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FINANCIAL CRIME: LIFTING THE VEIL ON THE TRUE ECONOMIC AND HUMANITARIAN COST

By Che Sidanius

The true cost of financial crime extends far beyond pure economics. Critical social and humanitarian consequences impact the lives of millions of individuals across the globe on a daily basis. When viewed in its entirety, can we ever really quantify the cost of this so-called 'victimless' crime?

> *"Financial crime causes incalculable harm around the world. The proceeds of bribery, corruption, fraud, narcotics trafficking and other organized crime have all been implicated in the financing of terrorism, human rights abuses such as slavery and child labor, and environmental crime. This has serious economic and social costs in terms of the lost revenues to national exchequers that could be invested in social development, and in terms of the impact on individual lives."*
>
> **Che Sidanius, Global Head Financial Crime Regulation & Industry Affairs, Thomson Reuters**

ON-THE-GROUND INSIGHTS

As part of our ongoing commitment to exposing the true cost of financial crime, Thomson Reuters commissioned a global survey during March 2018 and collated insights on this type of crime from over 2300 senior managers of large organizations, both publicly listed and privately owned, across 19 countries[1]. In order to build a more complete picture of the social and financial impact of financial crime, we broadened the scope to include bribery and corruption; money laundering; fraud; theft; cybercrime; and slave labor/human trafficking.[2] Survey results were further supplemented by conducting in-depth interviews with leading NGOs (Education Endowment Foundation, Transparency International UK and Walk Free Foundation) and the European Union's law enforcement agency to gain perspective on the humanitarian cost and implications of this pervasive form of crime.

BACKGROUND TO THE CHALLENGE

Before delving into the impact of different types of financial crime, our survey uncovered some of the factors that have created an ideal environment for these crimes to continue:

- ***Extensive networks***
  Survey results revealed that one in 10 organizations had dealt with over 10 000 third party vendors, suppliers or partners during the preceding 12 months and the global average number of such relationships was reported as 7 693.

- ***Inadequate screening***
  Whilst screening, both at the initial onboarding stage and on an ongoing basis, can never hope to completely eradicate financial crime, it is nonetheless recognized as an important tool to identify potential links to crime. Survey results revealed that an average of just 59% of these third party vendors, suppliers or partners were screened at onboarding and the same percentage are monitored and reviewed on at least an annual basis. This means that only approximately 35% of all relationships are fully screened.

- ***Lack of reporting***
  59% of all detected financial crime is reported internally and, for the most part, reported externally.

- ***Ever-increasing pressure***
  Organizations are under ever-increasing pressure: 83% of survey participants expected that pressure to increase turnover would be either extreme or significant in the 12 months post-survey.

This combination of factors – extensive third party networks and insufficient screening and reporting, against a backdrop of increasing pressure to grow profits – has led to a situation where financial crime is flourishing across the globe.

THE TRUE IMPACT: FINANCIAL AND HUMANITARIAN

Financial crime is pervasive, with 47% of organizations confirming that they had been the victim of such crime in the year preceding the survey. Public companies appear to suffer more – 55% of publicly listed companies said that they had experienced some form of financial crime in their global operations over this period, against 45% for private companies. The estimated total loss as a result of these financial crimes is USD1.45 trillion, equating to 3.5% of annual turnover.

Many people assume that financial crime impacts big business alone and it is therefore often regarded as 'victimless', but nothing could be further from the truth. The human cost of financial crime is also significant. The Global Slavery Index, produced by the Walk Free Foundation and International Labour Organisation, estimates that 40.3 million people today are in modern slavery, with just five countries – India, China, Pakistan, Bangladesh, and Uzbekistan – responsible for 58% of this total. The cost of slavery/human trafficking in the EU is estimated to be €30 billion, and extrapolating this on the dual assumptions that the EU represents approximately 20% of the global economy, and that other areas of the world have a similar prevalence, this puts the global cost at €150 billion, broken down as follows:

- USD99 billion from commercial sexual exploitation
- USD34 billion in construction, manufacturing, mining and utilities
- USD9 billion in agriculture, including forestry and fishing
- USD8 billion dollars is saved annually by private households that employ domestic workers under conditions of forced labor

> *"Ordinary people everywhere in the world unwittingly meet victims of modern slavery every day – we might walk past a young woman trapped in a forced marriage, a hotel cleaner that has had her passport confiscated, or touch this crime through clothes we wear that were made through illegal forced labor."*
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> **Fiona David, Executive Director of Global Research, Walk Free Foundation**

There are a host of further examples of financial crime impacting individual lives, such as lost tax revenue that could have funded essential services like education. When these funds do not reach the coffers of national exchequers, a vacuum is created. By way of example, The Education Endowment Foundation calculates that every USD1bn in missing tax revenue equates to:

- High-quality early years education for 150,000 toddlers in Spain.
- Places for 327,000 children in primary and secondary schools in Mexico.
- Approximately 2,000 more schools in India.

Examples such as these merely hint at the total societal and humanitarian cost born by millions of individuals across the globe every day.

THE CURRENT STATE OF PLAY

Compliance and training gaps

Organizations are largely aware of the incidence of financial crime and are hardly resting on their laurels. Respondents estimated that they spent an average of 3.1% of turnover to prevent these issues occurring around their global operations – a collective spend of USD1.28 trillion – in the past year. Despite this, inefficiencies and significant gaps in formal compliance procedures remain: respondents globally revealed that just 57% fully screen and classify risk; 52% fully conduct due diligence; and 52% fully monitor and refresh records.

Gaps in training are also evident. By way of example, just 46% of respondents confirmed that formal training is undertaken by colleagues around the globe in identifying, preventing and reporting breaches in slave labor/human trafficking.

A lack of data intelligence

Rob Wainwright, former Executive Director, Europol says that his organization estimates that barely 1% of criminal proceeds generated in the European Union are confiscated by relevant authorities, despite the fact that global banks spend billions of dollars each year meeting stringent anti-money laundering regulations. This suggests that current regulatory regimes are highly inefficient.

Europol research further shows that, over a period stretching back to 2006, an average of only 10% of all suspicious transaction reports received by law enforcement agencies across Europe ever led to any meaningful investigation, with a primary reason identified as 'the general paucity of good-quality intelligence delivered by the system'.

WHAT CAN BE DONE?

When it comes to rooting out financial crime, reliable and complete data, as well as industry-wide collaboration are important tools in this ongoing fight.

Data is a critical requirement needed to develop a 360 degree view of risk. Only when this 'paucity of intelligence' has been remedied can organizations hope to plug the identified compliance gaps. When selecting a financial crime data partner, advanced technological capabilities are a valuable area for companies: 66% saying they have this already and 31% are considering it. Approximately half of respondents cite the importance of subject matter expertise, research methodology and breadth and depth of information.

Globally, 94% of respondents are supportive of sharing financial intelligence/information on specific cases and sharing compliance best practice, pointing to a clear appreciation of the importance of collaboration in the fight against financial crime. To this end, new collaborations are already being formed, as David Craig, President

Financial & Risk, Thomson Reuters, elaborates, 'at Davos 2018, the World Economic Forum, Thomson Reuters and Europol launched a coalition to improve awareness of the extent of financial crime, promote more effective information sharing and establish enhanced processes to share best practice.'

Undoubtedly the first step to thwarting financial criminals is to unveil and raise awareness of the full impact – both economic and humanitarian – of this pervasive global scourge. Ongoing initiatives to root out financial crime at all levels are encouraging, and are further supported by recent IMF (International Monetary Fund) initiatives in this space: in April 2018, the IMF announced that its Executive Board had just endorsed a new framework for stepping up engagement on governance and corruption in member countries, commenting that, 'to be truly effective, anti-corruption strategies… require broader regulatory and institutional reforms. At the end of the day, the most durable 'cure' for corruption is strong, transparent, and accountable institutions.'[3]

Thomson Reuters, as a critical partner in the fight against financial crime and a source of trusted answers, helps customers anticipate, mitigate and act on risk with confidence.

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1 The individual countries included in the survey were: The USA, Canada, China, India, Singapore, Australia, the UK, Germany, the Netherlands, Spain, France, Russia, Poland, the UAE, Saudi Arabia, South Africa, Nigeria, Brazil, Mexico.

2 Please note that the standard convention of rounding has been applied and consequently some totals do not add up to 100%.

3 https://blogs.imf.org/2018/04/22/shining-a-bright-light-into-the-dark-corners-of-weak-governance-and-corruption/

AUTHOR BIO:

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Che is the Global Head of Financial Regulatory & Industry Affairs. His role is to manage how regulatory changes around financial crime affect Thomson Reuters Risk & Supply business globally. His responsibilities include proposing courses of action to address regulatory changes and drive execution throughout the organizations. His previous experiences include working at Big 4 consultancies within Capital Markets Advisory, as a Senior Advisor at the Bank of England, and a Senior Examiner at the Federal Reserve Bank of New York during the 2007-09 financial crisis.