people who were convicted of mortgage fraud. In particular, it sought to increase the custodial sentence to 35 years and also increase the levels of financial penalties to US$5 m. The proposals also aimed to enlarge the breadth of reports and evidence of mortgage fraud that were submitted to FinCEN. However, the Bill was not signed into law by President George Bush because it ran out of Congressional time. Nonetheless, following the 2008 Presidential election, the Fraud Enforcement and Recovery Bill was reintroduced in February 2009, and it was signed into law by President Barak Obama on May 20, 2009 (The White House 2009). Reidy suggested that the 2009 Act was a reaction to what he described as "economic calamity…ostensibly combating the type of chronic misconduct which may have helped foster economic instability rather than merely combating the acute symptoms of such instability" (2010, p. 295). The Act was also viewed as a "broad-based anti-fraud measure, designed to create more tools to prosecute fraud at all levels" and to "help protect Americans from future frauds that exploit the economic assistance programs intended to restore and rebuild [the] economy" (Lover 2010, p. 1129). The Act contained five important provisions. Firstly, it provided a significant increase in the

funding for the Department of Justice and FBI to combat fraud. Baer noted that "over a two-year period, [the Act] authorized the injection of an additional $500m [to agencies] with jurisdiction over crimes ostensibly related to the financial crisis" (2012, p. 577). The additional funding resulted in an increase in the number of appointed fraud-related prosecutors and investigators (Valukas 2010, p. 1). The Department of Justice welcomed the additional funding and stated that the Act had granted them essential "further resources to increase the scope of our collective enforcement response" (Department of Justice 2011). Secondly, the Fraud Enforcement and Recovery Act 2009 made some important amendments to fraud and money laundering legislation. Thirdly, the Act increased the penalties for those convicted of mortgage fraud. Fourthly, the Act extended the definition of financial institutions to include private mortgage lending businesses and mortgage brokers. Fifthly, the Fraud Enforcement and Recovery Act 2009 increased the supervision of Troubled Asset Relief Programme. Additionally, the Act contained measures to tackle healthcare fraud, it established the Financial Crisis Inquiry Commission, extended the protection afforded to fraud-related whistleblowers and amended the False Claim Act 1986. The False Claims Act now permits the government and private parties the ability to recuperate money that has been lost to fraud. This measure has become one of the most significant anti-fraud devices utilised by the government in civil fraud cases (Lover 2012, p. 1129).

The decision to provide additional funding for the Department of Justice and the subsequent increase in enforcement activities, as outlined above, represented a significant alteration in policy towards mortgage fraud from the previous administration (Smith 2010, pp. 474–475). Indeed, the Fraud Enforcement and Recovery Act 2009 was welcomed by the Department of Justice which stated that it "would provide federal investigators and prosecutors with significant new tools and resources, both civil and criminal, with which to combat mortgage fraud, securities and commodities fraud and related offenses" (Department of Justice 2009). McCann concluded that "the overall effect of the statutory enhancements and resources that FERA provides to federal law enforcement will be to more effectively police the home mortgage market…as a result…[it] will be more secure" (2010, p. 352). Despite the obvious

merits of the Act, it has been criticised. For example, it has been asserted that the provisions amount to a rash and hasty response to the financial crisis (ibid., 377). Indeed, Lowell and Arnold argued that politicians have bowed to pressure from consumer groups and turned towards criminal law provisions (2003, p. 219). The scope of the Act has questioned by Valukas who stated that merely providing additional funding and increasing the number of fraud-related prosecutions do not go far enough (Valukas 2010, p. 13). Moye stated that the Act "does not go far enough to eradicate fraudulent claims submitted to the government and its programs. Clearly, the law attempts to tie up loose ends from the financial crisis, but it could go further to send a message to those violating the law" (2011, p. 429). However, Ceresney et al. warned that "it is unlikely that they will be successful in systematically prosecuting the frauds that may have triggered the credit crisis" (2009, p. 243). Nonetheless, the Fraud Enforcement and Recovery Act 2009 represented a bold attempt by President Barak Obama to redress some of the imbalances created by President George Bush, who wrongly prioritised the 'War on Terrorism' at the expense of mortgage fraud. The Act has allowed the Department of Justice and FBI, to pursue white-collar criminals who have contributed towards the financial crisis, albeit low-level traders. This is demonstrated by the increase in mortgage fraud convictions and on-going investigations by the FBI. The link between the terrorist attacks in September 2001, the financial crisis and white-collar crime has been directly influenced by the decision by President George Bush to prioritise terrorism and national security over mortgage fraud. The diversion of resources away from mortgage fraud, despite several warnings and pleas from the FBI, left them unprepared and ill-equipped to deal with the incoming tsunami of mortgage fraud cases.

12.6 Conclusion

The aim of this chapter was to provide an alternative commentary on the association of the financial crisis with white-collar crime, and how this relationship was fostered by the declaration of the 'War on Terrorism' and the 'Financial War on Terrorism' in September 2001. The instigation of

both of these measures was to have a profound and adverse impact on the ability of the FBI to combat mortgage fraud. The decision to promote Homeland Security at the expense of mortgage fraud would result in the catastrophic redistribution of FBI white-collar crime agents to tackle terrorism, under the guise of the Homeland Security Act 2002. The creation of the Department of Homeland Security became one of the most significant reorganisations of the US governments in several decades. This saw the merger of numerous government, state and local agencies under one institution, which has been consistently provided with a huge annual budget, to promote homeland security and reduce the threat posed to the US by terrorism. Since the instigation of the 'War on Terrorism' in September 2001, the Counter Terrorism Section of the Department of Justice has secured 494 terrorist-related convictions (Federation of American Scientists 2012). However, these statistics, like those cited by the FBI, have been questioned, and it has been suggested that they are inaccurate (Department of Justice 2013). A direct result of the 'Financial War on Terrorism' was the adoption of an ill-advised CTF policy that was based on the existing AML model. The implementation of an AML model, that was originally used to target the laundering of the proceeds of criminal offences, was inappropriate to tackle terrorism. Terrorists will not use the proceeds of crime to disguise the true origins of the criminal offence; they will use the finances to commit acts of terrorism. The CTF model was initially based on extending the reporting obligations to the financing of terrorism that were contained in the BSA 1970. This was soon followed by the extension of the powers of the residing President to impose economic sanctions on enemies of the US at times of war. Yet, again, this part of the US CTF policy must be questioned, as there has not only been a significant reduction in the number of states sponsoring terrorism according to the US Department of State, but it is difficult to impose economic sanctions on terrorist groups such as Islamic State, Boko Harem and Al Shabaab. The untimely merger of the AML and CTF policies was mandated by the introduction of the Money Laundering and Financial Crimes Act 1998. This legislation was soon followed and further strengthened by the introduction of the USA Patriot Act 2001 and the signing of Presidential Executive Order 13,224. These measures domestically implemented the 'Financial War on Terrorism' in the US

and jettisoned mortgage fraud from the peak of the FBI's white-collar crime strategies. The actions of President George Bush, following the terrorist attacks in September 2001, were to have a profound impact on the ability of US law enforcement agencies to tackle mortgage fraud; the financial crime is associated with the financial crisis. Mortgage fraud is directly linked to its primary cause – the collapse of the subprime mortgage market. The subprime mortgage sectors grew at a spectacular rate before the onset of the financial crisis in 2007. For example, by 2006, the number of subprime mortgages peaked and accounted for over 25 per cent of all US mortgages. Financial institutions that were eager to profit from subprime mortgages contributed to their rapid growth. However, when the subprime market collapsed, in 2007, a number of financial institutions suffered significant losses with many applying for bankruptcy protection. Additionally, homeowners also suffered as a result of the failure, and there was a dramatic increase in the number of repossessions, which resulted in the discovery of widespread instances of mortgage fraud. This point has been clearly illustrated by the significant increase in levels of mortgage fraud since the onset of the financial crisis, a substantial surge in the number of reported instances of mortgage fraud to FinCEN and the related upturn in mortgage-fraud-related prosecutions by the FBI. However, this chapter has presented evidence from the FBI, which, in 2004, warned of the threat posed my mortgage fraud and asked President George Bush for additional funding to counteract this perceived threat. These warnings and pleas were consistently ignored by the Bush administration and left the FBI and other related law enforcement agencies with little resources to prevent an incoming flux of mortgage-fraud-related cases. The position was redressed in 2009 with the introduction of the Fraud Enforcement and Recovery Act by President Barak Obama, which redressed the imbalance of the strategies adopted by President George Bush.

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https://doi.org/10.1057/978-1-137-47384-4

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