

EDITORIAL: ISSUES IN FIGHTING FINANCIAL CRIME

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Introduction

The Centre for Financial Regulation and Crime (CFRC) at Cass Business School was asked by the Institute of Economic Affairs to put together a symposium on financial crime for *Economic Affairs*. In order to take an overview of what is now being recognised as a global concern,¹ we approached a number of colleagues around the world, asking them to analyse, from the perspective of their respective jurisdictions, the impact of serious financial crime and the efficacy of the measures that are currently in place to control it, and to indicate how they see future development. We selected eight articles from their contributions for inclusion in this issue.

The UK

As the article by Bowron and Shaw of the City of London Police points out, financial crime is under-reported, under-recorded and there are insufficient resources devoted to tackling the problem in the UK. The lack of a clear definition of financial crime has been pointed out by many commentators.² This contributes to the difficulty of receiving reports of incidents of financial crime, even if they are reported, and of recording them in such a way that is meaningful for statistical and research purposes. Notwithstanding the lack of general consensus, the term 'financial crime' is widely used, not least in the context of 'the reduction of financial crime', which is one of the four regulatory objectives of the Financial Services Authority, the UK's single regulator for financial services, as defined under the Financial Services and Markets Act 2000.³ The Act states that 'financial crime' includes any offence involving fraud or dishonesty; misconduct in, or misuse of information relating to, a financial market; or handling the proceeds of crime.⁴ For the purpose of compiling this issue, we gave each expert the discretion to identify the particular issues in the fight against financial crime to discuss in the context of their respective jurisdiction.

The impact of fraud is enormous, from corporate fraud, which is a serious risk to commercial organisations, to small-scale identity fraud which can have a devastating effect on the individual concerned. The article by Bowron and Shaw identifies

a number of factors contributing to the difficulty of addressing the problem of financial crime in the UK: firstly, the collective failure of the government, law enforcement agencies and business to inform the public of the true cost of financial crime; secondly, the lack of a statutory offence of fraud in the UK; thirdly, from the law enforcement perspective, the fact that a significant number of financial crime cases involve other jurisdictions which causes serious difficulty in obtaining evidence through a patchwork of Mutual Legal Assistance Treaties, thus delaying trials; finally, the current rules on disclosure of evidence are incompatible with the volume of documents obtained during an investigation.

In terms of the way forward, the ongoing legislative overhaul will result in the passing of the Fraud Act. Furthermore, the UK Fraud Review⁵ has recommended the creation of a National Fraud Reporting Centre (CFRC), which could share and provide access to data.

As the article recognises, there is a tension between the need in the commercial world to maximise profits on the one hand and to invest in anti-fraud measures on the other. This tension cannot be resolved until society appreciates the benefit of investing in strategies to fight financial crime. An holistic approach is needed as prevention is better than cure. It is argued that government, businesses and individuals must combine their resources to stifle financial crime at source. To this end, the CFRC is working closely with the City of London Police on a number of projects in research and business education. As the article points out, threats not only come from outside but also from within the organisation. Employee collusion or 'insider fraud' is prevalent in the UK due to inadequate vetting. The CFRC, in partnership with the City of London Police and other European law enforcement agencies and research institutions, will be conducting a major study on insider fraud in the retail banking sector in Europe, funded by the European Commission.

International perspectives

Australia

The difficulty of counting the costs of financial crime is also pointed out by Gilligan in the context of discussing financial crime in Australia. Given the

significance of the financial services industry, not only to its own economy but also globally, Australia has implemented many measures to combat financial crime which undermines the integrity of this sizeable sector. However, Gilligan points out the difficulty of the industry – i.e. the private sector – bearing the costs of fighting financial crime which is often multi-jurisdictional in nature, and the complex balancing of various imperatives such as investor protection, maintaining market integrity, promoting entrepreneurial activity and protecting society from terrorist and criminal activity.

Jamaica

The global move to control money laundering began as part of the initiative to curtail trade in narcotics, such as the United Nations Convention against Illicit Traffic in Narcotics and Psychotropic Substances of 1988. Since the tragic events of 9/11, counter-terrorist financing has been added to the global fight against money laundering.

Against this background, Ali's paper analyses the legislative measures to combat money laundering, terrorist financing and market abuse in Jamaica. As Ali points out, Jamaica is not only a major producer and exporter of marijuana but also an important transit point for South American cocaine. In order to protect the credibility of its financial services industry and of the jurisdiction itself so as to avoid loss of business, Jamaica attaches significant importance to ensuring that adequate measures are in place to control serious financial crime.

Central and Eastern Europe

The narcotics trade has been inextricably linked to organised crime. The intractable problem of organised crime is highlighted in the articles covering Russia and Central and Eastern Europe. Of course, organised crime is a significant problem in the corporate/financial sector in many other countries, including Japan.⁶ Given that financial crime is perceived as 'low-risk, high-reward crime', as has been pointed out by Bowron and Shaw, it is an area in which organised crime has been active for a number of decades in many countries.

Abramova's paper dispels the myths perpetuated by sensational newspaper headlines that we see in the West by demonstrating that there are hardly any large 'Russian mafia' organisations that currently control the entire Russian economy and network with other organisations. Research shows that most of these groups, engaged in organised economic crime, work autonomously and that their activities are still fragmented. However, we cannot be complacent as Russian organised crime is going through a period of transformation just as the Russian economy is. Abramova predicts

that criminals will try to expand their operations abroad through tried and tested means (violence, fraud and corruption), and that it will carve out its share in the existing global criminal market. This will, in turn, spread hostilities between criminal organisations to other parts of the world and financial crime will be of special interest to criminal groups.

Ridley's paper discusses financial crime in Central and Eastern Europe and the fight against such crime through the introduction of anti-money laundering measures. After discussing the region in general, he focuses on the current situation in Russia and Romania, where, notwithstanding many difficulties, some progress has been made, particularly within a relatively short period, compared with the Western nations which have had more time to tackle the problems emanating from financial crime.

Islamic jurisdictions

Appreciating that different legal systems exist in the world, Atbani gives a jurisprudential analysis of financial crime within the purview of the Shariah, Islamic law. This is gaining relevance in global financial services, particularly now that the FSA has authorised Shariah-compliant Islamic financial institutions to operate in the UK. He discusses how modern types of financial crime can be dealt with under the principles of Islamic law, notwithstanding the fact that 'financial crime' as a phrase does not exist. He calls for the creation of a unified code or doctrine which applies the principles of Islamic law amongst Muslim countries and for harmonisation with an international framework.

Indeed, one of the major problems encountered by Islamic financial institutions and their regulators is the inconsistency and uncertainty of Islamic law in this area.⁷ In this context, the Islamic Financial Services Board's initiative in corporate governance to create standards that are both permissible under Islamic law and compatible with international practices is to be welcomed.⁸

South Africa

As in the UK, the fight against financial crime is under-resourced in South Africa. However, the question of priority is raised in de Koker's paper as personal safety is a serious concern in that country. Furthermore, the increasing cost of compliance is highlighted in the context of a developing economy such as South Africa, as it is by Millar and Yeager in the context of the USA. Nevertheless, as de Koker points out, the benefits of compliance measures need to be understood in the context of South Africa where they have helped in preventing fraud, and have encouraged more foreign investment in the Johannesburg Stock Exchange.

The USA

Millar and Yeager make observations about the recent spate of corporate scandals in the USA, most notably, Enron, WorldCom and Tyco. In addition to those large-scale corporate failures, which were caused by fraud committed by senior management of the companies concerned, they also point out the media scrutiny of executive pay packages in the USA in this decade. This is not dissimilar to the trend in the UK in the 1990s. However, unlike in the UK where a study group was set up to look into directors' remuneration and share options, resulting in the publication of a report making recommendations,⁹ the media scrutiny in the USA has led to a number of ongoing investigations. There are also more than 130 companies that are currently being investigated by the US Securities and Exchange Commission for the widespread practice of manipulation and illegal reporting of executive stock options. They promise to be the next big corporate scandal. Millar and Yeager then analyse the government's response to the recent large-scale corporate frauds, most notably the Sarbanes–Oxley (SOX) Act.

Dangers inherent in political action

In the USA, on the other hand, even if it were a well-intended initiative in reaction to a series of large-scale corporate failures, SOX is currently being scrutinised for the spiralling cost and its efficacy.¹⁰ Even the US Vice-President, Dick Cheney, has admitted that SOX may have gone 'too far'.¹¹

More generally, the danger of dictating so-called 'international standards' to the rest of the world cannot be ignored, as is pointed out by de Koker in the context of South Africa where 'international template solutions' were applied initially instead of the country formulating its own responses to the problems concerned. The action therefore had the unintended effect of excluding the poorer population from access to financial services. Of course, at the same time there exists a global trend to follow 'Western models', most notably in the area of corporate governance.¹² It is, nevertheless, respectfully submitted that it is an area where a more flexible approach is required so as to accommodate local needs and circumstances. Indeed, the 'one size fits all' approach is now being reviewed.¹³

A wholesale transplant of foreign measures is destined for failure even though it is often the approach of governments when faced with external pressures. Having said this, the introduction of a local solution, instead of a foreign solution, does not always guarantee that local problems are taken into account, for political or other reasons. For example, the debate on corporate governance in Japan, whilst the resultant legislative changes gave companies the choice between a model based on traditional

governance structure (with some modifications) and a new structure on the so-called 'Anglo-Saxon' model, did not even refer to the widespread problem of organised crime.¹⁴ There is also a danger of foisting upon less developed economies so-called 'international best practices' which may at best be seen as negative.¹⁵

Education and financial crime

No complex cases of financial crime could be perpetrated without the help of bankers, lawyers and accountants. Indeed, recent successful prosecutions of organised financial crime in the UK have highlighted the fact that such professionals get involved to make 'fast and easy profits'.¹⁶ In this connection, it is worthy of note that the Financial Services Skills Council (FSSC), a body licensed by the UK government to work in partnership with employers to provide strategic and responsible leadership for training, education and development for the UK financial services industry, has recently published competence standards for those engaged in compliance and anti-money laundering functions.¹⁷

Education is an important factor in the prevention of financial crime. This was highlighted in the survey that the CFRC conducted with RSM Robson Rhodes in 1994.¹⁸ In addition to establishing competence amongst the professionals working in the area of compliance and anti-money laundering, we need to raise awareness in the business community of the importance of preventing financial crime. In order for us to make significant progress, we must avoid the creation of 'financial crime' as a specialist area where no one from outside can understand the jargon full of acronyms. Instead, this area should form a vital part of business education.¹⁹ We must not lose sight of the fact that whilst we need to pursue measures to fight financial crime, 'prevention is better than cure'.

1. For example, in September 2000, the International Monetary and Financial Committee requested the IMF and the World Bank to prepare a joint paper on their respective roles in combating financial crime and money laundering in the context of protecting the international financial system, and the OECD has led a number of initiatives including the establishment of the Financial Action Task Force to fight money laundering and the adoption of recommendations to combat harmful tax practices.
2. See, for example, International Monetary Fund, 'Financial System Abuse, Financial Crime and Money Laundering – Background Paper' (12 February 2001) para. 9 stating, 'No internationally accepted definition of financial crime exists'; and C. F. Wellford and B. L. Ingraham (1994) 'White Collar Crime: Prevalence, Trends, and Costs', in A. R. Roberts (ed.) *Critical Issues in Crime and Justice*, Thousand Oaks, CA, Sage Publications, quoting competing definitions given by different scholars and commentators.
3. Section 2(2)(d).
4. Section 6(3).
5. For background, see C. Nakajima (2006) 'An Overhaul of the Systems to Deal with Fraud in the UK', *Journal of Financial Crime*, Vol. 13, No. 2.

6. See C. Nakajima (1999) *Conflicts of Interest and Duty: A Comparative Analysis in Anglo-Japanese Law*, London: Kluwer Law International, Ch. 9; C. Nakajima (1998) 'Doom and Gloom in the Tokyo Market or a Global Storm?', *Amicus Curiae*, Issue 3; and C. Nakajima (1998) Editorial, 1 *Journal of Money Laundering Control* 292.
7. See C. Nakajima and B. A. K. Rider (2007) 'Corporate Governance and Supervision: Basel Pillar 2', in R. A. A. Karim and S. Archer (eds.) *Islamic Finance: Regulatory Challenges*, Chichester: John Wiley.
8. Islamic Financial Services Board, 'Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services' (21 December 2005).
9. *Directors' Remuneration: Report by a Study Group Chaired by Sir Richard Greenbury* (17 July 1995).
10. S. Labaton, *New York Times* (28 October 2006).
11. As quoted from an interview with CNCB in City of London Corporation, *City New Monitor* (28 October to 7 November 2006).
12. See, for example, J. Dean, 'China Turns to Western-style Governance', *The Sunday Times* (8 October 2006).
13. See, for example, I. Filatotchev, S. Toms and M. Wright, 'The Firm's Strategic Dynamics and Corporate Governance Life-cycle', paper presented at Corporate Governance Roundtable Forum, Cass Business School, City University, London (23 November 2006).
14. Corporate Governance Committee of the Corporate Governance Forum of Japan, 'Corporate Governance Principles – Japanese View – (Final Report)' (26 May 1998).
15. The direct importance of certain measures from one country may be perceived by the host country as a means of domination or 'neo-colonialism'; see C. Nakajima and W. Harry, 'Ethnocentric Organisations: How Hosts Perceive MNCs using HR Policies as a Means of Domination', paper presented at 4th EIASM Workshop on International Strategy and Cross Cultural Management, Toulouse (29–30 September 2006).
16. See, for example, *Proceeds of Crime News – Money Laundering Update*, Issue No. 30 (24 November 2006), reporting the convictions of members of organised crime groups for crimes such as money laundering, insurance fraud and VAT fraud.
17. For background, see C. Nakajima (2005) 'Ensuring Competence in Money Laundering Prevention', 8 *Journal of Money Laundering Control*, Vol. 8, No. 3. For National Occupation Standards for Compliance and Anti-money Laundering, see http://www.fssc.org.uk/cgi-bin/wms.pl/Standards_and_accreditation/133.
18. The initial findings of the 'Economic Crime Survey' conducted amongst UK companies were presented by RSM Robson Rhodes in London on 19 October 2004.
19. As the author emphasised in the roundtable discussion published in 'Telling It Like It Is', in *The Guardian Public* (June 2005) at p. 30.

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