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Indicators of Commercial Fraud**Note by the Secretariat*****Contents**

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* This note is submitted late due to the need to complete consultations and finalize subsequent amendments.



Indicator 6: Undue Secrecy

Commercial frauds frequently seek to impose undue secrecy and confidentiality on a number of issues including the existence of the opportunity to invest, the nature of the investment, the investment mechanisms and the source of return.

Explanation:

Transparency is critical to the functioning of modern financial markets and information about these markets and investments is widely available. On the other hand, investors do engage in investments based on confidential information or information whose significance is not widely understood. In some situations, acting on such information can be illegal. In other commercial activities, companies legitimately seek to prevent disclosure of confidential information or industrial techniques by employees or others by various legal devices in order to remain competitive in an industry. Such restrictions however, are almost never appropriate with respect to investors and particularly not with regard to the means by which funds are to be generated. Undue secrecy is a level of secrecy that goes beyond that which is appropriate to the transaction.

The requirement of secrecy may be set out in rules or requirements, often coupled with “legal sanctions” purporting to make investors liable for damages should they disclose any information, in order to suggest that the financial decision maker would be implicated, should the transaction be revealed. Such secrecy is intended to obscure the transaction, to inhibit the exercise of due diligence and to prevent investors from contacting advisors or appropriate sources of information that might assist the investor in avoiding the fraud.

Instances and Examples:

- Multiple excuses are given to justify undue secrecy.

Illustration 6-1: Frequently, it is claimed that consulting with knowledgeable persons or organizations disrupts the business transaction, interferes with the deal somehow, and ruins the opportunity for profits.

Illustration 6-2: Claims are often made that banks, stock markets, CEOs, professionals, or prominent persons engage in the type of investment at issue on a regular basis, but secretly, in order to prevent the public from gaining a similar financial advantage.

Illustration 6-3: It is often claimed that the laws of off-shore jurisdictions that are somehow connected to the investment require such secrecy.

- During the course of the transaction, victims are often warned against contacting the police, regulators, or other officials.

Illustration 6-4: It is often stated that the involvement of regulators will cause the transaction to be frozen, delayed, or jeopardized, placing the onus on the victim.

- The term “Non-Circumvention or Non-Disclosure” is frequently used in connection with attempts at secrecy. Such provisions are used in businesses

where there is a middleman linking buyer and seller, but are completely inappropriate or of concern with respect to ordinary investments.

Illustration 6-5: Victims are required to sign a detailed ICC (International Chamber of Commerce) Non-Circumvention and Non-Disclosure Agreement that, if taken at face value, would prevent them from discussing the investment with their accountant, attorney, or financial advisor.

- Confidentiality or secrecy is often given as an excuse for the lack of public information about the investment.

Illustration 6-6: Illogical claims that allegedly prove the genuine nature of the transactions, such as that the United States Federal Reserve chairman knows about this type of transaction, but if asked about it, he would deny it.

- Sources of concern include the following in a financial as opposed to a commercial transaction:

Illustration 6-7: Repeated insistence on absolute secrecy.

Illustration 6-8: Investors are required to sign agreements with disproportionately serious sanctions should they disclose information.

Advice:

- Investors should discuss the proposed transaction with a competent professional advisor.
- An investor should ask whether there is any commercial imperative for the secrecy or whether the secrecy is unrelated to the core concept of the investment.
- An investor should not be intimidated by the suggestion that liability will result from revealing aspects of the transaction to financial advisors.
- An investor should remember that legitimate confidentiality agreements do not prevent or forbid either the performance of due diligence on the transaction, or the contacting of authorities.
- An investor should not participate in investments when funds are moved off-shore unless complete and detailed information on the transaction is available in order to ascertain where money is flowing and whether movement of funds to that jurisdiction could be improper.

See also: Indicator 1 – Irregular Documents; Indicator 2 – Misuse of Technical Terms; Indicator 4 – Misuse of Names; Indicator 8 – Due Diligence; Indicator 9 – Corrupted Incentives; Indicator 10 – Ensnarement and Psychological Inducements; Indicator 12 – Immediate, Fast or Irrevocable Transfer of Funds; Addendum 1 – Performing Due Diligence.

Indicator 7: Overly Complex or Overly Simplistic Transactions

Commercial frauds are often designed to be overly complex in an attempt to obscure the fundamentals of the transaction, and may include illogical representations as well as convoluted, circuitous or impenetrable documentation. On the other hand, some commercial frauds may also be unduly simplistic or informal, with very little documentation or explanation, despite their apparent connection with a sophisticated or complex financial transaction.

Explanation:

Although commercial transactions, particularly international commercial transactions, may at times be complex by their very nature, the person being asked to make a decision with financial implications should have at least a basic understanding of the transaction in which participation is being solicited. Fraudsters often use as a model legitimate transactions that are highly complex and therefore marketed only to very sophisticated investors. This model is then used by the fraudster to involve less sophisticated individuals who may not be capable of understanding the nature of the transaction or the necessity of the complexity. Further, a web of companies or other entities may be created in order to distance the fraudster from blame when the fraud is discovered, to frustrate asset recovery, to launder the proceeds of crime, or to enable the fraudster to continue to operate a series of parallel schemes. Artificial or unnecessary complexity and absurd oversimplifications are two techniques that fraudsters use to obfuscate the fundamentals of the transaction, which, typically, make no economic sense.

Instances and Examples:

- Inordinately complex business structures that create a façade for multiple companies with no apparent role or reason are designed to make it difficult to hold fraudsters accountable.

Illustration 7-1: Six individuals formed a number of corporations and companies under the umbrella of a “programme of empowerment” and “wealth enhancement” network, conducting large workshops to entice unsophisticated investors into investments in foreign currency that they falsely described as highly profitable and “low risk”.

- Very little documentation may be associated with an unduly simplistic or informal transaction that would ordinarily require significant documentation.

Illustration 7-2: Homeowners in imminent risk of foreclosure were persuaded to sign a simple form to “temporarily” transfer ownership of their homes to “straw buyers”. The straw buyers then applied for mortgages on the homes using phoney credit histories. After draining the equity, the loans were defaulted upon, subjecting the owners to threats of eviction. The financial institutions recovered little.

Illustration 7-3: The presence of highly informal text in the documents, for example, the use of a phrase such as “telephone at the usual number”, may signal the presence of a commercial fraud.

- Complexity compounds problems related to tracking payments and disbursements and recovering funds.

Illustration 7-4: Frequently, fraudsters use multiple layers of business entities to conduct multiple transfers of funds and/or frequent changes of depository banks. Since transnational fraud schemes also often use Internet-based funds transfer mechanisms rather than conventional banking channels, such funds are extremely difficult to trace.

- Technology, including transportation, information and communication technology, is increasingly being used to inject complexity in order to avoid detection and to conceal proceeds.

Advice:

- Be aware that there may be commercial fraud when there is no explanation and no apparent commercial purpose for complexities in the transaction, where intricacies appear artificial, where there appear to be parties with no meaningful role, or where the number of transactions or transfers or the structure of the transaction make it difficult to investigate it.
- Ensure that the purpose of each element of the transaction is understood. Do not be afraid to ask questions, even though it is possible that the answers might be obvious.
- Legitimate transactions may be complex, but, if so, they require informed counterparties using independent advice from knowledgeable sources.
- If details cannot be provided immediately, it should not deter the investor from obtaining the details from elsewhere prior to investing.
- Inquire into who initiated the transaction, who is recommending it, who is promoting it, and why a particular individual was approached as a potential investor. When there is an apparent effort to discourage questions from being asked, be suspicious of the reasons.

See also: Indicator 8 – Frustration of Due Diligence; Indicator 10 – Ensnarement and Psychological Inducements; Indicator 19 – Unsolicited E-Mail and Related Misuse of Technology; Addendum 1 – Performing Due Diligence.

Indicator 8: Frustration of Due Diligence

Since due diligence is the key tool through which suspicions can be explored and suspicious transactions avoided, it is a primary goal of fraudsters to frustrate the proper exercise of due diligence.

Explanation:

The person or entity being asked to make a decision with financial implications should ensure that due diligence is conducted through independent sources to investigate the proposed transaction, particularly any unusual aspects. The person being asked to invest should have the greatest motivation, and be best-placed, to conduct due diligence. Commercial frauds employ a wide variety of devices to frustrate the exercise of due diligence, whether by creating distractions; by creating

false credibility through the impression of mass approval; by controlling the means by which due diligence is exercised; by directing the investor towards non-independent sources; through the use high-pressure sales tactics; through insistence on urgency or secrecy; or the like. Any attempt to thwart the complete and independent investigation of the transaction and especially unusual or questionable aspects is highly suspicious.

Instances and Examples:

- A fraudster may attempt to prevent the exercise of due diligence by:
 - Presenting information in support of the transaction that cannot be verified;

Illustration 8-1: A fraudster may suggest that eminent persons who cannot be contacted are involved with or have approved the transaction, or that the roots of the transaction lie in historical private or international agreements.

- Insisting on absolute secrecy;

Illustration 8-2: The fraudster promotes an investment to the potential victim but tells the potential victim that the investment and promised returns are only possible if absolute secrecy is maintained.

Illustration 8-3: The fraudster may claim that information used in promoting the investment is proprietary, secret, or confidential, and cannot be shared with independent sources for due diligence.

- Using high-pressure tactics;

Illustration 8-4: The fraudster insists that there is only a “short window of opportunity”, or a “last chance” to invest before the opportunity is lost forever.

Illustration 8-5: The sense of immediacy may be tied to unrelated but current world events or crises, such as political upheavals or natural disasters, in order to increase the pressure to invest quickly.

- Insisting that due diligence is unnecessary;

Illustration 8-6: In a situation where the fraudster controlled all parties to a transaction (the buyer, seller, and shipper), the buyer sought a letter of credit from its bank in favour of the seller. Although the goods did not even exist, the fraudster created forged documents that state that the goods had been delivered, and sought to draw on the letter of credit. To persuade the bank employee to issue the letter of credit, the fraudster persuaded the employee that he had spoken to the employee’s boss, who approved the transaction and the letter of credit, and the fraudster suggested that therefore the employee did not even require proof of ownership of the goods.

Illustration 8-7: A fraudster promotes a high-yield investment programme assisted by a lawyer and an accountant. Attendees at a

seminar touting the investment programme hear presentations by the lawyer and accountant who claim to have examined the transaction and found it to be legitimate. Attendees are led to believe that the lawyer and accountant are independent, but they are each co-conspirators in the scam.

- Suggesting that the transaction has gained the approval either of the public or officials in the field;

Illustration 8-8: The fraudster promotes a high-yield investment programme to the potential victim and invites the potential victim to a seminar where the potential victim can learn more about the programme. The potential victim is taken to a seminar with hundreds of other potential investors. At the seminar, the fraudster touts his or her wealth, and may use the additional technique of promoting an association of the programme with well-known public figures, even if in a general way. All of these techniques generate a sense of mass approval intended to dissuade the victim from performing proper due diligence.

Illustration 8-9: Fraudsters can use any type of media, including print and electronic media, e-mail, television, live presentations, and the creation of convention-like events, to create a sense of mass approval of a certain “opportunity”, in order to distract the victim from performing due diligence.

- Suggesting that due diligence is being performed and therefore it is unnecessary for the investor to do separate due diligence;

Illustration 8-10: A fraudster can give the impression that due diligence is being exercised when it is not by claiming that it is being undertaken by a third party, or by insisting that a guarantee, an escrow account, or some sort of outside professional involvement affords sufficient protection to the investor.

Illustration 8-11: A fraudster may recommend a specific professional to carry out the due diligence, but that professional has either been compromised by the fraudster, or has insufficient knowledge to carry out thorough due diligence.

- Or making due diligence impossible to accomplish, even while suggesting that the investor perform his or her own due diligence.

Illustration 8-12: A fraudster may encourage the potential investor to perform due diligence, but may effectively block its performance by providing incorrect or compromised contact information, creating excuses why key people cannot be contacted, providing insufficient detail regarding the transaction to perform the due diligence, and the like.

- Commercial fraud may be signalled where there is unusual difficulty in obtaining additional and independent information on the transaction or the parties, due to their identities, to their geographic location, or to other factors.

Illustration 8-13: Fraudulent transactions often involve international companies based off-shore, making due diligence more difficult.

- A fraudster may steer the potential victim toward non-independent sources of information when due diligence is being pursued, or may present false documents to bolster credibility.

Illustration 8-14: Fraudsters will use different means to frustrate due diligence, including setting up collaborators for the victim to call to verify information, and they have even been known to create elaborate shell businesses with actual premises when pursuing large investments from victims.

Advice:

- It is absolutely essential to seek independent advice from sources other than those provided by the person encouraging the investment.
- The person from whom advice is sought should be knowledgeable about the subject matter.
- The key facts of the transaction should be verified.
- Trust one's common sense and investigate thoroughly when an aspect causes one to feel uneasy.
- Be aware that modern commercial fraudsters often work in sophisticated groups that loosely corroborate and reinforce one another and the scheme.
- Evaluate the reasons for the immediacy, if any.
- Take time to investigate and do not rush into a business decision, especially when the decision is regarding something out of the ordinary course of one's business.

See also: All other indicators – effective due diligence is in all cases the key to avoid becoming a victim of fraud; Addendum 1 – Performing Due Diligence.

Indicator 9: Corrupted Incentives

Commercial frauds may involve taking advantage of an entity's performance incentives or offers of assistance, gifts, favours or other inducements to particular individuals in exchange for consideration that would not otherwise be available, or to overlook certain questionable activity.

Explanation:

Performance incentives designed in accordance with international and national laws, professional ethics and industry standards can be a useful tool for encouraging profitable performance, particularly when they are subject to rigorous oversight. However, they can also mask fundamental problems with an account or a relationship, or give employees strong incentives to ignore what might otherwise be troubling signs.

Unless properly communicated, reported upon and monitored, even the best-intended employee incentive programmes weaken an entity's protection from

commercial fraud. In addition to the possibility of employees themselves engaging in fraudulent activity to obtain incentives from their employer, outsiders may corrupt otherwise legitimate employee incentive programmes by seeking out poorly-managed schemes and targeting employees prepared to exploit those weaknesses.

Another aspect of corrupt incentives in general is the use of gifts, status, favours, money, data, information or other inducements to create a conflict of interest for the recipient. By using such means to persuade senior management or other employees to engage in practices that are contrary to the generally accepted standards of prudent operation, fraudsters may use incentives to undermine the organization as a whole. What is sought can range from general amenability to help or to encourage the recipient to do something specific that is not improper in itself, but that facilitates something that is improper, to inducements that result in the recipient becoming a collaborator in the scheme.

Fraudsters may also mirror business incentives as a device in the course of their schemes: for example, by offering early investors financial incentives to recruit others in pyramid schemes, where payments are made from other participants' money. Fraudsters often use such incentives to persuade participants to "roll over" or reinvest illusory profits rather than be paid.

Instances and Examples:

- Employees or fraudsters will take advantage of poorly monitored corporate performance incentives, for example, to enter into continuing transactions even when such transactions seem suspicious.

Illustration 9-1: One hedge fund executive lost several hundred million dollars of investors' funds and deceived them and related institutions for more than three years using fake account statements.

- Gifts, status, favours, money, data, information, or other inducements that may create a conflict of interest for the recipient are intended to cause the recipient to give consideration that would not otherwise be available or to overlook or examine things that would otherwise be suspicious or problematic.

Illustration 9-2: To curry favour, lenders provided all-expenses-paid trips for university financial aid officers and put university officials on their boards. Many universities operated as trusted middlemen by recommending these "preferred lenders" that did not necessarily offer the best rate to student borrowers.

- Internal and external incentives and gifts may signal corruption or fraud in certain identifiable ways.

Illustration 9-3: An employee is meeting very high performance expectations, with little oversight or understanding of transactions.

Illustration 9-4: Unusual hospitality or excessive professional fees or excessive consultants' fees are offered.

Illustration 9-5: A businessman well-known for generosity gave very expensive gold watches to bankers and lawyers that made it difficult for them to ask difficult questions about the large loans that he took out and ultimately defaulted on.

- Commercial and financial decisions should be made on their own merits.

Illustration 9-6: The person whose influence is sought can be either the direct or indirect recipient of the gifts or favours, which may also be given to children, parents, spouses, etc.

Illustration 9-7: The fraudster's goal is to obtain undue consideration or cooperation including obtaining contracts, information, documents, reducing the willingness to ask questions, providing access to people, compromising the integrity of the recipient or to encourage the recipient to become part of the scheme.

Illustration 9-8: Scheme incentives typically include promises of unusual or excessive returns and strong encouragement to re-invest the windfall.

Advice:

- The oversight of employee incentive programmes should include review and audit by independent persons.
- Systems should be in place to identify and resolve causes of employee grievances and to ensure that there are adequate and effective whistle-blowing policies.
- Employers should have policy guidelines in place regarding receipt and reporting of gifts and favours, and should ensure that employees are aware of, and adhere to, those guidelines.
- Professionals should be aware that they are often targets of attempts at improper inducements.
- When receiving a gift, any employee or professional should consider carefully the value of the gift and the identity of, and relationship with, the giver.
- Employers should ensure that purchases of gifts at company expense should be subject to review and approval by persons other than the donor.
- Investors must understand how returns on an investment are generated, ask questions when cautionary flags are raised, and be open to seeking confirmation from an expert advisor.

See also: Indicator 5 – Disproportionate Returns; Indicator 6 – Undue Secrecy; Indicator 8 – Frustration of Due Diligence; Indicator 13 – Questionable or Unknown Source of Repayment; Indicator 16 – Fraud By or Involving Employees; Indicator 20 – Pyramid and Multi-Level Marketing Schemes; Addendum 1 – Performing Due Diligence.

Indicator 10: Ensnarement and Psychological Inducements

Fraudsters may seek to entice victims by using psychological inducements and manipulation first to persuade them into participating in the fraud, and then to ensnare them with respect to the real or imagined illegality of their participation in the fraud. Such ensnarement is then used against them to distract them or to obtain their silence regarding the much more serious commercial fraud being committed.

Explanation:

Commercial frauds often use psychological inducements to encourage a financial decision-maker to enter into a fraudulent transaction, and then to avoid detection of the fraud. The most obvious inducement is an appeal to greed, but other factors can include flattery of the decision-maker, through gifts or references to investor sophistication or the general appeal of being included in a private and exclusive deal. Many fraudsters can be very charming and persuasive people.

In terms of ensnarement, there is a natural psychological and moral reluctance to commit an improper or illegal action. Where an investor is induced to commit an act that may be questionable or illegal by a person seeking to involve the investor in an investment or other financial opportunity, this may be a device to ensure their silence or to distract them from the commission of a commercial fraud. Later attempts to avoid detection can include such psychological tools as threats regarding disclosure and suggestions of collusion or ensnarement.

Instances and Examples:

- Fraudsters depend upon and prey upon powerful human emotions such as greed, pride, empathy or fear.

Illustration 10-1: Potential victims are seen by the fraudsters as predisposed to believe there are secret ways to make enormous amounts of money with no risk.

Illustration 10-2: While still in the enticement stages, a proponent of the investment appeals to the victim's ego by alluding to investment sophistication or by trying to make the victim feel foolish for asking for explanations of complex transactions or technical terms.

Illustration 10-3: In many common financial frauds, cheques and money orders are made out for amounts larger than the debt owed or commission to be paid to the victim, so that the victim is induced to deposit the cheque or money order in his or her bank account and to wire the balance of the funds to a foreign bank account before he or she is notified by the banks that the cheque or money order is counterfeit or invalid.

Illustration 10-4: Advance-fee fraud resorts to the victims' predisposition to cooperate with government regulations by inducing them to pay money to fraudsters for nonexistent "taxes", "fees", or "customs duties" before the fraudsters are expected to provide whatever goods or services (e.g., offshore tax shelters) they have promised to victims.

- Commercial fraud schemes may be designed to appeal to certain psychological profiles by suggesting 'secret' markets, conspiracies or exclusive business circles

Illustration 10-5: Those who may be seen as distrustful of government are offered investments to avoid paying taxes through offshore accounts. In one multi-million dollar fraud, victims were

offered 80 percent annual returns through a secretive web of money dealers supposedly set up by a coalition of governments in 1914 to pay for World War I debt. The scheme claimed that seven “world traders” control the entire global money supply and act as a board of directors for a few hundred “licensed traders” around the world.

- Promoters look for weaknesses in population groups, concentrations of immigrants, the poor, the elderly and the infirm, preying on emotions such as the fears of senior citizens running out of money.

Illustration 10-6: In a common scheme, information is received by the elderly that the recipient has won a large “unclaimed prize” or international sweepstakes drawing or lottery that must be claimed by submitting an advance fee or by calling a telephone or mobile phone number to which significant charges apply.

Illustration 10-7: Victims may be more at risk depending on their particular profile or their stage in life, such as whether they are elderly, recently divorced, have health problems, or may have recently won or been awarded a substantial amount of cash.

- Some fraudsters use flattery and the veneer of sophistication to entice victims to participate in the fraudulent investment.

Illustration 10-8: The fraudsters may make a display of lavish lifestyles and expensive luxury goods as they offer sophisticated sounding but fictitious investment products that mimic the many new legitimate products, while counting on naïve investors not to ask questions to avoid seeming to be themselves unsophisticated.

- When other psychological inducements fail, fraudsters often resort to inducing compliance by threat or actual use of violence.

Illustration 10-9: Investors who have not realized they are victims are used to entice others to participate. When the fraud is discovered, these middlemen fear they, too, will be implicated, and the fraudster uses that fear to keep the middlemen quiet.

Illustration 10-10: Once a victim discovers the fraud, the fraudster may threaten public embarrassment by exposing involvement in the scheme, or may string the victim along with a series of mythical difficulties, or may offer the potential of new schemes with even greater returns, all common tactics used to delay or deter disclosure of activities.

Illustration 10-11: It may be suggested to an individual involved with the scheme, often a professional, that the professional has become a conduit for money-laundering, although perhaps unwittingly, and once implicated, the professional may be reluctant to report the scheme.

Illustration 10-12: A major telephone service provider was threatened because a fraudulently activated phone had been shut off. In a recorded telephone call, the fraudster threatened the telephone service provider that if the provider did not provide

access to its computer system, he would cause its web service to collapse through a denial of service attack – an attack designed to ensure that a website is so flooded with requests for information that legitimate users cannot access the website.

Illustration 10-13: Fraudsters will try to frighten victims telling them that they are deeply implicated in the fraud and that they will not be allowed to escape the fraud, or that the fraudster has ways of seeing to it that they will be arrested by national or international law enforcement authorities. Witness intimidation is common in commercial fraud.

- Fraudsters rationalize that there are no real victims because their targets are avaricious, complicit and gullible.

Advice:

- Try to objectively appraise the merits of the proposed transaction, and be aware that suspicions that flow from one's own common sense appraisal should be taken seriously. Ask oneself "Why me? If this scheme really works, why is some stranger in a hotel meeting room or on the telephone or the Internet approaching me with a complicated financial deal with such high returns with an offer to allow me to participate?"
- One's ego should not override one's suspicions – keep asking questions, even though the scheme's promoter may intimate that one is foolish for not understanding. It is much more foolish to invest in something that is not completely understood.
- Obtain legal advice from independent counsel with the competence to advise regarding the transaction.
- Do not be discouraged from reporting a fraud to the authorities because of some ensnarement aspect.

See also: Indicator 4 – Misuse of Names; Indicator 6 – Undue Secrecy; Indicator 7 – Overly Complex or Overly Simplistic Transactions; Indicator 8 - Frustration of Due Diligence; Indicator 15 – Fraud Based on Abuse of Personal Affinity or Relationships; Indicator 17 – Unusual Involvement or Participation of Professionals; Addendum 1 – Performing Due Diligence.

Indicator 11: Crisis-Caused Breakdowns in Preventive Controls

Commercial frauds may exploit weaknesses in control systems in order to take advantage of generous or emotional impulses in the aftermath of natural and man-made disasters.

Explanation:

A hallmark of civilization is the exercise of generous impulses and actions towards those less fortunate. Natural and man-made disasters bring forth such impulses spontaneously. In response to recent hurricanes, typhoons, earthquakes and tsunamis, the public and private sectors of the international community have worked together and spent billions on recovery. The mass destruction of homes, businesses

and public infrastructure and the displacement of millions of individuals require emergency action, characterized by trust in common purpose. Commercial entities and transactions have a significant role in making possible support of disaster recovery by the private and public sectors. However, coincident with the common good, neither the presence of an emergency nor our natural crisis-driven impulse of mutual trust should take the place of understanding the investment or business transaction, or of the exercise of due diligence and vigilance in preventive controls. A key lesson of past disasters is that funding lost to fraud slowed the recovery effort and reduced the amount of support that could have been delivered to alleviate the suffering and needs of legitimate victims.

Fraudulent schemes anticipate that, in the aftermath of disasters, individuals, businesses and governments will tend to suspend due diligence or circumvent the operation of normal preventive controls. In the mental model of fraudsters, disasters create opportunities by opening or exposing control weaknesses at a time of enhanced national or international urgency and when there is a general heightened emotion on the part of populations wishing to place trust in a common purpose.

Instances and Examples:

- The outpouring of public generosity in the immediate aftermath of a disaster is often manipulated by attempts to exploit charities or charitable giving.

Illustration 11-1: There are always some fraud schemes involving solicitations for ostensibly charitable purposes. When natural disasters strike, the incidence of such schemes can rise dramatically. After the terrorist attacks of September 11, 2001, the Indian Ocean Tsunami and Hurricanes Katrina and Rita, for example, law enforcement authorities saw a significant number of schemes that purported to be collecting money for first responders and survivors of the disasters.

Illustration 11-2: “High-yield” investment schemes spring up very quickly after major disasters or world events. Characteristic of such schemes the selling tactics are not aimed at a purely charitable purpose but mix the promise of great profits with alleged charitable or “humanitarian project” benefits. Often fraudsters allege that the scheme is “sanctioned by the United Nations” or that it is a “UN approved programme for investment”.

- As governments organize for response, fraudsters search for control weaknesses in their procurement, benefit and grant processing.

Illustration 11-3: Procurement fraud schemes, such as kickbacks from vendors to contracting agency employees in exchange for favourable treatment, occur with frequency in contracts for procurement of goods and services after large-scale natural disasters, when many governments and international agencies enter into contracts for debris removal and infrastructure rebuilding.

Illustration 11-4: Fraudsters pressure evacuees to give the fraudsters permission to receive their mail. Government disaster assistance cheques intended for the evacuees are sent to the

fraudsters' addresses and then diverted to secure cash or buy goods from local businesses. Often the goods are then sold directly or through online auctions initiated by fraudsters in other regions, or even other nations, serving as "brokers" for theft rings in the immediate area of the disaster.

- As private sector resources are accessed to engage in disaster recovery, fraudsters take advantage of information gaps in the damage assessment process and systemic breakdowns in controls normally associated with financial systems.

Illustration 11-5: Examples of insurance fraud include fraudulent claims for property damage or loss, or for feigned physical injury, and false claims for renovations due to disaster damage, as well as sales of false insurance contracts.

Illustration 11-6: Displaced financial institutions attempting to provide emergency banking services to disaster survivors experience an increase in cheque kiting: the use of several bank accounts in different geographic areas to make deposits and write cheques against the accounts before the deposit cheques clear the banking system, creating a "float" of money out of nothing more than the lag in time while cheques clear and post to their respective accounts.

Advice:

- Exercise any charitable impulses through appropriate and recognized charities.
- Where there are claims that an investment will not only achieve high returns, but that it has the additional benefit of humanitarian purposes, disaster relief, or the like; or where such motives are held out as a basis for justifying investments or other financial opportunities that are not explicable or justifiable on their own business terms, there may be an indication of commercial fraud.
- The sudden interjection of a commercial transaction in a non-commercial setting should raise concern that there is no real or logical connection between the charitable cause and the proposed scheme.
- With a focus on substantially diminishing the opportunity for fraudulent access to systems through front-end controls, preventive controls are a key element of an effective fraud-prevention programme.
- Well before any disaster, preventive controls should be field tested to ensure they operate as intended.
- Repeat offenders are common in Internet-based fraud. Databases of prior fraud, as a defensive method, for example to compare elements of incoming orders to information in the prior-fraud database, may guard against repeat false orders or invoices.
- A well-trained work force that is aware of the potential for fraud can help prevent fraud. Fraud awareness training with frontline personnel – specifically on the potential for fraud within the programme and the likely types of fraud

they could encounter – is crucial to stopping fraud before it gains access into the business or government operation.

See also: Indicator 8 – Frustration of Due Diligence; Indicator 15 – Fraud Based on Abuse of Personal Affinity or Relationships; Addendum 1 – Performing Due Diligence.

Indicator 12: Immediate, Fast or Irrevocable Transfer of Funds

Commercial frauds often pressure potential investors not only to make a very rapid decision, but also to immediately or quickly transfer funds, leaving little to no time for due diligence or reliance on expert advice.

Explanation:

Legitimate transactions often require quick decisions and immediate action. However, the individuals or entities engaged in such transactions typically are able to participate because of a prior understanding of the nature of the risks and rewards involved. Thus, those individuals and entities do not suspend due diligence in favour of quick decision-making, but instead, exercise due diligence of a different variety, or at different points in the transaction.

A fraudster will often persuade a victim of the need for quick decisions in an attempt to thwart due diligence or to effect an irrevocable transfer of funds in the fraudster's favour. A person or entity being asked to make a decision with financial implications may be pressured to effect immediate, fast or irrevocable transfers of funds in order to complete the transaction. Once sums have been transferred, they are easily further transferred by the fraudster, often into other international jurisdictions that may make retrieval or tracing difficult or impossible.

Instances and Examples:

- The fraudster will insist on an immediate transfer of funds, leaving little or no time for even basic due diligence.

Illustration 12-1: The promoter of an investment touts the investment's certain rewards and high yield. At the same time, the promoter will warn the potential victim that the investment opportunity "will not last", or is a "once in a lifetime opportunity", and that the victim must "act fast". The promoter insists on a quick decision before the victim has sufficient time to thoroughly review the transaction.

- The immediacy of the transaction may be used to induce the victim to agree to additional terms.

Illustration 12-2: An investor is induced to authorize a transfer to a new account established for the fraud. Because of an alleged need for urgency and convenience, the investor is induced to add the fraudster or his or her accomplice as a co-signer on the new account. The fraudster and co-signer then transfer the funds in the new account into their control.

- A fraud may also involve the immediate and irrevocable transfer of funds to off-shore companies.

Illustration 12-3: A transaction involves transfers to an off-shore company described as an “anonymous” off-shore company, or to an off-shore company, trust, or account in a “tax-haven” jurisdiction.

Advice:

- Do not be induced to enter into a transaction before exercising the requisite due diligence because of pressure and time limitations.
- Never relinquish control over banking or investment accounts.
- Understand the reasons given for any transfer of funds, especially when a transaction involves multiple transfers.
- Be particularly vigilant regarding transfers of money to another jurisdiction, especially off-shore jurisdictions which have secrecy laws and make any recovery of transferred funds extremely difficult and cost-prohibitive.

See also: Indicator 6 – Undue Secrecy; Indicator 8 – Frustration of Due Diligence; Addendum 1 – Performing Due Diligence.

Indicator 13: Questionable or Unknown Source of Repayment

Commercial frauds often obscure the source of payment of alleged earnings or returns on an investment by referring to vague sources, foreign sources, uncertain sources, such as generic “trading programmes” (sometimes on “secret” markets), or by suggesting sources of payment in unregulated international jurisdictions or from non-regulated entities.

Explanation:

Knowing the source of repayment, as well as compliance with documented procedures that ensure accurate, timely repayment of earnings and returns is essential to legitimate commercial transactions. In commercial transactions, genuine financial intermediaries possess sound principles of management, clear business models and documented and well-executed processes that are subjected to ongoing evaluation of efficiencies. Efficient repayment operations are conditioned on clear and known rules and accurate communications with trusted counterparties. Commercial transactions often require foreign sources of repayment, however, transactions typically do not include unexplained complexities, or use of inefficient repayment methods, or requirements that sources of repayment depend upon unregulated international jurisdictions. Nor would it be usual for an offshore or foreign source of repayment to be part of an otherwise wholly domestic transaction. The person or entity being asked to make a decision with financial implications must understand the business reasons justifying the underlying transaction, and determine the specific commercial reasons for any complexities, and must know, with certainty, the source of repayment.

Fraudulent schemes often entice prospective investors into not questioning the source or method of repayment by offering unusual financial incentives that are not related to the underlying transaction, or that have no commercial justification.

Investors may be lured by an “enhanced rate of return” to accept a promise of repayment from an entity with no discernable business connection to the transaction. Often, part of a fraudulent scheme may depend on the investor agreeing to repayments transacted through jurisdictions regarded as secrecy havens. This “offshore source” feature subjects the victim to further manipulation: by agreeing to unusual sources of repayment in exchange for the potential to avoid paying any taxes on proposed returns, the investor becomes complicit in the scheme. Vague, uncertain or offshore sources of repayment are often used to keep investors in a state of doubt, so that a fraud is not noticed until it is too late.

Instances and Examples:

- The true nature of a transaction will be obscured, will likely lack commercial purpose, and will have improbable characteristics, such as disproportionate returns.

Illustration 13-1: “Historical bonds”, or bonds that were once valid obligations of commercial or sovereign entities but that are now worthless as securities and only collected or traded as memorabilia, are said to be worth millions or billions of dollars based on third-party statements often referred to as “hypothecated authentications” or “hypothetical valuations”, and are sold to unsophisticated investors at inflated prices far exceeding their value as collectibles.

- Returns are claimed to be from purported sales of more of a commodity than is produced or available in the world.

Illustration 13-2: The source of repayment is claimed to be gold, that is “collateralized” by fictitious “gold certificates” or “warehouse receipts”, variously said to have been issued by obscure or non-existent offshore banks, or by major financial institutions, or even by well-known international organizations, representing gold bullion that, if true, would require more gold than produced in recorded history.

- Repayments are sourced from other participants’ investments or from a participant’s own investment.

Illustration 13-3: In one “pyramid scheme” a “trading company” sold bags of ants asking investors to breed the insects and bring them back for a 130 per cent return. Initially, the purchase money received from new investors was used to pay returns to the previous investors. Pyramid schemes reach critical mass, and collapse, when the source of funds from new investors is inadequate for repayment of prior investors.

Illustration 13-4: After falling for “high-yield”, “Prime Bank” investment fraud, victims are often approached by a second team of fraudsters with an offer of “fraud recovery” services. Small amounts are “recovered” in exchange for an “advance fee”. The victims are then pressured for additional and more substantial fees, and promised “more complex” higher value recoveries. The source of all funds “recovered” by the second team is the victims’ own

funds in the hands of the first team. The fraud continues until the second team has extracted all the fees the victims are willing or able to pay. By this time, the victims will have lost all funds initially “invested” with the first team and all “advance fees” paid to the second team.

Advice:

- Be able to identify the commercial purpose of the transaction and understand how the returns are generated.
- An overemphasis on esoteric details, such as “historical bonds”, overly complex methods of payment, inconsistent explanations regarding sources of repayment, and unusual requirements predicate to earnings, are not typical of legitimate business dealings.
- When returns are overdue an investor should immediately seek independent, objective advice and accept no excuse.
- When a major source of returns is derived from inducing others to invest and, in turn, recruit others, great care must be exercised regarding the legitimacy of the scheme. If the major commercial purpose is obtaining percentages of investments from lower tier investors, it could be a so-called “pyramid scheme”.
- Do not become so focused on the amount of the alleged returns on the investment that one forgets to focus on the source of those returns.
- Be suspicious of repayment methods or sources that involve entities, jurisdictions or complexities having no discernable business justification in connection with the transaction.
- References to “high yield” and “no risk” investments in “secret trading programmes” or “secret trading rooms” in “tax-free” or “bank privacy” jurisdictions signal that the transaction departs from commercial norms and that there may be no commercial source of repayment. If confronted with such terms, investors must aggressively conduct due diligence.

See also: Indicator 5 – Disproportionate Returns; Indicator 8 – Frustration of Due Diligence; Indicator 9 – Corrupted Incentives; Indicator 10 – Ensnarement and Psychological Inducements; Indicator 20 – Pyramid and Multi-Level Marketing Schemes; Addendum 1 – Performing Due Diligence.

Indicator 14: Irrational or Illogical Aspects or Explanations

Once an investment has been made, in an effort to prolong the fraud or to hide the proceeds, a fraudster often relies upon any available or superficially plausible reason to explain any aspect that is questioned. Often, these excuses or explanations will not bear close scrutiny and will reveal the commercial fraud.

Explanation:

Modern commerce and finance has a rational and systematic character. Although it may sometimes be difficult to understand, there are always commercial, historical, systemic, or other reasons for its features that can be understood and explained.

Where there are irrational or illogical elements of an instrument or scheme, particularly with respect to failed performances, further investigation is warranted and an independent expert should be consulted.

A fraudster will frequently give inconsistent or illogical explanations to persuade the potential victim not to seek such advice, to prolong the fraud, or to hide the proceeds of the fraud. The victim may be given illogical explanations that attempt to induce the victim to participate further in the fraud. Or, when the proceeds are delayed, the fraudster may claim that returns due the investor are delayed by natural disasters, current events, or other such events that typically would not affect transactions of the type contemplated. The victim may also be induced to remain silent about the transaction based upon threats that reporting will delay payment or make payment impossible.

Instances and Examples:

- Fraudulent transactions may involve illogical explanations as to counterparties' roles or identities in the transaction.

Illustration 14-1: The fraud may involve unlikely connections in the overall scheme, such as a banking transaction with organizations that are not banks, such as the United Nations or the International Chamber of Commerce, or a private banking transaction with an international banking institution that does not conduct retail banking, such as the International Monetary Fund or the World Bank.

Illustration 14-2: The fraudster may describe clients or counterparties whom the victim never meets. For example, a lawyer promotes a transaction in which a "client" will trade financial instruments as a member of a secret inter-bank market in these instruments, but the client is never identified or introduced to the victim.

- Irrational or illogical aspects may appear in the very fundamentals of the transaction.

Illustration 14-3: There may be a serious disproportion in the overall structure of the transaction, such as a relatively small transaction with a huge, powerful bank allegedly behind it.

Illustration 14-4: Illogical logistics may appear, for example, in the sale of goods, where the movements of such goods do not make sense geographically in terms of where they are typically produced or grown.

- Irrational or illogical explanations may also be used to explain delays in realizing the proceeds of a transaction. In most situations, the reason claimed for the delay bears little relationship to any actual or likely delay in the transaction.

Illustration 14-5: The fraud may involve claims of delays falsely attributed to legal considerations, governmental interference, current events such as natural disasters or political changes. In one

case, for example, the fraudster claimed that international payment systems were shut down after the death of a member of the Royal Family, and the proceeds of a transaction would not be available until after the systems had been reopened.

- A fraudster may actively discourage reporting the current failure to complete a transaction or the failure to make payment by claiming that doing so will make future completion or payment impossible.

Illustration 14-6: When proceeds are not realized, the fraudster may tell victims that realization of the investment is pending and that, if reported, the authorities will not understand the transaction and will cause unnecessary delays while they investigate it.

Illustration 14-7: When a victim questions the fraudster about delayed proceeds, the fraudster may attempt to ensure silence by leading the victim to believe that he or she, too, is implicated in any fraudulent conduct. For example, the fraudster may admit to the victim that the transaction is of questionable legality but that because the victim had received some proceeds from other victims, he or she is just as guilty as the fraudster.

Advice:

- Think critically about the logic or likelihood of explanations, and when the explanations are not understood, do not be embarrassed or afraid to seek independent advice.
- Always ask the promoter of a transaction to explain necessary terms or critical roles if they are not understood. Be suspicious of a promoter who cannot explain vital roles or terms satisfactorily, and be willing to seek objective advice in such cases.
- It is better to face unpleasant suspicions and investigate them sooner rather than later, since time is always in favour of the fraudster.
- If there is doubt, seek assistance from the authorities.

See also: Indicator 3 – Inconsistencies in the Transaction; Indicator 8 – Frustration of Due Diligence; Addendum 1 – Performing Due Diligence.

Indicator 15: Fraud Based on Abuse of Personal Affinity or Relationships

Commercial frauds often take advantage of non-economic factors like the natural trust between people of similar backgrounds to cause potential victims to reduce the due diligence that they would otherwise exercise and to use the group as a source of potential victims. Moreover, commercial frauds often tailor themselves to the beliefs or commonalities that unite or are characteristic of a group.

Explanation:

It is normal to give credibility to and to defer to those with whom one is closely associated such as relatives, friends, or those of similar backgrounds, including religious, social, political, ethnic, charitable, fraternal and other relationships. Commercial frauds often play on these affinities to promote themselves and cause

investors to substitute the security of the affinity for understanding or seeking out advice with respect to the proposed investment. The problem lies not in the affinity or relationship, but in an excessive reliance on the common linkage instead of objective factors related to the proposed investment.

Instances and Examples:

- Relationships that can be abused include:

- Family relationships;

Illustration 15-1: Fraudsters often induce relatives and friends to invest in a scheme of which they would otherwise have been sceptical.

- Sports teams or apparent celebrity endorsements;

Illustration 15-2: The fraudster uses the reputation of a major sports figure to induce and promote investments that are fraudulent.

Illustration 15-3: An eminent citizen or celebrity is invited to an event promoting an investment, and by accepting the invitation, appears to be personally endorsing the investment.

- Religious or cultural affinity;

Illustration 15-4: A religious or cultural group is encouraged by other members or a leader to join an investment scheme that purports to benefit their common faith or heritage only on the basis of that relationship.

Illustration 15-5: A group suddenly becomes focused on a particular investment or scheme, seeming to support it en masse, when it is unrelated to the purpose or common theme of the group.

Illustration 15-6: A previously unknown individual becomes a member of a particular group, becomes influential in the group, and strongly encourages a particular investment or scheme to members of that group.

Illustration 15-7: A sudden change in the group dynamic from a religious or cultural focus to a more commercially-oriented one.

- Or charities.

Illustration 15-8: A fraudster uses a current tragedy to set up a false charity whose proceeds benefit the fraudster and affiliates and not the victims of the tragedy.

Illustration 15-9: It is common for commercial frauds to state that a certain portion of funds will be used to benefit a given humanitarian or other charitable cause.

- Assurances: The fraudster may attempt to link the fraud to the group to provide added comfort.

Illustration 15-10: Fraudster may convince a group that funds invested will remain in the control of the group.

- The credibility of these schemes can be enhanced considerably by returns paid as promised from the same money invested or the investments of others.

Advice:

- Trust based on shared interests or relationships should not take the place of understanding the investment or business transaction or of the exercise of due diligence and vigilance in protecting one's interests.
- Think independently.
- Do not substitute the friendly advice or suggestions of an acquaintance from a social or other group for professional advice when finances are involved.
- Because a counterparty has had a history of financial solvency in the past, do not assume that it is necessarily solvent today.
- Knowing one's counterparty must be an ongoing process, since circumstances can change, and business stresses can lead to reckless and fraudulent behaviour even in a previously legitimate business.
- Do not allow outward trappings like expensive cocktail parties at luxurious hotels, or meetings of like-minded individuals, to cloud one's judgment regarding a potential investment.
- Be careful which invitations are accepted and thus those to which one's name and reputation are lent.

See also: Indicator 4 – Misuse of Names; Indicator 5 – Disproportionate Returns; Indicator 8 – Due Diligence; Indicator 10 – Ensnarement and Psychological Inducements; Indicator 11 – Misuse of Motives; Indicator 20 – Pyramid and Multi-Level Marketing Schemes; Addendum 1 – Performing Due Diligence.
