



Nicholas Ryder

# Financial Crime in the 21st Century

Law and Policy



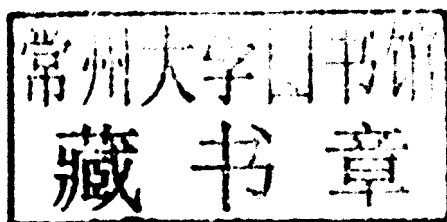
# Financial Crime in the 21st Century

Law and Policy

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Nicholas Ryder

*University of the West of England, UK*



**Edward Elgar**

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# **Financial Crime in the 21st Century**

# Contributors

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and  
**Dr Karen Harrison**, University of Hull

# Abbreviations

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AML	anti-money laundering
ARA	Assets Recovery Agency
CFI	Court of First Instance
CTR	Currency Transaction Report
ECJ	European Court of Justice
EU	European Union
FATF	Financial Action Task Force
FBI	Federal Bureau of Investigation
FinCEN	Financial Crimes Enforcement Network
FIU	Financial Intelligence Unit
FSA	Financial Services Authority
IMF	International Monetary Fund
MLR	Money Laundering Regulations
OFAC	Office of Foreign Assets Control
SAR	Suspicious Activity Report
SEC	Securities and Exchange Commission
SFO	Serious Fraud Office
SOCA	Serious Organized Crime Agency
UN	United Nations

## Preface

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Financial crime has gained increased notoriety since the international community recognized the problems posed by money laundering in the 1980s. Since the introduction of the first anti-money laundering initiatives in the late 1980s, different types of financial crime have gained international recognition. For example, the terrorist attacks on 11 September 2001 resulted in the instigation of the 'financial war on terrorism' by President George Bush. Similarly, the collapse of Barings Bank, Enron and WorldCom and the threat posed by mortgage fraud during the financial crisis have propelled fraud to the top of many countries' financial crime policies. Insider trading has also become a significant problem to the global financial services sector. This work focuses on the financial crime policies adopted by the international community and how these have been implemented in the United Kingdom and the United States of America. Furthermore, it also considers the appropriateness of confiscation and forfeiture of the proceeds of crime. The work also focuses on the financial crime agencies in both jurisdictions and the effectiveness of their sentencing policies towards financial crime. The objective of this work is to recommend a 'model financial crime policy' based on a detailed analysis of the measures discussed in this book.

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# 1. Introduction

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## 1.1 FINANCIAL CRIME – IN CONTEXT

When President Richard Nixon declared ‘war’ on the illegal drug cartels in the 1970s by targeting their proceeds of crime, no one could have foreseen that four decades later the ‘war’ would become global and fought on many fronts. Financial crime has evolved into a multifaceted business or industry with a global reach and is commonly associated with the illegal drugs trade, human trafficking, organized criminals and terrorists. It has become a global problem that demands a global response. Financial crime gained notoriety in the 1980s when money laundering was propelled to the top of the international community’s agenda by the United States of America (US) following its battle with the drugs trade. Resultantly, the United Nations (UN) introduced a series of legal instruments designed to tackle the problems associated with money laundering. Additionally, the Financial Action Task Force (FATF) was established with the purpose of making a series of recommendations aimed at tackling money laundering. The terrorist attacks on 11 September 2001 transformed the way in which the international community tackled financial crime and efforts moved from money laundering to terrorist financing after President George Bush instigated the ‘financial war on terror’. The terrorist attacks resulted in the introduction of several UN Security Council Resolutions and the enactment of a plethora of statutory measures by nation states. Fraud has recently emerged from the shadow of money laundering and terrorist financing following several high profile instances of fraudulent activities involving multinational corporations.<sup>1</sup> The impact and scale of these scandals are overshadowed by a new threat to the financial markets in the US and the United Kingdom (UK) – mortgage fraud.<sup>2</sup> Furthermore, insider dealing materialized in the

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<sup>1</sup> This includes for example the Bank of Credit and Commerce International, Barings Bank, Enron and WorldCom.

<sup>2</sup> Ryder, Nicholas and Chambers, Clare (2010), ‘The credit crunch and mortgage fraud – too little too late? A comparative analysis of the policies adopted in the United States of America and the United Kingdom’ in S. Kis and I. Balogh (eds), *Housing, housing costs and mortgages: trends, impact and prediction*, Nova Science, New York, pp. 1–22.

US in the 1970s following the Ivan Boesky affair,<sup>3</sup> yet although its existence in the UK was documented in the 1950s and 1960s,<sup>4</sup> it was not until 1980 that insider dealing was criminalized in the UK.<sup>5</sup>

## 1.2 WHAT IS FINANCIAL CRIME?

According to the International Monetary Fund (IMF), 'there is no internationally accepted definition of financial crime' and it 'interprets financial crime in a broad sense, as any non-violent crime resulting in a financial loss'.<sup>6</sup> However, they did admit that 'while there seems to be broad agreement on the meaning of such concepts as money laundering, corruption, and tax evasion, the terms financial abuse and financial crime are far less precise'.<sup>7</sup> It has been suggested that in its broadest context financial crime has been 'used to refer to any type of illegal activity that results in a pecuniary loss. This would include violent crimes against the person or property such as armed robbery or vandalism'.<sup>8</sup> Conversely, 'the term has been used in a more narrow sense to refer only to those instances where a nonviolent crime resulting in a pecuniary loss crime also involves a financial institution'.<sup>9</sup> Financial crime has also been referred to as 'white collar crime'; a term first used by Professor Edwin Sutherland which has since 'become synonymous with the full range of frauds committed by business and government professionals'.<sup>10</sup> More recently the Department of Treasury and HM Treasury have referred to financial

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<sup>3</sup> For a more detailed discussion see Hatch, J. (1987), 'Logical inconsistencies in the SEC's enforcement of insider trading: guidelines for a definition', *Washington and Lee Law Review*, **44**, 935–954.

<sup>4</sup> Financial Services Authority (2007d), 'Insider dealing in the city', Speech by Margaret Cole at the London School of Economics, 17 March 2007, available at [http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2007/0317\\_mc.shtml](http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2007/0317_mc.shtml) (accessed 10 June 2009).

<sup>5</sup> Companies Act 1980, ss. 69–73.

<sup>6</sup> International Monetary Fund *Financial system abuse, financial crime and money laundering – background paper* (International Monetary Fund: Washington, DC, 2001) at p. 5.

<sup>7</sup> *Ibid.*, at 3.

<sup>8</sup> International Monetary Fund above, n 6 at 20.

<sup>9</sup> *Ibid.*, at 20.

<sup>10</sup> Federal Bureau of Investigation (n/d), 'White collar crime', available at <http://www.fbi.gov/whitecollarcrime.htm> (accessed 1 March 2009). For a more detailed discussion see Sutherland, Edwin (1949), *White Collar Crime*, The Dryden Press, New York, Hanning, P. (1993), 'Testing the limits of investigating and prosecuting white collar crime: how far will the courts allow prosecutors to go?',

crime as 'illicit finance'.<sup>11</sup> Within the UK, a useful starting point is the Financial Services and Markets Act 2000 (FSMA 2000), which 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'.<sup>12</sup> Fleming noted that 'financial crime as defined by the FSMA relates to a broad and potentially indistinct range of offences'.<sup>13</sup> Financial crime has been referred to as a 'victimless crime' and sometimes it is impossible to identify who or what has suffered a financial loss.<sup>14</sup> If this statement is to be believed, why do so many governments dedicate resources and time to limit financial crime? The answer to this question is found in the following quote from the FATF, 'criminal proceeds have the power to corrupt and ultimately destabilise communities or whole national economies'.<sup>15</sup> Furthermore, financial crime is attributed to organized criminals who seek to maximize their profits so that they can enjoy a so-called 'champagne lifestyle',<sup>16</sup> and it can erode the integrity of a nation's financial institutions.<sup>17</sup> Vaithilingam and Nair stated that 'financial-related crimes have significant economic and social consequences for nations worldwide. It weakens the financial systems which are the main players for global financial transactions'.<sup>18</sup> It is also a threat to national security because terrorists need money and resources to carry out their illegal activities.<sup>19</sup> Although much of the finance for terrorism comes

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*University of Pittsburgh Law Review*, 54, 405–476 and Strader, J. (1999), 'The judicial politics of white collar crime', *Hastings Law Journal*, 50, 1199–1273.

<sup>11</sup> Department of Treasury (n/d), 'Fighting illicit finance', available at <http://www.ustreas.gov/topics/law-enforcement/index.shtml> (accessed 16 April 2010) and HM Treasury (n/d), 'Counter illicit finance', available at [http://www.hm-treasury.gov.uk/fin\\_money\\_index.htm](http://www.hm-treasury.gov.uk/fin_money_index.htm) (accessed 16 April 2010).

<sup>12</sup> Financial Services and Markets Act 2000, s. 6(3).

<sup>13</sup> Fleming, M. *FSA's Scale & Impact of Financial Crime Project (Phase One): Critical Analysis Occasional Paper Series 37* (Financial Services Authority: London, 2009) at p. 2.

<sup>14</sup> For a more detailed commentary see Hansen, L. (2009), 'Corporate financial crime: social diagnosis and treatment', *Journal of Financial Crime*, 16(1), 28–40.

<sup>15</sup> Financial Action Task Force *Report on Money Laundering and Terrorist Financing Typologies 2003–2004* (Financial Action Task Force: Paris, 2004).

<sup>16</sup> National Audit Office *The Assets Recovery Agency – Report by the Comptroller and Auditor General* (National Audit Office: London, 2007) at p. 4.

<sup>17</sup> International Monetary Fund above, n 6 at 8.

<sup>18</sup> Vaithilingam, S. and Nair, M. (2007), 'Factors affecting money laundering: lesson for developing countries', *Journal of Money Laundering Control*, 10(3), 352–366, at 353.

<sup>19</sup> See Ryder, N. (2007a), 'A False Sense of Security? An Analysis of Legislative Approaches Towards the Prevention of Terrorist Finance in the United States and the United Kingdom', *Journal of Business Law*, 821–850.

from legitimate sources a large percentage stems from criminal activities; a good example of this is the terrorist attacks in September 2001 where some of the finances were obtained from credit card fraud and identity theft.<sup>20</sup>

What is the extent of financial crime? It is important to note that despite the best efforts of such agencies as the UN, the FATF and nation states, it is impossible to accurately state the extent of financial crime. It is simply fraught with too many methodological difficulties. However, it is possible to refer to official documentation that offers an intriguing insight into the estimated levels of different types of financial crime. For example, the FATF, citing the IMF, stated that between 2 and 5 per cent of the world's gross domestic product (GDP) is associated with money laundering, which equates to \$590bn and \$1.5tn.<sup>21</sup> According to the Treasury Department, the estimated amount of money laundered in the US is approximately \$600bn per year,<sup>22</sup> while Mitchell claimed that the figure is nearer \$300bn.<sup>23</sup> Therefore, it has been estimated that 99.9 per cent of the proceeds of crime is successfully laundered.<sup>24</sup> According to HM Treasury 'organised crime generates over £20bn of social and economic harm in the UK each year'.<sup>25</sup> In 2004, the Home Office stated that organized crime 'reaches into every community, ruining lives, driving other crime and instilling fear'.<sup>26</sup> According to the FATF:

<sup>20</sup> The 9/11 Commission *The 9/11 Commission Report – Final Report of the National Commission on Terrorist Attacks upon the United States* (Norton & Company: London, 2004) at p. 170.

<sup>21</sup> Financial Action Task Force (n/d), 'Money laundering FAQ', available at [http://www.fatf-gafi.org/document/29/0,3343,en\\_32250379\\_32235720\\_33659613\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/document/29/0,3343,en_32250379_32235720_33659613_1_1_1_1,00.html) (accessed 13 January 2010).

<sup>22</sup> Weller, P. and Roth von Szepesbela, K. (2004), 'Silence is golden – or is it? FINTRAC and the suspicious transaction reporting requirements for lawyers', *Asper Review of International Business and Trade Law*, 4, 85–130, at 86.

<sup>23</sup> Mitchell, D. (2003), 'US Government agencies confirm that low-tax jurisdictions are not money laundering havens', *Journal of Financial Crime*, 11(2), 127–133, at 128.

<sup>24</sup> Baker, R. (1999), 'Money Laundering and Flight Capital: The Impact on Private Banking', testimony before the Permanent Subcommittee on Investigations, Committee on Governmental Affairs, US Senate, 10th November, 1999, available at [http://www.brookings.edu/testimony/1999/1110financialservices\\_baker.aspx](http://www.brookings.edu/testimony/1999/1110financialservices_baker.aspx) (accessed 2 August 2010).

<sup>25</sup> HM Treasury *The financial challenge to crime and terrorism* (HM Treasury: London, 2007) at p. 6.

<sup>26</sup> Home Office *One Step Ahead – A 21st Century Strategy to Defeat Organised Crime* (Home Office: London, 2004b) at p. 1.

UK law enforcement estimates the economic and social costs of serious organised crime, including the costs of combating it, at upwards of £20bn a year. It is estimated that the total quantified organised crime market in the UK is worth about £15bn per year as follows: drugs (50%); excise fraud (25%); fraud (12%); counterfeiting (7%); organised immigration crime (6%).<sup>27</sup>

Financial crime has an adverse impact on the economies of countries. For example, Scanlan noted the economic impact of terrorism and stated that 'the disruption to the transport system in London caused by the bomb attacks of 7 and 21 July 2005 alone have been estimated to have cost the nation in excess of £3bn'.<sup>28</sup> Similarly, the Bishopsgate bomb in London in 1993 caused damage to property in excess of £1bn.<sup>29</sup>

### 1.3 RATIONALE

The aim of the book is to provide a detailed commentary and analytical review of the financial crime policies adopted by the international community and how these have been implemented in the UK and the US. A question that needs to be addressed is why this book concentrates on the US and the UK. The US was one of the first countries to tackle and criminalize different types of financial crime, and it is an integral player in the development and implementation of the international community's financial crime policies. The book illustrates the role of the US in the implementation of a number of international legal instruments designed to tackle money laundering and terrorist financing. Furthermore, through the Department of Treasury, the US has played a key role in the creation of the FATF. Another reason why the US is utilized is the importance of its financial services and banking sector and the threat posed to it by financial crime. There are approximately 1800 chartered commercial banks with \$6tn assets, over 900 state chartered banks with \$1.3tn assets, over 5200 commercial and savings banks with \$2tn assets in addition to a large number of savings associations and over 8500 credit unions. The same

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<sup>27</sup> Financial Action Task Force *Summary of third mutual evaluation report: anti-money laundering and combating the financing of terrorism – United Kingdom of Great Britain and Northern Ireland* (Financial Action Task Force: Paris, 2007) at pp. 1–2.

<sup>28</sup> Scanlan, G. (2006), 'The enterprise of crime and terror – the implications for good business. Looking to the future – old and new threats', *Journal of Financial Crime*, 13(2), 164–176, at 164.

<sup>29</sup> HM Treasury *Combating the financing of terrorism* (HM Treasury: London, 2002) at p. 11.

can also be said about the US securities sector which has \$5.4tn in assets and \$256bn in capital.<sup>30</sup> During his eight-year tenure, President George Bush's administration was forced to tackle a large number of corporate frauds and terrorist financing which led to the introduction of a plethora of legislative provisions, the creation of numerous fraud task forces and the instigation of the financial war on terror. Therefore, important comparisons are sought with the policies adopted by President Barak Obama toward financial crime and those implemented by President George Bush.

The UK has adopted a robust stance toward financial crime and it shares the lead role with the US in the global fight against financial crime. The UK has fully implemented its international money laundering, terrorist financing, fraud and insider dealing obligations and acted as the president of the FATF in 2007. There have also been significant developments in the UK policies towards money laundering, fraud and terrorist financing including the creation of the Serious Organized Crime Agency (SOCA), the impact of the decision of the Supreme Court in *A v HM Treasury*<sup>31</sup> on its terrorist financing policy and the fraud policy implemented by the former government following the recommendations of the Fraud Review. The proposed creation of a 'super economic crime agency' by the coalition government also makes this a timely review of the UK's financial crime strategies. The most significant factor for using the UK is the importance of its financial services and banking sector to its economy. The economic functions of the financial services sector can be divided into three broad categories – matching savers, borrowers and investment through the investment chain; risk pooling and management; and facilitating payments.<sup>32</sup> From an historical perspective, London's importance as the centre of the global financial services sector can be traced to the twelfth century.<sup>33</sup> Blair took the view that 'the process of internationalisation received an important boost in London's "big bang" in the mid 1980s . . . which led to enormous inward investment'.<sup>34</sup> Furthermore, there are more companies listed on the London Stock Exchange than the Tokyo or

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<sup>30</sup> Financial Action Task Force *Third mutual evaluation report anti-money laundering and combating the financing of terrorism – United States of America* (Financial Action Task Force: Paris, 2006) at p. 10.

<sup>31</sup> UKSC 2.

<sup>32</sup> HM Treasury *The UK financial services sector: rising to the challenges and opportunities of globalisation* (HM Treasury: London, 2005) at p. 5.

<sup>33</sup> For a general discussion see Davies, Glyn (2002), *A history of money from ancient times to the present day*, University of Wales Press, Cardiff; Ferguson, Niall (2008), *The ascent of money*, Allen Lane, London.

<sup>34</sup> Blair, W. (1998), 'The reform of financial regulation in the UK', *Journal of International Banking Law*, 13(2), 43–49, at 43.

New York stock exchanges.<sup>35</sup> HM Treasury reported that ‘the UK financial services sector also contributes directly to output, employment, trade and productivity in the UK. It accounts for over 5 per cent of UK gross value added, one million jobs and a trade surplus of 1.6 per cent of GDP. Moreover, there is evidence that it is a source of higher-than-average productivity within the UK, and that productivity within the sector is growing faster than in the economy as a whole’.<sup>36</sup> The British Bankers Association reported that ‘the UK’s financial industry has grown faster than any other business sector over the past ten years’.<sup>37</sup> Its Chief Executive stated that ‘financial services are the powerhouse of the UK economy: a massive contributor to the Exchequer through tax, an employer of more than a million people directly and one of the UK’s last acknowledged world-leading industries’.<sup>38</sup> The UK has a long history of financial scandals that have plagued the overall effectiveness of its financial crime strategy and important comparisons can be made between the policy approaches adopted in the UK and the US.

## 1.4 CONTENTS OVERVIEW

The book concentrates on four types of financial crime: money laundering, terrorist financing, fraud and insider dealing. The second chapter critically reviews the anti-money laundering policies in both the US and the UK in light of the measures introduced by the international community. It is the author’s contention that the US anti-money laundering strategies can be divided into two parts – the criminalization of money laundering and reporting identifiable or suspected money laundering transactions to the relevant authorities. The UK’s policy can be divided into three parts: the criminalization of money laundering; regulated financial institutions being compelled to put in place systems to preclude and identify money laundering; and reporting identifiable or suspected money laundering transactions to the relevant authorities. Chapter 3 deals with terrorist financing and it is the author’s contention that the US and the UK terrorist financing policy can be divided into three parts – the criminalization of terrorist financing; the ability to freeze the assets of known

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<sup>35</sup> HM Treasury above, n 32 at 9.

<sup>36</sup> *Ibid.*, at 18.

<sup>37</sup> British Bankers Association (2008), ‘Financial services sector tops UK growth tables’, Press Release 18 January 2008, available at <http://www.bba.org.uk/bba/jsp/polopoly.jsp?d=1569&a=12022> (accessed 9 June 2009).

<sup>38</sup> *Ibid.*



or suspected terrorists; and the reporting of suspicious transactions. There is a link between terrorist financing and fraud. Several commentators have suggested that terrorists use this type of financial crime to fund their activities.<sup>39</sup> Furthermore, fraud is the 'crime of choice for organised criminals',<sup>40</sup> and it must be taken seriously. Therefore, the fourth chapter investigates the anti-fraud policies adopted in the US and the UK. The development of a global anti-fraud policy is difficult to determine because unlike money laundering and terrorist financing, there is no international instrument from either the UN or the EU that targets fraud. Both have concentrated their efforts on fraudulent activities on their own finances. The international community has had no impact on the US anti-fraud policy and only a minimal impact on the UK's strategy. The chapter concludes that the US and the UK anti-fraud policy can be divided into three parts – criminalization of fraudulent activities; regulatory agencies; and anti-fraud reporting requirements.

The fifth chapter of this book deals with insider dealing and market abuse. This chapter concentrates on the link between the misuse of insider information. In particular, it discusses the provisions designed to ensure the integrity of securities markets and the legislation aimed at tackling insider dealing and market manipulation in the financial services sector. Although a long-standing part of US law this is a relatively new arena for UK lawmakers and regulators. The chapter also looks at the market abuse regime created by the FSMA 2000 and regulated by the FSA and outlines the influence of the EU Market Abuse Directive. An integral part of the global financial crime strategy is the ability of law enforcement agencies to deprive organized criminals, drug cartels and terrorists of their illegal earnings, which is the focus of Chapter 6. The international measures that allow the confiscation of illicit profits are extensive and have been implemented in the US and the UK. The ability to confiscate the proceeds of crime has become an integral part of the financial crime policies in the US and the UK. The seventh chapter identifies the regulatory and law enforcement agencies that have been created to tackle the different types of financial crime referred to in this text. This chapter identifies the agencies at a global, regional and national level and places the agencies in the US and the UK into three distinctive categories – primary, secondary and tertiary. The penultimate chapter deals with the sentencing policies adopted in the

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<sup>39</sup> Ryder above, n 19 at p. 825.

<sup>40</sup> Wright, R. (2007), 'Developing effective tools to manage the risk of damage caused by economically motivated crime fraud', *Journal of Financial Crime*, 14(1), 17–27, at 18.