Contemporary Financial Crime

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Abstract

The concept of financial crime changes constantly as social contexts and technical aspects surrounding financial transactions advance. This paper aims at understanding contemporary financial crime with consideration on various factors associated with it. Firstly, financial crime is classified with definition, components, and typology. Secondly, related crime types, extent of financial crime, and its victim are suggested in a way that comprehends the scale of it. Lastly, to better capture the concept of financial crime in relational terms, its facilitating factors and relationships with other crimes are explained. This paper demonstrates that contemporary financial crime develops in a complicating manner as a reflection of its environmental changes.

Keywords: financial crime, classification, victims, facilitating factors, relationships

1. Introduction

The volume of financial transactions increases at a staggering rate as an online banking system becomes a norm these days. Due to convenience of monetary transactions on a global scale, illegitimate money also takes advantage of the structured transaction systems, along with legitimate finances. Considering the nature of surrounding environments, financial crime is not an isolated concept. It evolves as a reflection of its environmental changes, such as social contexts and ICTs advancements. Against these backdrops, financial crime proliferates and diversifies itself into more sophisticated subsets.

Financial crime is one of deeply entrenched illegal activities in any society. However, the concept of financial crime has not been agreed upon until now. Without proper classification and conceptualising of financial crime, it is difficult to figure out ways to identify and respond to recent types of financial crime. Therefore, it is critical to understand the nature and characteristics of contemporary financial crime.

In this paper, several questions are answered: (1) what are the definition, components and typology? (2) who are victims? (3) what are the facilitating factors and what are priorities of public organisations? (4) how does financial crime relate to other crimes? By answering these questions, it is hoped that both researchers and practitioners have a clearer picture on the recent trend of financial crime.

2. Definition, Components and Typology of Financial Crime

2.1 Definition

There is no internationally accepted definition of financial crime (IMF, 2001; Ryder, 2011). Financial crime is often defined as crime against property, involving the unlawful conversion of property of another to one's own personal use and benefit. According to the International Monetary Fund (2001), financial crime refers to "any non-violent crime that generally results in a financial loss". In the UK, the Financial Services and Markets Act 2000 (FSMA) 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'.

Some researchers and government institutions do not clearly distinguish financial crime, financial abuse, and white collar crime and use them interchangeably without any differences. IMF (2001) suggests that financial abuse is encouraged by poor regulatory and supervisory frameworks and weak tax systems and as a subset of financial abuse financial crime requires a financial loss. Pickett and Pickett (2002) define financial crime as 'the use of deception for illegal gain, normally involving breach of trust, and some concealment of the true nature of the activities', using the terms financial crime, white-collar crime, and fraud interchangeably. On the other hand, Interpol[1] states that financial crime is also often referred to as white-collar crime which was first coined by Sutherland (1939) as "committed by a person of respectability and high social status in the course of his occupation". By this definition, white collar crime is equivalent to occupational crime. It is analysed that financial crime encompasses white collar crime in that the former is perpetrated by individuals or groups regardless of occupations. Examples of white collar crime are money laundering, insider dealing, fraud, and market manipulation, which can be captured by financial crime.

2.2 Components

FBI (2005) states that financial crime is characterized by deceit, concealment, or violation of trust without dependency on physical force or violence. Pickett and Pickett (2002) enumerate several components of financial crime as following; ①*deceitful* ②*intentional* ③*resulting in pecuniary losses* ④*possible concealment* ⑤*breach of trust* ⑥*possible appearance of outward respectability.* Based on the definitions and components above, some elements are

[1] http://www.interpol.int/Crime-areas/Financial-crime/Financial-crime

found to be important in conceptualizing financial crime; *deceitful, intentional, concealment, and financial loss as a result.* Among these elements, a financial loss is considered the core element in that without this element it might be confusing with other types of crime that takes advantage of a financial system or network. For example, when criminals and terrorists have come to rely on the financial system and the information within it, it can be said to have abused financial systems *(financial abuse)*, but cannot be classified as financial crime as long as it does not generate pecuniary losses.

2.3 Typology

Gottschalk (2010) classified a wide range of financial crime into four main categories (i.e. corruption, fraud, theft, and manipulation). Although any justification on why these four categories were chosen was not provided, recent types of financial crime were reviewed in an exhaustive manner.

<Classification of financial crime by Gottschalk (2010)>

Corruption	Kickbacks, bribery, extortion, embezzlement
Fraud	Identity, mortgage, occupational
Theft	Cash, intellectual, fraud
Manipulation	Laundering, cybercrime, bid rigging, insider trading

IMF (2001) interpreted financial crime in a relatively narrow sense, distinguishing the two terms. Financial abuse is defined as a broad concept. As a subset, ‘financial sector crime’ involves a financial institution or financial market, while ‘other financial crime’ includes a range of unlawful activities which entail financial loss. And, the rest is conceptualised as ‘other financial abuse’.

<Classification of financial crime by IMF (2001)>

Financial sector crime	Money laundering/fraud/tax evasion/circumvention of exchange restrictions /other
Other financial crime	Sale of fictitious financial instruments or insurance policies/ embezzlement/tax evasion/stock manipulation/other
Other financial abuse	Tax avoidance/connected party lending/stock manipulation /other

3. The Activities and Extent of Financial Crime

3.1 Activities

Examples of financial crime are money-laundering, tax evasion, fraud (embezzlement, check and credit card fraud, securities fraud, insurance fraud, health care fraud and pension fraud), stock manipulation, tax avoidance, bribery and corruption, insider trading, terrorist financing, etc. FBI (2005) focuses its investigations on corporate fraud, health care fraud, mortgage fraud, identity theft, insurance fraud, and money laundering.

Interpol[2] points out that financial crime is generally transnational by the use of networks such as internet. In nature, transnational crime and cybercrime are closely connected to financial crime, causing a detrimental impact on financial institutions or individuals around the world. Why is financial crime more likely to be transnational and hinge on electronic networks? First, proceeds from financial crime need to be stored in a safe place where local law enforcement agencies are unable to trace. It means that sending the proceeds overseas to where cross-border cooperation does not work well reduces the chances of being caught. Second, wiring the proceeds does not require going through customs inspections, thus limiting the reach of law enforcement agencies. It is almost impossible for local agencies to spot and freeze the proceeds before transferring beyond the border in that online money transaction finishes within seconds. These natures correspond to the characteristics of an information society mentioned by Castells (2000); *Informational, global, and networked.* Let's think about remittance of illicit money. It can be elaborated that "financial information on the proceeds is delivered to a third person beyond the border (global) via computer networks". This explanation substantiates the argument that financial crime exactly reflects the current societal change into an information society.

3.2 Extent

It seems to be impossible to accurately calculate the extent of financial crime (Ryder, 2001). A study from the United Nations Office on Drugs and Crime (UNODC, 2011) estimated that in 2009 all criminal proceeds were likely to amount to 3.6% of global GDP, which was equivalent to about $2.1 trillion. Besides, the research pointed out that the volume of international money-laundering was expected to be about 2.7% of global GDP or $1.6 trillion. This money-laundering figure falls within the often called 'consensus range' suggested by the International Monetary Fund in 1998, which is from 2 to 5 per cent of the world's GDP. This estimate would be translated into from $590 billion to $1.5 trillion by using actual numbers of 1998, while FATF estimated about $500 billion. The lower figure roughly equates to the value of the total output of an economy the size of Spain.

In terms of corruption which is "abuse of entrusted power for private gain" (Transparency International[3]), the World Bank states that approximately $1 trillion is paid in bribes around the world. Considering the economic and societal ripple effects, the World Economic Forum estimates that the cost of corruption equates to 5% of global GDP, which is about $2.6 trillion and that corruption increases the cost of doing business by up to 10% on average (World Economic Journal[4]). IMF research has revealed that investment in corrupt countries is about 5% lower compared to countries that are relatively corruption-free (OECD, 2013). It is important to notice that a country's capital productivity is adversely related to corruption (Lambsdorff, 2003). The argument that corruption is directly associated with economic

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[2] http://www.interpol.int/Crime-areas/Financial-crime/Financial-crime

[3] http://www.transparency.org/what-is-corruption

[4] http://world-economic.com/articles_wej-373.html

growth in a country gives more weight to the significance of tackling corruptive activities.

The UNODC estimated that in the U.S. about $300 billion or about 2 per cent of the economy was generated in illicit proceeds in 2010. Among all the financial crimes in the US, illicit drug sales and fraud was estimated to account for most proceeds. The UK HM Treasury (2007) estimated that over £20 billion of social and economic damage was brought about in the UK and more than half of the damage is generated by illicit drug use. KPMG's 2012 survey with 281 respondents reported that the total value of fraud for public and private sector organisations in Australia and New Zealand was $372.7million, with an average loss per organization of $3.08 million. According to the Australian Institute of Criminology (2011), fraud is estimated to have cost the Australian society $6.05 billion in 2011. To sum up, these figures show that money-laundering, drug sales, and fraud are major illegal activities that do harm on the national and international scales.

4. Victims of Financial Crime

Victims range from individuals to institutions, corporations, thus affecting all levels of society (Gottschalk, 2010). At a micro level, individual citizens and corporations suffer the effects of serious financial crimes. Some market frauds have taken in thousands of people, with many losing their savings, security and also affecting their emotional wellbeing, physical health and relationships (Australian Crime Commission[5]). At a macro level, financial crime has a negative impact on the entire economic and social system through the considerable loss of money incurred.

<Classification of victims>

	Individual	Organizational
Internal	1	3
External	2	4

(Nestor, 2004)

1. Individual internal victims : Individuals in the organization are the victims
2. Individual external victims : Individuals outside the organization are the victims
3. Organizational internal victims : Organizations as such are the victims
4. Organizational external victims : Outside organizations are the Victims

Each type of victims has their own interests in different forms of financial crime. Firstly, individual citizens using services from financial institutions usually fall for fraud and identity theft either by insiders or outsiders. The Ponzi scheme by Bernard Madoff in 2008 is an example of fraud by an insider and it can also be called as occupational financial crime. Fraud by insiders is not expected to happen a lot because of increasing internal control, but once it occurs, the amount of damage is massive. On the contrary, it is more frequent case

[5] https://crimecommission.gov.au/organised-crime/crime-types/financial-crimes

that criminals outside a financial institution target individuals. It is quite obvious that *phishing* has become the most prevalent style of fraud against individuals. By the use of computers and networks, criminals can target tens of thousands of potential victims by automated calls or emails or text messages. As cyber financial crime, *phishing* affects each individual with a relatively small amount of damage, but large in aggregate. Secondly, corporations including financial institutions become victims of financial crime. Insiders are more inclined to commit crimes such as corruption, embezzlement, cash and inventory theft, and intellectual property theft, while outsiders including customers might be responsible for identity fraud, insurance fraud, and consumer fraud, etc. Thirdly, financial crime destabilizes national economies (FATF[6]). Ryder (2011) claims that the integrity of a nation's financial institutions can be eroded and the effects of financial crime can ultimately threaten national security. Enron scandal was the big single case that rocked the whole US economy. In fact, a national financial scandal sometimes gives rise to a ripple effect throughout the global economy.

Lastly, international financial system and institutions are victims on the global level. Western countries have placed a high priority on tackling money-laundering and terrorism financing. Responding to calls from the international community, international organizations such as IMF and FATF have extended their reach to the areas of anti-money laundering (AML) and combating the financing of terrorism (CFT). The aim of them is to secure the integrity of the international financial system. In this year, it has been discovered that international sport institutions such as FIFA and IAAF have had serious internal financial problems, which is corruption. The scandals surrounding FIFA and IAAF were, respectively, over the selection of hosting cities for World cup and covering up positive doping tests. It is quite surprising that those non-profit institutions supposed to maintain a high level of integrity have a difficulty in preventing kickbacks and bribes. However, it is not easy to pinpoint victims on a global scale for two reasons. First, victims such as financial system are intangibles. Second, the actual amount of financial damage is intricate to figure out.

5. The Facilitating Factors and Priorities of Public Institutions

5.1 Facilitating Factors

IMF (2001) argues that globalization and financial market integration drives financial abuse. It indicates that the scale and severity of financial crime are proportional to the extent of global connectedness. Australian Crime Commission[7] states that market diversification, globalization, and technology are the factors that drive this type of crime. There is a notion that global financial crime is enabled by tax havens networks. The financial secrecy of some jurisdictions such as Switzerland and the Cayman Islands provides the favourable environment for fraud, market manipulation, and money laundering (Ruggiero, 2015).

Some others approached financial crime from criminological perspective. Michel (2008) asserts that financial crime is driven by opportunity and that opportunistic malefactors such as a weakness in a procedure should be addressed. This assertion is largely based on the

[6] http://www.fatf-gafi.org/faq/moneylaundering/#d.en.11223
[7] https://crimecommission.gov.au/organised-crime/crime-types/financial-crimes

rational choice theory. If they think that they can gain more benefits from financial crime compared to costs invested and being caught, it will be worth taking the risk. Either reducing costs or increasing benefits will lead to a higher return of investment (ROI). This perspective is related to the rationales of money-laundering and tax evasion. If criminal proceeds are guaranteed to be deposited in a secured place, it is more likely to increase the commission of financial crime.

5.2 Priorities of Public Institutions

Interpol puts their resources primarily on money laundering, counterfeit currency and security documents, payment cards fraud, lottery fraud, and Nigerian letter scam, while main initiatives of FATF and IMF focus on money laundering and terrorism financing. And, World Bank and OECD take corruption seriously. International institutions try to inhibit a large scale of activities perpetrated by organized criminal groups. On the national level, each country has its own initiatives in financial crime. The US has been treating fraud, money laundering, and counterfeit currency seriously and is moving more into, specifically, corporate fraud, market manipulation fraud and mortgage fraud after 2008 financial crisis caused by failures in financial regulation and fraudulent financial products. National Crime Agency in the UK directly deals with money laundering and counterfeit currency, cooperating with Serious Fraud Office when it comes to fraud, bribery and corruption. On the global stage, there is a broad consensus among some leading international and national entities that they are regarding corruption, fraud, money laundering, and counterfeit currency as their core priorities in order to maintain the integrity and order of global financial markets. Similarly, common themes are also found on the national level, which are health care fraud, insurance fraud, identity theft, intellectual property theft, etc.

6. Relationships among Financial Crimes

Some financial crimes occur independently, but some others may involve other types of crime, whether it is financial or non-financial crime. Australian Crime Commission[8] reports that key crime enablers include money laundering, cyber and technology-enabled crime, identity crime, exploitation of business structures, and public sector corruption. These are often criminal activities in their own right, enabling other types of organized crime.

6.1 Money Laundering

FATF defines it as “the processing of criminal proceeds to disguise their illegal origin”, while the U.S Treasury department explains it in greater detail as “financial transactions that criminals, including terrorist organizations, attempt to disguise the proceeds, sources or nature of their illegal activities”. There should be a predicate crime before money laundering is pursued. Thus, money laundering is not acknowledged if the money is not recognized as criminal proceeds. The predicate crime can be physical crimes, but IMF (2001) suggests that it is often financial crimes. The types of predicate crimes vary according to the context and jurisdiction of a nation. It is generally argued that most of financial crimes entail money-laundering in order not to be disclosed by law enforcement agencies.

[8] https://crimecommission.gov.au/organised-crime/organised-crime-groups/professional-facilitators

6.2 Identity Theft

It is generally committed to facilitate other crimes, such as credit card fraud, check fraud or mortgage fraud, and phishing. Rested on information from an identity theft, fraudsters make up a story or impersonate someone to defraud potential victims. Gottschalk (2010) contends that identity theft is an enabler of identity fraud.

6.3 Exploitation of Business Structures

Complex business structures and sophisticated networks of companies can hide real beneficiaries behind the curtain by engaging multiple offshore jurisdictions. This strategy primarily involves money laundering, tax fraud, illicit commodities, investment and superannuation fraud. In often cases, global corporations including financial institutions tap into this strategy in order to get away from corporate tax or to siphon off illicit funds.

6.4 Public Sector Corruption

Organized criminal groups attempt to corrupt politicians or public officials in an effort to gain access to information, public funds and to affect future investigations on them. This enabler facilitates general organized crimes which include both non-financial (drug smuggling, human trafficking) and financial crime. For example, bribes taken inevitably lead to money-laundering and tax evasion.

6.5 Relationships with Cybercrime

Internet can be considered a breeding ground for financial crimes (Wall, 2007). Many financial crimes are known to have a close relationship with cybercrime. Technically speaking, most of financial crimes, nowadays, can also be classified as cyber-enabled crime in that perpetrators end up taking advantage of networked ICTs at some point in the course of committing a financial crime. Like cybercrimes, financial crimes are exacerbated in their scale and reach by the use of networked computers and other ICTs. McGuire and Dowling (2013) posit that fraud and theft are the most widely published instances of cyber-enabled crime. Main forms of cyber-enabled fraud are electronic financial frauds (internet banking fraud), fraudulent sales through online or retail sites, mass-marketing frauds, consumer scams, phishing, and online romance. Snyder and Crescenzi (2009) argue that intellectual property crime has links to cybercrime and the increase of cybercrime paves the way for more victimization of intellectual properties of businesses.

7. Conclusion

Organized criminal networks are often behind financial crime. Baker (1999), citing the U.S. Treasury Department, stated that 99.9 per cent of the criminal money has ended up being deposited in secure accounts. In order to secure evidence or to freeze and seize illegally obtained assets, law enforcement officers need to react swiftly. The amount of being seized and frozen by legal institutions is less than 1 per cent of global illicit financial flows (UNODC, 2011). As a matter of fact, there are some debilitating factors that make it hard to trace the criminal or the illegal assets. These factors are differences among countries in terms of their national jurisdictions, their implementation of international conventions, and the level of expertise of their investigative and prosecutorial authorities.

When financial sector crime occurs, it is difficult for law enforcement agencies to hold employees in financial institutions accountable for illegal transactions. More frequently, government departments pursue enormous multi-billion-dollar civil penalties against big banks, rather than charges against individuals (Bloomberg News[9]). Especially, for some countries that are based on adversarial legal system, jurors drawn from the ranks of working people find themselves stuck with little grasp of what the defendants want to argue. In order to reach a final verdict, jurors should struggle to understand the mind-boggling modern financial system. Although many difficulties in restitution exist, regulatory authorities and law enforcement agencies need to figure out ways to outsmart criminals who take advantage of loopholes in financial systems.

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