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ADVANCE FEE FRAUD AND BANKS

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Ladies and gentlemen, good afternoon.

Advance Fee Fraud, particularly Prime Bank Instrument Fraud, has become a major business in recent years and has generated very large profits for those who perpetrate it. Despite the corresponding losses it causes for individuals, businesses and banks, it remains a little understood type of fraud both by the business community and law enforcement in general. My objective today is to try to shed a little light on how it works and who it affects - particularly the impact it has on banks.

I would like to discuss five main areas and these are:

- . .What is an Advance Fee Fraud.
- . .Understanding who the victims are likely to be.
- . .How Advance Fee Fraud affects banks.
- . .Identifying Advance Fee Fraud Approaches.
- . .What action banks can take to combat Advance Fee Fraudsters.

I shall also provide some examples to show you what I mean.

What is an Advance Fee Fraud

An advance fee refers to an upfront payment by the victim to the fraudster, to allow the victim to take part in a much larger financial transaction which he believes will either bring him a profit or will result in credit being extended to him. This larger financial transaction is always bogus and the victim never makes a profit nor does he receive the loan.

To give you a simple example, a businessman urgently requires a significant amount of credit which he is unable to get from his bank. He replies to an advert in a newspaper and is told he can obtain a loan of USD4 million - but first he has to pay an arrangement fee of USD25,000. He is willing to pay the money and does so. The loan never materialises and the businessman loses his money. There are very many variations on this, some of which are very complicated but all generally involve some form of advance fee being paid at some stage.

Let me give you a somewhat more complicated example:

A fraudster in Country A persuades his victim that he has access to a covert secondary market - generally only known to large banks - which trades in so-called .Prime Bank Guarantees.. Enormous profits are said to be made in a short time. However, in order to be able to invest in this market the victim is told he needs to demonstrate that he has available capital - so he is then asked to deposit some money in an account in a bank. Let us say the amount is USD3 million. The victim is the only person who is a signatory to the account and has not been asked for any payment so he feels he is not at risk.

In the meantime the fraudster requests that the victim arranges for the bank to issue a .Blocked Funds Letter., which states that the USD3 million is blocked in the account for a year and a day. The fraudster says this is a further demonstration of the availability of funds. This is all fairly meaningless to the bank but it agrees to issue the letter as it wishes to please the customer and cannot see any risk.

This letter is then used by the fraudster in Country B to assist him in persuading another group of victims to join him in placing a deposit on an ore smelting plant which is being sold cheaply, which can apparently then be sold for scrap at a good profit.

The fraudster then runs away with the contributions of the investors in Country B whilst persuading the victim in Country A to hand over an arrangement fee of USD50,000 to allow him to start trading in the guarantees. The victim in Country A is still concentrating on protecting his USD3 million and so gladly hands over the smaller amount. This time the fraudster does not run away but insists that the trading cannot begin because of some technical violation by the victim and claims that the arrangement fee has been forfeited. The victim is unsure but is eventually convinced and puts his loss down to experience.

This example is based on an actual fraud but others can be far more complicated and sometimes involve several frauds at the same time.

Understanding who the victims are likely to be

First I should say that in the vast majority of cases the targeted victims are not banks but are rather individuals and small businesses. That said, it is also true to say that the fraudsters almost invariably attempt to involve banks in some way in their frauds, and in some cases it is the banks and other large organisations themselves which are the intended targets.

Many of the individuals who fall victim to advance fee fraud broadly fall into one of two categories. Either they or their business are seeking credit and are having difficulty in obtaining this elsewhere, or they are persuaded that they have the opportunity to join a business deal which is going to make them a great deal of profit. Surprisingly, it is often very difficult to persuade these victims that they have been defrauded - even after they have lost their money.

People, particularly businessman, find it hard to believe that their judgement has allowed them to be fooled into losing money that they will not recover. This pride, if that is what it is, along with embarrassment when they do realise that they have been duped, is one of the major contributory factors in allowing fraudsters to successfully get away with their crimes, as victims are often reluctant to make a report to the authorities.

I mentioned before that the fraudsters almost invariably attempt to involve banks in these transactions in some way. The most common reason for this is to add credibility to the transaction. By making the victim believe that a major financial institution is underwriting, or at least involved, in a large deal, they make the victim that much more confident in handing over the advance fee.

In other cases it is large corporations or the bank themselves which are the intended victims of the fraudsters. It should be remembered that advance fee fraudsters are often involved in many other types of fraud and financial crime, one day they may be involved in approaching a bank with a prime bank guarantee fraud and the next day be involved in a tested telex scam involving the same institution. They may be simply laundering the proceeds of their frauds through the bank concerned. Whatever their activity it is clear that no reputable financial institution would wish to have anything to do with them.

How Advance Fee Fraud affects banks

Banks are affected by these fraudsters in a number of different ways, some more serious than others. At the lowest end of the scale considerable executive time can be wasted. Advance Fee Fraudsters are very keen to obtain signed letter headed bank notepaper which they can then alter and use to convince others that a bank is actively participating in a deal. To get the maximum number of items of signed correspondence they will frequently send numerous letters and faxes to the bank which relate to deposits and remittances which they claim will be made or received at some time in the future. These deposits of course never materialise. It is quite common for a junior, or even medium level executive, to spend a great deal of time answering this correspondence and making other arrangements in the mistaken belief that he or she is promoting a very profitable deal for his bank. What he is in fact doing is storing up trouble for the future!

Sometimes the fraudsters approach the banks through a middleman, perhaps a trusted customer whom they have managed to convince and who is willing to invest in their scheme. This trusted customer may wish the bank to loan money to the scheme, hold documents against receipt, issue guarantees or any number of other actions which all add up to the same thing - involvement by the bank and possible financial exposure.

Advising this trusted customer that he is being defrauded is not always easy. As mentioned before, he may not wish to believe it and even if he does, he may well go directly to the fraudster and repeat what he has been told. In many jurisdictions this can then lead to the fraudster threatening the bank with legal proceedings for defamation. Knowing from experience that a scheme is fraudulent and proving it are two different things. It is not unheard of under these circumstances for banks to make ex-gratia payments to fraudsters simply to quickly extricate themselves from possible legal action. Great care and sensitivity therefore needs to be exercised in dealing with these cases.

The threat of legal action can be a potent one - particularly in western countries. With it can come publicity and possible damage to reputation, even when the bank concerned is absolutely blameless. In a recent case in Asia that I am aware of two large banks inadvertently became involved in issuing some perfectly genuine low value guarantees to a particular company. Unknown to the banks, the individuals behind this company were involved in a major fraud that was designed to dupe a large number of investors. Crucial to the victims investing in the fraudulent scheme was their belief that it was guaranteed by these two banks

- something that was falsely claimed in the fraudsters investment literature. The investors have now reportedly lost over USD100 million whilst the fraudsters have fled, leaving the banks proclaiming their innocence and defending themselves from claims for compensation and demands for the repatriation of funds transferred overseas.

In another case last year a European bank was sued in the United States for over USD300 million by a group of investors who had lost money and who claimed that the bank, which has a spotless reputation, was party to the fraud that cost them their money. A large part of the victim.s claim was understood to rest on bank letter headed documents that they had been shown by the fraudsters. I leave you to draw your own conclusions.

Occasionally, the fraudsters will attempt to involve or defraud a bank directly, often targeting a small branch or a junior or susceptible manager which they believe they may be able to deceive. A common tactic will be to persuade the manager to accept, for safekeeping against receipt, some certificates which are claimed to be worth millions of dollars. Armed with this receipt the fraudsters then deceive others who may later seek redress from the bank. The fraudsters may also attempt to obtain credit using their so-called Prime Bank Guarantees as collateral or to persuade the manager to issue other forms of guarantee based on documentation that they provide. The variations are endless and whilst most follow a common theme, it is rare for two schemes to be precisely the same. No reliable figures are available to indicate how much money is lost annually to these frauds but it can safely be assumed to be considerable.

Another reason why bankers need to be aware of advance fee fraud today is the increasing introduction of money laundering regulations around the world. Fraudsters have to put their ill-gotten gains somewhere and this is usually in the banks. The sums involved can be significant. In one recent example, I was contacted by law enforcement agents in one Asian country who were making enquiries about the proceeds of a particular advance fee fraud where a group of investors had lost in excess of USD20 million, which had then been transferred out of the country into a series of overseas bank accounts. The reputational and regulatory problems that can be caused when active fraudsters open and maintain accounts with a bank means that this type of customer is one to be avoided at all costs.

Identifying Advance Fee Fraud approaches

Although the nature of these types of frauds tends to vary and mutate as time passes, there have been some common indicators or warning flags that have stayed much the same for a considerable period. Should a bank receive an approach, either in person, by letter or through a trusted middleman, where mention is made of some of these warning flags then they should immediately be put on alert. Some of the most common are these:

- . those proposing the scheme arrive out of the blue and are not introduced to the bank or referred in the normal manner
- . the proposal is grandiose, possibly unusual for the country concerned, has a high price tag and very complicated financing which possibly does not even make commercial sense
- . the proposers deliberately surround the deal in secrecy, alluding to behind the scenes funding and funders and alliances with other financial institutions
- . a refusal to reveal the source of funds

In conjunction with these warning flags, the following references are often included in any documentation produced by the fraudsters:

- . Prime Bank or Top 50 Bank
- . KTT or Key Tested Telex.
- . Blocked Fund Letters
- . Master Collateral Commitments
- . Discounted SBLCs or Standby Letters of Credit
- . Funds of Good Clean (or Clear) and Non-Criminal Origin

There are many other indicators that should put a banker on notice of a possible fraud and often it is best for him to simply trust his instincts. When an approach

is made about a very complicated deal involving huge amounts of money by persons that have not been properly referred through another institution, then he will obviously be right to be suspicious. Where the fraud approach is not so clear cut it can be more difficult to detect. It is precisely this type of case which causes the most problems for bankers, as they do not wish to turn away what may be a profitable relationship - whilst at the same time being uneasy.

The fraudsters themselves are frequently very convincing, which is not surprising perhaps as this is how they earn their money - they need to be convincing to survive. To create the illusion of respectability they are prepared to invest money into renting plush offices, staying at 5 star hotels and travelling first class when they fly. They can also be fairly dismissive when a banker confesses to not understanding what they are talking about when they propose a scheme - the banker may be afraid to admit that he does not understand what they claim to be .High Finance. and so says nothing. The fact is that when pressed, the fraudsters are unable to explain their scheme because it does not make commercial sense and in any case does not really exist.

Whilst probably the most common advance fee frauds involve the supposed trading in a so-called grey market for guarantees or letters of credit, other common frauds revolve around secret physical gold deposits in banks, gold or currency certificates issued by banks or vast lost inheritances held in long forgotten bank accounts. The fraudsters explain to their victims that of course the banks wish to deny the existence of these markets or certificates or accounts - they wish to keep all the profits for themselves! Unfortunately there are many gullible people in the world and these fraudsters are plentiful and make a good living.

You may ask yourself why it is that if these fraudsters are so successful at taking people.s money, they are not caught and punished. The answer is that the international conman is fully aware of the limitations of national law enforcement agencies and always ensures that he is one step ahead. He will see to it that whenever possible he maintains batches of instructions emanating from a principal in a country in which it is difficult to make enquiries. Extensive use is made of the fax and photocopies of documents - making it difficult to prove that he is holding fraudulent documentation. When things go wrong he will claim to be merely an agent - or sometimes a victim himself! He will try and spread his actions over a number of countries in order to make it difficult to prosecute him.

The conman will not always run when his fraud is complete, he may try and

rationalise the loss to his victim and sometimes will even manage to extract a second advance fee. The explanations given to individuals are often very plausible and the victims may remain unaware they have been deceived. The reality is that very few fraudsters are caught and fewer still are successfully prosecuted.

What action banks can take to combat Advance Fee Fraudsters

The first mistake that some bankers make is to try and understand the fraud and only accept it as such if they can rationalise the process behind it and see where the money will be lost. To try and understand is a futile exercise, the banker will probably only be seeing a small part of the fraud and will certainly never be in possession of the full picture. What is of primary importance is to recognise a fraudulent approach for what it is and to ensure that the bank does not become involved, thus protecting itself from possible financial loss, litigation and damage to reputation.

The advice that I give to our branches in Asia, is that as soon as they recognise that a proposal is likely to be an advance fee fraud they should halt any communication in writing. They should then politely advise the proposers that the bank is not interested in this type of business (whatever the proposal may be) and then close any accounts associated with the fraudsters. Depending on local practice a report to the police may also be a requirement or appropriate.

The best defence that a bank can have against these types of approaches is to establish a point of reference within an institution where all potentially suspicious transactions can be referred. This point of reference, be it an individual or a department, must ensure that it become as conversant as possible with all types of fraud and is in a position to advise colleagues who make referrals to it. Many international comen make fraudulent approaches to banks in different countries time and time again, if possible therefore it is also a good idea to get to know some of their names in order that steps can be taken to avoid inadvertently opening accounts for them and to reject any proposals at an early stage. Having a mechanism to enable some background checks or due diligence on a prospective large customer can also be advantageous.

The next step is to institute a fraud awareness and prevention programme,

advance fee fraud being only one of the many ways that banks can be affected by dishonesty. Staff should be made aware of what a typical fraudulent approach may comprise and what they should do about it. They should be told to refer suspicious letters before replying and to avoid handing out business cards to those that they have doubts about. They should learn to recognise some of the warning flags mentioned earlier.

Cooperation between banks, particularly amongst those responsible for dealing with fraud, is one of the best defences against the conman. For the reasons mentioned before it is not possible to simply rely on law enforcement agencies to deal with fraudsters on the bank's behalf - this is not enough. Combatting fraud should not be a competitive issue for banks - it should be one where a common front is established and the sharing of information is one of the best ways of achieving this. The only loser is the fraudster himself.

Ladies and Gentlemen, I hope that this has given you some idea of how the international conman operates and how he tries to involve banks in his schemes. We can do something about protecting our institutions against him through mutual support, and I think that the fact that we are here today talking and helping each other learn about financial fraud demonstrates that well.

Thank you for your attention.