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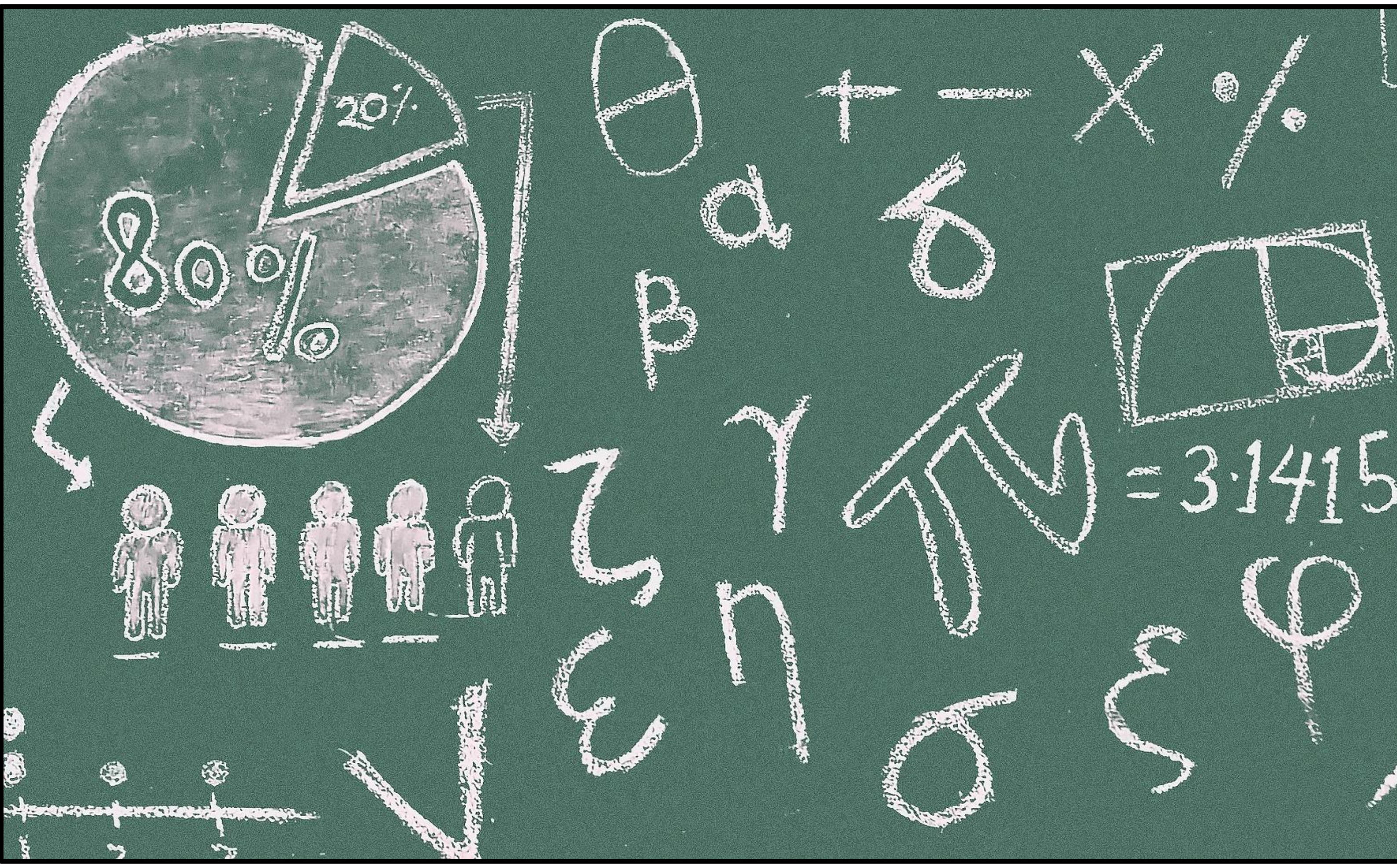
Get Smart About Scandals

Past Lessons For Future Finance



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CARDANO FOUNDATION

The Z/Yen Group

CITY OF LONDON

THE FINANCIAL SERVICES GROUP OF LIVERY COMPANIES

Get Smart About Scandals

Past Lessons For Future Finance

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Foreword

As the 690th Lord Mayor of the City of London, I am promoting a programme titled "The Business of Trust". This programme seeks to improve public trust in business, and financial and professional services in particular. The UK relies on financial services for payments, pension funds, insurance, mortgages and bank accounts. The financial services sector is a major employer and contributor to the UK's tax revenues. And yet a series of well-publicised examples of poor, negligent and sometimes criminal behaviour have led to widespread public distrust of the sector. We all have an interest in improving the trustworthiness and success of the sector. This research, "Get Smart About Financial Scandals", is therefore very timely.

When we began our research into "The Business of Trust", it became immediately apparent that the public wants things to improve. People are tired of distrusting their banks. They understand the sector's contribution to employment, tax revenue and trade – and they want that success to be reflected in their own relationship with the sector. The following recommendations emerged from the public regarding the behaviour of firms:

- Do what they do *well*;
- Do the right thing;
- Have a wider purpose;
- Focus on customers;
- Communicate clearly.

Alongside our discussions with the public, an advisory group of industry leaders carried out a separate process of reviewing and distilling thousands of years of guidelines, standards and codes of conduct. These surveys ranged from the earliest merchants to the most cutting-edge FinTech start-ups. The group expected their research to lead to a separate set of findings – or so they thought. In practice, there was a huge overlap between the professionally developed guidelines and our discussions with the public. We were buoyed with confidence that we were really onto something.

We subsequently combined our two sets of findings into five principles for better business, trusted by society. These guiding principles took the mnemonic 'CIVIC':

- Competence and skills – doing what you do well;
- Integrity – being honest, straightforward and reliable;
- Value to society – recognising and meeting wider societal needs;
- Interests of others – respecting the interests of customers, employees and investors;
- Clear communication – being transparent, responsive and accountable.

We in the sector must understand the conditions that led to previous financial scandals. How did they occur? Why did they occur? Can they be prevented or mitigated in future? Financial scandals create responses that in turn change financial environments, though there are often unintended consequences. This report helps us to anticipate how financial scandals may occur in future, and how we might prevent them.

The Rt Hon Lord Mayor of the City of London (2017-2018),
Alderman Charles Bowman

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Preface

Long Finance's Distributed Futures research programme, managed by Z/Yen and sponsored by Cardano Foundation, has long explored what past financial scandals might teach about future prevention. Our last major report though was back in 2009, "The Road To Long Finance: A Systems View Of The Credit Scrunch". Thus, we are delighted to publish a further considered work at what might be a crucial time.

Smart ledgers (aka blockchains) are distributed, multi-organisational databases with a superb audit trail and embedded, 'intelligent', computer code. They are widely reckoned to be a potential new force for fair play in a globalised world. A plethora of initiatives intends to use them to rework the world's identity, documentation, and agreement exchanges, thus transforming and renewing the world's financial and payments 'plumbing'.

Yet, with hindsight, it is clear that many other past commercial and technical innovations, from tally sticks to databases, have not succeeded in stopping successions of scandals. This report's title, 'Get Smart', refers indirectly to a 1960s satirical spy show with catch phrases such as "Would you believe...", "Missed it by that much!", "Sorry about that, Chief", "The old (such-and-such) trick", and "I asked you not to tell me that". The bumbling agent, Maxwell Smart, works for CONTROL and is repeatedly fooled by the same tricks of the "international organization of evil", KAOS. Will smart ledger enthusiasts be similarly caught in the ceaseless loop of reactions to past scandals being the seed of future ones?

Past reactions to scandals rightly focus on preventing future scandals, but too often only focus on the exact one they faced. It's building rifles against many-coloured wolves that work only with specific wolf colours. Or, 'fighting the last war'. One might contend that past reactions, with their rules and regulators, sometimes only redistribute the power and money for the next round of exploitation.

The longer-term solutions may need to be built around moving people from hunting to farming. By this I mean that people in the market have an ethical responsibility to the market itself. Society has many ways of solving resource allocation issues from direct control through taxation. Markets are one choice. A bubble is a collective delusion about added value that can be extracted. A scandal is a theft from some close-to-true value. Both feed society with incorrect information and cause wider harm.

Market participants have an obligation to themselves and to society to clean their own markets. Society may also encourage markets to apply voluntary market standards alongside them, with accreditation and certification. If market participants need stronger oversight, then regulation arrives. As this report shows often, when direct regulation is essential, markets are frequently at their weakest. Finding ways of avoiding direct regulation involves getting individuals to have 'skin in the game', ranging from financial commitment through professional cultures to criminal liability.

The specific relevance of taking a long-term view in the rear-view mirror is the permanence of smart ledgers. Information technology in the 20th century nearly crashed into a Millennium Bug barrier. Now smart ledger enthusiasts are trying to build smart ledgers designed to hold immutable data for centuries. They need to exercise caution and humility, which hopefully this report might inform.

This report is unlikely to be the end of Distributed Futures' work on preventing scandals in the use of new technology. It makes recommendations that require further work. It raises questions, such as the apparent futility of regulation when subjected to benefit-cost ratio measures, that need innovative answers. With foresight, it is clear that this report, as well intentioned as it is, will not succeed in stopping successions of scandals. Perhaps though, it might ameliorate two or three, and perhaps even prevent one or two.

Professor Michael Mainelli
Executive Chairman, Z/Yen Group

Executive Summary

"Get Smart About Scandals" is a Research Paper in the Distributed Futures Research Programme under the series Economic/ Changing Systems. At a time when the velocity of change in technology and systems is challenging the business and economic models for conducting financial services, it is prescient to analyse the cause and effect of financial scandals past and present, while reflecting how financial scandals may unfold in the future. Lessons are learned about financial scandals and then more frequently forgotten.

Perhaps, it is no coincidence that this year's Lord Mayor, Charles Bowman, who has kindly written the foreword to this Research Paper, launched "a business of trust programme" as one of his major initiatives during his year of Office. Financial services contribute significantly to employment, tax, revenue and trade not only in the UK but throughout the world. The Public must have trust and confidence in the people, institutions and services within the sector to ensure its success. Critical success factors are providing the right services, communicating and delivering services effectively, placing the client first and ensuring that the financial services fulfil the broader purpose of economic and financial benefit to the client.

The Paper evidences why financial scandals should be studied. Key factors in the long history of financial scandals are analysed with reference to historical scandals from ancient to modern times. Identification and conduct of financial scandals are analysed and referenced to corrupt practices and procedures. Illustrations of the cause and contribution of booms, busts and bubbles are examined. The analysis continues by examining how scandals may be avoided and concludes by examining the direction and dynamics of future financial scandals.

The conclusions of the Paper are stark:

- There is too much detailed regulation
- Regulations are too complex to detect or prevent financial scandals
- One size of regulation does not fit all

- Although current forms of sanction for violation of financial regulation are severe, they don't seem to deter scandals

- Adherence is paid to the forms and processes of regulation as much as the substance

- Advances in globalisation present complexity and conflicts across jurisdictions arising from differences of business culture and ethics

- Major financial centres have to develop their own specific agents of change to address financial scandals

Recommendations cover Policy, Structure, Procedures and Training:

The recommendations may be categorised as:

- Policy recommendations to propose guidance to those bodies and institutions which have the power to make changes in order to improve measures to combat financial scandals

- Structural and procedural recommendations which propose changes to combat financial scandals

- Training recommendations, which propose enhancement in training to combat financial scandals

The conclusions reflect the expansion and growing sophistication of financial markets over the past 30-40 years and the financial regulation which followed the developments. Much regulation was implemented to prevent market and consumer abuse and in some instances to buttress financial markets and services. This may all appear obvious but, if that is the case, why have they not been addressed? Is the reason that the industry is so swamped by a plethora of detailed regulation, processes and procedure that it is unable to think with clarity? In any case, it is evident that finance industry stakeholders have been reluctant to articulate them.

The Research Paper provides a key message in its analysis, conclusions and recommendations: the financial services industry must "Get smart in addressing the causes and effects of financial scandals."

Why Study Scandals?

- Financial scandals are a permanent media feature
- Institutional corruption has risen
- Financial remuneration features extensively in financial scandals
- Remuneration and financial disparity contribute to the reputational damage arising from financial scandals
- Global and financial centre competition have contributed to the rise in financial scandals
- Structured transactions, tax planning and avoidance and their use of jurisdictional arbitrage have contributed to the perception of financial scandals
- For the future, technology may provide defensive and mitigation measures to combat financial scandals

The financial world is shaken at intervals by scandals or revelations involving activities which, although not strictly speaking legal, provoke a level of moral indignation in particular from people who do not own large assets, or find themselves in a situation where they need to engage in complex tax planning. In addition, serious disquiet is being expressed in the newspapers about practices which seem to be out of line with the expectations of workers in ordinary jobs. Although such practices are not against the law, they do provoke a cynical response from some, and righteous indignation in others.

The rise in institutional corruption may take many forms: inflated salaries which are out of line with equivalent jobs elsewhere or which do not correspond to the financial standing of the organisation in question; upward only contracts which mean that staff who do not measure up to the job in practice can only be removed either by paying large sums in compensation or by moving them to a post of equivalent or higher status; the revolving door between organisations (whether state or private) which are linked to each other in some way; public sector posts which are being paid in line with private sector salaries (which may now well lag behind, especially insofar as pension rights are concerned) and which do not need to reflect the financial, professional or personal risk which enterprise so often implies.[1]

Whilst there can be no suggestion of improper behaviour on the part of any particular individuals, press (and indeed parliamentary sources) have become increasingly concerned at the level of remuneration and golden parachutes being meted out to university vice-chancellors in particular. Similar scrutiny could be applied to other public sector areas such as the BBC, the higher echelons of local government or the NHS, as well as academies and educational trusts. There is no doubt that even with senior positions which involve high degrees of responsibility, oversight of large organisations and (quite possibly) an overview of large numbers of personnel, serious disquiet is being expressed about the gap that has grown up over several decades between the junior and senior posts. Unions will argue that the terms and conditions of the former have deteriorated over a lengthy period of time. Even more public indignation has been directed at the cases of those senior figures who have been paid off despite having failed in some way, or where the company has actually gone under.[2]

The problem lies in the disparities between various groups in terms of hopes, aspirations and expectations. The bulk of the working population are waged or salaried, and will be paying tax at source, and are paying national insurance on top of that, and which increasingly is viewed as a further form of tax as it cannot now be linked directly either to pensions or health. Pensions have been severely eroded and the financial press points regularly to the prospect of shortfalls in returns and the fact that most workers are not saving

[1] With regard to the Prime Minister's salary as a yardstick, see http://metro.co.uk/2017/07/19/how-much-does-the-prime-minister-earn-6790035/
World leaders' pay makes an interesting comparison: see https://www.msn.com/en-us/money/savingandinvesting/pay-check-how-much-do-these-world-leaders-earn/ss-AAawHzo#image=12
[2] The matter has been raised by Bernard Jenkin in the House of Commons: https://hansard.parliament.uk/Commons/2018-01-22/debates/972B2F1D-CDAD-40E0-A8E1-C33C820091B8/PrivateSectorPensions

sufficiently for their retirement.[3] On the other side there are those who quite possibly see themselves as the wealth makers and job creators, the successful entrepreneurs who are leading or driving the markets.[4] The funds they command, the income they generate and the bonuses they pay themselves appear colossal to the average worker or newspaper reader, as such sums are unimaginable in a salaried context.[5] Yet such people at the top end of the economy will expect what they view as a reasonable share of the wealth that they have helped create – however extravagant or even reckless such payments may seem to the rest of the workforce, especially those who work hard at the lower levels of the same sector or who are trapped on the minimum or even living wage in unskilled and semi-skilled jobs, working inconvenient shifts and perhaps on unfavourable zero hours contracts.

There is a doubtless simplistic view that massive bonuses or payments could somehow be passed further down the line, or recouped and redistributed for general beneficial purposes via taxation at levels which the people accustomed to handling large sums of money may consider excessive or even punitive.[6] The fact that positive performance by stock markets at home and abroad may well prove to be of a wider benefit by virtue of improved revenues accruing to pension funds or help to reduce the burden of government debt is overlooked by the bulk of the populace who have long since lost confidence in pensions as a means of saving or as a source of future comfort. And the returns on savings schemes (ranging from traditional friendly societies and building societies to ISAs and other more esoteric forms of saving) are now too low to be much of an incentive to save.

Such financial and economic realities clash with gushing stories of the extravagant lifestyles of footballers, top models and oligarchs, offset only by

[3] The deficit in the pension fund is one of the items that so damaged Carillion and other companies. For Tata Steel as an example, see http://www.bbc.co.uk/news/uk-wales-40889824 Tough new rules have been promised for company pension funds, but the matter is increasingly contentious. City AM 23.1.18.
[4] An interesting example is the TESLA boss Elon Musk, who stands to receive a 7.2 billion dollar bonus if the company reaches a market capitalisation of 100 billion dollars. Particular milestones will have to be met on the way.
[5] The Oxfam report about disparity of wealth worldwide demonstrates the divide: https://www.oxfam.org/en/pressroom/pressreleases/2017-01-16/just-8-men-own-same-wealth-half-world
[6] That said, it would appear that the wealthier do pay a disproportionate amount of tax: http://www.dailymail.co.uk/news/article-3560745/High-earners-foot-bill-nearly-half-adults-don-t-pay-income-tax-1-pay-2020-rise-personal-allowance-12-500.html

the fourteen million to one chance of winning the lottery.[7] Conspicuous consumption of course is not limited exclusively to the uber-rich with their mega-yachts. The Sunday papers have whole supplements on attractive cruises to exotic and far-flung parts of the world, quite possibly encouraging people to eat into the pension pots that can now be accessed so much more easily than before. Those older people who have been investing in buy-to-let properties as a means of supplementing their income in retirement now find themselves under pressure from both sides of the political spectrum, whether it be the threats to control private landlords from the Left, or the tendency to see them as an easy source of increased taxable income from the Right.

Increasing the tax take within realistic political limits has always engaged minds across the political spectrum, with traditional gibes about tax evasion on the one hand and benefit fraud on the other. Taxation then becomes an evolutionary process between governments trying to raise taxes without losing political support, and individuals and companies looking for loopholes or means of ensuring that, at best, they pay no more tax than legally required. The balancing act between tax avoidance (legal) and evasion (illegal) is perhaps levelled by the more favoured term of amelioration, whereby the tax paid is seen to be proportionate.

This has become increasingly difficult in a globalised economy that relies for the bulk of its work on its international connections and indeed reputation. Automation of banking processes and the development of tax havens in increasingly exotic locations have provided opportunities for wealthy individuals and major organisations to move their money to places where they are either sheltered (legally but possibly not ethically) from tax at a national level or even hide the existence of the funds themselves, which of course is not legal. Cyberspace has lent itself to deliberate criminal activity at every financial level, which in turn creates a whole range of legal issues, including the passing of laws which may not be applicable or even workable in such a new

[7] The contrast is marked between Alexis Sánchez and his transfer to Manchester United in January 2018 and the obituary for the late Jimmy Armfield who played for England 43 times and who was captain on 15 occasions. In the 1950s and 1960s he was originally paid £20 a week and turned up for local matches on his bike. Alexis Sánchez is thought to be earning up to £600,000 a week. The entire deal is calculated to be worth £180 million to all parties. See The Daily Telegraph for 23.1.18.
Winning chances on the lottery are at http://lottery.merseyworld.com/Info/Chances.html
The chances of winning any prize with a £1 premium bond are thirty thousand to one: https://www.lovemoney.com/guides/5317/premium-bonds-odds-winning-prize-investment-average-win-rate

environment. At the other extreme, a combination of instantaneous banking operations and places which are hard to regulate have encouraged the growth of such activities as money laundering, gun running or the drugs trade. Recent revelations such as the Panama Papers or the Paradise Papers have cast light on areas of which the public in general has been unaware.[8] Much of what has been revealed does fall within the law, but for many observers and quite possibly the general public, the ethics of hiding vast sums from the tax man are questionable to say the least.

Such practices need to be seen separately from the financial scandals which erupt at depressingly regular intervals. These can be traced back to ancient times and many, such as Tulip Mania in Holland or the South Sea Bubble in London, are the subject of legend. Financial people with a long memory will refer darkly to Rolls Razor, the Bank of Gibraltar, BCCI and a whole range of more recent instances where regulations have been overlooked, ignored or deliberately flouted. Such events have led to massive losses to investors (whether private or institutional) and have, in the case of major crashes such as Lehman Brothers, caused substantial and almost terminal damage to parts of the banking sector.

The revelations from the Panama Papers and now the Paradise Papers show that highly respectable institutions are invested overseas in tax havens.[9] Ironically this can mean that a far wider segment of the population actually benefits from what some would see as prudent forward planning as the funds accruing may well go in to education (Oxbridge colleges), and even local government in much the same way that similar entities in their time benefited from the economic incentives of the age arising from investments in slavery and tobacco[10].

Modern practices may now derive from globalisation: multinational companies can opt to move their activities off-shore or domicile themselves in the most

[8] Investigations and related stories are sure to continue for some time. The Guardian announced a scoop on 24.1.18, even though the main firm involved, Appleby, is suing both the Guardian and the BBC on the grounds that the matter is not in the public interest.
[9] The Panama Papers should not be confused with the Panama Canal Scandal in 1893 when leading French politicians were accused of accepting bribes from Ferdinand de Lesseps.
[10] http://www.theweek.co.uk/paradise-papers/89524/five-strangest-things-we-learnt-from-paradise-papers

tax-effective location for the taking of profits, thereby irritating governments and infuriating ordinary tax payers as the companies in question do not pay tax on the substantial turnovers that are generated in the larger economies, such as that of the UK. And those profits are based on encouraging people to spend their hard-earned money – on which they have already paid their taxes (both direct and indirect). What the companies are doing is of course perfectly legal, although more than one government is reviewing the situation.

More scandalous, of course, is the deliberate practice of hiving off massive sums of money by leading political figures, senior members of government and even the military, either in third world countries, or those with considerable economic assets such as oil. Such practices would appear to be commonplace in failing states as far apart as Zimbabwe and Venezuela, and it is widely believed that other states as distinct in style as Brazil and Russia are not exempt from such practices.

Reprehensible though this might be, it would not be possible without the co-operation and even connivance of the international banking system, either in complicit tax havens or even through the misuse and abuse of legitimate and highly regarded banking centres such as the City of London.

What defences can be set up to ensure that corruption and scandal are to be prevented or at least avoided? Since the banking crash of 2008 in particular, compliance has become a major issue and the emergence of more open accounting via the introduction of Smart Ledger (aka blockchain or distributed ledger) technology that may well rectify much of the problem. Transparency has become rather an over-used word, but it is still a valuable concept. If you have nothing to hide, the mantra goes, then why be cautious over publishing information or revealing data, within the bounds of commercial confidentiality of course.

Smart Ledgers should prove to be a workable system that casts light into dark corners and that will prevent the continuing existence of what are sometimes referred to as Old Spanish Practices. It will hopefully reinforce confidence in companies, the system and financial centres, which is all to the public good. It will also protect individual workers (especially the young and inexperienced) from accusations of malpractice. Other technological advances will be one factor in changing current practices, as will further developments involving the Internet and social media. The latter however are still open to abuse, so other measures need to be considered in ensuring that different working practices will become the industrial standard. There needs to be a clear policy on ethical issues at individual and company level, backed up by a system of oversight and compliance that can function without being obtrusive. The workforce at all levels needs to be trained to understand what constitutes good practice, the dangers that need to be avoided, and the benefits that will surely accrue for all of us from a financial and economic system that offers positive aspects for trade and long-term stability, all of which are surely prerequisites for long-term prosperity.

A study of regulations and other measures to combat financial scandals ever since the end of World War Two shows no shortage of effort or goodwill on the part of government or the financial authorities either to control excess or channel the market into pathways which will reduce or obviate the dangers that have proved to be all too evident and damaging on so many occasions. Unfortunately, this has not had the desired effect of reducing the number of incidents, which have grown incrementally in recent years above all. It is almost as if on each occasion the authorities are preparing for the last war, rather than putting measures in place which are ahead of the scandals which continue to crop up. And the response all too often is for people to ask why nobody saw them coming.[11]

So it is worth looking at such financial scandals, the circumstances which engendered them, and the measures taken both before and after which were designed to prevent them, in order to see whether there is a discernible pattern which can be traced and therefore classified and used in the hope that such things can be headed off or even avoided in future.

[11] Most recently in City AM 24.1.18.

1. Historical Context

Figure 1 - Key Factors In Historic Scandals And Crashes

	Ancient Rome	Medici Bankers	Tulip Mania	Mississippi Bubble	Sea Bubble	Kingdom of Poyais	Railway Shares
Political instability	X	X					
Uncertain economic conditions	X	X		X			
Economic conditions not understood	X	X	X				X
Surplus funds available for investment		X	X		X		X
Unreal expectations			X	X	X	X	
Lack of reliable information	X	X		X	X	X	
Herd instinct			X	X	X	X	
Mania			X	X	X	X	X

From prophets to pirates

Modern problems go back a long way – as do the measures taken to control them. Human failings and dishonesty, even back in antiquity, have a curiously modern ring to them. Business relations have always needed to be formalised. The earliest forms of recorded writing from the Middle East in cuneiform script contain details of credits and debts, harvest records, even letters from dissatisfied customers.

In the Old Testament, the prophet Jeremiah is told by the Lord to purchase a piece of land – which he does in the proper legal form of the time:

> And I bought the field of Hanameel my uncle's son […] and weighed him the money, even seventeen shekels of silver. And I subscribed the evidence, and sealed it, and took witnesses, and weighed him the money in the balances. So I took the evidence of the purchase, both that which was sealed according to the law and custom, and that which was open: and I gave the evidence […] of the purchase in the presence of witnesses that subscribed the book of purchases. […] Thus saith the LORD of hosts […] Take these evidences, this evidence of the purchase,

> both which is sealed, and this evidence which is open; and put them in an earthen vessel, that they may continue many days.[12]

So there is written evidence that payment is made in due form with witnesses and checked. And that was in about 586BC at the time of the Babylonian Captivity.

In another time and another world, the pirates of the Caribbean showed that there could be honour among thieves. Alexander Exquemelin, in his *History of the Buccaneers of America* (1678) recounts how the buccaneers drew up an agreement before setting sail, agreeing on shares of the spoils, and even a compensation plan for the wounded (payable in pieces of eight or the allocation of slaves). Ironically, the crew then had to swear on the Bible that they would take no more than their fair share. There were even arrangements to make payments on credit.[13]

Whether for prophets or pirates, the rules still seem to apply which demonstrates that, whatever the circumstances, from a city under siege to a modern-day trading floor, business cannot take place without respect for a legal process recognized and adhered to by all parties, and which can be demonstrated. This also goes to show that major trading centres like the City of London can only function fully and successfully within agreed legal frameworks which will protect all parties. Therefore illicit trading, sharp practices and underhand dealings will be costly and damaging to all – and not just in the long run.[14]

However, it may simply be human nature, or because for some people rules are there to be broken, but the history of financial failure and misdoing goes back into the mists of time. It is salutary to look at some of these to try and

[12] Jeremiah 32 vv 6-15 in the King James Version.

[13] A O Exquemelin (1678) *The Buccaneers of America* Chapter 7. First published in Dutch.
Folio Society edition 1972.

[14] This was also evidently the case in the City even in Roman times. Over 400 wooden tablets have been unearthed near the Mithraeum and contain details of actual people, daily transactions and even complaints. See the excellent Gresham College lecture by Dr Roger Tomlin at https://www.gresham.ac.uk/professors-and-speakers/dr-roger-tomlin/
And for a useful article go to http://www.dailymail.co.uk/sciencetech/article-3619586/Earliest-handwritten-notepads-unearthed-London-Discovery-410-wooden-tablets-provides-glimpse-life-city-s-earliest-Romans.html

identify what went wrong – and how such mishaps can be recognised or even anticipated in future.

Ancient Rome And The Impact Of Devaluations

The Romans, under Aurelian (c.215 – 275 AD) and Diocletian (284 – 305 AD) in particular, had problems with balancing the value of the currency across an increasingly diverse Empire, one over which they did not always have control without resorting to expensive, albeit successful, military campaigns.[15] There were local arguments over the relative value of the coinage, which was re-issued at different times and with different levels of precious metal content. Aurelian also had to contend with a strike at the mint, as it would appear that the workers had all been pilfering small quantities of silver. Aurelian actually introduced a new coin, the Antoninianus, containing 5% silver, but then had trouble recalling the old coinage that it was meant to replace (shades of Gresham's Law!). The new coinage was actually produced at a loss, so silver had to be levied from wealthier citizens.[16] Considering the challenges he faced, Diocletian was fortunate to remain Emperor for so long and actually to retire quietly, no mean feat given the wars and revolts he faced, not to mention the upheavals caused by his persecutions of the Christians.[17] In his time the currency reforms of Aurelian were shown not to work, and so he introduced new monetary values and a different system of coinage. Difficulties arose because of inflation and the failure or inability of government to impose the new system across the Empire, where there were cases of disputes over the relative local value of the new coins, and black markets emerged to take advantage of goods which were then in short supply. Although Diocletian's tax and administrative reforms persisted, it was not until Constantine some years later that the currency stabilised again by reverting to a form of gold standard.

KEY FACTORS: political instability, industrial unrest, an unreliable coinage, a lack of understanding of economic consequences or a realistic view of economic conditions at different times and in different places.

[15] To some extent this is reflected in some of the problems faced by the euro today!
[16] https://en.wikipedia.org/wiki/Aurelian
[17] https://en.wikipedia.org/wiki/Diocletian
See also http://mariamilani.com/ancient_rome/Ancient_Roman_Currency_Economy.htm

The Medici 1397 – 1494

The Medici Bank operated between 1397 and 1494 and is known in banking history for the introduction of the double entry system for recording debits and credits. It became very powerful and operated across various European countries. The reasons for its failure appear quite modern: in Lyons it nearly failed because of dishonesty on the part of the manager; in London it tried to ingratiate itself with the ruling elite who were resistant to letting them into the market; in the mid-Fifteenth Century this was especially problematic because of the Wars of the Roses. An unstable political situation is not generally beneficial for investment but in a civil war it is unwise to lend to both sides at once as one will inevitable lose and default on its debts, even though King Edward IV lifted the tariffs on Medici exports of English wool by way of compensation. The English debts were eventually passed over to the Bruges office, which failed in turn thanks to them making the same mistake of placating the elite (in this case, the Burgundian court) and then making poor investments, such as the purchase of shipping which was lost to storms and piracy. The problem was compounded when the office was wound up in 1478, as the book value of assets had been written up considerably and therefore did not cover the payment of outstanding debts. The bank's fortunes continued to decline, partly because of military conflicts in the region, the inability of the Medici family to concentrate on their business rather than their many cultural interests and the devaluation of the value of gold over silver at the time. In the later stages, the Medici reduced interest rates (which affected their public standing) and bad loans could not be covered at short notice since as little as 5% of assets were held in cash. The French invasion of 1494 put paid to the whole venture – a further example of the impact of external forces over which neither the bank nor the family had any control.[18]

KEY FACTORS: Unstable political situation, staff mismanagement, unwise lending, a lack of collateral, poor investment, insufficient cash reserves, falling interest rates and insecurity over the means of trade in the form of the relative value of gold and silver.

[18] https://en.wikipedia.org/wiki/Medici_Bank ; http://www.themedicifamily.com/The-Medici-Bank.html

Tulip Mania 1620s and 1630s

In the Seventeenth Century Holland was enjoying a massive boom thanks principally to its trade with the Far East. The tulip, originally from Turkey, became the ultimate status symbol and because of its comparative rarity increased rapidly in value. It reached a point where a tulip exchange was created, and this led almost immediately to a range of practices which in turn led to massive speculation: some traders hid their stock in order to raise prices because of scarcity; forward contracts were issued and before long tulips were changing hands at the equivalent of nine times the average workman's annual wage. By 1623 a single tulip was worth more than a merchant's house in Amsterdam and in 1633 one was actually sold for a handful of bulbs. The crowd instinct was at work, which meant that prices collapsed almost as quickly as they had risen and in February 1637 many people were ruined. It is thought that the economy fell back by almost forty years in value.[19]

KEY FACTORS: Surplus funds for investment; a vehicle for trade in the form of a specialised exchange; hoarding; forward contracts based on an item with only an intrinsic value; the herd instinct.

The Mississippi Bubble 1718

When King Louis XIV of France died, his opulent lifestyle left the country in dire financial straits. John Law, an itinerant Scotsman, persuaded the Duke of Orleans that he had a cunning plan to resolve the problem: a state-owned bank would issue a fiat currency by taking in gold and issuing paper money – which could be redeemed in due course at face value. The state would therefore be able to lend money to entrepreneurs, and thereby invigorate the economy and recoup the benefits via taxation. Phase 2 was to launch the Mississippi Company, along the lines of the East India Company which had created so much wealth for Holland. However, Louisiana was little more than a swamp at the time and did not yield the returns anticipated. John Law increased the nominal value of the Company by issuing further stock. At this

[19] https://www.managementstudyguide.com/tulip-mania-of-17th-century.htm and http://www.bbc.com/culture/story/20160419-tulip-mania-the-flowers-that-cost-more-than-houses

point some investors became justifiably anxious and tried to withdraw their funds. The reserves were not there and the crash was spectacular.[20]

KEY FACTORS: A prior economic crisis; a fundamental misunderstanding of fiat currency in paper form; a link to a dubious economic resource; official support followed by public scepticism, followed by crowd panic.

South Sea Bubble 1719-1720 [21]

There were some parallels with the Mississippi Bubble in that the House of Lords hoped to benefit from trade with South America, following the signing of the Treaty of Utrecht in 1713. This was some time before the voyages of Captain Cook to the actual South Seas. Under the Treaty Britain was allowed limited access to particular ports in the Spanish colonies of South America via the so-called register ships. The South Sea Company was awarded a monopoly on the trade, and the Company in turn underwrote the National Debt in return for 5% interest from the Government. This would in turn facilitate a loan of 7 million pounds in order to pursue war with France. Favoured individuals were awarded blocks of stock in advance of the launch in anticipation of high returns. Speculation became rife (and drew in all levels of society) as shares rapidly increased to ten times their face value. In a frenzied atmosphere all sorts of bizarre companies were set up on the basis of it, ranging from exploiting bogs in Ireland to designing square cannon balls. The best one of all was "For carrying on an undertaking of great advantage but no-one to know what it is".[22] Plans were even made to extend the scheme in order to cover the National Debt. With apparent government support, the value of the stock rocketed to ten times its original value before panic set in. The price started to fall, despite attempts to get investors to prop up the price by buying more stock on credit. The price fell back almost to its starting point and a wave of bankruptcies followed, although it was noted that the key shareholders and directors had got out some time before. Even Sir Isaac Newton was caught out: "I can calculate the movement of the stars," he is widely quoted as saying, "but not

[20] https://www.managementstudyguide.com/john-law-and-mississippi-bubble.htm
See also http://uk.businessinsider.com/bitcoin-is-a-lot-like-the-mississippi-bubble-carl-icahn-says-2017-11?r=US&IR=T for possible comparisons with Bitcoin.
[21] See the Companies Act chart in Appendix 2 for more on the legal repercussions of the South Sea Bubble.
[22] Jonathan Swift satirises this with the "projectors" in *Gulliver's Travels* (Part III chapter V.)

the madness of men." It was Horace Walpole as First Lord of the Treasury who came up with a scheme to divide the debt between the Government and the East India Company. The directors were forced to pay compensation to offset investors' losses. Normality was gradually restored, despite the fallout from bubbles in Paris and Amsterdam at the same time.[23]

KEY FACTORS: An unrealistic scheme based on an unproven economic plan; unreal expectations given the size of the debt to be covered; relying on overseas investment with uncertain terms and at a time of uneasy peace; allowing widespread speculation; incompetence and corruption among government; an irresponsible attitude towards the general economic good; the herd instinct.

Kingdom of Poyais 1820s

Gregor McGregor is perhaps an unlikely figure in the history of scandal.[24] A British Army Officer at the time of the Peninsular War, he served in Spain with the 57th Regiment of Foot and subsequently in America and Venezuela (where he remains a heroic figure for his part in the wars of independence from Spain.) He actually held Cartagena briefly against Spanish forces, but the reality tended to be rather different from his tales of his own exploits. This carried over into his various plans for settlements in Florida, various islands and, most notoriously, the Kingdom of Poyais on the Mosquito coast of today's Nicaragua. In 1821 he returned to London claiming to have received a land grant from the King of Poyais, where he had been appointed "Cazique" or great leader. He was even given a reception by the Lord Mayor of London at the Guildhall, and the following year seventy eager settlers, including professional people, set off to his new kingdom, having swallowed completely McGregor's tales of a country with its own parliament, legal and banking systems and even its own army. The prospectus, entitled *A Sketch of the Mosquito Shore*, extolled the beauties of the capital city St Joseph, with its boulevards and population of twenty thousand people, but it had quite possibly been written by McGregor

[23] https://en.wikipedia.org/wiki/South_Sea_Company Charles McKay wrote *Some Extraordinary Public Delusions,* which was first published in 1841, and which contains chapters on both Tulip Mania and the South Sea Bubble. Available in Penguin 2010.
[24] https://globalvoices.org/2016/03/01/poyais-the-19th-century-con-that-remains-one-of-historys-boldest/
See also https://en.wikipedia.org/wiki/Gregor_MacGregor

himself and was widely discredited, as a man called Michael Rafter had just published a book casting doubts about McGregor's supposed exploits.[25] However, land grants were sold and went up in value (an early form of securities fraud). A 200,000 pound loan, backed by eminent people, was raised on the London Stock Exchange, with scrip to be bought in three instalments. However, problems with bonds for other emerging South American countries meant that the final instalment was hardly taken up, and it soon became clear that the first two waves of settlers (including several hundred artisans from Scotland) were in dire straits in the new colony, from where they were rescued by the Royal Navy and taken mainly to British Honduras. Some settled in America, many died, and only a handful returned to Britain. Undeterred, McGregor fled to France, where he tried to raise further funding and a new expedition, but without success. Almost unbelievably, he tried to float various Poyaisian schemes right up until 1837, when he returned to Venezuela and acclaim as a veteran of the Wars of Independence.

What persuaded people to be so credulous? Maps did exist at the time, the area had been settled (though not extensively) by Spain. It was a time of massive change as the various Spanish colonies became independent. People were aware of the natural wealth of the region.

But with growing post-war prosperity, interest rates were falling in London and investors were attracted by interest rates on South American government securities which were almost double. Profits were there to be made, but different states offered widely differing opportunities and not a little risk as the process of independence did not come to an end until 1828, and civil wars were to continue for several decades.

KEY FACTORS: Support from key figures in public life and the banking world; distance and a lack of concrete information, though people do not appear to have carried out any kind of due diligence; the prospect of far higher returns than the ones available on the London market; the herd instinct.

[25] Rafter, Michael (1820). *Memoirs of Gregor M'Gregor: Comprising a Sketch of the Revolution in New Grenada and Venezuela,*

Railway shares 1840s – 1860s and beyond

Although railways had come into regular use by the 1830s, economic conditions did not encourage their development until the mid-1840s when interest rates were cut and industrial production became more buoyant. Government bonds were less attractive just as railway shares became more attractive, and so the railway network increased rapidly. At one point over two hundred and fifty acts were before Parliament for the building of new railways. MPs were eager to encourage them for the benefit of their constituencies, not least because they were heavy investors themselves. But too many companies were set up, often with insufficient capital, and it became clear that many people (even experienced smaller investors with local knowledge) were over-stretched. When it became clear that they were unlikely to see the returns expected, there was a run on shares and large numbers of middle-class families were actually ruined. The more established railway companies bought out the smaller ones, with valuable freight lines and parts of trunk routes in particular. Although railway building came back into fashion in the 1860s there was an air of greater caution, a higher degree of government control, and fewer opportunities for the promise of massive returns that had so driven the earlier craze for shares.[26]

KEY FACTORS: The availability of cash as the economy developed; a fall in interest rates; encouragement from government without corresponding levels of caution or control; too many companies operating in the same sector; a lack of broader planning to avoid unnecessary duplication or competition; over-investment on the part of small shareholders; bad timing.

Summary

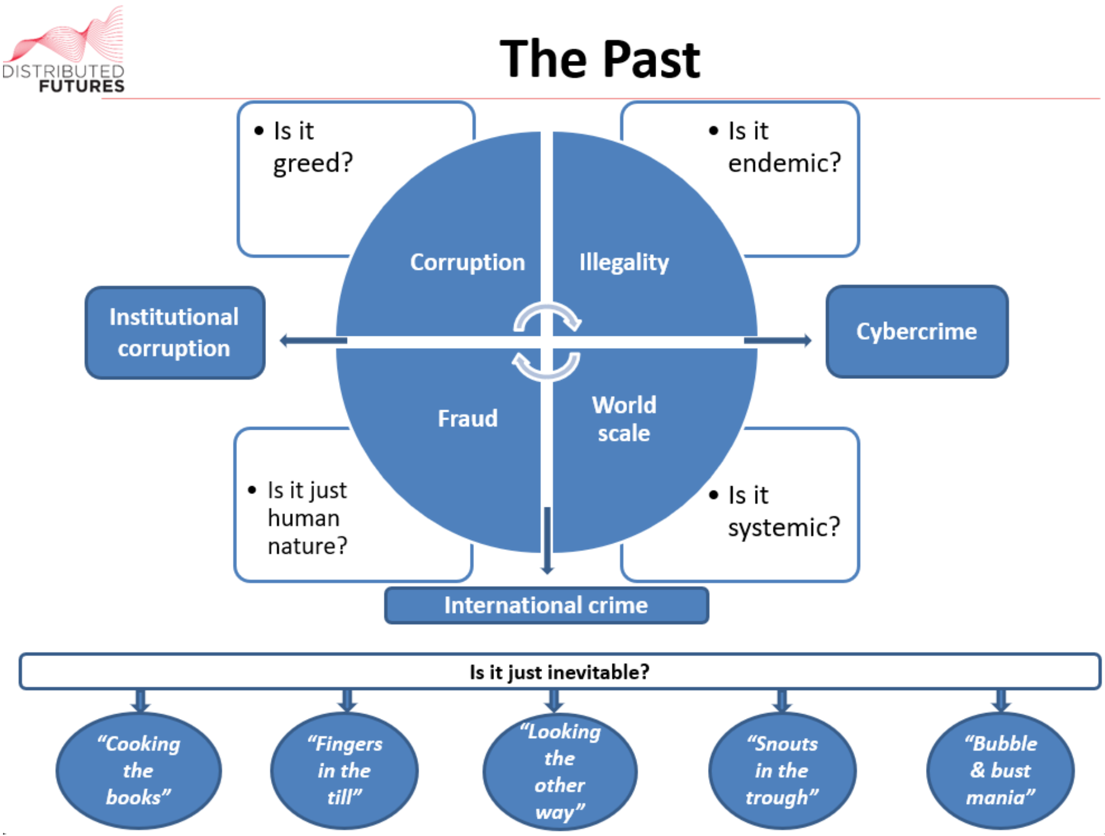
Throughout history similar situations arise, whether it is the desire to ensure that business procedures are carried out correctly, or whether the over-ambitious, credulous or just plain greedy fall for the same tricks every time. The underlying factors have a familiar ring to them: hopes for sudden wealth (which may be possible initially), euphoria, followed by mania, followed by panic. The modern-day mantra of "too big to fail" somehow has a similar ring to it.

[26] http://www.railwaymania.co.uk/ See also https://en.wikipedia.org/wiki/Railway_Mania

Most of the examples in this section contain an element of fraud, and in most cases government failed to take the necessary steps in time to control the situation. "Due diligence" is a phrase of quite recent creation, but it does indicate a healthy degree of caution and quite possibly scepticism and it makes sense to ensure that all avenues have been explored before proceeding with what could be major outlays of funding with unknown levels of risk.[27]

[27] There is a rather nice story that the Portuguese phrase *está bom para o inglês ver* ("It's good enough to show the English" – suggesting a botched job!) derives from railway building in Brazil. Some people say that this was because the British supervisor built his bungalow from where he could see the workers, while others say that some crafty locals built each end of a railway and persuaded the British investors that the bit in the middle had actually been constructed.

2. Scandals: How To Identify Them – And How To Stop Them



What Is A Scandal?

Roget's Thesaurus places "scandal" within a range of analogous terms such as disrepute, notoriety, infamy, disgrace, and even such old-fashioned concepts as shady reputation, ignominy and dishonour. It demonstrates how damaging such revelations can be to both individuals and the companies they represent, which cannot be good for business as a whole. However, scandal only becomes a scandal when it comes to light, whereupon the press and financial pundits start asking why it was that nobody noticed, blew the whistle or took steps to stop it. Something evidently has gone wrong along the way. The cause may be deliberate illegal activity, the flouting or simple disregarding of the rules or reckless behaviour which then gets out of control. These forms of behaviour are not confined to the financial world (see chapter 4 for no shortage of examples). There are seemingly endless stories in the press about political corruption or collusion; money laundering; large-scale tax evasion (whether personal or corporate); misuse of aid funds; general mismanagement and sleaze, ranging from the poor behaviour of public figures through to the expenses scandal at Westminster.[28]

The Danger Signals For Scandals In The Technology Age

It is curious that the danger signals are so often ignored or perhaps deliberately overlooked. This may be because people hope that the matter will not come to light, or that damage limitation or control will put the matter to rest. Inexperienced traders such as Nick Leeson at Barings or (more recently) Jérôme Kerviel at Société Générale and Kweku Adoboli at UBS, thought that they could trade their way out of trouble, rather than digging themselves deeper into a situation over which they had less and less control. In both instances proper supervision and an operational system of oversight might have brought things under control before they caused terminal damage in the case of Barings, while massive damage resulted from the cases of Société Générale. and UBS, with prison terms for both young men.[29]

Lessons Learnt?

So often we hear the mantra that lessons have been learnt, which appears to be true until the next scandal comes to light. There have been massive efforts at national and international level to introduce legislation, structural change, compliance regulations and professional body qualifications in order to combat the many instances of poor practice or illegal activity which have been identified both before and after the events of 2008 – 2009. Ultimately, the responsibility must lie with the individual at every level of the organisation, from the senior staff setting the direction of the company and approving major initiatives through to the junior staff who are tasked with putting such plans into effect. However, pressure can build up in different ways. There will be targets to meet, quite possibly with incentives attached, and individuals may

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[28] Concern is sometimes expressed as to whether financial journalists are fully *au fait* with their subject. City, University of London actually offers an MA in Financial Journalism: http://www.independent.co.uk/student/postgraduate/postgraduate-study/city-university-launches-londons-first-ma-in-financial-journalism-1895231.html

[29] https://en.wikipedia.org/wiki/Jérôme_Kerviel There was an extra twist in the tale of Jérôme Kerviel. See http://www.telegraph.co.uk/news/2016/06/07/societe-generale-fined-450000-for-firing-rogue-jerome-kerviel-wi/ For the Kweku Adoboli case see https://en.wikipedia.org/wiki/Kweku_Adoboli

be concerned not only over their own P&L (and hence bonus at year's end) but also any impact on their annual appraisal and quite possibly future employment - a situation which becomes more tense in times of economic downturn when staff may be concerned about holding on to their own job, plus the uncertainty of finding another job if they are "let go".

Unorthodox Personal Gain

Then again, circumstances might arise where an opportunity is seen to make money via unofficial means, whether for personal gain or the company's benefit. Regulation should be reducing such opportunities, but then so often change is retrospective and in response to a situation which emerges, quite possibly some time after the event. (The rigging of LIBOR might be an example.[30]) The Bribery Act of 2010[31] will have concentrated minds wonderfully, as indeed has the introduction of compliance at all levels, though it is important for penalties to be real and ultimately inevitable in order to dissuade the wrongdoers.[32] Much will depend on the corporate culture, the lead taken by key figures, the role of training (especially in smaller organisations with fewer resources) plus a general awareness among staff at all levels as to what is expected of them. The threats posed by modern legislation have become stronger. They are beginning to cover a wider range of situations. The Unexplained Wealth Orders (UWOs) which have been introduced in January 2018 will enable law enforcement authorities to follow up on suspicious cases.[33] Accusations regarding infringements of regulations or a breach of corporate duties can lead to civil or criminal investigation involving both individuals and companies. Even if the outcome is a civil settlement or a deferred prosecution agreement, the damage can be considerable and the whole matter costly and time consuming, which suggests that the best course of action is to avoid getting into such situations in the first place.[34]

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[30] See https://www.cfr.org/backgrounder/understanding-libor-scandal
For an interesting range of articles on LIBOR see https://www.ft.com/libor-scandal

[31] http://www.legislation.gov.uk/ukpga/2010/23/contents

[32] For an ironic insight into the impact of compliance regimes, see the highly observant Alex and Clive cartoons in the Daily Telegraph: http://www.telegraph.co.uk/business/alex/

[33] https://www.transparency.org/news/feature/unexplained_wealth_orders_how_to_catch_the_corrupt_and_corrupt_money_in_the

[34] The Association of Independent Financial Advisers actually set up a data-gathering scheme in 2005 to protect members against retrospective action from FSA:
https://www.professionaladviser.com/ifaonline/news/1353464/aifa-stakes-ground-retrospection

Transparency

Transparency, regular oversight and proper internal controls are all useful in establishing a system which will alleviate the risk, although arguably there is nothing in the first instance to stop the determined individual who is tempted to stray into an area which might range from questionable practices to downright fraud. A lack of proper oversight or weak internal controls may encourage individuals to buck the system, especially if figures are not kept up-to-date and published in a timely fashion. Asymmetric information might be used to change the image of a company to make it appear stronger or weaker as the case may be. Future earnings might be over- or under-stated according to circumstances. Anticipated expenses or credits may be delayed or brought forward, executives facing a takeover might be tempted to understate the value of a company, and then benefit from the bounce-back when the takeover has gone through. The balance sheet can appear to be inflated, which in turn is likely to affect share price. Tesco overstated its profits in 2014 by 326 million pounds.[35] In 2017 it was obliged to pay out a fine of 129 million pounds as part of a deferred prosecution agreement, legal fees of 235 million pounds, plus 85 million pounds to be paid out in compensation, so the stakes can be high.[36]

The Role Of Fraud

Fraudulent activity can affect a wide range of sectors and take many forms. In the commercial world there might be an element of caution in recognising or acknowledging fraud as this may involve sensitive or confidential data. Actual conditions will vary between sectors. In motor insurance staged accidents may prove damaging to individuals but they are very harmful when the whole industry is taken into account, whereas credit card fraud will be of more concern in banking. Phishing scams are indicative of the fact that the many innovations taking place in finance seem to provoke a criminal response which can be ahead of the curve in terms of the measures needed to protect both customers and firms.[37] Remote banking fraud is already an issue, whether via

[35] https://www.theguardian.com/business/2017/mar/28/tesco-agrees-fine-serious-fraud-office-accounting-scandal Three Tesco executives went to court in Autumn 2017.
[36] See https://en.wikipedia.org/wiki/Accounting_scandals for a list going back to 1925.
[37] Open banking, introduced in mid-January 2018, may well prove to be a case in point. See the Sunday Times for 7.1.18.

the internet or phone. Cases have doubled in the past four years, despite assurances regarding the levels of security that have been built into the system.[38]

Innovation Can Stimulate Scandals In The Electronic Age

It is advisable to exercise particular care when opening any new venture, particularly one that relies on any sort of electronic basis, and to look and see where the weaknesses might lie from a criminal perspective. Human ingenuity can work both ways, and it is almost inevitable that any innovation will come under scrutiny to see whether it has an alternative application. Examples range from the launch of the original computer viruses to the lower depths of the dark web. Equally, novel products in the financial world should be tested to destruction before being launched on the outside world, as investors may well take new offerings at their face value, or they may even believe that they are taking a calculated risk by getting in at ground level.

Contemporary Experiences

The experience of the past thirty years or so is, however, salutary. It was perhaps unfortunate that high income bonds, premier bonds or extra income and growth plans were launched at a time of low interest rates and at the times of the market crash in around 2000 – the name precipice bond was only applied later, and a lot of pensioners would have saved a lot of money had they been called that at the time. The basis of the high yield was in the form of complicated financial instruments and no thought was given to protecting the initial capital and hence the value of the product in a recession.

[38] See the Sunday Times for 7.1.18.

"If it's too good to be true…"

It is a general premise that if something is too good to be true from the outset – then it usually is too good to be true, and high rates of return which do not appear elsewhere in the market ought to come under that category. Broker funds became notorious for high charges, poor returns and a conflict of interest for the advisers that would not be allowed today. Many investors chose products in good faith and on the basis of advice that in all probability would not be allowed today either as it seems to have been driven by the prospect of high rates of commission. At the time some investments seemed attractive and were offered no doubt in good faith, the endowment mortgages of the 1970s being a case in point, whereby the monthly mortgage payments would, over a period of twenty-five years, generate more than enough to pay back the original capital. This was attractive at a time when inflation and increasing property values reduced the impact of the original loan, but circumstances changed, in much the same way that Equitable Life, a venerable mutual company founded in 1762, was offering very attractive pension prospects which attracted a lot of sensible and serious professional people back in the 1970s and 80s. But the company was not building up sufficient reserves to cover the forward costs of annuity rates which were guaranteed, nor could it cover the cost of the all-important terminal bonus. At the end of 2000 it closed to new business and the matter of compensation eventually went to the House of Lords.[39]

Institutional Oversight?

Other errors that might have been spotted by the appropriate authority are the lack of available funds and the need to hold sufficient liquid assets in order to meet likely demand.

Arch Cru held investments in assets that included wine, forestry and a small shipping fleet although the 20,000 investors assumed that this was a low-risk cautious-managed fund. Damages of 22 million pounds (plus damages and costs) were eventually paid out in 2015 on the grounds of negligence and

[39] https://www.gov.uk/guidance/equitable-life-payment-scheme . The Equitable Life Members Support Group has an interesting web page at http://www.equitablelifemembers.org.uk

breach of contract, though few investors got back as much as half of their losses.[40]

Banks, corporate investors, individual investors and their advisers, even the financial press, all have a role to play in combating the kind of malpractice that leads to the sort of scandals listed above. To avoid the damage, the grief, the legal costs, compensation payments and court cases and even jail terms, there is also a key role for government to play to ensure that legislation is timely, relevant and applicable to all foreseeable situations. To do that it needs to be fully aware of developments in business and in the markets, and to do so it needs the support of all those involved. The National Fraud Initiative is run by the Cabinet Office and is designed to combat fraud in both the public and private sectors. It matches electronic data in and between public and private sector bodies to prevent fraud.[41] Action Fraud is the national centre for fraud and cybercrime, and is run by the City of London Police. Actual cases are taken by the National Fraud Intelligence Bureau.[42] This works with a commendable list of partners covering business, public and third sector and involves entities such as CIFAS, which is the country's largest fraud-sharing organisation[43]. It holds databases designed to prevent fraud and also runs training courses.[44]

Fraud Permeates Every Aspect of Economic Life

The scandal here is that fraud permeates every aspect of economic life and is far from being a victimless crime. The cost, the damage to public confidence, and the time lost in legal procedures are all very damaging. Criminal ingenuity is such that novel ways of making money in extra-legal ways are constantly appearing and this means that constant vigilance is required, ranging from simple measures like setting up firewalls and changing passwords regularly, through to ensuring that proper procedures are followed in the workplace and ensuring that any innovations should be fully tested before launch.

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[40] For further detail of these cases, plus others, go to http://citywire.co.uk/money/10-financial-scandals-the-fsa-could-have-prevented/a467704

[41] https://www.gov.uk/guidance/taking-part-in-national-fraud-initiative

[42] https://actionfraud.police.uk/about-us/who-we-are See also https://www.cityoflondon.police.uk/advice-and-support/fraud-and-economic-crime/nfib/Pages/default.aspx

[43] Data sharing for the prevention of fraud is actually a requirement under the Serious Crime Act of 2007: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/415469/Data_Sharing_for_the_Prevention_of_Fraud_-_Code_of_Practice__web_.pdf

[44] https://www.cifas.org.uk/

3. Vehicles For Fraudulent Behaviour

Technology Opens New Horizons for Fraudulent Behaviour

Wrongdoing in the marketplace is distressingly common, despite a plethora of new laws and regulations in recent years, not to mention the setting up of a whole range of organisations designed to combat fraud and to help companies set up systems to prevent it. Advice is also widely forthcoming with regard to ethical behaviour in business by government departments, professional bodies, exam boards and other worthy organisations. (See Chapter 6 and Appendix 3). It is therefore disheartening that fraudulent behaviour is still widespread and that the advent of new technology seems to bring with it another whole area which requires protection for companies and individuals alike. Even so, scams can still follow the traditional pattern, based on novel money-making schemes, the prospect of high returns, pitches made by plausible individuals or by people who have developed a name for themselves and who manage to build up a following.[45]

The Madoff Scandal

Classic among these must be Bernie Madoff who was a stockbroker and financial adviser who was ostensibly a leading figure in the business world in both New York and London.[46] He sat on boards, was well acquainted with key figures in the world of business and was even a major contributor to the Democratic Party. His company operated from 1960 to 2008 but, despite new opportunities, it was running a massive Ponzi scheme from 1991 onwards, meaning that he used clients' deposits to make payments to other clients who assumed that these were dividends.[47] The matter did not come to light until he confessed the matter to his two sons, who promptly reported it to the authorities. It would appear that his papers were never properly scrutinised; queries were raised about the remarkably small number of staff employed by

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[45] Note that fraud and embezzlement are not quite the same thing. See http://www.differencebetween.com/difference-between-fraud-and-vs-embezzlement/

[46] See Kindleberger (2013) chapter 7.

[47] In the 1920s the original Charles Ponzi offered clients a 40% return on investments within just 90 days, at a time when yields were normally 5%. Within six months he was taking in $1m dollars a day, which of course was unsustainable. See http://www.telegraph.co.uk/business/0/bernard-madoff-ponzi-scheme-does-work/

the company; doubts were expressed about the level of returns that the company was consistently making; and people who began to investigate the case were diverted on to other projects. In the end there were over 24000 victims, who did receive some compensation from government, but nowhere near the 68 billion dollar loss that the fraud is thought to have caused. It is the largest fraud in US history to date,[48] although comparable schemes appear to start up with some regularity, including alleged cases which are currently ongoing.[49] Pyramid selling and Ponzi schemes have also taken root in China, even though they were banned there in 1998.[50]

The high profile nature of the Madoff operation and the years it managed to run without detection is perhaps surprising, but there have been other types of case involving major companies which have led to massive losses, upheavals in the market and damage to both companies and individuals which have gone to extremes before being detected.

The Enron Scandal

Enron became notorious in the early 2000s because of the extensive harm it caused, involving systematic accounting fraud on a widespread basis. Enron was an energy company based in Texas, employing 20,000 staff across more than forty countries, with an annual turnover at the time in excess of 1 billion dollars a year.[51] It was highly regarded, the seventh largest company in America, and yet it lied deliberately about its profits and debts which were concealed by means of a complex series of transactions - what were termed aggressive accounting practices. As commercial confidence waned, it became apparent that the eminent accounting firm Arthur Andersen had actually advised Enron staff to destroy key documents.[52] The impact on Arthur Andersen, one of the so-called “Big Five” accounting firms in America, was devastating, although the firm eventually recovered, albeit in a much reduced form.[53] The Enron Scandal did however have one positive outcome: the passing

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[48] https://www.investopedia.com/terms/b/bernard-madoff.asp. See also Ponzi scheme below.
[49] https://en.wikipedia.org/wiki/List_of_Ponzi_schemes
[50] In 2016 the Chinese government closed down a scam called Ezubao that had duped no fewer than 900,000 investors. See *The Economist* 3.2.18
[51] http://news.bbc.co.uk/1/hi/business/1780075.stm
[52] http://content.time.com/time/specials/packages/article/0,28804,2021097_2023262,00.html
[53] http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/11069713/Arthur-Andersen-returns-12-years-after-Enron-scandal.html

of the Sarbanes-Oxley Act in 2002, which improved oversight of both public and private companies, and made the wilful destruction of evidence a felony.[54]

Pyramid Selling

Another scheme with a long and disreputable history is pyramid selling, whereby what is on offer is not actually a tangible product, so much as the chance to recruit other people to sell, which is ultimately not possible mathematically.[55] Pyramid selling is not to be confused with direct selling, which is usually respectable.[56] The salami swindle, also known as penny shaving and (to older people) the milkman's penny, aims to take very small sums in a random fashion, for example from the odd pence in a pay cheque.[57] Modern computer techniques could reduce that to fractions of a penny (or cent), thereby making any losses virtually unidentifiable. The swindle usually goes wrong when people get greedy, work with someone else who gets greedy, or is spotted by a random security check.

Cyber Crime - An Emerging Developing Form of Financial Crime

New systems are emerging with bewildering speed and increasing rapidly beyond the comprehension of the average punter or individual investor who is likely to skip over the standard warnings that you should only risk capital that you are prepared to lose, and that the value of your investment could go down as well as up. Natural evolution suggests that there will always be a process of development and counter-development as competing forces strive for economic advantage. This is especially the case with technology (think Betamax versus VHS, or mainframes versus the laptop) and is applicable on both sides of the legal equation. Where a new secure system emerges an opposite (though not always equal) force will emerge to counter it. The Internet, which has changed the world for good in so many ways, has also spawned viruses and the Dark Web – and a whole new range of measures in

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[54] Sarbanes-Oxley (also known as Sox) was very far-reaching. See http://www.soxlaw.com/ for details.

[55] https://money.howstuffworks.com/pyramid-scheme1.htm So ten new recruits have to find 10 new recruits who then have to find another ten recruits…

[56] http://www.dsa.org.uk/about-the-dsa/

[57] In the film M*A*S*H the character Radar manages to ship a whole jeep home by sending it one piece at a time. See https://scams.wikispaces.com/Salami+Slicing for other examples. The origin of the phrase is actually political. The Hungarian leader László Rajk took power with the Communists in 1947, claiming that he had cut his former partners off like slices of salami. https://en.wikipedia.org/wiki/History_of_Hungary

turn to counteract them. A good example of this is the development of forensic services in the financial world. It is now possible to carry out forensic accounting procedures which can delve into accounting black holes, investigate possible cases of regulatory breaches, employee misconduct or even recover lost data. Increasingly this involves going across international boundaries as there is no single jurisdiction in cyberspace.[58] A cybercrime vulnerability scorecard has actually been produced to show a wide range of organisations how exposed they are to cyber attack, what the damage is likely to be in their specific case and how resilient their safeguards actually are.[59] It is surely an area now where everyone has to be vigilant with firewalls, up-to-date anti-virus software and a regular change of passwords.

Criminal Authorities: Behaviour & Reaction

Despite all these developments, there must be a temptation for the authorities not to go for the smaller fry, but constant vigilance and the fear of being caught should act as deterrents. However, the larger the returns the more people might consider taking a risk. The website of the National Fraud Investigation Bureau (operated by the City of London police) gives some interesting insights into the sheer range of illegal activities that need to be investigated, with gold, diamonds and oil at one end, through mortgage fraud and insider trading to identity theft. Many people have had experience in recent years of receiving official-looking letters, or pleas from friends supposedly stranded in odd parts of the world.[60] E-alerts and warnings via social media can help the police, as indeed can reports from concerned members of the public.[61] Steps are being taken to close gaps and make crime harder to commit and easier to report, whilst the processing of cases can be

[58] For some idea of the range of forensic services on offer, and how they can be applied to legal procedures, go to https://www.bdo.co.uk/en-gb/services/advisory/forensic-services . BDO also produces an annual fraud report: https://www.bdo.co.uk/en-gb/insights/advisory/forensic-services/bdo-fraudtrack-2017

[59] The vulnerability report has been published by Crowe Clark Whitehill in collaboration with the Institute of Criminal Justice Studies at the University of Portsmouth.
See *https://www.croweclarkwhitehill.co.uk/cyber-vulnerability-scorecard/*

[60] One acquaintance of mine had his phone hacked, so that his friends received pleas for money from him (supposedly in the Philippines). Someone then emailed him to ask if this was a scam, and back came an OGM from his email account to say that the message was genuine – which of course it wasn't.

[61] Some fraudsters have a lot of nerve: an email came round in September 2017 purporting to be from the NFIB itself with regard to the return of stolen funds. The fact that the details of the bank meant to be involved was in South Africa rather gave the game away.
http://news.cityoflondon.police.uk/r/906/warning__fraudsters_send_out_letters_claiming_to_

speeded up. In October 2017 plans were announced for the setting-up of a new Fraud and Cybercrime Court, which will focus on a growing area of crime,[62] which can take a variety of forms. Its work will doubtless be reinforced by the proposed new national crime centre, which will be located within the National Crime Agency, and will focus on financial crime (including money laundering) and will also target drug dealers and people traffickers. It is also intended to target so-called corrupt insiders within the police, prisons and border force.[63]

Growth Of Fraud

Apart from identity theft, there is now clean fraud, friendly fraud, affiliate fraud, triangulation fraud, and merchant fraud, all of which indicates a need for highly skilled staff to counteract it all.[64] However, the rate of growth in the number of cases makes it hard to keep up not only with the growing ingenuity of the fraudsters, but also the sheer volume of cases coming to light, with complaints that banks are not following up on cases, or that the police do not pursue cases where funds have already been moved abroad.[65] Concern has also been expressed with regard to the number of officers available to investigate fraud cases relative to growth in this area. So-called boiler room activities are, however, actively pursued. These set-ups are usually run from abroad, and target people (especially the elderly) in this country by cold calling to persuade them to buy worthless, overpriced or non-existent shares. The whole thing is dressed up on occasion with a flashy address somewhere, the promise of regular reports, special offers and surefire tips.[66] Increased international cooperation is necessary to counteract this kind of activity.

[62] http://www.information-age.com/cybercrime-court-opened-city-london-123468972/

[63] Daily Telegraph 12.12.17. The same article reports that the estimated value of crime proceeds each year is 90 billion pounds, and that financial fraud is costing the economy 6.8 billion pounds a year.

[64] http://www.information-age.com/seven-types-e-commerce-fraud-explained-123461276/ ActionFraud, run by City of London Police, identifies no fewer than 124 types of fraud, ranging from bogus tradesmen and clairvoyant scams to tabnapping, a type of phishing attack that impersonates a popular website. They are cheerfully described as “hooks to catch the crooks”!
See https://actionfraud.police.uk/a-z_of_fraud

[65] http://www.thisismoney.co.uk/money/news/article-3536632/You-conman-raids-bank-account-fraud-epidemic-sweeps-Britain-just-two-1-000-cases-investigated.html This report is dated 2016 so the figures will have changed by now. But the case studies are illuminating.

[66] https://actionfraud.police.uk/fraud-az-boiler-room-fraud

Globalisation, Digitisation And Growth Of Financial Crime

However, it is inevitable that globalisation and the massive changes that have come with it will have created a tremendous variety of opportunities for criminal activity. Nowhere is this more pertinent than in the case of the internet and its many offshoots, both positive and negative. Apart from the grim realities such as viruses and computer hacking in its many forms, the internet has had a massive effect on the dissemination of information, and allowed the development of trolling and fake news. Emails and text messages have revived the art of writing (and quite possibly spelling) though many office workers complain of the blizzard of emails that they receive every day, and many people at least filter their emails on holiday in order to avoid coming back to an absolute avalanche. Business transactions have speeded up enormously – writing a cheque, putting it in an envelope and posting it now feels almost quaint.

On the other hand, there are endless cases of on-line transfers going missing, being diverted or intercepted by fraudsters. VAT Carousels (also known as Missing Trader Fraud) are an example of the sophisticated manipulation of equally complex regulations, whereby VAT is fraudulently claimed back in trading between EU states.[67] Digitisation has given ordinary people access to a range of materials that previously would only have been found in one of the great universities. As against that, musicians in particular are seeing their livelihoods slip away as more and more material is available on-line and, increasingly, this is where people expect to find it. All this is before taking into account fraud, blackmail, pornography, and sexting plus all the unpleasantness of the Dark Web.[68] It might equally be argued of course that cash (especially in high denomination bills) is what has driven major and international crime in the drugs trade, arms trade, people trafficking, racketeering and money laundering.[69] Cash (which is now referred to as "fiat currency") also involves forgery & counterfeiting, both of which are a constant headache for banks and governments and may involve the withdrawal and re-issue of coins and notes at intervals.[70]

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[67] http://www.rawlisonbutler.com/blog/taken-ride-dangers-vat-carousel-missing-trader-fraud/
[68] http://thecomputersimpact.weebly.com/the-positive-and-negative-effects-of-the-internet.html
[69] For an interesting discussion about the future of cash see Rogoff 2016.
[70] Counterfeit is when an illicit copy is made of something. Forgery is the production of something made with intent to deceive. https://www.cps.gov.uk/legal-guidance/fraud-act-2006

Cryptocurrencies: Don't Confuse The Technology With The Product And Service

So the advent of an on-line system that is reliable, safe and even quite possibly foolproof might seem to be a positive thing. Yet the Mutual Distributed Ledgers "Smart Ledgers" (aka blockchain) have met with mixed reviews, "highly disruptive and revolutionary"[71] on the one hand, though quite possibly quicker, safer and cheaper on the other. Smart Ledgers were developed long before Bitcoin appeared, but their use is spreading out to other crypto- or cybercurrencies and to a wider range of possible applications. Equally there is no system of regulation that prevents it from being used by criminals. It is even being reported that some firms are hoarding bitcoin in order to pay off hackers who increasingly are using ransomware to damage organisations ranging from the NHS to major accounting firms.[72] The important thing behind blockchain technology is the distributed ledger, meaning that all transactions are timestamped and published, besides which the recipient knows that the item is genuine and that it does really belong to the other party. Distributed ledger seems to be resistant to cyberattack and these transactions are also anonymous and free from interference, which is why they also appeal to the criminal fraternity. However, this is a new area of development and if previous inventions are anything to go by, then the outcomes will be positive as well as negative. This new technology could be applied to anything which has a unique number. It could be used to track the export of cattle with the right health certificate, to control the sale of vehicles by using the chassis number and there may well be applications for government with regard to everything from land registry to passports.[73]

Growth Of Products And Services Derived From Cryptocurrencies

In the same way that Bitcoin has generated an increasing number of cryptocurrency rivals,[74] so there is no doubt that this is an area which will not only grow, but will also do so exponentially. Kodak's recent launch of

For a philosophical discussion about money see https://ieet.org/index.php/IEET2/more/danaher20150407

[71] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/492972/gs-16-1-distributed-ledger-technology.pdf Chapter 5.

[72] *The Times* 18.12.17.

[73] I am indebted to my Gresham colleague Professor Martyn Thomas, whose lecture of 9.1.18 covers Bitcoin and Blockchain in great detail – and in a way that make it easily accessible to the non-specialist.

[74] https://www.quora.com/How-many-cryptocurrencies-are-there

Kodakcoin increased the share price by 245%.[75] Cryptocurrency exchanges and trading take place via trading desks with individual traders and, increasingly, traditional financial firms. Despite assurances that this groundbreaking technology is unbeatable, human ingenuity will undoubtedly find ways of subverting the system.

[75] The Times 23.1.18. See also the BBC: http://www.bbc.co.uk/news/technology-42630136

4. Corrupt Practices And Procedures

Taxation: Its Role In Corrupt Practices

There has been a lot of news recently about tax havens and the movement of funds worldwide through the release of the Panama Papers in 2015 and the Paradise papers last year.[76] It should be stressed that there have not necessarily been contraventions of the law or any clearly illegal activity in all that has been revealed, although it does indicate that finance nowadays works at different levels, particularly as a consequence of globalisation and the rapid increase in the speed and efficiency of the internet in recent years. Tax evasion of course remains illegal, though avoidance refers simply to making use of existing legislation to reduce the tax take as far as possible, and tax amelioration might well be seen as part of cautious standard business practice. However, a lot of anger and frustration has been expressed by the general public whose income and financial expectations do not run into millions let alone billions, and the squeezed middle may well feel justified in feeling that they are the sitting ducks in the tax equation whilst wealthy individuals and multinational companies whose assets exceed those of a medium-sized republic are paying less than they ought in comparison. In addition, repeated news stories concerning massive bribes or the sums of money diverted from government by corrupt politicians and presidents worldwide continue to emerge and have added to the public impression of there being a two-tier financial system in the world which is of disproportionate benefit to cliques, elites and major criminal organisations.

The Odebrecht case, which has spread over much of South America, is a prime example.[77] Despite the name, Odebrecht is actually a Brazilian company with a long and eminent track record in civil engineering and a wide range of other sectors, including oil, gas and technology. It became heavily involved with a

[76] The Panama Papers were leaked to the German newspaper Süddeutsche Zeitung who passed them to the International Consortium of Investigative Journalists in 2015. 11.5 million documents were hacked from the law firm Mossack Fonseca. The Paradise Papers followed the same path in 2017 with 13.4 million documents. https://panamapapers.icij.org/ https://www.icij.org/about/ http://www.bbc.co.uk/news/world-41880153

[77] See the Financial Times for 28.12.16:
https://www.ft.com/content/8edf5b2c-c868-11e6-9043-7e34c07b46ef
Also Business Insider for 30.5.17 http://uk.businessinsider.com/what-is-the-odebrecht-corruption-scandal-2017-5?r=US&IR=T

large number of major projects across Latin America, covering motorways, dams, airports and even the Maracaná stadium in Rio. However it has become clear that Odebrecht obtained massive contracts by dealing with major political figures, allegedly up to presidential level in some countries, who were using Odebrecht money to fund elections and other political activities. Over a dozen countries in Latin America have been implicated, not to mention Mozambique and Angola.[78] The political fallout could be enormous and the damage to Odebrecht has been calamitous: revenues down by half, staff reduced by two thirds, all of which has actually had an impact on the economy of Brazil and added to the already fraught political situation arising from allegations in the so-called *lava jato* case involving the state oil company Petrobrás.[79] During his visit to Lima in January 2018, Pope Francis touched on a number of sensitive social themes: political corruption, the damage being caused by business interests to the environment and the wellbeing of indigenous peoples – all of which was well received by the massive crowds who turned out to hear him.[80]

There have been several high profile bribery cases in recent years[81]. In 2008 Siemens was found guilty of dispensing 1.4 billion dollars in handouts intended to obtain government contracts in areas as diverse as healthcare and energy. BAE managed to extricate itself from the Al-Yamamah case involving arms sales to Saudi Arabia on the grounds of national security in 2006, but not long afterwards was fined for unauthorised payments in half-a-dozen countries, and subsequently paid 400 million dollars in fines in the USA for not having implemented anti-bribery regulations (having said that it had done so) and also paid 30 million pounds in fines in the UK over the case of the radar system in Tanzania.[82]

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[78] The Odebrecht affair has even had repercussions in the UK. The University pension fund USS has agreed to a 50 million dollar compensation payment from PwC because of it. http://www.pensionsage.com/pa/USS-reaches-50m-settlement-with-PwC-after-Petrobras-scandal.php

[79] http://www.bbc.co.uk/news/world-latin-america-41109132 *Lava jato* means "car wash" and refers to the need to clean up the levels of corruption that have bedevilled Brazil for so long and have caused a public outcry.

[80] https://www.theguardian.com/world/2018/jan/22/pope-francis-condemns-political-corruption-in-Latin-America

[81] Transparency International's Corruption Perceptions Index of February 2018 makes depressing reading in this respect: https://www.transparency.org.uk/press-releases/uk-gains-one-point-in-transparency-international-corruption-perceptions-index/#.WpXPv0x2v4g

[82] https://www.worldfinance.com/comment/a-history-of-bribery

Tax Heavens or Havens ?

Tax havens[83] have increasingly become a major issue for governments, as has the current practice of domiciling major companies in countries with a lower tax regime, which has led to calls for tax to be paid in the country where the income is generated, rather than the profits being processed via a third country. It should also be noted that beneficial tax regimes are not limited to fabled tropical islands: the US state of Delaware offers similar incentives for investments and some other states seem to be following suit.[84] Despite damaging revelations and the increasing use of tighter regulations and the introduction of greater control over access to data by governments, banks and other international organisations, offshore investment continues to be a prime vehicle for depositing large sums and that continues to be legal, which does not of course prevent it from attracting criminal elements, though arguably the same could be said of high street banking. Excessive behaviour, poor practice and bad management decisions of the sort that led to the crisis of 2008 are being identified, steps are being taken to prevent further crises and both organisations and individuals who broke rules have been punished. The City of London Police have their own Money Laundering Investigation Unit which can confiscate laundered money under the Proceeds of Crime Act – and have used some of the money raised to investigate the boiler room frauds mentioned in Chapter 3.[85]

The Legal & Moral Dilemmas of Globalisation?

In a globalised world it is too easy to get into difficult situations, as evidenced by HSBC which bought a bank in Mexico, only to discover that it had had no compliance team in place before the takeover. So HSBC became embroiled in problems with US regulators as the bank that had been acquired had been dealing with some of the notorious Mexican drug cartels. HSBC got into further difficulties over US sanction regulations concerning other countries such as Iran, Libya and Cuba. It paid a record-breaking fine and was faced with

[83] For a list of tax havens, see http://www.zyra.org.uk/taxhaven.htm It does not seem to be up-to-date however, and is written from the point of view of a tax exile, so some people might find the tone flippant.
[84] https://www.bloomberg.com/news/articles/2016-01-27/the-world-s-favorite-new-tax-haven-is-the-united-states
[85] https://www.cityoflondon.police.uk/advice-and-support/fraud-and-economic-crime/fraudsquads/Pages/Money-Laundering-Investigation-Unit-(MLIU).aspx The Proceeds of Crime Act was passed in 2002.

a five-year deferred prosecution agreement, which was only lifted in December 2017[86].

No Room For Complacency In Combating Intrusive, Questionable And Illegal Activities

There is no room for complacency, or for anyone to think that the leading economic powers in the West are necessarily exempt from involvement in illegal, improper or questionable activities abroad. A recent report by Transparency International claims that hundreds of companies have been set up in the UK with the specific intention of processing laundered funds.[87] Tax and Companies Service Providers set up so-called "company factories" and cases have emerged where literally hundreds of companies were registered at only eight addresses. It seems that a company can set up in the UK without being registered or even based here, and that Companies House just does not have the staff to be able to check on the large number of companies which are registered with it. This is indicative of the size of the problem in policing a growing and increasingly complex commercial sector. BDO is a long-established company which produces an annual report on the growth of fraud.[88] It demonstrates that fraud cases are increasing rapidly, almost triple those reported in 2003 and these have more than doubled in value. Total losses across all sectors could amount to 190 billion pounds a year.[89] Changes in working practices such as the trend towards on-line or telephone banking have created new opportunities for fraud, as has the change in pension regulations which has given people access to their pension funds well before retirement, and greater flexibility in how to invest them.

[86] HBOS: as reported in The Daily Telegraph 12.12.2017. Standard Chartered was fined $670m for misconduct relating to money laundering regulations, and was also given a DPA – which was later extended to July 2018.
[87] http://www.transparency.org.uk/press-releases/revealed-britains-own-applebys/#.Wl47XUx2vIW
[88] https://www.bdo.co.uk/en-gb/insights/advisory/forensic-services/bdo-fraudtrack-2017 contains the report, based on fraud cases reported with a value in excess of £50,000 in 2017.
[89] https://www.croweclarkwhitehill.co.uk/annual-fraud-indicator-2017-uk-foots-190-billion-annual-fraud-bill/

Enterprises Disguise Illegal Activities Internally

Clearly there are cases where individuals rather than the parent company have deliberately engaged in illegal practices, as in the curious case of the Reading branch of HBOS shortly before it was taken over by Lloyds. Vast sums were siphoned out of the bank by a small group of corrupt officials by using small firms as a conduit. These were ruined in the process, although 29 million pounds were subsequently offered in compensation.[90] Other cases have emerged of unsavoury practices which have been deemed to be illegal, such as the cases in which Deutsche Bank and Hewlett Packard both carried out spying on senior staff and journalists.[91] Such behaviour may be due to individuals acting under pressure or feeling cornered in some way. They may even justify it to themselves by asserting that circumstances demand it. But what constitutes proper or perhaps reasonable behaviour has been more clearly defined after each scandal, as in the case of Enron and Sarbanes-Oxley. The Dodd-Frank Act was brought in in 2010 in order to head off the possibility of another Lehmans case. It is very detailed and to some minds overbearing, but it aims to protect consumers from abusive lending or being exposed to unsuitable mortgage offers.[92] Some years later the rules are being criticised for being too overbearing and prescriptive, to the extent that President Trump called for a review in 2017.[93] Arguably, given the amount of legislation in this area, more stringent regulations might have been avoided had everybody simply followed the rules as they then existed, and fallen back on their own business experience, knowledge of history and even common sense to avoid either getting themselves into situations over which they had lost control, or finding themselves facing a situation not of their own making, but which was sure to cause damage.

Moral Hazard

It might even be possible to fall back on matters of principle. Moral Hazard is an interesting concept whereby some companies are thought to be too big to

[90] The Times 1.12.17. See also http://³ www.thisismoney.co.uk/money/news/article-5117185/HBOS-covered-losses-scandal-branch.html
[91] https://protectinginvestorssecuritiesandinvestmentfraud.wordpress.com/cases/25-biggest-corporate-scandals-ever/
[92] https://www.cnbc.com/id/47075854
[93] https://www.theguardian.com/us-news/2017/feb/03/trump-dodd-frank-act-executive-order-financial-regulations

fail, regardless of the errors that have been committed up to that point, and without due consideration for the likely impact on other parties, particularly ordinary staff or clients.[94] Bear Sterns might be a case in point.[95] They were possibly the first casualties of the sub-prime mortgage fiasco as they were too heavily invested and were using these instruments as collateral. As consumer confidence fell, Bear Sterns was unable to meet its obligations and was eventually sold off to JP Morgan Chase for a mere $10 a share. The managers did not take into account how the sub-prime mortgage market would work when placed under pressure. Nor did they increase liquidity to allow for any eventuality. In addition, they charged very high fees in an attempt to meet the 20% profit margin that had been set for them. Doubtless no-one thought that there would be a chain reaction in the loss of business confidence and the realisation that sub-prime mortgages as an instrument were totally unsuitable for the purposes they were being put to. The classic mantra to think outside the box might have saved the situation whereas it eventually led to even more regulation as well as a long-term loss of confidence in the market.

Rules & Regulations – A Response To The Global Financial Crises Since 2007

Another development in response to the difficult trading conditions of the last decade has been regulatory action, which has appeared in different guises across different parts of government and the business world. Rules are now stipulated, with penalties for infringement ranging from public censure to financial penalties. The Bank of England, for example, stresses that its intention is to address emerging risk but that it also has powers of investigation.[96] Hopefully oversight by people with appropriate knowledge and experience will maintain a balance within the system, so that financial institutions and their directors will not be allowed to drift into situations where they cannot back their loans, or should maintain sufficient liquid assets in order to meet unexpected demand. Both operators and regulators need to keep a weather eye on the market to ensure that when unusual or even unique situations begin to build up, then suitable and timely action will be

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[94] https://www.investopedia.com/terms/m/moralhazard.asp
[95] https://en.wikipedia.org/wiki/Bear_Stearns
For a separate analysis see http://silverseek.com/commentary/what-really-happened-bear-stearns-12942
[96] https://www.bankofengland.co.uk/prudential-regulation/regulatory-action
For regulatory action by other bodies see https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/377014/2012-03-05-taking-regulatory-action-version.pdf for the regulations laid down by Ofqual in the field of education.

taken. Such steps were not to be seen in the case of Northern Rock, which was at the beginning of the stormy period that beset banking in the UK (and elsewhere) after 2008.[97]

The Moral Hazard of Lehman Brothers, Northern Rock & Others

Between Lehman and Northern Rock the banking sector might have thought it was going to have a bad year, but worse was to come with Iceland. A miniature country for the size of the banking operation which blossomed in a very short period, Icelandic banks were offering what proved to be unrealistic and unsustainable rates of interest. These were targeted in particular at the UK and the Netherlands. In the UK not only small investors got caught out. Some local authorities (charged quite rightly with the duty to obtain maximum returns on investments) had been lured by the siren call from Iceland, so that when the banks overbalanced (as, in retrospect, was inevitable) the matter became one of international dimension. Gordon Brown made himself very unpopular by using anti-terrorist legislation to try and restore the situation. The matter eventually (after three referenda in Iceland) went to the EFTA Court – and Iceland won.[98] So what happened? The Icelandic krona was hardly a robust currency; the three banks, Kaupthing, Landsbanki and Glitnir, were heavily leveraged by international standards, and their combined foreign debt ultimately amounted to between five and ten times GDP, besides which the stock market collapsed under the pressure.[99] There had been references to the Icelandic Miracle, in line perhaps with the adulation in previous decades for the Asian tigers, the Celtic tiger and various other economic big cats and investors may have been looking for a quick fix and a rapid return. Certainly the Icelandic entrepreneurs behind the rapid growth of both the banks and the economy were upfront, optimistic and aggressive, and they created a positive image for their activities. But court cases also followed with convictions for fraudulent loans, insider dealing and market manipulation.[100] This would seem to illustrate the fact that it is unusual for there to be a lone wolf, although conspiracy may sometimes be hard to prove.

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[97] See http://www.bbc.co.uk/news/business-41229513 for an appraisal of the Northern Rock episode ten years on.
[98] For a very detailed explanation of a complex episode, see https://en.wikipedia.org/wiki/Icesave_dispute
[99] http://www.bbc.co.uk/news/business-35485876
[100] http://www.spiegel.de/international/europe/financial-recovery-of-iceland-a-case-worth-studying-a-942387.html provides some interesting insights, and from a German perspective.

Moral Hazard And Government Intervention

The banking crisis was not confined to one-off calamities for a few big banks or one-off cases. The malaise spread rapidly and led to government intervention on a large scale. In the UK the government had to prop up Lloyds TSB, HBOS and Royal Bank of Scotland, with newspaper headlines screaming that banks were being nationalised, which was not quite the case.[101] However, the upset was to last for nearly ten years. In America, The US Financial Crisis Inquiry Commission of 2011 found that the crisis was avoidable: there had been widespread failures in financial regulation; corporate governance had failed with firms behaving recklessly and taking on too much risk; key policy makers did not fully understand the situation; and there had been "systemic breaches in accountability and ethics at all levels", suggesting that many employees had not functioned as they should.[102]

A Post-Mortem On The Global Financial Crisis

So have all the troubles of the last ten years been caused by misbehaviour, and corruption? Not entirely, though negligence, poor oversight and mismanagement should be included in the mix.[103] The banking crisis may be attributed to poor control over fiscal policy, an easing of monetary policy in emerging markets and the growth of foreign exchange reserves and lax lending standards arising from benign trading conditions.

Poor oversight of the financial sector also played a part but new financial institutions and instruments were emerging that were not fully understood, and banks felt the need to compete. The notorious housing crisis in America and the sub-prime mortgage also played their part, as indeed did mortgage lending in the UK based on minimal deposits.

Globalisation has reached a point where countries have responsibilities going beyond their own borders. Goods and services, ranging from finance and the

[101] http://www.telegraph.co.uk/finance/financialcrisis/3187946/Financial-crisis-Banks-nationalised-by-Government.html
[102] https://en.wikipedia.org/wiki/Financial_crisis_of_2007–2008 And see Appendix 2.
[103] For a perceptive lecture on the subject (not long after the crisis broke) see https://piie.com/commentary/speeches-papers/global-financial-crisis-lessons-learned-and-challenges-developing by Edwin M Truman of the Peterson Institute for International Economics.

movement of labour to tourism have made economies more inter-dependent with each other. Ultimately, both government and business should have contingency plans looking forward, in much the same way that they all have emergency procedures in place for everything from an outbreak of fire to a terrorist attack. Bull markets in the last twenty to thirty years have been long and sustained, but interrupted by periodic crises. In order to benefit from the one, preparations need to be in place to deal with the other.

Leading figures from the global finance world and G20 jurisdictions at Davos in 2018 declared that there are various fracture points to watch. The financial system is stretched because of quantitative easing; there are new factors to consider like peer-to-peer lending; cryptocurrencies are worrying; and debt builds up in China. Pessimists say that the banking sector would find it hard to cope with another Lehman-style crisis.[104]

[104] The Daily Telegraph 23.1.18. Also City AM 24.1.18.

5. Bubbles, Booms And Busts

Bubbles, Booms And Busts Are Unexpected Periodic Events

The financial world is shaken at intervals by scandals or revelations involving activities which, although not strictly speaking illegal, provoke a level of moral indignation in particular from people who do not own large assets, or find themselves in a situation where they need to engage in complex tax planning to protect what they have. In addition, serious disquiet is being expressed in the newspapers about practices which seem to be out of line with the expectations of workers in ordinary jobs. Although such practices may not be against the law specifically, they do provoke a cynical response from some, and righteous indignation in others. A series of errors or miscalculations, based perhaps on misinformation or reading the market wrongly are by no means a rare event, Nor indeed is the damage always caused by unethical or illegal actions. In that respect history is probably doomed to repeat itself, which is ironic as danger signals are often there in plain view.[105]

Bubbles Or Waves?

Rather than bubbles we should perhaps be thinking in terms of ocean waves and tides.[106] Pressure begins to build because of a number of key economic factors: a war, that increases the price of strategic materials such as copper, thereby creating a boom for key exporting countries and on the major exchanges; or quite possibly the end of a war, which means opportunities for re-building or re-investing the sums expended on the waste of war. It could be new technology (iron, coal and steam in the Industrial Revolution, the cutting of canals or building of railways); or there could be markets for new commodities (trade with the Far East or the profits arising from the Black Triangle with cotton and sugar).[107] The best opportunities come for those who

[105] Kindleberger & Aliber 2011 chapter 8 “International Contagion 1613 – 1930”.

[106] For a useful chapter on booms, busts, bubbles and frauds, see Buckley 2011 Chapter 9 charts 9.1 to 9.3.

[107] This refers to the trade between England, West Africa and the Caribbean. Manufactured goods were traded for slaves, who were then sold in the Caribbean to produce valuable cash crops such as sugar and tobacco, and to provide the cotton mills which in turn contributed to the industrial goods being sold, hence a triangle.
See http://www.liverpoolmuseums.org.uk/ism/slavery/triangle.aspx

get in first – by the time the matter is public news the real profits have probably gone.

The Poseidon Bubble

The Poseidon Bubble is a key example.[108] In the late 1960s nickel was at a premium because of the Vietnam War. Poseidon was a little-known Australian mining company whose shares were trading at 80 Australian cents. Then the news broke that a large nickel deposit had been found and the market went mad within weeks. The top price was 350 Australian dollars, and the mania had lifted expectations for a whole range of other mining companies in Western Australia who might, or might not, strike rich. Mining in general is a slow-moving business, mineral prices tend to fluctuate according to demand, and the deposits were not as rich as hoped, so confidence was lost almost overnight and the shares plummeted – and there was a backlash from outraged investors who had clearly forgotten most of the lessons of economic history.[109]

The sudden rise and fall in Poseidon's fortunes acted rather like a tidal wave, driven by what is sometimes referred to as the herd instinct or just mania. Normally rational individuals, often with strong qualifications and professional experience, are driven by what almost becomes a collective madness to get in while the going is good, to maximise returns and to catch the crest of the wave. This could be controlled by cutting off credit or raising interest rates, but this might be hard to achieve politically and the wave can rise and fall before firm action can be taken, but not until damage has been done. The euphoria that turns to mania will soon turn to apprehension and mistrust as cooler logic is applied, and that in turn will lead to a form of revulsion, whereby those who led the rush all too often will turn and run, thereby creating the panic which leads to a crash.

The Dot.Com Boom And Bust

Ironically, the dot.com boom came almost as a reaction to the shares crash of 1987 as the bull market resumed. Investors were dazzled by the speed with

[108] Calverley (2009) chapter 1 "An anatomy of bubbles".
[109] https://www.managementstudyguide.com/poseidon-bubble-in-australian-stock-market.htm

which the Information Super Highway came into effect and the impact that it had on all aspects of both public and private life.[110] Multiple small firms developed as talented individuals worked on new ideas to exploit the new technology to the full, and investors piled in, hoping to be on the ground floor of the next major invention, bearing in mind that great new companies such as Apple and Google had literally started in someone's garage.[111] Clearly there were winners, but equally there were large numbers of losers as the market focused on the key developments, whilst others withered because of a lack of investment, because the idea (to use an image from an earlier gold rush) had not panned out or because it had been overtaken by another innovator. There were also technical issues to be addressed such as the speed of connectivity given the rapid increase in the sheer number of users and other questions such as how to introduce clear speech and images into the system.[112] By 2000 the market had over-reached itself and the NASDAQ stock index fell precipitately. As so often, leading shares collapsed from over-optimistic highs to the harsh reality of catastrophic lows and a lot of people lost money, jobs or illusions.[113] However, as with the railways, the cutting edge of technology soon recovered and the novel developments which continue to change every aspect of daily life to this day began to re-appear. Whether that could have been done without resorting to boom and bust is of course a matter of speculation for economic historians.

Cryptocurrencies – A Suitable Case For Treatment Under Boom And Bust?

Is history doomed to repeat itself with Bitcoin and cryptocurrencies? There is certainly a danger of the biggest bubble in history, as Warren Buffet has observed.[114] The rapid rise in the growth of all cryptocurrencies has been quite remarkable, and concerns about booms and busts in this area have become more widespread, even as opinion has polarised and hardened. The independence from traditional banking systems, government and fiscal control, the reliability of blockchain ledger technology all militate in favour of

[110] It seems strange now, but on-line services were fairly limited until the Super Highway was rolled out, particularly by Al Gore during the Clinton Administration. For a copy of Al Gore's launch speech in 1994 see: https://www.uibk.ac.at/voeb/texte/vor9401.html
[111] https://www.inc.com/drew-hendricks/6-25-billion-companies-that-started-in-a-garage.html
[112] For a technical discussion on the challenges being faced, go to http://www2.lbl.gov/Science-Articles/Archive/information-superhighway.html
[113] http://www.thebubblebubble.com/dot-com-bubble/
[114] http://www.telegraph.co.uk/business/2018/01/11/warren-buffett-predicts-bad-ending-bitcoin/

cryptocurrencies. As against that, the very fact that some governments are coming out against trading in cryptocurrencies[115] suggests that those in favour of traditional methods of dealing in finance (or who will benefit from it) will fight back, pointing out that unless cryptocurrencies somehow become embedded in the mainstream then they are unlikely to have much intrinsic value, and will remain out on some electronic equivalent of the wild frontier. It is pointed out that banks can be regulated, fined or sued for misdemeanours. Bitcoin itself can still only manage up to seven transactions a second as against a maximum of 56000 per second for Visa.[116] The amount of electricity to mine for Bitcoin exceeds the individual consumption of 159 countries worldwide (or three million American homes).[117] Fortunes have been made and history suggests that fortunes will be lost, not by those who get in at the right time and choose the right moment to take their winnings so much as those who misjudge the timing, or who find that unexpected events lead to a sudden downturn, or who have gone into dangerous terrain with futures contracts, margin trading, hedging and derivatives.[118]

Don't Blame The Technology For The Product Or Service?

A distinction is to be made between the uncertainties of cryptocurrencies and the solid technology behind Smart Ledgers, which are a genuine innovation with the capacity to make the processing of money easier, quicker, cheaper and safer.[119] However, there are aspects of cryptocurrencies that have already attracted the criminal elements.[120] Anonymity, the lack of oversight and regulation, the lack of a national location all make them an attractive vehicle (if still potentially hazardous), but then credit cards and cash machines have never been safe, and there are serious concerns about the security of open banking.[121] Crooks can carry out so-called push payment scams, whereby they persuade account holders to make payments into bogus accounts by pretending to be from the bank, and offering bogus bona fides, based on

[115] South Korea has announced the introduction of more stringent regulations. The Times 29.12.17
[116] Daily Telegraph 19.12.17.
[117] Daily Telegraph 17.12.17
[118] Daily Telegraph 12.12.17
[119] That said, people are going to incredible lengths to keep their bitcoin passwords safe. The Times 15.12.17
[120] It has been reported that one tenth of ICOs (initial coin offerings) are lost or stolen in hacker attacks. And the Capital One credit card will not allow users to buy bitcoin because of the associated risks. Both in City AM 23.1.18.
[121] https://www.scribd.com/doc/298568600/Introducing-the-Open-Banking-Standard

personal data that has been collected illegally.[122] Cryptocurrencies have already attracted the gambling industry through sites that will accept bitcoin. There is a clear link between the use of cryptocurrencies and darknet marketplaces such as AlphaBay (and previously Silk Road[123]), where "mixers" can swap bitcoins anonymously for ones with a different transaction history, which is effectively a form of laundering. "Conversion services" are platforms where users can convert bitcoins into fiat currency, another cryptocurrency or even move them to another bitcoin address available to the user.[124] Criminals have also made use of cryptocurrency for direct (rather than electronic) blackmail. A hitman was hired in Denmark for a contract killing in December 2017 and was paid in bitcoin.[125] Terrorists have seen the advantages too – a woman in New York was recently convicted of trying to send Bitcoins[126] to ISIS. Biggest of all, however, was the WannaCry attack in May 2017 which nearly crippled the NHS and surfaced in one hundred and fifty countries. The attackers demanded to be paid in cryptocurrencies, though it is thought that in reality the payoff was limited.[127] This illustrates the evolutionary element in all new areas – a problem arises and a solution (hopefully) will be found.[128] However, it is a constant process.[129]

"Cash Is King" In A Financial Crisis

A key factor to consider when tracing all these booms and busts is the availability of cash (following on from the cases cited above) or the willingness of banks in particular to make easy credit available to those investors who are anxious to take advantage of any perceived opportunity as quickly as possible.

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[122] https://www.ukfinance.org.uk/authorised-transfer-scams-data-h12017/

[123] Silk Road was shut down in 2013 and AlphaBay was closed in 2017. Others will doubtless replace them. For a follow-up on Silk Road plus details of more scandals involving bitcoin go to https://www.coindesk.com/7-biggest-crypto-scandals-2014/

[124] For a very useful report on bitcoin laundering, produced by Elliptic for the Center on Sanctions and Illicit Finance see http://www.defenddemocracy.org/content/uploads/documents/MEMO_Bitcoin_Laundering.pdf It is dated 12 January 2018, so is very up-to-date. It includes a useful glossary of latest terms.

[125] https://cointelegraph.com/news/woman-in-denmark-imprisoned-for-hiring-hitman-using-bitcoin reports on both the Denmark hit and the New York ISIS case.

[126] Bitcoin with a capital B refers to the specific currency, whilst bitcoin refers to crypto-currencies.

[127] http://www.telegraph.co.uk/news/2017/05/13/nhs-cyber-attack-everything-need-know-biggest-ransomware-offensive/ It has also been suggested that some firms have stockpiled Bitcoin in case they have to pay blackmailers off.

[128] Tech Pro Research offers some practical solutions in the battle against ransomware at http://www.techproresearch.com/downloads/cybersecurity-spotlight-the-ransomware-battle

[129] For more information on some key scams see https://baseberry.com/crypto-scandals-know/

This can be seen with the periodic housing booms of the Post-War. With population movement and demographic growth the demand for housing is constant, but controlled by such factors as the availability and price of land, government policies and permits to build on it, credit for construction companies to take on major projects, and mortgages for people to buy. In the UK especially, housing is seen as a key investment, whether as the family home (and hence a possible nest egg for the next generation), as a buy-to-let property to supplement the pension, or as a solid investment in bricks and mortar. There are strong political forces at work with contradictory claims of affordable housing versus investment properties.[130] London has been seen for a long time as a good place to invest in property from abroad, hence the massive growth of high-rise blocks of apartments South of the River in the old Battersea Power Station site and the new Embassy quarter. Many of these properties are being sold off-plan to investors from Eastern Europe and the Far East in particular as a means of diverting surplus funds to what is regarded as a safe place for investment. Critics point out the impact that the drawing-in of foreign capital has had on house prices, building policy and population density, although concern has also been expressed that as investment properties many of these new blocks will remain empty for much of the year.

The Financial Risks Of Cash Markets

However, risks are beginning to emerge:[131] it is possible that the market is being flooded; in the longer term it may prove easier to buy than to sell, which could destabilise the housing market across a broader spectrum; and the management and running costs of largely empty high-rise blocks may prove to be costly, and hence reduce their attractiveness as vehicles for investment.[132] There is a further worry that built-up areas with low rates of occupancy will finish up like Spanish holiday towns which are largely vacant out of season, meaning that the local infrastructure, ranging from public transport routes to supermarkets, will also be closed for much of the year and therefore make the locality less attractive for an all-the-year-round population. And the sight of

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[130] There is increasing local bitterness in the London Borough of Lambeth with regard to development plans for the Elephant and Castle, where high-value properties seem to be replacing council housing.
See https://southwarknotes.wordpress.com/graphics/

[131] Estate agents in central London are reporting a clear downturn in the price of luxury properties:
The Guardian 24.1.18.

[132] Some architects have also commented on the high density of some of the new tower blocks, which will not let in light but will allow neighbours to shake hands with each other…

empty high-rise buildings with no lights on at night will add pressure to the political issues of high property costs and homelessness in Greater London.

Controlling Economic Development During Market Booms

Any major economic development, especially during the furore of a boom, may well lead to unexpected consequences, such as the sub-prime mortgage episode which started in America and caused wider international disruption. Such a boom also runs the risk of being subverted for other purposes. It is widely believed that when Spain converted to the euro from the peseta in 2002, criminal organisations with large amounts of undeclared funds purchased property in pesetas, and subsequently sold it for euros, which could then be deposited quite legally. Current legislation concerning money laundering would make that practice difficult today. However, the suggestion is that even the Mafia poured money into large-scale building projects, thereby fuelling a boom that could not be sustained from the point of view of the buyers, leading to a lot of vacant property and the depression in the housing market which has characterised Spain in recent years.[133] A further issue regarding the Spanish property boom came with extensive and hurried speculative building on land which turned out not to be earmarked for housing. Whether this is because paper records had not been kept, whether speculators have been slapdash or whether corrupt officials have been responsible, the negative experiences of many overseas investors in Spain has highlighted the need to be cautious when dealing in particular with foreign jurisdictions where there may be language barriers, different legal practices and possible disruption in the continuity of maintaining legal records for historical reasons.[134]

Factors Contributing To A Boom

Certain factors can be identified in the development of a boom: apart from the amount of cash sloshing about, there needs to be an element of optimism which leads to a willingness to take a punt in the hope that it will turn out right, as indeed it may for the people who find themselves on the crest of the wave.

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[133] https://en.wikipedia.org/wiki/Spanish_peseta section 8. It may be noted that the peseta as a coinage has survived in the former Spanish colony of the Sahrawi Arab Democratic Republic. (See the same entry.)
[134] For the cautious investor, see https://www.eyeonspain.com/spain-magazine/problems-buying-spanish-property.aspx

Others then get sucked in as the tide begins to flow and increased economic activity will build up demand and perhaps increase employment and average wages. Of course, in the process the economy may overheat and inflation might start to rise. [135] Some investors might see the way the tide is running and hope to take further advantage of conditions before pulling out. If there is a stock market correction when they do so then concern will turn into a run which will then create a panic, which could well provoke a crash or at least a loss of business confidence which in turn will lead into a recession.[136]

Booms And Busts Have A Long And Disreputable History

Boom and bust cycles have a long and disreputable history. The Nineteenth-Century banker Lord Overstone [137] saw it quite clearly: "quiescence, improvement, confidence, prosperity, excitement, overtrading, convulsion, pressure, then stagnation", ending in quiescence again.[138]

Governments have tended to hesitate about intervening and, in a global context, individual governments are perhaps less able to do so than they might have been before. Apart from any considerations regarding liability and massive calls on public funding, there is often political opposition to the idea of bailing out the bankers.[139] However, in major cases such as Lehman Brothers or (dare one say) Carillion, major losses can actually lead to an adjustment in the market. Questions being asked now (and almost certainly they have been asked in similar situations in the past) will revolve around how nobody from Government, directors, banks, partners or creditors apparently saw the danger signals. Lord Overstone might have added complacency to his list of economic phases.

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[135] See https://www.thebalance.com/boom-and-bust-cycle-causes-and-history-3305803 for an interesting chart of boom and bust cycles. They occur with monotonous regularity and seem to be a regular feature of economic activity.

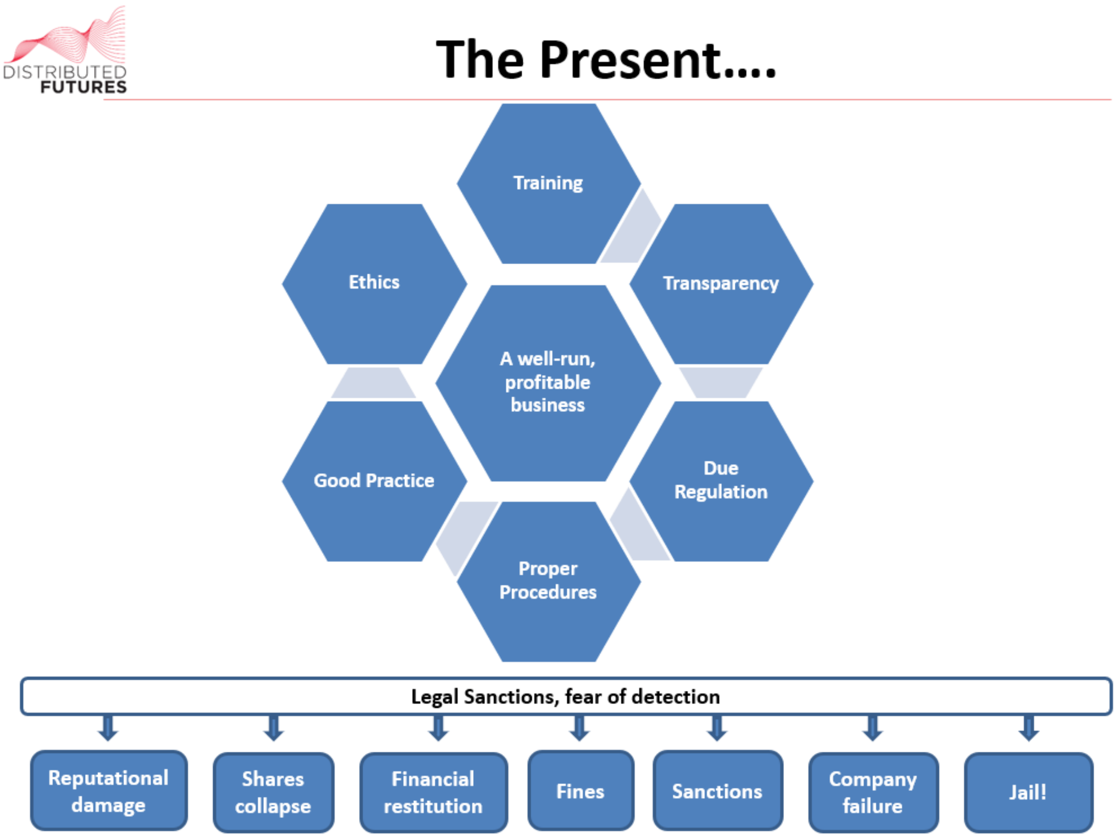
[136] Calverley (2000) has an interesting chart showing all the factors that can give rise to a bubble. See Chapter 1 chart 1.1 which contains seventeen possible symptoms.

[137] Baron Overstone is a key figure in the history of monetary policy. He is known for the Bank Charter Act of 1844 which led to the Bank of England having the exclusive right to issue banknotes. He was however opposed to limited liability and decimal currency. See https://en.wikipedia.org/wiki/Samuel_Jones-Loyd,_1st_Baron_Overstone

[138] Quoted in Kindleberger and Aliber (2011) Chapter 8.

[139] The ongoing example at the moment is Carillion, which press reports are suggesting could cost the Government millions. The Government might bravely assert that it will not save a commercial company, but then Carillion held over 450 government contracts at the time of the crash. See The Times 16.1.18.

6. The Good Guys: Scandals And How To Avoid Them



Good Practice

In a way it is encouraging to see that good governance and best practice have been a concern in public life for many years: much of it goes back to the Cadbury Report of 1992, which made a number of key recommendations in light of the recent crop of company scandals and failures, Robert Maxwell, Polly Peck and BCCI in particular. [140] Cadbury made some strong recommendations with regard to proper corporate governance, senior management structures, non-executive directors, and the make-up of remuneration committees. Cadbury was followed in regular succession over the next ten years by reports which looked at various modifications. Much of this is embedded now in the UK Corporate Governance Code, which is

[140] https://en.wikipedia.org/wiki/Cadbury_Report See http://www.ecgi.org/codes/documents/cadbury.pdf for a copy of the original report. It is quite odd to see how basic the presentation and layout are by modern standards, with the old-style Courier typeface.

principles-based and designed to encourage good practice.[141] It has kept the Cadbury idea of comply or explain, although the latest proposal is to require companies to have elected staff representatives on company boards. Cadbury's suggestions regarding openness have now morphed into transparency, a word so widely used that it has lost most of its impact and much of its meaning. But far more information is published nowadays in annual reports and the kinds of analysis widely found on-line, and more data is collected about clients than may have been the case before. Customer Due Diligence is designed to protect itself in case a new customer might expose it to risks such as money laundering or terrorist financing.[142] That extends into compliance with the EU's Fourth Money Laundering Directive.[143]

Professional Ethics

Ethical issues can be raised with the Institute of Business Ethics.[144] It arranges training days and provides a useful range of short videos. It can arrange briefings, offers a useful range of publications, and carries out surveys (one of which is due in 2018.) There is an international element with country papers and surveys of corporate practice in other countries as well as the UK. The Bribery Act (which came into force in 2011) is an example of an area where it is actually recognised that the "bribee" can find themselves in difficult situations, as they may be unaware of a corrupt purpose; hospitality on a reasonable scale may be hard to define, as may the giving or taking of gifts – particularly in countries where gift-giving is part of the national culture.[145] However, despite misgivings from many sides, a survey in 2015 indicated that the impact on business had not been as fierce as predicted. And the introduction of American-style Deferred Prosecution Agreements allows for some flexibility in negotiation with financial penalties, compensation payments, and the introduction of compliance programmes as possible solutions.[146]

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141 https://frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code
142 https://www.gov.uk/guidance/money-laundering-regulations-your-responsibilities#customer-due-diligence-requirements In fact CDD has become something of a career path. See https://www.int-comp.org/careers/a-career-in-aml/what-is-cdd/ on the International Compliance Association website.
143 http://www.acams.org/aml-resources/eu-fourth-aml-directive/ What will happen post-Brexit remains to be seen.
144 http://www.ibe.org.uk/
145 http://www.legislation.gov.uk/ukpga/2010/23/introduction
146 https://www.ashurst.com/en/news-and-insights/legal-updates/bribery-and-corruption-what-now-for-2016-january-2016/

The Cadbury Report seems to be the starting point of much current thinking on matters of ethics and proper behaviour in business as it is quoted so frequently. It is perhaps no coincidence that Sir Adrian Cadbury was a Quaker, and Cadburys was one of the last of the great Quaker companies that had been so high profile in different areas of business: Terry's, Fry's and Rowntree, Sampson Lloyd, James Barclay, Huntley and Palmer, Bryant and May, and Clark's Shoes all attest to the impact that the Quakers had on business, partly because as non-conformists they were banned from public service, and partly because their opposition to war precluded any service in the army or navy.[147] In a lecture given in 2003 at St Mary's Temple Balsall Church (which is near Solihull) Sir Adrian outlined the Quaker principles that allowed them to flourish in business: they inspired trust as they were deemed to be honest; they saw life as a whole; they respected the worth of every individual; decisions were made by agreement; and they were encouraged to look for a better way forward rather than to accept the world as they found it.[148] (The Quaker and Business Group have stated it even more simply: do the right thing; live your values at work; take the middle way between charity and business.[149])

Training

A wide range of professional bodies exist to support staff in their own particular areas. There is a number of accountancy bodies, and qualifications are available at all levels.[150] The reports referred to above stress the need for proper procedures with regard to both accounts and audit. In far too many cases, disaster could have been avoided if more attention had been paid to both of these. Tyco was an American company set up in 1960, focusing on fields such as materials science and energy conservation. It became a successful major company through a process of mergers and acquisitions, only to run into serious trouble in the early 2000s because of the non-disclosure of financial information, artificially inflating its earnings and, finally, dishonesty on

[147] https://en.wikipedia.org/wiki/Quakers There is also an interesting lecture given by Professor James Walvin at Gresham College, on the Quakers, to be found at www.gresham.ac.uk/lectures-and-events/quakers-business-and-morality

[148] http://www.leveson.org.uk/stmarys/resources/cadbury0503.htm The lecture was given under the auspices of the Foundation of Lady Katherine Leveson, who died in 1674. The website contains more details.

[149] https://qandb.org/about-us

[150] http://www.accountantswithin.co.uk/organisations/default.asp City and Guilds offers examinations in business skills and IT.

the part of senior financial staff. The company survived by re-organisation, adopting new principles of governance, and introducing tighter controls on the handling of cash. A guide to ethical conduct was drawn up and now forms part of core staff training.[151] Parmalat is a leading world brand in dairy products, but became known as Europe's Enron because of the 14 billion euro hole that appeared in its accounts in 2003. The court case revealed that documents had been shredded, even computers had been smashed, and other accusations ranged from money laundering to forgery.[152]

Training opportunities are now extensive and there is a whole plethora of institutes and associations offering training across the financial spectrum. One which has been particularly successful is the Chartered Institute for Securities and Investment (CISI).[153] It was formed in 1992 by Stock Exchange members, so closely linked to its target group and is driven today by 750 volunteer practitioners. Today it has 45000 members in 104 countries, and although English is in many ways the preferred language, papers are also set in Arabic, Greek and Spanish. There is an interesting link with Barcelona and the Caixa, one of the few survivors of the *cajas de ahorros,* the popular savings banks that came to grief in the 1980s.[154] There are also links with other Spanish-speaking countries, India and a number of key markets in Africa such as Nigeria. CISI qualifications are being recognised across an increasing number of jurisdictions. Modules on offer are extremely up-to-date and include such current topics as economic crime, cyber security and Islamic finance and it has recently published guidelines on MiFID II to ensure that firms are compliant.[155] MiFID comes under the aegis of ESMA, the European Securities and Markets Authority, so a key question to raise is what regulation will be needed post-

[151] https://en.wikipedia.org/wiki/Tyco_International It is interesting to see the range of legislation that was used against the Company over the years: the Securities Exchange Act, the Racketeer Influenced and Corrupt Organization Act, and the Foreign Corrupt Practices Act, which Tyco fell foul of in 2012.

[152] The company survived and was taken over by the French group Lactalis in 2011 and now operates at world level.
https://en.wikipedia.org/wiki/Parmalat https://www.worldfinance.com/markets/the-parmalat-scandal

[153] https://www.cisi.org/cisiweb2/cisi-website/about-us The CISI offers interesting guidance on ethical conundrums and how to deal with them through a series of practical guides to trust and integrity dilemmas. For further examples see Place (2017).

[154] See https://en.wikipedia.org/wiki/Savings_bank_(Spain). The *cajas* became so notorious that foreign bankers referred to them as the "cages of horrors".

[155] https://www.cisi.org/cisiweb2/cisi-website/misc-pages/esma-mifid-ii

Brexit and to what extent international regulations or guidelines will have to be either recognised or followed.[156]

MiFID II itself is the latest attempt to provide a structure that aims to protect investors and promote stable and orderly financial markets.[157] Workers will need to hold appropriate qualifications, carry out programmes of continuous professional development, and "demonstrate adherence to standards of business ethics". ESMA itself is responsible to the European Parliament, so it may be assumed that other arrangements will have to be made in due course for the UK.[158]

Transparency

A useful source on governance is the Governance web page which provides a useful range of links.[159] Its international information list showing systems of governance runs from Algeria to Yemen and it also provides access to a number of UK-specific reports going back to Cadbury. Under Governance Good Practice can be found:

- The Institute of Directors' Good Governance Report 2016
- Common Sense Principles of Corporate Investment (US 2016) which includes a useful section on remuneration within its 9 pages
- The Charity Governance Review 2016 (which contains an interesting chart); plus Governance in 2016 – Coming down the Track
- The Institute of Business Ethics Survey on Business Ethics 2015
- Principles for Good Governance and Ethical Practice – a Guide for Charities and Foundations, which comes with 33 principles listed (including Code of Ethics, Whistleblower policy, Board Compensation, Reimbursements, Gift Acceptance Policies; and Lessons from Successful British Companies)

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156 https://www.esma.europa.eu/about-esma/who-we-are
157 https://www.cisi.org/cisiweb2/cisi-website/misc-pages/esma-mifid-ii
158 What needs to be covered is demonstrated very clearly by the CISI guidelines on the matter: https://www.cisi.org/cisiweb2/docs/default-source/default-document-library/esma-mifid-web.pdf?sfvrsn=2
159 https://www.governance.co.uk/

Due Regulation

Ample guidelines and regulations do already exist. (Some might argue that there are in fact too many, which makes compliance increasingly difficult.) At international level there is the ISO, the International Organisation for Standardisation.[160] Based in Geneva, it was set up in 1947 and works in 162 countries. Its work involves setting recognised international standards as a yardstick for industries ranging from agriculture to technology. Financial Intelligence Units have been set up across Europe by Europol following early initiatives by Britain, France, Italy, Holland and Luxembourg as the free trade, movement of people and goods and increased prosperity have attracted criminals and terrorists, and funds for both crime and terrorism have become an issue.[161] The UK end of the FIU is handled through the National Crime Agency which will presumably have a continued role to play in future.[162]

The Financial Action Task Force on Money Laundering is another international initiative which was set up by the G7 in 1989, and is headquartered at the OECD in Paris.[163] The key policies are based on the Forty Recommendations plus the Nine Special Recommendations on Terrorist Financing. These have been updated periodically and are indicative of the amount of work that has been done to improve the way in which funds are handled at international level in order to prevent their misuse or misapplication. It also maintains a blacklist which indicates those countries which have not implemented agreed standards or which are considered to be a high risk to the international order. It is encouraging to see how many jurisdictions appear in the list of countries which have "substantially implemented the standard".[164]

Proper Procedures

Global and Regional Trends for 2016 predicts that "there will be a demand for more tools to promote accountability and transparency from companies and their boards". Ultimately, the report says, scandals create the momentum for

160 https://www.iso.org/home.html
161 https://www.europol.europa.eu/about-europol/financial-intelligence-units-fiu-net
162 https://www.europol.europa.eu/about-europol/financial-intelligence-units-fiunet/eu-fius-points-of-contact
163 http://www.fatf-gafi.org/about/
164 https://en.wikipedia.org/wiki/FATF_blacklist#February_2016_statement

change in companies - so something positive might come out of them, though it always seems to be only a matter of time before something else blows up.[165]

It may be that greater transparency or oversight might have helped in that case, something that is promoted by the Financial Reporting Council.[166] It regulates auditors, accountants and actuaries, and also sets up the UK's Corporate Governance and Stewardship Codes. It has taken up the mantle quite clearly from Cadbury and covers five main principles: leadership, effectiveness, accountability, advice on remuneration and relationships with shareholders.

Fraud And Whistleblowers

For advice on fraud, the Fraud Advisory Panel offers useful advice, produces reports and runs seminars. Its website also includes an inter-active fraud map.[167] Its Business Behaving Badly report on fraud, corporate culture and ethics is a very thorough exposé of fraud and other examples of mismanagement worldwide and also contains useful advice on protection against cybercrime.[168] It contains a sensitive discussion on ethics and why seemingly nice people do wrong things, possibly as a result of stress, undue pressure or the wrong corporate culture. Worryingly, the Fraud Advisory Panel also reports on whistleblowers who, strictly speaking, are covered in the UK by the Public Interest Disclosure Act 1998[169] and in America by Sarbanes-Oxley and Frank-Dodd as previously mentioned. The UK Government offers practical advice to people who feel that they have been unfairly treated after reporting some aspect of wrongdoing.[170] The reasons for reporting an issue are quite clear cut, and people are discouraged from doing so anonymously: in the case of a criminal offence (such as fraud); health and safety issues; environmental harm; a miscarriage of justice; if the company is breaking the law; if it is believed that someone is covering something up. The reality on the ground

[165] Citibank has recently reported heavy losses largely as a result of "an episodic loss in derivatives of approximately $130 million, related to a single client event." The Times 17.1.18
[166] http://frc.org.uk/
[167] https://www.fraudadvisorypanel.org/ It is encouraging to see on the world fraud map that Britain is in 10th place out of 168 countries in the Corruption Perception Index of 2015.
[168] https://www.fraudadvisorypanel.org/wp-content/uploads/2017/06/Businesses-Behaving-Badly-July-2017.pdf
[169] http://www.legislation.gov.uk/ukpga/1998/23/contents
[170] https://www.gov.uk/whistleblowing/treated-unfairly-after-whistleblowing

may be different though there have been cases where an employer who has gone after a whistleblower has got into trouble themselves. Surveys suggest that people feel constrained or concerned that they will suffer from reprisals if they take action. Conscientious employers will need to be aware of the law, especially as it is updated from time to time, so that there is now a public interest criterion and there are specific requirements for revelations of a financial nature.[171] Wendy Addison, of Speak Out Speak Up (who herself had harsh experience as a whistleblower) advises companies to have pathways open so that situations do not get past a point where staff do not need to speak out or have recourse to law.[172]

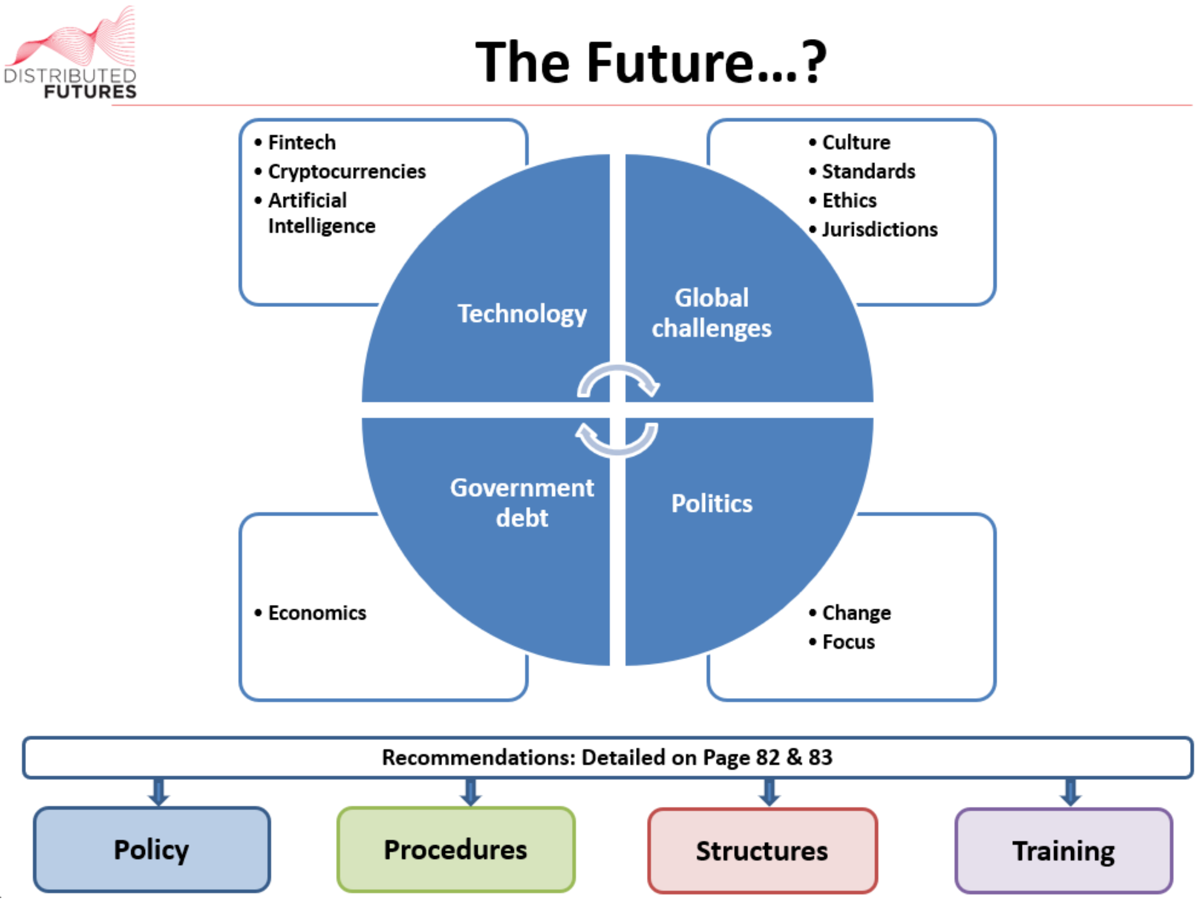
In a letter to the Daily Telegraph at the time of the controversial takeover of Cadbury's by Kraft, Sir Adrian Cadbury said:

"A bidder can buy a business. What they cannot acquire is legitimacy over the character, values, experience and traditions on which that business was founded and flourished." [173]

That seems to sum it all up nicely.

[171] https://www.personneltoday.com/hr/whistleblowing-five-steps-compliant-recent-changes-legislation/
For details of the changes in 2016 to financial cases see http://www.tltsolicitors.com/insights-and-events/insight/2016-brings-new-whistleblowing-rules-for-financial-institutions/
[172] On the Fraud Advisory Panel website.
For Speak Up Speak Out see http://www.speakout-speakup.org/
[173] https://www.theguardian.com/business/2015/sep/06/sir-adrian-cadbury

7. The Future Direction And Dynamics Of Financial Scandals



Technology

Fintech - A New Dynamic for Future Scandals

Perhaps the fastest-moving area for the whole of commerce, let alone just finance, is what is termed FinTech. Fintech is used to refer to any technological innovation applied to servicing and delivering the full range of financial products and services ranging from retail banking to cryptocurrencies. It is certainly moving at bewildering speed, as demonstrated by the EY FinTech Adoption Index, which was first launched in 2015.[174] It suggests that the

[174] http://www.ey.com/Publication/vwLUAssets/ey-fintech-adoption-index-2017/$FILE/ey-fintech-adoption-index-2017.pdf

FinTech firms have reached critical mass and are having an expanding role to play across an increasing range of sectors. Not only is this a fertile area for start-ups, but established firms are also beginning to scale up in order to compete. FinTech derived and supported products seem to be particularly attractive to the 15 to 24 age range, who do not have established links with banks and other providers. They are computer literate and have grown up with the expectation that they can find anything on-line. Advantages for them are access and speed for things such as money transfers, borrowing and saving, plus other services such as investments and insurance. Increasingly they are finding work in this sector as it is burgeoning, with start-ups focused in particular on America and Asia.

The Global Financial And Investment Dynamics of FinTech

Funds are beginning to flow in for investment - Berlin is actually ahead of London for InfoTech: 421 million dollars to 375 million dollars between January and September 2016.[175] Take-up is also happening worldwide, with emerging markets showing a great deal of interest, not only in China as might be expected, but also in Brazil, India, Mexico and South Africa.[176] Universities including Oxford, Wharton and MIT are offering appropriate courses already and other institutions such as Cambridge Life Sciences are following suit, not to mention Silicon Valley.[177] There is ample scope here for joint research, development and delivery for both sectors, especially if ethical issues and matters of security are embedded across them.

Apart from in-house funding by established companies, FinTech is an area for heavy, if still speculative, investment. CB Insights see this area, and Artificial Intelligence as a whole, as major areas for development.[178] Such areas include open banking, smart contracts and robo-advisors which use algorithms to streamline investment advice. Algorithms also exist to build up an image of a client's interests and tastes (via "predictive behavioural analytics"), which will be of benefit to sales and marketing.[179] This does of course highlight the issue that anyone who is going on-line will expose themselves to a vast array of

[175] See https://africa.mishcon.com/the-fintech-revolution/
[176] http://www.ey.com/Publication/vwLUAssets/ey-fintech-adoption-index-2017/$FILE/ey-fintech-adoption-index-2017.pdf
[177] See Mishcon de Reya above.
[178] https://www.cbinsights.com/
[179] https://www.investopedia.com/terms/f/fintech.asp

watchers, and increasing amounts of data are being stored about us as individuals, not to mention the spectacular thefts of personal data that have taken place over the years. The credit ratings agency Equifax, for example, announced in 2017 that private details for more than one hundred million peopled had been leaked – and that was by no means the only recent example.[180] News items make it clear that a lot of cyber attacks are quite deliberate and of high quality, indicating that they are not normally carried out by some computer geek in his bedroom though there are exceptions to this rule too. Only in December 2017 a Russian cyber gang devised a way of infiltrating the IT systems of US and Russian banks and then using "mules" (confederates) to take money out of cash machines. Doubtless a patch has already been devised to block further attacks.[181]

Challenges Of Monitoring The Velocity Of Changes From Fintech

It is difficult to keep up with changes, and most individuals have to rely on the skill of whichever company is providing their anti-virus software. Penetration testers are being used increasingly by companies and the authorities to challenge their own security systems to see where the weaknesses lie. Cambridge-based Darktrace has been very successful in monitoring normality and looking for false positives in order to counteract internal attacks, stealth attacks and zero-days.[182] It is disheartening to see, even so, how many people do not keep up with things, and who either rely on the same password or who do not change it very often.[183] There are those who still open an attachment in good faith, or who fall for the latest scam that either tells you that you have just inherited a fortune in some far-off country or that HMRC owes you money.[184] However, an increasing number of internet-enabled devices that allow remote access to your home (such as apps that will let you adjust the central heating) may also just provide a point of entry for the hackers, who are becoming ever more ingenious in different ways. People may find that not only has their personal information been hacked, but data may even be altered

[180] Michael Mainelli in the Harvard Business Review 5.10.17 https://hbr.org/2017/10/smart-ledgers-can-help-us-reclaim-control-of-our-personal-data
[181] Daily Telegraph 12.12.17
[182] https://www.darktrace.com/
For zero-days see https://en.wikipedia.org/wiki/Zero-day_(computing)
[183] Daily Telegraph 30.12.17
[184] https://www.mirror.co.uk/money/clever-hmrc-scam-email-thats-9611469

in a process known as "doxing".[185] And an attack in February 2017 targeted networked printers – and got in to 160,000 organisations worldwide.[186]

Calibrating Timing And Scale Of Fintech Investment

As with any new development (bearing in mind the history of the railways for example) there will be winners and losers. Some investors will be too fast off the mark, and invest before particular technical innovations are fully proven (think mobile phone technology) and there will probably be scope for fraud. Origination costs might be too high to recoup before the returns are there on a regular basis. Backers and the general public might get cold feet if there is a negative incident – some major breakthrough which is proved not to be workable, a financial scandal or a major hack of some sort. The whole concept of FinTech moves markets on from tried and trusted technologies and procedures into the unknown, which may prove less attractive to older and less tech-savvy clients and investors. There will probably be a legacy issue of major IT systems which prove not to be compatible in some way, or firms might feel that it is better to wait till systems are going to be upgraded before taking a leap into something which is as yet unproven and unknown. Such firms may also feel challenged by newer, younger and more aggressive newcomers, so there may be an element of uncertainty or instability during a period of takeover and merger (visions of VHS and Betamax, or mainframes and laptops again). A steep learning curve has already started for managers, forward planners and those responsible for the maintenance of systems and procurement as it is difficult to assess the relative effectiveness of rival systems and there may be a broader compatibility issue across the sector as a whole (think Macintosh and Microsoft).[187]

Legislation To Address The Uses And Abuses Of Fintech

At an institutional level, forthcoming legislation is likely to tighten up procedures. The General Data Protection Regulation (GDPR) will be backed up

[185] Doxing: altering someone's on-line details on their home page for example.
See https://www.gohacking.com/what-is-doxing-and-how-it-is-done/ for a most illuminating piece on what it is, how it is done – and how to protect yourself from it.
[186] https://www.theregister.co.uk/2017/02/06/hacker_160000_printers/
[187] See Mishcon de Reya note 173

with the threat of heavy fines for non-compliance.[188] Data breaches will have to be reported within seventy-two hours, and companies which handle large amounts of data (and the public sector) will need to appoint a data protection officer. A whole range of items from dealing with minors to explaining the policy on privacy to clients will have to be covered.[189] Open Banking, which is being launched through the revised Payment Service Directive (PSD2) is another regulation for banks to contend with and which might confuse the customer. Sharing login details and passwords with anyone is unwise in the extreme without an API (application program interface) in position, and the technical standards for those will not be in place until September 2019. Techniques such as screen scraping, whereby logins and passwords are captured by a third-party and then used to imitate the user will also be banned then. [190] In the meantime, constant vigilance (backed up by solid procedures) is recommended by everyone.[191] The latest developments may, however, come to the rescue. Smartphones can already be activated by fingerprint recognition and biometric technology will undoubtedly come up with more than that – bank cards for example are already being fitted with fingerprint sensors.[192]

Evolution And Artificial Intelligence

Evolution in the hi-tech industries is likely to continue apace, with an asymmetric process through new and possibly disruptive new inventions and processes with legislation and regulation attempting to keep up, whilst the fraudsters will be circling out of sight but never too far away. Might Artificial Intelligence be part of the solution, or simply a new aspect of the current problem? Again, this is an area which is moving very fast and even annual reports can seem out of date within a matter of months let alone a couple of years. Ethical issues spring to mind immediately, with questions as to whether machines can ever be programmed to respond sensitively to human affairs. There is also concern as to whether any single system of ethics can be agreed, as commerce and government do not always coincide in outlook or purpose,

[188] http://gdpr-legislation.co.uk/
[189] https://ico.org.uk/media/1624219/preparing-for-the-gdpr-12-steps.pdf
[190] City AM 15.1.18
[191] See the World Economic Forum report of June 2015 on the subject: http://www3.weforum.org/docs/WEF_The_future__of_financial_services.pdf
[192] City AM 25.1.18.

and moral values may well differ between a party manifesto and the realities of working life.[193]

Human Interaction With Artificial Intelligence

Will humans be empowered, have far greater insight into topics and the means to develop them, or will they become the operators rather than the drivers of the new technology? Government plans for a National Centre for Data Ethics are indicative of the concerns that arise from something which is both fast-moving and yet little understood.[194] AI systems are likely to be developed in such areas as research, sales, trading and compliance, although it must surely be some time before decisions based on the data obtained will be taken by machines rather than mankind. Increased pressure on costs and possibly lower margins may reduce personnel resources, or possibly replace the higher-level decision-taking executives, with the processors, operators and maintenance staff who in all probability will increase, albeit at lower salary levels. At what stage can machines be expected to engage in blue-sky thinking? Hedge funds are already devising algorithms which will come up with investment ideas, and it is possible that they will also be able to calculate best strategies for executing orders for securities. Large sums are being invested in this area in the hope that the idea will become operational before long, not least because it will not be necessary to include machines in the annual bonus calculations.[195]

Security And Fraud Implications of Artificial intelligence

As ever, the question of security and fraud comes to mind. Machines will not know the difference between right and wrong, although they can be programmed not to permit particular actions, to allow limited access to certain areas, to keep out unauthorised persons, or to stave off hostile cyber attacks. The moral element in all probability will have to remain in human hands, which again has positive as well as negative elements. For fraud analysts, the

[193] For a philosophical discussion on the contrasts between different value systems see Jacobs 1993
[194] It is interesting to note that the American philanthropist Bill Miller has donated 75 million dollars to the Philosophy department of Johns Hopkins University as he would like to "change the trajectory". https://www.nytimes.com/2018/01/16/arts/bill-miller-75-million-gift-philosophy-johns-hopkins.html
For a philosophical discussion about money see https://ieet.org/index.php/IEET2/more/danaher20150407
[195] https://www.fnlondon.com/articles/investment-banks-to-choose-artificial-intelligence-over-human-minds-20170308

constant electronic watch on data or price movements may well pick up unusual patterns that are worth investigating, though false declines can cause irritation, for example when someone travels abroad at short notice and tries to use their credit card. Particular sectors tend to suffer from similar cases of fraud. ("Friendly fraud" for instance, is common in the luxury goods segments, whereby people order goods and then claim that they never arrived.)[196] Human observers will build up knowledge and experience and may therefore be more effective than a data collection program showing perhaps the number and type of cases in a given area. Clients may be more receptive to a friendly call or email from a live person rather than a warning pinging up as a text message. Humans are more likely to react more quickly to low-level attacks or spot the emergence of something new – although doubtless an algorithm will emerge in due course to do just that.

Artificial Intelligence Provides Immediate Access To Volumes Of Data

What machines can do far more effectively and rapidly than humans is to retrieve and process far larger amounts of data.[197] Staff involved in research and analysis may be at risk here, but then it could be argued that they would be better employed working on the data rather than getting it all together, particularly in an age of mass information. Automatic investment has been around for a long time, via standing orders, payroll giving and pound cost averaging.

Whether it is wise for investment decisions to be taken automatically and within a matter of seconds (or less) is a moot point. High frequency traders are now acting in milliseconds, but there are still hazards, for instance the Flash Crash of 6th May 2010: it was election day in the UK, there was concern about the Greek debt crisis, when there was a sudden near 1000-point dive in prices. Hundreds of billions of dollars were suddenly wiped off the value of major companies such as Proctor and Gamble and General Electric. The conclusion was that the US mutual fund Waddell and Reed had carried out an automated algorithm trading strategy to sell a large number of contracts known as e-minis,

[196] http://dataconomy.com/2016/05/machine-learning-fraud-artificial-intelligence-isnt-enough/
[197] For an interesting piece on the subject see the New York Times for 28.2.2016: https://www.nytimes.com/2016/02/28/magazine/the-robots-are-coming-for-wall-street.html

although this was later challenged.[198] It was a sudden major change and sparked off selling by high frequency traders among others. The index fell by 9% but returned to a mere 3% down by the end of the day. Even in 2015 trading was halted on the New York Stock Exchange because of a computer problem.[199] Such incidents increasingly will be put down to glitches and it is only to be expected that there will be more with further automation[200].

Transparency Of Business Applications Deriving From Artificial Intelligence

High Frequency Trading or even trading through the so-called Dark Pool has become widespread and is controversial in that neither are transparent, are difficult to oversee and only available through particular channels.[201]
Whole new technologies (let alone processes) are likely to emerge in coming years, as will (hopefully) the security systems to go with them. Even then, the risks arising from the development of private code will lead to private advantage and quite possibly abuse. In the medium term restrictions and oversight will need to be applied through legislation or regulation of code development. In practice this may prove to be complex and subject to individual legal challenges.

Staff manipulating six screens at a time will be a feature of the trading floor for a long while to come, although they may eventually go the way of the trading pits, and open outcry is largely a thing of the past.[202] Robots stealing jobs is a story that has been around for a long time. Certainly there are sectors which will be hit by automation. Antony Jenkins, former head of Barclays, referred to

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[198] This is not accepted by everyone. See https://www.theguardian.com/business/2014/jun/07/inside-murky-world-high-frequency-trading for a highly critical but carefully argued article on the dangers of HF trading.
[199] http://www.bbc.co.uk/news/business-34264380
[200] There was also the Hash Crash of 2013, when an untrue report on news media spooked the market: http://www.wallstreetandtech.com/trading-technology/after-the-hash-crash-worrying-about-the-next-glitch/a/d-id/1268082
[201] For HTF see https://www.investopedia.com/articles/investing/040414/high-frequency-trading-fancy-term-cheating.asp and for the Dark Pool see: https://www.investopedia.com/articles/markets/050614/introduction-dark-pools.asp
Michael Lewis's *Flash Boys* provides interesting insights into HTF. He is also the author of *Liar's Poker* (based on his time as a bond trader at Salomon Brothers).
[202] The Chicago Mercantile Exchange closed most of its remaining trading pits in 2015. http://www.bbc.co.uk/news/business-34264380
The London Metal Exchange still continues to trade by open outcry. https://www.lme.com/en-GB/About also contains a video of the trading ring in full cry.

this as an Uber moment [203] and it is true that the number of bank branches is reducing across the sector, and the number of staff in face-to-face positions is being cut back. But banking has evolved beyond measure since the first ATM machines were introduced and doubtless there will be further changes as new technologies emerge.[204] Jobs will evolve as circumstances change, in much the same way that shunters and wheeltappers are no longer needed on the railways - but railway police will always have to be on duty.

Global Challenges

Global challenges result from both the development and expansion of specialist and global financial centres throughout the world and from development of very powerful newer forms of institution in other continents such as Sovereign Wealth Funds and Family Offices. They may take a different cultural and unfettered approach to execution serving and relationship management. The differences will be based on the *mores* of the jurisdictions, where they are domiciled and operate. There has to be some form of cultural compromise or understanding if they are to do business based on respect for each others' values to mitigate or avoid financial scandals

Culture

The financial services sector faces a dichotomy. The sector, like many, is exploring ways in which to improve the diversity of its ranks, particularly in leadership positions. Key areas of concern for candidates are the being in place of diversity and inclusion policies, while for employers, finding ways to reduce biases and improve the hiring process continue to be on the agenda. By contrast, Financial services organisations do face challenges, where they operate in jurisdictions, which have different cultural attitudes to matters such as diversity, equality, notions of discrimination, hierarchy structures and the powers of hierarchy. These cultural differences, while they have to be understood, can precipitate scandals in the form of cronyism, misguided personal and corporate loyalties, sex and pay discrimination. All stakeholders can play a material role in causing reputational and financial scandal. Different

[203] https://www.theguardian.com/business/2015/nov/25/banking-facing-uber-moment-says-former-barclays-boss
[204] Daily Telegraph 23.1.18.

cultural and governance modes will continue to pose conflict, especially to Western Hemisphere Financial Institutions who seek to derive the very substantial flow of business from these institutions. There has to be some form of cultural compromise or understanding if they are to do business based on respect for each others' values to mitigate or avoid financial scandals.

Standards

While it is possible to reach agreement on technology and technical business product and operating standards globally, it is more difficult to achieve detailed implementation standards for example in regulation, risk, capital and financial reporting standards. Through supra-national organisations, such as the International Monetary Fund, Bank for International Settlements, G20/G10/G7, principles may be agreed, they will continue to be diluted for implementation at a regional and jurisdictional level to accord with what will work practically on a local basis. Exceptionally, both regional level competition and co-operation may bring more granularity to regulatory, risk and capital requirements standards.

Ethics

Global business and personal ethics remain a constant challenge. They will always remain uncertain and even aspirational, as they can only be enforced through the determination of political power reinforced by legislation and relevant forms of authority. Initiatives to improve ethical values can serve as an example of leadership to other financial centres but require a sharper autocratic approach in some centres.

Jurisdictions

Jurisdictions compete as financial centres on a product, service, and specialisation basis. Technology and communications infrastructure sharpen jurisdictional competition. Infrastructure support, pools of relevant professional competencies, taxation concessions and grants all contribute to the competitive edge. At what point do the attractions become unethical inducements or illegal? Financial centres can be established and in operation much more quickly than manufacturing and distribution centres. The centres can provide a financial ripple benefit quickly for everyone's benefit in small jurisdictions, creating an environment for financial scandals. Financial institutions respond by arbitraging their business and operations in centres which minimise cost and risk and overhead versus goods and services

Politics

Close and deep political engagement can create the environment for financial scandals in the form of favoured lending, soft infrastructure lending and financing politically motivated economic projects. Political engagement with the financial services industry has developed since the 1970s/1980s when financial institutions expanded geographically, capital controls were dismantled, financial markets deregulated. Engagement with the sector and strong jurisdictional leadership can provide material economic benefits and electoral support. Politics is fickle. Changes can come quickly. Political demands and expectations may have to be met by the finance sector, which are not easily accommodated but must be balanced against objective business risks and rewards.

Government Debt

OECD members' total sovereign debt has increased from US 25 trillion dollars in 2008 to US 45 trillion dollars this year. Under the fiat currency regimes, which have developed since the failure of the Bretton Woods Agreement in 1971, when the US dollar role as a gold-backed currency ceased, Governments have been able to borrow with ease both to fund economic development and extract themselves from the consequences of poor economic and financial judgement debt. Government debt has most recently been used to alleviate the perceived consequences of the financial crisis in the form of Quantitative Easing by introducing new money into the financial system by buying back government debt in an artificially created low interest regime. The process of reversing Quantitative Easing by selling enormous amounts of Government Debt back to institutions as interest rates rise will take a long time. It is likely to require Governments to repackage their current debt issues to encourage purchase, a technical default with revised credit evaluations.

Final Points

Firms need to offer an element of stability with regard to intangible assets, for example their brand name, market share, distribution networks and any patents. There is a school of thought emerging which refers to "preventable surprises", things which with hindsight could have been handled differently, and "predictable surprises" which can arise from making false assumptions or engaging in oversight before hindsight. Over-confidence, impetuous responses, fixed ideas and assumptions can all lead to subsequent difficulties.[205] Moral hazard (discussed in Chapter 4), no fault capitalism, economic or social justice, even the rule of law are all ways of looking at how the essential features of modern life can be analysed and fitted into a structure for people to understand and with which they feel comfortable. From jobs and career, through investments to pensions, everyone has a place or a point of contact with the economic structure of the country, but too many people either feel alienated by what they see, or do not feel a sense of commitment or belonging.[206] Increased transparency and accountability, more secure accounting systems via MDLs not to mention greater protection against computer failures and cyber attack would re-assure the public.[207]

Rather than governments, or even international organisations, the driving force for maintaining acceptable conditions for trade lies with multinational corporations, not to mention the many entities that invest in them worldwide. It is shareholders ultimately who pay the price for bad business practice, shady deals or downright criminality, not to mention the knock-on effect on pension funds and the long-suffering taxpayer. So guidance should be given by the bodies that facilitate that trade and who process investments. The regulations they establish ought to reflect common interests and there do need to be sanctions for people to see that unacceptable behaviour will not be tolerated and to ensure that they can trade with confidence and ease. That in turn means that the work force needs to be introduced to ethical issues, good practice and legal requirements in their training, which should range from modules in degree courses or professional body qualifications to on-line

[205] For more on predictable surprises, see the lecture by Emeritus Gresham Professor Helga Drummond of 4.12.14. Her lecture on The Psychology of Doing Nothing (29.1.15) also provides some interesting insights. See the Gresham College website at www.gresham.ac.uk

[206] http://www.cesj.org/learn/definitions/defining-economic-justice-and-social-justice/ explores these topics in detail.

[207] The Government has announced the creation of a dedicated national security unit to tackle fake news and disinformation. The Guardian 24.1.18. The National Cyber Security Centre website offers help in taking decisions about cyber risk. It also provides the latest information on possible flaws in processors. https://www.ncsc.gov.uk/

programmes which people have to take in order to obtain or keep a licence to trade.

Ultimately it is the rule of law that matters, with greater accountability, better relations between government and business, and an awareness of the relationship between politics and economics.[208] If checks and balances actually work, if regulations are open and understandable, and penalties clear and properly applied, then it is possible that business can go forward without becoming enmeshed in the scandals, frauds and crashes that seem to have become part of business life in almost every decade of the last two centuries.

[208] See http://unpan1.un.org/intradoc/groups/public/documents/un/unpan010193.pdf for a useful discussion about good governance, the rule of law, transparency and accountability.

8. Conclusions & Recommendations

Conclusions

Financial scandals have produced a lack of trust

- Improper practices and corruption are damaging to everyone and will cause damage not only to the companies involved, but also the sector as a whole and the people who work in it.

- A one-size-fits-all will in turn cause alienation or provoke a herd instinct in responding negatively to what may be seen as a series of hostile moves which will create an unfair environment to work in at international level.

- Heavy fines, increasingly onerous regulations and other disincentives do not seem to be the answer to financial misbehaviour.

Measures are required to remedy lack of trust

- Creation of an atmosphere of greater trust, even if it has to be admitted that self-regulation in various sectors has not worked (Banks traditionally were seen as places where prudence, caution, even respectability were the touchstones).

- A certain level of tolerance may have built up over the years in the face of so many instances of wrongdoing, and the larger the scandal, the less ordinary people will feel that it somehow involves them, as they feel that there is little that they can do about it.

- Compliance is viewed in some ways as a necessary evil and is frequently lampooned in cartoons. It is important for regulation to be reflected in daily thinking, not only on the part of the committees which set company policy but also in the way that teams and even individual members operate.

Globalisation has added complexity to financial scandals

- Finance in a globalised world has moved well beyond the focal points of yesteryear such that both the laws and the ethical standards will vary. The current scenario of scandals, conflict and abrasive encounters between the financial world and the international bodies that extend the work of government around the world is even less attractive.

- The advent of globalisation meant that even typical Western values came into conflict with people and companies arriving from all over the world, who were accustomed to different styles of working.[209] The complexities of the Internet and the lack of national boundaries in Cyberspace have also compounded the problem, hence the need for regulations and procedures that everyone can understand and adhere to.

- Internet communication and cyberspace have allowed financial organisations to operate worldwide and sometimes in quite unlikely places. Perhaps rather than regulations (which can be skirted round) or rigid frameworks (which may not be able to keep up with Fintech and robo-trading) there need to be beacons of good practice and focal points which will provide a lead in offering services which are clean and reliable, and which will avoid the scandals, heavy fines and commercial upheavals of the past few years.

- Cybercrime, fraud and underhand dealing are a hindrance to fair trade and damaging to all. It is therefore in everyone's interest to work ethically and with due regard to regulations and controls which need to be fair, workable and easy to understand if they are to have the desired effect.

[209] For contrasts in commercial attitudes and working practices between the West and the Middle East, see City AM 24.1.18. In the latter, expectations are said to be higher with regard to annual returns, high up-front commissions are normal and fee structures are not always clear-cut.

A number of very specific conclusions emerge with respect to major financial centres, using the City of London as the reference financial centre:

- The benefits of a firm policy towards ethical practices need to be recognised in order to reassure foreign investors and for them to make the City their first choice location for investment in Europe. London's role at world level also needs to be reviewed and the strength of English Law, English Courts and City exchanges emphasised as a safe and reliable place in which to invest and keep deposits.
- Consideration has to be given post-Brexit to the position of the City with regard to the EU and what regulations and procedures need to be in place to maximise commercial activity.[210]
- The Lord Mayor's CIVIC Plan to restore trust in the City and the industries that work there, is much to be welcomed and deserves every support.[211] Five principles have been put forward, using the mnemonic CIVIC: **C**ompetence and skills; **I**ntegrity; **V**alue to Society; **I**nterests of others; **C**lear Communication. This combination reinforces the need to provide services of world-beating value in such a way that the benefits that accrue from business are apparent to outside observers.
- The City of London ought to be in prime position to be a world leader in establishing proper procedures, offering security to investors and shareholders alike.[212]
- The remoter frontiers of new technology such as robo advisers, robo investors, smart bots, chat bots and even killer bots need to be brought in to the public mind so that fast moving developments may be seen as benefits not threats – after all, Siri and Cortana are really bots and are now commonplace.[213]

[210] For a very negative view of the impact of EU policy on business see the Daily Telegraph for 23.1.18.
[211] https://www.cityoflondon.gov.uk/business/economic-research-and-information/Documents/the-business-of-trust-booklet.pdf
[212] For an interesting discussion of the issue see the paper by Professor André Spicer of Cass Business School at https://www.cass.city.ac.uk/faculties-and-research/research/cass-knowledge/2013/january/deep-change-to-banking-ethos-needed
[213] https://www.cnet.com/how-to/what-is-a-bot/ However, it appears that my laptop was attacked by a bot recently.

Recommendations: Policy, Structures, Procedures, Training

Policy

Encourage professional and commercial agencies working to maintain ethical standards to collaborate more closely in order to maximise effort and reduce costs while replicating their initiatives at international level for closer co-operation.

Review the financial regulatory and compliance procedures which have been implemented since the financial crisis of 2008 to gauge their effectiveness.

Anticipate improper or illegal responses to new commercial developments, electronic advances and changes in the law through the application of risk management skills and technologies.

Competence and skills;
Integrity;
Value to Society;
Interests of others;
Clear Communication.

Structures

Recognise and reinforce the City of London by reference to its global financial reputation but understand that ethical attitudes, legal structures and commercial processes can vary across jurisdictions, which follow different political structures and business processes.

Draw on a wider range of skills and resources to pursue e-criminals with support from commercial and law enforcement agencies. These subject area specialists would be recruited, trained and supervised.

Establish projects in commercial, professional and higher educational institutions to review, consolidate and implement developments and changes in corporate governance.

Competence and skills;
Integrity;
Value to Society;
Interests of others;
Clear Communication.

Procedures

More legal powers are probably unnecessary but current procedures and red tape are time consuming and frustrating. Fewer but more robust processes are needed for compliance in such a way that they that they can be embedded into operating functions rather than being seen as an irritating "box-ticking" exercise.

Review best working processes so they may be applied to the fast moving changes within professional services.

Strengthen identity and verification checks on new enterprises.

Competence and skills;
Integrity;
Value to Society;
Interests of others;
Clear Communication.

Training

Review and develop programmes for teaching ethics as well as establishing operating procedures to combat fraud in the training curricula of commercial, professional and higher education institutions.

Revise Continuous Professional Development programmes through commercial, professional and higher educational institutions. Ensure that development programmes address current issues and requirements and provide financial and other resources for training staff and provide SMEs with tax relief on financial costs for both individuals and the companies for whom they work.

Encourage research into new technologies with acknowledged business application opportunities to ensure they meet security and operating standards. Where necessary, set out how external oversight might be applied.

Competence and skills;
Integrity;
Value to Society;
Interests of others;
Clear Communication.

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Appendix 1 - Factors And Visibility

Ten factors which may lead to a crash[214]

- Failures in government regulation
- Overlooking key political factors
- Corporate mismanagement
- Poor leadership on the part of senior managers
- A lack of scrutiny and an unwillingness to intervene
- Insufficient capital held in reserve
- Inattention to potential risks
- Taking unnecessary risks
- Inadequate accounting procedures
- Over-reliance on untried financial instruments

Why did people not see the crisis or crash coming?

- The nature of the risk not understood
- Insufficient data available
- Reliance on false or over-optimistic reports
- Economic danger signs ignored
- The size of the forthcoming crisis not recognised
- A false assumption in modelling that markets and economies are inherently stable
- An assumption that the market makers make rational decisions
- An under-estimate of the willingness of investors to accept risk and even invest funds that they do not have, relying instead on loans or borrowing
- A desire (leading to panic) to get in on the action before it is too late, prompted by stories of high returns or fortunes being made by others.
- Following the crowd blindly.

[214] http://www.nytimes.com/2011/01/26/business/economy/26inquiry.html

Appendix 2 - The Development Of The Companies Act

Summary of the Historical Objectives of English Company Law Legislation
English Company Law has developed through a number of distinct elements of legislation, which permeate Company Law:

- Company formation and registration processes
- Legal personality, which distinguish companies from other forms of business association
- Rules of attribution of rights and duties to those who act for the company
- "Piercing the corporate veil"
- Capital construction and reconstruction legislation
- Corporate governance
- Constitution (Articles of Association)
- Directors' rights and duties
- Shareholder's rights
- Investor's rights
- Employee rights

Legislation	**Objectives**
Chartered Corporations (1319-1698) E.g. Hudson Bay Company East India Company Bank of England *Corporations could only be established by Charter granted by UK Government*	• Corporations which acted on UK Government's behalf • Brought in revenues from their activities abroad • Increasingly integrated into British Military and Colonial Policy • Dependent on British Naval Policy to control trade routes
The Bubble Act 1720 *Response to the scandal of The South Sea Bubble*	• Prohibition on establishing companies (except by Act of Parliament) remained in until 1825 Note Adam Smith's *The Wealth of Nations (1775)* "Mass corporate activity could not match private entrepreneurship, because people in charge of others' money would not exercise as much care as

Legislation	**Objectives**
	they would with their own.”
The Trading Companies Acts 1834 *Response to capital raising demands of the Industrial Revolution*	• Empowered the Crown to confer any of the privileges of incorporation except limited liability by Letters Patent
The Chartered Companies Act 1837 *Piecemeal refinement of The Trading Companies Act 1834*	• Re-enacted the 1834 Act by providing that personal liability of Members may be expressly limited to a specified amount per share by the Letters Patent
The Joint Stock Companies Act 1844 *Complementary legislation to the Bank Charter Act of 1844 ,which responded to the number of regional banking failures in the UK*	• Registration of Companies with more than 25 members or shares or with shares transferable without consent of all members • Incorporation by registration • Created the office of “Registrar of Companies.” • Details of the Constitution of Companies, charges on the Company and Annual Return to be filed with the Registrar of Companies
The Limited Liability Act 1855 replaced along with The Joint Stock Companies Act 1844 by Joint Stock Companies Act 1856 *Response to more sophisticate forms of capital raising for railway companies and to judicial decisions*	• Any company registered under the Joint Stock Companies Act 1844 might limit liability of its members for its debts and obligations generally to the amount unpaid of their shares • 7 or more persons could form themselves into an incorporated company with or without limited liability by signing a memorandum of association and complying with the requirements of the Act
Companies Act 1862 *Response to the scandals arising from “The Railway Mania.”*	• Consolidated the Companies Acts 1844/55/56 Additionally: • Separate Memorandum & Articles of Association (forms of which were provided in the statute) to state the purpose of the

Legislation	Objectives
	company and provide for director and shareholder rights and responsibilities • Accounts and disclosure requirements • Financial statements (following statutory forms) audited by Board of Trade approved auditors • Provision regarding shareholder meetings and rights of shareholders to inspect books • Procedures for appointment of auditors
Companies Act 1908 *A genuine consolidation of Company Law, a response to the response to the booms and busts of capital raising and incorporation of judicial decisions into UK Company Law.*	• Consolidated 17 Statutes passed between 1862 and 1908 • Established Private Companies (those that do not sell their shares to the Public) to provide limited liability, separate legal personality and fewer disclosure requirements • Private companies file less detailed accounts • Private companies exempt from minimum share capital requirements
Companies Act 1929 *A consolidation of judicial decisions Influenced by the all powerful Montagu Norman who supported increased privacy for capital enterprises*	• Mandates directors to provide current profit and loss data at the Company • AGM • Directors are not obliged to file profit and loss data publicly • Directors are not obliged to disclose interim financial results/developments
Companies Act 1948 *Post war review of corporate law to reflect Political and Economic Demands from Company Owners and Trades Unions*	• Created a new class of "exempt private companies" distinct from other private companies • Do not have to file public accounts • Expanded disclosure requirements by Public Companies • Public share offerings accompanied by larges prospectuses with more disclosure requirements • Profit and loss statements and balance sheets publicly filed in accordance with a form prescribed in the Act • Consolidated Accounts for Group Companies

Legislation	**Objectives**
	"The Act stimulated more company takeovers because outside investors now had access to data for analysis for takeover bids."
Companies Act 1967 *Response to the Labour Government 1964/1966 Manifestos which sought to increase State's oversight and supervision of private enterprise*	• Abolished "exempt private companies" • More prescriptive form of disclosure of employee and director remuneration • Increased accounting and auditing disclosure and reporting requirements for companies
Companies Act 1981 *Response to the growing sophistication of the domestic and international capital markets*	• Focus on capital construction and reconstruction and the processes to achieve these changes
Companies Act 1985	• Largely replaced by 2006 Companies Act Enabled companies to be formed by registration • Sets out the responsibilities of companies, their directors and secretaries • A consolidation of elements of company legislation which sets out rules governing companies in addition to its own memorandum & articles of association as well as setting out default articles of association
Insolvency Act 1986 & Company Directors Disqualification Act 1986 *Response to UK domestic insolvency scandals*	• Provided tougher sanctions against directors who negligently operated companies at a loss
Companies Act 2006 *Response to Political demands and governance codes for Public Companies*	• Current version of company legislation in the UK and first consolidation since 1985 • Primary objectives of changes to public company law was to encourage long term performance through shareholder engagement

Legislation	Objectives
	and dialogue between investors and business • Directors of listed companies were required to disclose their compensation packages to shareholders while shareholders were allowed a non-binding vote on executive remuneration • Codified common law provisions on directors' duties replacing the principles that directors must act in the interest of the company and its shareholders with principles of corporate social responsibility. • Directors were required to promote the success of the company through having regard for the long-term consequences and interests of employees and other stakeholders. • Directors were required to exercise reasonable care, skill and diligence by applying both objective and subjective standards of care • Directors had to avoid conflicts of interest and disclose related transactions with the company • Reform of private companies to make them easy to establish and operate by "thinking small" in terms of abolishing the requirement for a company secretary and AGM as well as reducing accounting requirements • Implemented EU directives on takeovers • Abolished the prohibition on private companies providing financial assistance for purchase of its shares

Appendix 3 - Organisations Fighting Financial Crime Or Promoting Good Practice

City of London Police
https://www.cityoflondon.police.uk/advice-and-support/fraud-and-economic-crime/Pages/default.aspx

National Crime Agency
http://www.nationalcrimeagency.gov.uk/

Transparency International
http://www.transparency.org.uk/

CISI (Chartered Institute for Securities and Investment)
https://www.cisi.org/cisiweb2/cisi-website/about-us
The CISI offers qualifications from foundation to practitioner level in all areas of financial services. Its examinations are offered in eighty countries.

Cass Business School
https://www.cass.city.ac.uk/
Offers degrees from BSc to PhD and a prestigious executive education programme.
And see ETHOS: The Centre for Responsible Enterprise
https://www.cass.city.ac.uk/faculties-and-research/centres/cre

Institute of Business Ethics
http://www.ibe.org.uk/
Founded over thirty years ago, the IBE is a non-profit professional organisation which encourages high standards of business behaviour based on ethical values. It publishes books, offers training programmes and promotes the study of business ethics.

Banking Standards Board
https://www.bankingstandardsboard.org.uk/
Aims to promote high standards of behaviour and competence across UK banks and building societies.

City Values Forum
http://www.cityvaluesforum.org.uk/
Formed in 2011 to deliver the Lord Mayor's initiative to restore trust in the City, it works to embed the principles of trust and integrity in the financial and business services sector and to improve business cultures and behaviours.

Tomorrow's Company
https://tomorrowscompany.com/video/about-tomorrows-company/
A not-for-profit think-tank that exists to inspire and enable business to be a force for good.

Global Financial Integrity
http://www.gfintegrity.org/
Global Financial Integrity works to curtail illicit financial flows by producing groundbreaking research, promoting pragmatic policy solutions and advising governments.

Global Witness
https://www.globalwitness.org/en-gb/about-us/
Global Witness exposes the hidden links between demand for natural resources, corruption, armed conflict and environmental destruction

Open Ownership
https://openownership.org/
A new project to create a global beneficial ownership register

Axiomhq.com
http://axiomhq.com/
A dedicated compliance platform for regulated financial firms

https://tomorrowscompany.com/
An independent non-profit think tank that inspires and enables business to be a force for good in society.

St Paul's Institute
http://www.stpaulsinstitute.org.uk/
St Paul's Institute seeks to foster an informed Christian response to the most urgent ethical and spiritual issues of our times: equality, stewardship and the meaning of the common good.

The All-Party Parliamentary Groups bring MPs and Lords together to discuss specific issues:

APPG Corruption
http://www.anticorruptionappg.org/

APPG Corporate Governance
https://publications.parliament.uk/pa/cm/cmallparty/171220/corporate-governance.htm

APPG Corporate Responsibility
https://publications.parliament.uk/pa/cm/cmallparty/171220/corporate-responsibility.htm

There are also APPGs covering Artificial Intelligence, FinTech and (most recently) Blockchain.

Appendix 4 - Transnational Crime

Report by Channing May for the Global Finance Initiative 27.3.17

This March 2017 report from Global Financial Integrity, "*Transnational Crime and the Developing World*," finds that globally the business of transnational crime is valued at an average of $1.6 trillion to $2.2 trillion annually. The study evaluates the overall size of criminal markets in 11 categories: the trafficking of drugs, arms, humans, human organs, and cultural property; counterfeiting, illegal wildlife crime, illegal fishing, illegal logging, illegal mining, and crude oil theft.

The combination of high profits and low risks for perpetrators of transnational crime and the support of a global shadow financial system perpetuate and drive these abuses. The report also emphasizes how transnational crime undermines economies, societies, and governments in developing countries. National and global policy efforts that focus on curtailing the *money* are needed to more successfully combat these crimes and the illicit networks perpetrating them.

Primary Findings
Transnational crime is a business, and business is very good. Money is the primary motivation for these illegal activities. Of the 11 illicit activities studied, counterfeiting (923 billion dollars to 1.13 trillion dollars) and drug trafficking (426 billion dollars to 652 billion dollars) have the highest and second-highest values, respectively; illegal logging is the most valuable natural resource crime (52 billion dollars to 157 billion dollars).

The ranges demonstrate the serious magnitude of and threat posed by global transnational crime. The revenues generated from the 11 crimes covered in this report not only line the pockets of the perpetrators but also finance violence, corruption, and other abuses. Very rarely do the revenues from transnational crime have any long-term benefit to citizens, communities, or economies of developing countries. Instead, the crimes undermine local and national economies, destroy the environment, and jeopardize the health and wellbeing of the public.

The report rankings for the illicit markets examined are:

Transnational crime	Estimated annual value (US $)
Counterfeiting	$923 billion to $1.13 trillion
Crude Oil Theft	$5.2 billion to $11.9 billion
Drug Trafficking	$426 billion to $652 billion
Human Trafficking	$150.2 billion
Illegal Logging	$52 billion to $157 billion
Illegal Mining	$12 billion to $48 billion
Illegal Wildlife Trade	$5 billion to $23 billion
IUU Fishing (Illegal, Unreported, Unregulated)	$15.5 billion to $36.4 billion
Organ Trafficking	$840 million to $1.7 billion
Small Arms & Light Weapons Trafficking	$1.7 billion to $3.5 billion

Policy Recommendations

Transnational crime will continue to grow until the paradigm of high profits and low risks is challenged. In addition to current efforts to fight these crimes, this report calls on governments, experts, the private sector, and civil society groups to seek to address the global shadow financial system by promoting greater financial *transparency*. This will help cut off the money flows and the profits, and it will increase the ability to bring these criminals to justice and defeat their illicit transnational networks.

GFI recommends several steps governments and other regulatory bodies can take to increase the levels of detection and interdiction of the proceeds of transnational crime:

- Require that corporations registering and doing business within a country declare the name(s) of the entity's true, ultimate beneficial owner(s)
- Flag financial and trade transactions involving individuals and corporations in "secrecy jurisdictions" as high-risk and require extra documentation
- Scrutinize import and export invoices for signs of misinvoicing, which may indicate technical and/or physical smuggling
- Use world market price databases such as GFTrade™ to estimate the risk of misinvoicing for the declared values and investigate suspicious transactions
- Share more information between agencies and departments on the illicit markets and actors that exist within a country's borders

http://www.gfintegrity.org/report/transnational-crime-and-the-developing-world/

Appendix 5 - United Nations Convention Against Transnational Organized Crime And The Protocols Thereto (2004). Foreword by Kofi Annan:

"With the signing of the United Nations Convention against Transnational Organized Crime in Palermo, Italy, in December 2000, the international community demonstrated the political will to answer a global challenge with a global response. If crime crosses borders, so must law enforcement. If the rule of law is undermined not only in one country, but in many, then those who defend it cannot limit themselves to purely national means. If the enemies of progress and human rights seek to exploit the openness and opportunities of globalization for their purposes, then we must exploit those very same factors to defend human rights and defeat the forces of crime, corruption and trafficking in human beings. One of the starkest contrasts in our world today is the gulf that exists between the civil and the uncivil. By "civil" I mean civilization: the accumulated centuries of learning that form our foundation for progress. By "civil" I also mean tolerance: the pluralism and respect with which we accept and draw strength from the world's diverse peoples. And finally, I mean civil society: the citizens' groups, businesses, unions, professors, journalists, political parties and others who have an essential role to play in the running of any society. Arrayed against these constructive forces, however, in ever greater numbers and with ever stronger weapons, are the forces of what I call "uncivil society". They are terrorists, criminals, drug dealers, traffickers in people and others who undo the good works of civil society. They take advantage of the open borders, free markets and technological advances that bring so many benefits to the world's people. They thrive in countries with weak institutions, and they show no scruple about resorting to intimidation or violence. Their ruthlessness is the very antithesis of all we regard as civil. They are powerful, representing entrenched interests and the clout of a global enterprise worth billions of dollars, but they are not invincible. The Millennium Declaration adopted by the Heads of State meeting at the United Nations in September 2000 reaffirmed the principles underlying our efforts and should serve to encourage all who struggle for the rule of law. The Declaration states that "men and women have the right to live their lives and raise their children in dignity, free from hunger and from the fear of violence, oppression or injustice". At the Millennium Summit, world leaders proclaimed freedom—from fear and from want—as one of the essential values in the twenty-first century. Yet the right to live in dignity, free from fear and want, is still denied to millions of people around the world. It is denied to the child who is working as an indentured labourer in a sweatshop; to the father who must pay a bribe to get medical care for his son or daughter; to the woman who is condemned to a life of forced prostitution. I believe the trafficking of persons, particularly women and children, for forced and exploitative labour, including for sexual exploitation, is one of the most egregious violations of human rights that the United Nations now confronts. It is widespread and growing. It is rooted in social and economic conditions in the countries from which the victims come, facilitated by practices that discriminate against women and driven by cruel indifference to human suffering on the part of those who exploit the services that the victims are forced to provide. The fate of these most vulnerable people in our world is an affront to human dignity and a challenge to every State, every people and every community. I therefore urge the Member States to ratify not only the United Nations Convention against Transnational Organized Crime, but also the Protocol to Prevent, Suppress and Punish Trafficking in Persons, Especially Women and Children, which can make a real difference in the struggle to eliminate this reprehensible trade in human beings. Criminal groups have wasted no time in embracing today's globalized economy and the sophisticated technology that goes with it. But our efforts to combat them have remained up to now very fragmented and our weapons almost obsolete. The Convention gives us a new tool to address the scourge of crime as a global problem. With enhanced international cooperation, we can have a real impact on the ability of international criminals to operate successfully and can help citizens everywhere in their often bitter struggle for safety and dignity in their homes and communities. The signing of the Convention in Palermo in December 2000 was a watershed event in the reinforcement of our fight against organized crime. I urge all States to ratify the Convention and the Protocols thereto at the earliest possible date and to bring these instruments into force as a matter of urgency[215]"

[215] A note on the Palermo Convention: The UN's Convention Against Transnational Organized Crime 2000 is known as the Palermo Convention. It contains three protocols: the Protocol to Prevent, Suppress and Punish Trafficking in Persons, especially Women and Children; the Protocol against the Smuggling of Migrants by Land, Sea and Air and the Protocol against the Illicit Manufacturing and Trafficking in Firearms, Their Parts and Components and Ammunition
For a review of the Convention and further details of transgressions see the findings of the conference on Transnational Organized Crime and the Palermo Convention in 2010:
https://www.ipinst.org/wp-content/uploads/publications/e_pub_palermo_convention.pdf

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The Financial Services Group of Livery Companies aims to support the Lord Mayor in his overseas visits, his meetings in the City with overseas delegations, and his role of promoting "the City" brand of UK financial and other business services. The Financial Services Group can act also as a gateway for those wishing to establish businesses in the City or who require professional and financial services in their country of operation.

- The Worshipful Company Of Solicitors Of The City Of London
- The Worshipful Company Of Chartered Accountants In England And Wales
- The Worshipful Company Of Chartered Secretaries And Administrators
- The Worshipful Company Of Marketors
- The Worshipful Company Of Actuaries
- The Worshipful Company Of Insurers
- The Worshipful Company Of Arbitrators
- The Worshipful Company Of Information Technologists
- The Worshipful Company Of World Traders
- The Worshipful Company Of Management Consultants
- The Worshipful Company Of International Bankers
- The Worshipful Company Of Tax Advisers

Distributed Futures is a significant part of the Long Finance research programme managed by Z/Yen Group. The programme includes a wide variety of activities ranging from developing new technologies, proofs-of-concept demonstrators and pilots, through research papers and commissioned reports, events, seminars, lectures and online fora.

Distributed Futures topics include the social, technical, economic, and political implications of smart ledgers, such as identity, trade, artificial intelligence, cryptography, digital money, provenance, FinTech, RegTech, and the internet-of-things.
www.distributedfutures.net

Cardano Foundation is a blockchain and cryptocurrency organisation based in Zug, Switzerland. The Foundation is dedicated to act as an objective, supervisory and educational body for the Cardano Protocol and its associated ecosystem and serve the Cardano community by creating an environment where advocates can aggregate and collaborate.

The Foundation aims to influence and progress the emerging commercial and legislative landscape for blockchain technology and cryptocurrencies. Its strategy is to pro-actively approach government and regulatory bodies and to form strategic partnerships with businesses, enterprises and other open-source projects. The Foundation's mission is the promotion of developments of new technologies and applications, especially in the field of new open and decentralised software architectures.
www.cardanofoundation.org

"When would we know our financial system is working?" is the question underlying Long Finance's goal to improve society's understanding and use of finance over the long term. Long Finance aims to:

- expand frontiers - developing methodologies to solve financial system problems;
- change systems - provide evidence-based examples of how financing methods work and don't work;
- deliver services - including conferences and training using collaborative tools;
- build communities - through meetings, networking and events.

www.longfinance.net

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