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Special Feature

White Collar Crime: Fraud, Bribery and Corruption – all alive and well?

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Abstract

The writer focuses on the alarming growth and prevalence of white-collar crime – in general as well as specifically in relation to financial markets – aiming to dispense with cries of woe, disbelief, anger and anguish in favour of categorising, typifying and analysing the root causes of such crime. Individuals as much as businesses suffering the consequences of fraud directly in addition to the tedium of precautions and preventive measures – anti money laundering checks, banking procedures and call-centre security procedures, to name a few – bring these gangland mysteries close to home, but with little prima facie understanding as to what makes it grow inexorably and evade the barriers, sanctions and law.

The underlying strategy of this article is to link familiar events and known criminal tactics with the unfamiliar background failings and phenomena which allow the incidence as well as seriousness of fraud to expand virtually unchecked. References to historical names and events such as Lloyd George and the contemporary cash-for-peerages scandal, Harold Wilson, Parmalat and Enron aim to colour the structured and analytic approach so that the threat of dry theorising is bypassed in favour of linking familiar reality and events with the trends and changes which spawn them.

On top of the world, thank you – from the point of view of the perpetrator. But inquire more closely in to the blood-count of any one or more – or of their close relatives: deceit, counterfeiting, extortion, forgery, robbery and sundry other felonies, all members of the self-same family – and it becomes evident that, as time passes, definitions become broader, variations more widespread, precedent more cumbersome and clustered examples more sinuously intertwined.

It is agreed that 'Fraud' ostensibly has to do with hoodwinking, 'Bribery' with payment criminally to conform, and 'Corruption' with exertion of criminal influence on goodly citizens – but the Lowest Common Multiples (LCM) merge in to an indeterminate mass of planned criminal behaviour knowingly designed to bring about enrichment at the expense of others – and it is this amoebic, merged LCM which guides this approach. Assessing the status quo and its impacts begins to look as daunting as an essay title such as 'Space', or 'Love', or 'Matter' – each topic so unbounded and unbridled that one sighs, shakes one head and doodles forlornly on the lined paper rather than take the first step of the mighty march through the thinking.

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Where does it all begin, middle and end? This forum rightly expects the searchlight-beam to sweep over fraud in the business world, where white-collar versions, corporate victims and market-related crime drilling in to securities and investments all matter more than equivalent crimes and delict in other areas and arenas of life.

The over-used term 'high-level' comes in to its own: it allows one to provide a broad and sweeping assessment of fraudulent activity in the round and on the whole. The plight of the business world follows on naturally in sharper focus – the leader in the pack of segments victimised by 'money crimes'.

Seen from that lofty angle, three developments in recent patterns of fraud stand out. First, it is remarkable that, in a world where education is improving (they say), governments support values, religions jostle multi-denominationally and civic structures are more efficient, fraud is actually increasing sharply.

Second, if one believes that the world – business or otherwise – can usefully be seen as consisting of three tiers: sovereign state, corporate entity and individual, then one has no option but to recognise that fraud is growing within every tier. Third, it has become uncomfortably clear that there is a large proportion of all fraud which is never detected. Illegality defying detection, morality, justice and righteousness is very frightening – but it is evident from exposure long after the events, from dead-ends to enquiries – (remember that poor freemasonic banker hanging under Blackfriars' Bridge? – Nearly 20 years ago, and they still don't know who did what) and from process of elimination, yet without evidence or justice, that it is so.

A researcher will ask himself painstakingly 'why' an increase in fraud comes about where text-book factors should be reducing it to the point of extinction. The answer is that there is no categorical solution to this, although criminologists, legislators and jurists struggle indirectly with the conundrum day in, day out. Consider the following possible explanations, neatly falling in to an orderly list:

Computers
Computers have a lot to do with it – but at both ends of the spectrum. Hacking and cyberabuse let the criminal in to systems, secrets and security structures: syphoning funds from on-line accounts seems to be child(-prodigy)'s play. Forensic technologists can turn the tables, however: they can track value-transfers, communications, interference and logistics from invisible footprints ... and it comes down to the question as to which side wins. At the moment the battle lines are drawn and both are winning, both are losing: technology is on the march and many of the victories seem to be Pyrrhic.

Accumulation and distribution of wealth
There is little doubt, looking at the socio-economic factors in play,

that the patterns of accumulation and distribution of wealth stimulate biblical sins such as lust, envy, greed and covetousness. The richer the rich become, and the more of them there are, the more the less rich will want to help themselves to other peoples' riches to enrich themselves. A clumsy epithet, but it speaks the truth.

Rebalancing of time allocation and application
Gradual rebalancing of time allocation and application has contributed to the phenomenon, too: in the old days when a serf spent 18 hours a day ploughing and six sleeping, he had no time for mischief. Today's quest for the holy grail of the Life/Work quality and balance are allowing more time for today's neo-serfs to visualise, speculate, plot, implement and cover their tracks: who was it that said, 'The devil makes work for idle hands'?

This sounds facile, yes – but it is worth putting more emphasis on considering the lifestyles and leisure styles of fraudsters and those who bribe and corrupt others: more often than not they inadvertently testify to this tendency. An eminent journalist has just researched a piece – 'When top appointments turn bad: They seem so right for each other, but sometimes the perfect match can, indeed, be too good to be true' – and it says it all.

Automation
Automation is also playing an ever greater role – or perhaps it should be 'anti-role', in the idiom of the anti-hero of literary acclaim. Distinct from computers and technology (consider the ATMs outside your bank: dispensing cash has become automated whilst technology controls the banknote flow), automation is removing people from functions which used to allow them to notice irregularities, observe behaviour, compare notes and develop hunches – all simple human behaviour which deterred and sometimes ensnared fraudsters; the gradual disappearance of those humans has led to a higher level of broader vulnerability in many respects.

Geographical scale and limitations
It is plain from studying the statistics of significant fraud and corruption that the geographic scale and limitations have changed dramatically over recent years. This is the 'flip-side' (perish the neologism) of globalisation, instantaneous communication, uninterrupted market activity and of even slicker, ever quicker travel. Off-shore havens and Special Purpose Entities (SPEs), urgent calls for dirty money (and for laundering it) for Islam extremists, poppy-farmers in Afghanistan and Colombian cocaine barons have added to the motives for corruption and provided a monster Laundromat for circulating and bleaching it. Not only that: as the world inches its way towards unity, agreements and ratification, it has the perverse effect of creating more loopholes and lacunae – in relative terms – where there were previously simply black holes and no-man's-land before, a paradox which the statistics don't immediately explain. More precisely, non-alignment of laws, conflicts over extradition and

money-laundering rules, regulatory arbitrage and political indignation kick up thick dust-clouds behind which it has proved increasingly easy to hide money, identities, semtex, cadavers, tracks and trails.

Regulation and de-regulation

There is little doubt that any random cross-section of recent fraud cases throws up the proliferation effect due to the constant ebb and flow in the field of regulation and de-regulation. The impact of regulation of financial markets is self-evident, and so is less relevant for these purposes than the murkiness caused in industries – related to financial services and otherwise – in which there is an active, high-level principle of *de*-regulation on the move: yet areas of regulation or re-regulation persist or are introduced notwithstanding. Insurance is a case in mind – and Equity Release/ Reversion of Freehold broking is going the same way, as are, putatively, Estate Agency and Cosmetic Surgery. Change and uncertainty (echoes the fears expressed in that traditional hymn 'Change and Decay in all around I see …' – never thought an English hymnal would end up spicing a treatise on Bribery and Corruption, but it says it all in stout, 19th Century ecclesiastical wording) breeds criminal dishonesty as though it were Agar Jelly.

Change and proliferation of statutory law

Mirroring the negative effects of this sort of change is the companion phenomenon of change and proliferation of statutory law. Modifications, for example, of procedures within corporates and industries set up in order to respect new legal provisions automatically create not so much an amnesty period as an interregnum of uncertainty in which errors, confusion, delays, old processes and new processes reign supreme: a perfect tenor in which a scam can be set up with the minimum chance of breaking the surface. Consider, for example, our Finance Acts: budgets, mini-budgets and Gordon Brown's delicate-yet-clumsy balancing act between political ideology and generating fiscal revenues have set up a number of new, repealed and modified provisions in the prevailing legislation such as has never been seen before in the history of our Common Law. Beyond the Treasury – more or less – lies the terrain of money-laundering regulatory and statutory provisions.

This is a minefield which does not bear introduction: every one of us has been belaboured by banks, brokers, lawyers, and Uncle Tom Cobbleys righteously demanding photocopies, more photocopies, passports, certificates, signatures, details, bank statements (originals, please; copies won't do), utility bills, pension books and rent records. The intentions are, of course, always for the best. However, there is a sharp hint of 'hoist by your own petard' about all this. With endless replicas of personal identities lying in every file, drawer and waste-bin, and checking and processing procedures which have grown to resemble wholesale warehouses rather than niche specialisation, the whole area of identity theft, dual identities,

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bogus credentials and passport-production warehouses in south London has already got out of hand. Apart from the fact that such sleights of hand and of papers are in themselves instances of fraud, generically they form one of the stoutest planks for further criminal activity with strategies, implementation and getaways all supported by closeness of the underworld to money-laundering procedures, personalities and paperwork.

Procedural law and processes
The Serious Fraud Office, (SFO), Financial Services Authority (FSA) and Police (and how about the Dedicated Cheque and Plastic Crime Unit of the Met and City police forces!) are constantly seen smarting at the weaknesses inherent in our procedural law and processes in the courtroom.

It is often not until the ninth day of a trial that it all collapses because of a trifle constituting correct procedure yet going unobserved; usually after £x million of public money has been spent on the proceedings. Extradition proceedings as a precursor to a fraud trial are particularly prone to this finale. The frustration caused to the authorities is evident; the opportunities handed on a plate to con-men, less so. A criminologist would tell us that the whiplash-effect lies in the impact on criminals' assessments of opportunities. As a good fund manager or risk manager will always identify and assess the downside risk of a potential commitment, so a fraudster casing the joint or developing his plot will be encouraged by the rising statistics of failed cases where the obviously guilty perpetrators walk free from the dock.

Illegal immigration and asylum-seeking
Not only for political correctness fanatics, a recent – and increasingly serious – feature on the landscape affecting growth in fraud is the impact of illegal immigration and asylum-seeking. No-one is going for discrimination here: it is a statistical fact, though, that an increasing number of sophisticated frauds are masterminded and executed by such individuals. But why? The main reasons are that the levels of education – notably technological training – are good in young countries. Secondly, individuals, having striven to get here, want to get rich quick, and therefore inevitably against the odds. Thirdly and, in the view of the criminologist, most importantly, newcomers have nothing to lose save the shirts on their backs if things go wrong. It is known that a great deterrent in potential fraud considered by old timers from round the corner is the reputational risk, the domestic and social downside, if it all goes pear-shaped. By logic, if you don't have a domestic set-up yet and no-one knows you from Adam, you are more likely to take the risk of inserting strip-readers and miniature cameras in to the ATM round the corner: you've actually got very little to lose if the pear comes in to play.

Mafia gangs
This ties in closely with increasing awareness of '... mafia gangs infiltrating British banks', a key issue held up by the chairman of the

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FSA, during a recent financial crime conference. The relevance is that a single new arrival in the UK – or even a local – chancing it big time is a desperate loner. Add four mates, and they become a 'mafia' with an exponential increase in potential haul rates and escapology tricks. They need not, of course, be recent arrivals through Heathrow from the sierras, tundras and savannahs, but the tentative links are certainly there. Let it not be said that this observation is undiscerning: it is clear that such chancers from far away go for lower profile cons, and are less likely to bring Enron or Tyco to its knees than to raid ATMs or steal bank account details and help themselves to its contents.

Increasing market complexity

The eleventh point (there must be a Bingo Hall convention for that) should, in a way, come first, but it affects financial market fraud rather than criminal dishonesty in a wider framework, so sits separately on the list. This reflects the growing tendency of increasing market complexity to attract fraudsters as well as its perverse side-effects of giving them more cover to get away with it. Rather a mouthful, that, but consider the rationale. First, patterns of capital distribution are such that retail investors play an ever greater part in markets – but they lack market expertise, for perfectly honourable reasons, and the protective machinery put in place and set in motion for them is cumbersome. Some market experts would say the result is that financial markets have become unnatural: insider dealing, for example, remains a vexed matter, with many claiming that advance or privileged intelligence is a natural fuel for market activity.

One by-product is that the mix of private and professional market participants, together with the 'noise' created in the market-place in the defence of the former, give the criminal more leeway to infiltrate and act, and reduce the chances of being caught – either at all, or before having cost the country's coffers ten times as much as the value which he has stolen. Second, there is little doubt that the introduction of traded derivative products has given rise to a number of weaknesses in market structure and practice (at the same time, of course, as providing attractive opportunities, both defensive and aggressive, for those who know how to manage and to trade them).

This last point begs the question: look at three notorious instances of abuse of markets – Leeson's Tokyo index trades out of Singapore, the LTCM fiasco, and Refco. The hallmarks (can one countenance an anti-hallmark', in that selfsame 'anti-hero' idiom?) of those collapses, as of countless others involving mismanagement of derivatives positions, are that the senior managers didn't understand how the instruments worked is not of itself a crime, although it represents a regulatory transgression), and either didn't know that they didn't understand, or didn't admit it (which is beginning to look a crime, and is definitely a regulatory infringement), or both – and that the practitioners, the traders, the managers started off by making errors of judgement (neither a crime

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nor a regulatory transgression) – aka gambling – then compounded them, by hiding them (a regulatory breach, and the start of a crime), and by adding to the 'bad positions' (invariably guilty on both counts) until the groaning cumulative disasters could no longer be hidden.

Third, the comparatively recent expansion in to long/short trading and strategies echoes the risks posed by derivatives. As gearing is to a derivative, so is open exposure to a short position… and that's just for starters, as they say in the playground. Add in a manager who doesn't understand shorts and a trader who has made a bad call (or gambled recklessly) and tries to pull the market his way with further trades the same way, and – Bingo! – you have Leeson all over again.

The fourth, last and least obvious is the increasing tendency in markets – notably equities and related ones – to more active volatility, provoked more by active trading strategies – directional, momentum and programme trading, for instance – than by 'natural' market behaviour. This leads directly and indirectly to increasing criminal concealment and compounding activities which lead to losses. Consider the Japanese brokers' balance-sheet disasters in the early '90s after the markets tumbled and they acted in accordance with their local code of 'honour' by hiding their clients' losses to the extent that clients and brokers were all totally cleaned out by further declines. (This last is a case to dazzle the jurisprudentialist: can an act of honour in Tokyo also constitute a crime or regulatory breach there at the same time; and can that act of honour in Tokyo be simultaneously billed a crime in the UK? – more of our rationale based on conflicts of international laws.)

Such examples of market complexity – modernisation or manipulation; call it what you will – underline an important feature of fraud in financial markets, namely that they form an arena in which such crimes are committed by insiders (not to be confused with insider dealing, of course) as much as – if not more than – by outsiders; and are the results of errors or, at worst, recklessness – 'gambling with other people's money' – rather than premeditation, for instance, criminal intent.

Political instability and extremism
Far from twelfth in terms of importance, weight or menace-quotient is that of political instability and extremism. If you want to add religious or ethnic slants in to this mix, please do. The twelfth ranking position here is due to the fact that: such things are – arguably, at least – not rooted in the UK, but the UK happens to bear the brunt of numerous manifestations of these malaises; and political and quasi-political causes are not *per se* causes of criminal behaviour. The umbilical cord is, of course, the need for funding – endlessly, and in vast sums – of the waves of sentiment which inevitably express themselves in expensive violence. This leads on to equally inevitable financial crime – getting hold of the money is

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more often than not a matter of widespread criminal activity; laundering it to run bank accounts, buy cars, engage lawyers and invest in flight tickets leads to another layer of fraud and corruption. One scarcely needs reminding that the three main – but far from only – sources of this kind of trouble are the Muslim states harbouring extremist factions, the CEE/CIS states and, less so, of late, the Latin American countries.

Against this background of movement in the field of fraud, what of the DNA of the typical example – if such a thing exists? Whys and wherefores are one thing; defining the protons and neutrons of the events which they engender is another. Suffice it to say that instances of financial fraud in corporate contexts and financial market environments tend to bring together a number of the following features:

(a) It is very rarely the doing of an individual. Typically, three people or more, up to the dimensions of a 'mafia network', will be at it.

(b) Time is of the essence. Unlike lightning raids on a jeweller's shop with swag-bags and plastic pistols, financial fraud rarely breaks the surface until it has been underway for months or years. This vaguely explains the traditional contractual obligation at investment banks to take at least one holiday of at least two weeks a year … the theory being that scams can remain undiscovered if key malefactors are there without more than a week's break, since so many procedures such as reconciliations, checks, audits and reporting occur on a weekly basis.

(c) There is more likely than not to be a Special Purpose Entity (SPE) or a Special Purpose Vehicle (SPV) in play – as likely as not offshore-based, and playing a part in an off-balance-sheet debt scam.

(d) Offshore components also signal that a spot of regulatory arbitrage may be involved – apart from distance and tax-haven factors, lesser reporting obligations attract the fraudster big time.

(e) A mature fraud or ongoing corruption tends either to be tightly restricted to that small group of perpetrators, or it is characterised by a spiralling effect, in which it expands as it goes forward, bringing in more people as they discover it or need to know, silenced with used fivers … the bribery element, also explaining why the word 'Corruption' is rarely uttered beside it. This tendency, of course, becomes its own worst enemy: sooner or later more people cause a fatal leak somewhere.

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(f) Somehow, somewhere the firm's auditors are usually involved: sometimes by omission – missing signs that certificates and letters are forged or falsified (look at Parmalat and that key certificate of deposit, turning out to be a non-certificate of non-deposit); sometimes by commission – a core individual paid to turn a blind eye. The numbers of recent frauds which have involved cases in professional negligence against auditors is astonishing, to the extent that accountancy groups are now to be supported by new legislation, no doubt based on instincts to protect endangered species.

(g) Notably in trading environments, fraud often originates in error or misjudgement which, cloaked in turns by fear and optimism, leads to deliberate concealment and series of compounding moves. This is also significant because so many frauds are sparked off not by overt rogues and sly brethren but by charming and innocent people who put a foot wrong in an environment which does not tolerate errors – let alone fools – to any extent at all.

No-one has yet invented a score-card or an intelligent detection device which attributes points and probabilities in order to detect criminal acts by reference to this schedule, but a methodical trawl through reported cases confirms that it has important diagnostic properties. If the resulting 'symptom-scores' are interpreted in the context of the foregoing reasoning to explain why fraud is, paradoxically, increasing rather than dying away, it becomes relatively easy to understand what would otherwise remain an obscure and erratic side of UK business existence.

'The Export Credit Guarantee Department (ECGD) recently published its delayed new anti-bribery rules, and said that its 'provisional conclusions' strengthened procedures to ensure that taxpayers' money would not be used for overseas bribery. But an anti-corruption lobby group said the new proposals stopped short in key areas ... : "although there is some strengthening, there are also a lot of loopholes", attacking the document's suggestion that a business might not have to tell the ECGD the identity of agents so long as the firm agreed to reimburse the ECGD if it later emerged that the agents had committed corrupt activity.'

From the navel of Italy on the occasion of Parmalat's reinstatement as a quoted entity come these salutary words, via the press, of a senior Italian lawyer: 'Parmalat reflected a feature common to many financial frauds: their global dimension. Global markets are being overseen by fragmented supervisory regimes, usually organised on a national basis, allowing fraudsters in multinational countries to seek out regulatory weak points round the world, often thousands of miles away from where business is being conducted. Parmalat raised money on international capital markets from lenders based in

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some 100 countries. Many of the financial shenanigans by the former managers were in certain offshore centres where financial regulation is, to put it politely, skimpy. International co-operation must be stepped up, with the European Union and the US taking the lead.'

Under the tantalising header, 'Why corrupt practice is now deemed acceptable?' recent UK press comment tells us, 'The most telling vignette of the misuse of the honours system is about a shady South African millionaire and George V. In 1922, Sir Joseph Robinson was nominated for a peerage by Lloyd George. The King, however, objected so strongly that Downing Street was forced to withdraw the nomination. An emissary was despatched from Number 10 to the Savoy, where Sir Joseph was staying, to break the news to him. Even before he could state his business, Sir Joseph – 82 – had whipped out his cheque-book, uttering the anguished cry of, "How much more?" It is no longer fanciful to suggest that some such scene could take place today ... admission to the Lords is now as blatantly determined as it ever was by contributions made to party funds ... why is this type of corruption now more or less openly accepted?'

And another headline screams, 'Computer records provide 80% of fraud case evidence': The average fraud case now requires analysis of more than 500,000 e-mails and electronic documents, and computer records make up more than 80% of the evidence ... digital fraud investigations tripled in the past two years ... The warning about the growth in electronic fraud investigations comes amid signs that fraud remains a big, and arguably growing, problem for business ... Cases involving identity theft showed a particularly marked increase ... '.

So there we have it.........or perhaps we don't. Like Harold Wilson's resemblance at the time to the new 50p piece, the essence of the matter can be expressed by having two faces and many sides. There is no answer except for the obvious, the long-haul and the expensive ones. Just in case anyone is tempted to drum fingers petulantly on the desk now and say it's just an overblown matter in any case, and one which is never going to happen here, let him take note of a couple of figures.

Fraud currently costs the UK economy around £14 billion, or £230 per person, each year. This equates to almost 4% of the current US current account deficit, which has been scaring the world and its markets for a long time, now. Some £25 billion of 'dirty money' is laundered through UK financial institutions every year – that's equivalent to 6% of the US Deficit. In 2004/5, 278,902 fraud offences were reported ('But how many were actually committed?' I hear you rightly and righteously ask. Probe a bit further, and it becomes clear that £505 million of those pounds represent credit card fraud in 2004 alone, whilst another tranche of £46 million was lost in that year to cheque fraud.

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Eyes bulge, minds boggle and imaginations surge at figures like those, whilst the wallets of the just get slimmer and those of the unjust get fatter. Remember the refrain, 'The rain it raineth on the just, and also on the unjust fella; but mainly on the just, because the unjust steals the just's umbrella'. Must have come from Flanders and Swann or some such distinguished source, but the core message is still as right as rain). We won't reverse the truths of proverbial lyrics in a hurry, but at least forewarned is forearmed.