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Report on UNCITRAL Colloquium on International Commercial Fraud

Note by the Secretariat

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I. Introduction

1. At its thirty-fifth session in 2002, the United Nations Commission on International Trade Law (UNCITRAL) decided that the secretariat should prepare a study of fraudulent financial and trade practices in various areas of trade and finance for consideration at a future session of the Commission.[1] The Commission noted that many fraudulent practices were international in character, that they had a significant adverse economic impact on world trade, that they also had a negative effect on the legitimate instruments of world trade, and that their incidence was growing, in particular since the advent of the Internet, which offered new opportunities for fraud. The secretariat accordingly convened a meeting of experts on 2-4 December 2002 at Vienna, at the headquarters of the Commission's secretariat to discuss this issue and to assist in drafting a note on possible future work for the next session of the Commission (A/CN.9/540).

2. At its thirty-sixth session in 2003, the Commission had before it the note by the secretariat on possible future work relating to commercial fraud (A/CN.9/540). Strong support was expressed by the Commission for the recommendation made by the secretariat (A/CN.9/540, paras. 65-67) that an international colloquium be organized to address various aspects of the problem of commercial fraud from the point of view of private law and to permit an exchange of views from various interested parties, including those working in national Governments, intergovernmental organizations and private organizations with a particular interest and expertise in combating commercial fraud. The Colloquium would also provide an opportunity to promote an exchange of views with the criminal law and regulatory sectors that combat commercial fraud and to identify matters that could be coordinated or harmonized. Further, on being informed of the possibility that the Commission on Crime Prevention and Criminal Justice could, through the Centre for International Crime Prevention of the United Nations Office on Drugs and Crime (UNODC), conduct a study of aspects of commercial fraud in consultation with UNCITRAL, the Commission, noting that its resources were fully engaged in the formulation of private law rules and related activities, sought the assistance of the Commission on Crime Prevention and Criminal Justice in conducting such a study.

3. The Colloquium was organized with the co-sponsorship and assistance of the Institute of International Banking Law and Practice and George Mason University, and in cooperation with the International Institute for the Unification of Private Law (UNIDROIT), the Organization of American States and the Hague Conference on Private International Law (the Hague Conference) at Vienna from 14 to 16 April 2004.

4. The speakers and panellists at the Colloquium consisted of a selection of experts from each of the practice areas examined, representing as broad a spectrum of approaches to the problem of commercial fraud as possible. The approximately 120 participants from 30 countries included lawyers, accountants, bankers, academics, security experts, law enforcement officials, regulators, and experts in the recovery of funds, as well as representatives of Governments and international

[1] *Official Records of the General Assembly, Fifty-seventh Session, Supplement No. 17* (A/57/17), paras. 279-290.

organizations such as the Hague Conference on Private International Law, the OPEC Fund, the Arab League, the International Monetary Fund, the World Bank, the International Chamber of Commerce and the North American Securities Administrators Association.

5. The present note provides a summary of the Colloquium proceedings and key issues and includes recommendations to the Commission for possible future work in this area.

II. Commercial fraud in specific areas of private law

A. General remarks and work in other international organizations

6. There was general agreement that commercial fraud represented a serious drain on international commerce and brought harm to banking and financial systems and markets. It was noted that commercial fraud particularly affected small and developing countries, and led to instability. Further, it was acknowledged that fraud was linked to organized crime and possible connections could be drawn to terrorist activities. It was suggested that the goal of the Colloquium was to explore areas worthy of further study, to consider the prevention aspects of commercial fraud, and to consider working with the Commission on Crime Prevention and Criminal Justice in the furtherance of any studies on commercial fraud that might be undertaken.

7. Work related to the prevention of commercial fraud in other international organizations was discussed. UNODC noted the significant criminal law dimensions of commercial fraud, as well as its own responsibility for criminal law and criminal justice issues, and outlined its achievements in the development of international law in this area. In particular, UNODC outlined its role as the secretariat for the negotiations that led to the United Nations Convention against Transnational Organized Crime and Protocols Thereto,[2] and to the United Nations Convention Against Corruption,[3] which was recently opened for signature. Key aspects of both of these global instruments were highlighted, including their universality, their highly participatory nature in aiming to achieve consensus and involve practitioners in the development of the instruments, their inherent equilibrium between the need for domestic measures and provisions for asset recovery. UNODC advised the Colloquium of the upcoming thirteenth session of the Commission on Crime Prevention and Criminal Justice to be held from 11 to 20 May 2004 in Vienna and of the United Nations Eleventh Congress on Crime Prevention and Criminal Justice to be held from 18 to 25 April 2005 in Bangkok. UNODC reported that the recommendations of the African Regional Preparatory Meeting held in March 2004 in Addis Ababa and the Asia and Pacific Regional Preparatory Meeting held in March 2004 in Bangkok, in preparation for the Eleventh Congress, specifically recognized that new forms of economic and financial crimes had emerged as

[2] New York, 15 November 2000, 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 of and Trafficking in Firearms, Their Parts and Components and Ammunition.

[3] Adopted and opened for signature by United Nations General Assembly resolution 58/4 of 31 October 2003.

significant threats to the national economies of States, and recommended that the Eleventh Congress explore the possibility of negotiating international legal instruments in those fields. UNODC noted that the preparatory meetings had indicated that it was increasingly apparent that more knowledge was required with respect to the incidence, effects and consequences of commercial fraud. UNODC expressed its support for and keen interest in the Colloquium, noting that its conclusions and recommendations would assist UNODC in the development of its own future programme of work.

8. A presentation on related work at the Hague Conference was also presented, focusing on the 1961 Apostille Convention,[4] which recent studies have shown to be widely used in the avoidance of the forgery of signatures on public documents. The Hague Conference on the use of apostilles is preparing a handbook, which should be available by the end of 2004.

B. Banking and trade fraud

9. Using the context of recent examples of commercial fraud perpetrated in banking and trade, participants in the Colloquium discussed a number of major issues common to such frauds, and, it was noted, to many frauds in general. This opening discussion set out a number of key issues that arose throughout the course of the Colloquium.

10. Two key aspects that emerged were how the volatility of the commodity in issue could exacerbate the fraud, and the importance of the financial institution's gaining a complete understanding of all aspects of the transaction that it was financing. Other problems were said to be the organization and structure of the defrauded institution or organization itself, and that internal rivalries and commission-based compensation or other incentive schemes could worsen the potential for an institution or organization to be defrauded. Other areas of vulnerability were said to emerge when a financial institution was eager to become involved in a particular type of business or transaction, and was perhaps less diligent as a result, and the relatively short institutional memories that most organizations have that can result in their being victimized by similar frauds after a cycle of approximately 10 to 12 years. A particularly complicating factor in detecting frauds was said to be cases in which the buyer and the seller of a commodity colluded in carrying out the fraud. One hallmark in banking and trade frauds was said to be the initial use of legitimate financial instruments and transport documents, and the gradual introduction of worthless and meaningless documents in subsequent transactions. Important factors in combating such frauds were suggested to be the courage of a board member or a banker to admit a lack of understanding of a complex transaction, and the implementation by the institution of appropriate due diligence programmes.

11. The difficulty in prosecuting economic crimes and in taking civil actions on fraud was discussed. While some frustration was expressed with the punishment meted out in successfully prosecuted cases, there was agreement that there was an increasing realization that the effects of economic crime can be very damaging.

[4] Hague Convention of 5 October 1961 Abolishing the Requirement of Legalisation for Foreign Public Documents.

Concern was expressed at the lack of successful prosecutions in complicated fraud cases, which require a high degree of expertise on behalf of all involved, including prosecutors, judges and jurors. The suggestion was also made that successful prosecution of fraud was not necessarily a sufficient deterrent, and that perhaps efforts should be made to examine fraud prevention from the perspective of why people commit fraud. Other aspects discussed included the extent of the liability of parent companies and their officers for fraudulent actions by subsidiaries, whether they may be liable to make restitution, and whether a reporting obligation should be imposed.

12. Another topic explored was the common situation of proceeding in fraud cases on dual track criminal and private investigation, enforcement and recovery, and the problems this can create. For example, criminal enforcement agencies are often unable to provide information that would assist in private investigation and recovery. Recovery of assets is the primary concern of private entities, but is not the main aspect of criminal sanctions. In addition, it was generally agreed that increased cooperation between the two sides would often help companies with respect to prevention and investigation, but companies are often wary of appearing susceptible to fraud. It was also suggested that, given the scarcity of resources, sometimes law enforcement agencies prefer that commercial entities perform their own investigations. However, for examples of the public and private sectors working together to combat fraud, see paragraphs 17 and 25 to 28 below, with respect to investigation and prevention.

13. One problem raised was the lack of hard data on the extent and type of fraud that is committed. Other recurrent themes in the Colloquium were the importance of dispelling the image of commercial fraud as a victimless crime, and the general difficulty of having to prove fraudulent intent. This difficulty is compounded when, for example, documents are presented that were forged by a third party.

C. Investigation

14. The session on the investigation of fraud and the issues faced during an investigation noted the importance for most victims of fraud of finding evidence that would lead to financial recovery. Of particular importance in this regard was the use of computer forensics, which can allow investigators to take immediate action to preserve assets and to uncover evidence of further fraud that often becomes apparent after the initial discovery. Using such techniques, investigators are able to discover, preserve and analyse digital data including activity of deception, copies of documents, profiles of the fraudster, and patterns of activity. It was noted that a traditional audit would probably not detect management fraud, which was the source of most material frauds.

15. A case study concerning a case of employee fraud was given to demonstrate some of the investigative techniques that can be used to track and uncover frauds. The case emphasized the importance of cooperation between private fraud investigators and law enforcement personnel, especially early in the investigation. It was suggested that fraud on the part of employees and other insiders of existing companies, whether among themselves or in cooperation with persons outside the

company, accounted for considerable losses and that corporations should be encouraged to screen and monitor their employees more effectively.

16. It was noted that recent major corporate scandals have threatened investor and corporate confidence and have made it clear that the commercial community should be prepared for large-scale fraud. Some countries have responded to these scandals with specific legislation, increased criminal enforcement and increased recognition of financial crime as a major problem.

17. The participants in the Colloquium heard a presentation on a system developed in one country to respond to these types of corporate scandals, where civil recovery was occurring, but no criminal sanctions were being assessed. Rather than simply to issue guidelines to industry, it was decided that increased criminal enforcement of corporate crime was the key to prevention and enforcement of commercial fraud. The government set up integrated market enforcement teams in four major financial centres of that country in order to target high-level corporate fraud that affected publicly traded companies. The teams, whose job is to anticipate and prevent certain types of fraud before they cause bankruptcies, are comprised of representatives from local and international law enforcement, securities commissions, and private businesses. These teams involve local prosecutors and the judiciary and are meant to meet the threat of fraud quickly, to deal rapidly with enforcement, then to move on to address the next potential problem.

18. There was general agreement that proactive techniques by law enforcement agencies were very important to the prevention and detection of fraud, particularly with respect to the public impact of such operations. It was also noted that speed was very important in the investigation and prosecution of frauds, and that this was likely to mean that investigators would focus on certain aspects of the fraud, rather than on every detail of it.

19. A particular fraud that investigators have encountered frequently concerns prime bank instruments or high-yield instruments, through which fraudsters have been able to steal large sums of money. The fraud is typified by complex transactions that often have an international component, unrealistic rates of return and other enticing rewards for investors and demand of investors a high level of secrecy. It was noted that the national law enforcement agencies have successfully organized major investigations of these types of fraud, and that coordination with law enforcement agencies from around the world often plays a key role in the investigation of these frauds.

D. Cyber fraud

20. The session of the Colloquium addressing cyber fraud advised participants of a project supported by a national government to study the protection of critical infrastructures within the country and internationally. The project aims to enhance the security of cyber networks and economic processes supporting the country's critical infrastructures, and as a consequence, examines the vulnerability of computer systems to fraudsters and hackers. The intersection of cyber security and cyber fraud was explained, in that government, industry and individuals form part of the network and must each play a role in preventing fraud and hacking activities.

21. It was noted that computer systems were particularly vulnerable to fraudsters because of increased access to the Internet, which could enable them to attack government, corporate, and individual computer systems. It was suggested that avoidance of such attacks could best be achieved by increasing the awareness of Internet users regarding how their transactions might be susceptible to fraud.

22. It was noted that cyber security was particularly important to businesses, which have unique responsibilities to keep confidential their customers' personal information. To that end, technology experts have developed new methods to protect information and new methods of using computer forensics.

23. The participants heard about a new security technique being developed by technology experts, mainly for military and intelligence purposes. However, the technology could be used to allow a business's computer system to persuade a potential fraudster that it is succeeding in attacking the business, while allowing the business to gather information about the fraudster and avoid the threat.

24. In addition, it was acknowledged again that the Internet played an important role in the growth of commercial fraud because it enabled fraudsters to increase their reach and profits. As such, Internet security plays an important role in the prevention of fraud.

E. Prevention

25. The Colloquium session on the prevention of fraud introduced the participants to a novel approach to the prevention of commercial fraud at a regional level. A group of law enforcement officials and representatives from the public and private sectors in northern England have organized a forum to fight fraud and financial crime in the region. The participants heard that the North East Fraud Forum (NEFF) links the public and private sectors with government and international agencies and meets at various points throughout the year to discuss prevention issues. NEFF also organizes a series of workshops and classes to educate the public and private sectors about commercial fraud. NEFF agreed that fraud is an international problem, but emphasized its success in addressing commercial fraud on a local level.

26. NEFF's goal since its inception in 2003 has been to provide realistic solutions to fight commercial fraud, and through a series of master-classes and workshops, to provide education for professionals in the area. The long-term goals of NEFF include studying and measuring fraud, reducing it in the region and assisting other regions locally and throughout the world in the adoption of its public-private sector model. It was suggested that such forums could eventually be united under one international forum, so that each region could address its own problems of fraud, while working with other regions to reduce the global effects of fraud.

27. An update of the estimated effects that commercial fraud has had on the global economy was provided by the International Chamber of Commerce (ICC). Using Austria as an example, it was estimated that the losses from fraud amounted to approximately 3-4 billion euros, or 5-10 per cent of Austria's gross domestic product. In any case, it was suggested that estimates of losses are likely low because only 3-5 per cent of cases of fraud are actually reported. It was also noted that the ICC, particularly in Austria, has closely interwoven connections with the public and

private sectors that it uses to prevent commercial fraud. It was further suggested that prevention of commercial fraud could also benefit from a deeper examination of the systemic causes that provide opportunities and incentives for fraud.

28. Interest in the NEFF model was expressed by a number of participants. One concern that was expressed was the extent to which information and intelligence could be exchanged between the public and the private sectors. It was noted that local legislation could be helpful in this regard, as was the conclusion of memoranda of understanding between the various organizations involved in NEFF.

29. Questions were also raised during this session with respect to whether and how commercial fraud could be defined. While it was noted that under common law, theories of fraud under tort and contract law could allow for enforcement and recovery without using the criminal law apparatus, commercial fraud tended to have both a criminal dimension and a civil dimension, and it was suggested that both were necessary in order to enable the private sector to protect, defend or allocate its rights in light of serious departures from normal commercial behaviour. Further discussion of the difficulty of defining the term is in paragraph 64 below.

F. Transport

30. The Colloquium session on transport fraud began with a discussion of maritime fraud. It was noted that maritime transport provides a fertile breeding ground for fraudsters because of the complexity of the transactions and because of the use of negotiable documents. Four of the essential commercial requirements of negotiable documents are susceptible to fraud, particularly in an uncertain legal environment: the reliability of the shipper and the carrier; the reliability of the contents of the document (particularly the description of goods); the exclusivity of the right of the holder of the document; and the availability of the document when it is needed at the place of destination of the goods.

31. The participants heard how a draft instrument on the carriage of goods [wholly or partly] [by sea] currently being discussed in UNCITRAL's Working Group III (Transport) specifically addresses each of these points of weakness (the draft instrument).

32. Provisions in the current version of the draft instrument require that the carrier be properly identified and traceably located, failing which, the owner of the vessel would be identified as the carrier, and joint liability of the actual and contractual carriers will mean that recourse may be had to the assets of the actual carrier. The carrier's obligations will be clarified, with fault-based liability and a reversal of the burden of proof such that recourse actions against the carrier will be more successful and more predictable for sellers and banks. Shippers, too, will be better identified and categorized and their obligations and liabilities clarified, with the expectation that the opportunities for fraudulent misrepresentation will thereby be reduced.

33. The draft instrument also attempts a detailed regulation of the contents of the documentation involved to resolve current uncertainties to as great an extent as possible. It also addresses the transferability of the rights incorporated in a negotiable instrument and the exercise of those rights with their attendant liabilities.

Other innovations in the draft instrument concern the inclusion of provisions on the right of control, including the right to demand delivery of the goods before their arrival at the place of destination and the right to replace the consignee with another person, both important rights to safeguard the interests of an unpaid seller or of a bank, and which may apply even in cases where no document at all is issued. Further, the consignee is under a duty to collect the goods if he exercises any rights under the contract of carriage and the bill of lading holder has an exclusive right to take delivery of the goods upon their arrival at the place of destination. In addition, the draft instrument recognizes that the innocent holder of a bill of lading deserves protection, such that the holder loses its rights to take delivery only if it should reasonably have known that the goods might already have been delivered. However, there may still be rights outside of the right to take delivery connected with the document if it is a result of a string of contractual or other arrangements made before delivery. Finally, the draft instrument also makes provision for electronic transport documents, including negotiable documents. Through these and other measures, the draft instrument attempts to clarify the uncertain legal environment that can allow transport fraud to thrive.

34. In addition to the complex documentary aspects of maritime trade, factors that further complicate transport fraud in general are the international nature of the transactions, the fact that the transport is only one aspect of a particular contract of sale and that there are often a number of buyers and sellers in the chain.

35. It was reported that the air transport industry alone saw losses of over US$ 300 million detected in 2002, but that the total estimated fraud in that period was US$ 1.5 billion. Airline fraud has been defined as any action that deprives the carrier of the revenue to which it is entitled that is undertaken without the carrier's knowledge or consent. These losses are typically a result of ticketing irregularities and other fraud, frequent flyer account fraud, credit card fraud and ticket fraud. The air transport industry again demonstrated the difficulty in addressing these frauds because they typically cross international borders and that the Internet and use of electronic distribution methods have compounded the problem. The air transport industry expressed both its belief that only cooperation can protect businesses from fraud and its eagerness to work with other entities in combating fraud.

G. Insurance

36. During the session on insurance fraud, participants heard that insurance fraud may include false claims or inflated insurance claims, or genuine losses where a lack of evidence is exploited. More complex insurance frauds could include money-laundering through legitimate insurance markets by channelling insurance premiums through a chain of valid insurance and reinsurance companies, ultimately into the fraudster's reinsurance company. A complicating factor in insurance fraud is that, because of the definitions typically used in insurance policies, insurance companies must prove fraud beyond a reasonable doubt, without having the powers available to law enforcement. In addition, the civil and criminal interface of fraud is particularly prevalent in insurance fraud and, as outlined above in paragraph 12, information-sharing and cooperation between the two may be limited, and there are often competing priorities between criminal punishment and financial restitution. Other complicating issues in insurance fraud are data protection and human rights issues,

as well as the need to maintain good customer relations while avoiding being victimized by fraud.

37. Another aspect raised was the issue of how companies insure themselves against losses due to fraud and economic crimes. It was noted that this issue is a function of the risk-management decisions that each company makes and, depending on the potential economic costs of a commercial fraud, there may even be a decision not to insure that risk at all.

38. When an insurance company has been victimized by a fraud, companies have often found it difficult to prove the fraud in court to recover their losses. Again, it was noted that the companies face difficulties in educating juries regarding the operation of a normal insurance policy, as well as which aspects of a specific transaction were fraudulent.

39. It was suggested that insurance frauds might involve other areas of law enforcement or regulation, which may assist in investigating the fraud. For example, the resale of life insurance policies for the terminally ill, which involves middlemen or investors, can result in involvement by securities regulators and investigators. This was cited as another example where cooperation between the public and private sectors could lead to faster and more effective action against fraudsters.

H. Recovery

40. Participants in the Colloquium also discussed the important issue of asset recovery once a fraud has been detected. A number of practices were suggested that would help businesses to recover their assets quickly before they are completely dissipated and lost. These practices include: fast action, taking risks in investigation, working with proven experts, using technology, cultivating and using networks of professionals and using civil and criminal facets of the law simultaneously.

41. It was also suggested that businesses consider traditional as well as non-traditional means of recovery. For example, it was suggested that a careful selection of which action to bring may help a business to recover its assets more efficiently, and a particular type of action may be more successful in recovering assets in a particular country. Because there may be specific procedures established, it was suggested that maintaining relationships with lawyers in multiple jurisdictions may help assist in recovery. In addition, reliance on private tracing and enforcement may be necessary, especially in jurisdictions where cooperation with the judiciary is either inappropriate or inefficient. Further leverage in obtaining information and recovering assets may be obtained by suing insurance companies and individuals or entities that have orchestrated the structure set up to diffuse the assets. Again, the importance of computer forensics was noted in the tracing of assets and the discovery of frauds.

42. It was noted that, given that assets have often been transferred to other jurisdictions, a major problem in recovering them has been a lack of reciprocity between different jurisdictions. While mutual legal assistance treaties have been useful in some circumstances, it was suggested that more widespread legal cooperation should be encouraged to help businesses recover assets more efficiently, and the UNCITRAL Model Law on Cross-Border Insolvency was cited for its

inclusion of provisions on judicial cooperation. Again, it was noted that greater cooperation between the public and private sectors would also be an enormous help in the recovery of assets. A further complicating factor in the recovery of assets has been the issue of bank secrecy as an excuse for non-cooperation. It was also suggested that tolerance of low-grade corruption and of judicial corruption must stop in order to put an end to fraud. It was also noted that the United Nations Conventions against Transnational Organized Crime and against Corruption (see para. 7 above) include provisions for the recovery of assets.

I. Money-laundering

43. In the session on money-laundering, it was noted that, originally, the money-laundering rules that had been established internationally were aimed at recovering the profits of illegal drug trafficking. However, international organizations recently recognized that money-laundering was a problem on its own terms and should be addressed separately from other laws.

44. The primary set of rules that has been established for countries to follow concerning money-laundering is the Financial Action Task Force's Forty Recommendations on Money Laundering, which establish a comprehensive framework for combating money-laundering and terrorist financing. The Recommendations provide a set of standards and procedures for member countries to follow in establishing their own rules for combating money-laundering and terrorist financing, and for implementing those measures. The recommendations broaden the definition of illegal acts, the proceeds of which should be the subject of anti-money-laundering statutes. In addition, they establish a framework for international cooperation and mutual assistance.

45. In addition, the United Nations Convention against Transnational Organized Crime has recently defined money-laundering to include a broader range of illegal acts to include all serious offences instead of merely drug charges. It also extends its provisions to cover laundering of property as well as cash.

46. It was emphasized that it was important for banks to monitor their customers' accounts and to know their customers. Typically, a bank's internal controls might monitor specific transactions, but recently technology has been improved to monitor suspicious transactions in general. The company must also monitor its accounts and transactions, looking for those that are suspicious or susceptible to fraud. In addition, since due diligence can be a defence to certain actions, it is important that the bank or business be able to demonstrate that it had used proper procedures and had established the proper mechanisms to protect itself.

47. The intersection of terrorism, money-laundering and fraud was noted. Further, participants were advised that the International Monetary Fund had recently made money-laundering part of its permanent body of work, and that it had devised a methodology to assess whether a specific country had adopted sufficient procedures to protect against money-laundering.

J. Insolvency

48. During the session on insolvency, it was noted that the insertion of fraud into an insolvency case makes it much more complicated and that there were two main areas where fraud and insolvency overlapped. The first area was where fraud resulted in insolvency and the second was where the legal tools available in insolvency could assist in dealing with commercial fraud and tracing funds, for example, powers of execution, the ability of the liquidator to set aside certain transactions and the like. It was noted, however, that the purpose of insolvency rules was to allow creditors to make informed decisions regarding how they should proceed and that, generally, it would not be practical for specific insolvency rules to be created to deal with fraud.

49. It was suggested that in some jurisdictions the legal framework to tackle fraud in insolvency exists, but improvements are needed in implementation, in controlling the misuse of legal tools, and in providing for specialized and vigilant insolvency professionals, including judges. Again, participants pointed to the importance of international comity and coordination and cooperation between the public and private sectors in combating insolvency-related fraud. It was noted that a valuable and practical tool in this area is the UNCITRAL Model Law on Cross-Border Insolvency,[5] which both promotes and makes specific provision for recognition, assistance and cooperation between jurisdictions where an insolvent entity has assets or debts in more than one State. It was also observed that the effectiveness of the Model Law would be greatly enhanced by its widespread adoption.

K. Prosecution

50. In the session on the prosecution of fraud, it was noted again that a major problem facing investigators and prosecutors is the fact that frauds are often hard to prove, both because of the limited access to evidence and because of the sophistication of the schemes involved. Further, cooperation with foreign governments and institutions would often provide the level of access that a prosecutor needs to obtain evidence and information regarding the transaction, but such cooperation is often hard to establish.

51. With respect to high-yield investment frauds, it was noted that several factors are typical to these transactions and can be established by expert testimony or through comparison of the fraud with legitimate transactions. For example, certain phrases such as “clean and clear funds of non-criminal origin” or “high-yield investment” or “medium-term notes” or “top ten world banks” appear in many fraudulent transactions. The schemes will also often use the reputation of legitimate international organizations or instruments of commerce, or impressive buildings or foreign addresses, to establish a degree of credibility in order to persuade the victim of the genuine nature of the scheme.

52. It was noted that a number of organizations had adopted web sites in their attempts to educate individuals regarding the fraudulent nature of these schemes or the improper use of the organization’s name or legitimate products. These include

[5] *Official Records of the General Assembly, Fifty-second Session, Supplement No. 17* (A/52/17), annex I.

the World Bank, the International Chamber of Commerce and the United States Department of the Treasury Bureau of the Public Debt.

53. Finally, despite the unwillingness of victims to admit that they have been victimized, investigators and prosecutors advised that they have had success in persuading victims to admit their plight by having local law enforcement serve the victim with a document asserting that they have taken part in a fraudulent scheme and that any further activity of this type will result in charges being laid against the victim.

L. Procurement

54. During the session on procurement fraud it was suggested that procurement frauds are generally of two types: inward fraud where the procuring company is being victimized by a fraudster and outward fraud where a company is complicit in the fraud and allows itself to be a part of the scheme. It was noted that while there is generally good cooperation by the public and private sectors in preventing and discovering inward fraud, there is little assistance or incentive in the prevention and investigation of outward fraud. Further, it was suggested that many multinational corporations actually assist in exporting fraud through engaging in bribery, corruption and price-gouging. It has been estimated that 20 per cent of procurement fraud is known to the public, 20 per cent is known to only a few individuals, and 40 per cent of the fraud is known by no one.

55. Some of the typical types of fraud involved in procurement include services not being performed, terms of the contract being ignored, the involvement of front companies to steal money, non-existent and over-priced goods, failure to enforce contract conditions and blatant theft. Various strategies were discussed to prevent and identify fraud and fraudsters, including the importance of the segregation of various duties within a business to separate individuals. Another aspect of procurement fraud that was examined was the "slippery slope" argument, where what starts out as a few perquisites for customers gradually descends into corruption and bribery.

56. It was also noted that the main thrust of UNCITRAL's fairly extensive body of work in the procurement area has been to ensure the transparency and fairness of the procurement process, thereby, at least implicitly, attempting to reduce or eliminate fraud. In addition, it was suggested that consideration should be given to the issue of fraud in relation to the privatization of public assets.

M. Role of professionals

57. During the discussion on the role of professionals with respect to commercial fraud, the participants in the Colloquium were informed of a particular instance where a self-regulating professional body had taken its own measures to combat fraud and dishonesty in the profession. The Law Society of England and Wales created a Fraud Intelligence Unit to build links with financial institutions and law enforcement agencies, to generate and collate intelligence, to investigate and enforce, and to establish a forensic investigations unit and develop expertise in using statutory powers proactively. A network of public and private sector groups

has been established for whistle-blowing, liaison and mutual assistance purposes. Specific areas of concern to the Law Society are mortgage fraud, advance fee fraud, legal aid fraud, high-yield investment fraud and money-laundering activities.

58. One aspect discussed by participants was that the involvement of professionals such as lawyers and accountants in commercial frauds contributed considerably to their scope and success, and that in many locations the mechanisms of regulation and discipline have not been adapted to deal with professionals who have entered into systematic commercial frauds. It was also noted that the participation of professionals in frauds is particularly problematic, since it serves to legitimize the fraud and thus to perpetuate it. It was suggested that the formation of model guidelines might be encouraged to assist self-regulating professional bodies in such situations.

N. Securities

59. During the session on securities fraud it was suggested that, while the popular perception was that insider trading was the largest problem with respect to securities matters, one of the most serious and damaging problems in the area of securities was actually fraudulent financial reporting. It was estimated that in the United States of America alone, between 1997 and 2002, the Securities and Exchange Commission instituted over 200 enforcement matters against more than 150 entities and over 700 individuals, resulting in over 500 disciplinary actions for financial reporting and disclosure violations. The participants heard that the areas of financial reporting most susceptible to fraud are improper revenue recognition, improper expense recognition, and improper accounting in connection with business combinations, while there exists a host of other minor violations.

60. Boards of directors are often implicated in such activity through failing in their fiduciary duties, high risk accounting, inappropriate conflicts of interest, extensive undisclosed off-the-books activity, excessive compensation and lack of independence. Further, the primary categories of auditor violations are outright fraud, violation of disclosure requirements and improper professional conduct. Again, it was noted that the involvement of professionals, such as accountants, grants credibility to the fraud and enables it to continue, while self-regulation of professions may not be effective. Enforcement procedures in such cases are often administrative proceedings based on the rules of the securities regulator and often involve civil and criminal prosecution.

61. The Colloquium also heard that a large number of fraud prosecutions have been conducted by securities regulators and, although there is some international cooperation between those regulators, a higher level of such cooperation is required. Nonetheless, it was suggested that increased sharing of information, for example, with respect to databases that have been developed, would greatly assist in the enforcement and prevention of commercial fraud.

III. Conclusions and suggestions for future work

62. There was broad consensus that the Commission had been well advised to convoke a Colloquium on international commercial fraud and that it had contributed

to an important first step in recognizing the existence of the problem. It was agreed that the Colloquium had dispelled any doubts that remained as to the widespread existence of commercial fraud and its significant impact on all countries, regions, economies and industries, regardless of the stage of economic development or system of government. Each of the substantive areas addressed at the Colloquium had been seriously affected by commercial fraud.

63. It was also agreed that education and training play a significant part in fraud prevention and could help address the problems resulting from under-reporting. Not only are the resources of the criminal justice system often focused on other law-enforcement priorities, they are ill-suited to undertake efforts of education without active cooperation from the private sector. It was also agreed that prevention, which is perhaps the most potent tool against commercial fraud, is primarily within the purview of commercial law and self-regulation by the commercial community, and is manifested through standards such as those affecting corporate governance, standards of professional conduct and audits. It was suggested that it would be particularly useful to identify common warning signs and indications of commercial fraud. Moreover, commercial fraud raises questions of the allocation of risks and losses in addition to the recovery of the proceeds of fraud, matters that are within the sphere of commercial law. In many cases, these matters involve cross-border issues. It was also agreed that the impact of commercial fraud could be disproportionately harmful to developing countries and undermine the positive effects of international efforts to improve their economic situation. Participants were hopeful that the Commission would continue to address the problem of commercial fraud in a manner consistent with its mandate and resources.

64. Although in the preparatory work leading to the Colloquium some progress was made towards fashioning a description of commercial fraud (see A/CN.9/540, paras. 12-26), it was generally thought that additional work would be necessary to formulate a definition, characterization or precise description. For example, while money-laundering, as such, would probably not fall within the definition of commercial fraud, and corruption may or may not do so, depending on how "corruption" is defined, both topics are of considerable concern in any work on commercial fraud. Money-laundering also often follows from a successful commercial fraud and may even be a tool to assist in perpetrating one. Corruption can facilitate commercial fraud whether or not it is technically a form of commercial fraud.

65. It was suggested that serious consideration should be given to developing a means of gathering and publicizing statistics and information about commercial fraud. While it was recognized that there might be some privacy concerns regarding information about individuals, it was also agreed that there are estimates and other figures, publicly available in a variety of different forms, such as trade association figures, that are typically only known within relatively small industry groups. It was suggested that gathering such figures would itself add considerably to the understanding of the nature and extent of commercial fraud and in developing an analysis of the relative costs and benefits of fraud prevention and relevant law enforcement. Moreover, it was suggested that public information about types of fraud, typical patterns and links to other sources of information would be of considerable value in the fight against commercial fraud.

66. Participants emphasized that education and training were of particular importance and value in fraud prevention. It was also agreed that local cooperative efforts between police and the private sector as demonstrated in NEFF's model seemed particularly effective and should be encouraged in other regions (see paras. 25-28 above).

67. It was generally agreed that the United Nations Convention against Transnational Organized Crime and the United Nations Convention against Corruption were significant achievements in the development of international law related to increased awareness and prevention of commercial fraud and related activities, as well as international cooperation thereon and asset recovery. The Commission may wish to endorse these two important conventions and encourage States to sign and ratify them.

68. Further, in light of the presentation made by UNODC (see above, para. 7), and in light of the paucity of firm data on commercial fraud, the Commission may wish to suggest to the Commission on Crime Prevention and Criminal Justice that it consider conducting a study on commercial fraud through the United Nations Office on Drugs and Crime, in consultation with UNCITRAL, in preparation for the Eleventh United Nations Congress on Crime Prevention and Criminal Justice. The aims of such a study would be to explore and increase knowledge of the criminal law and criminal justice perspectives of commercial fraud, their implications for commercial law aspects of fraud and vice versa, and to address the requisite international cooperation to deal with this problem.

69. Given the technological developments and experience in the application of the UNCITRAL Model Law on Procurement of Goods, Construction and Services,[6] it has been proposed that procurement law should be included in the programme of work of the Commission, including a review by Working Group I (Procurement) of certain provisions of the Model Law and its accompanying Guide to Enactment (A/CN.9/403). It is suggested that as part of its work during its next session, the Working Group could specifically consider the issue of commercial fraud in terms of issues of integrity management and corruption avoidance. In particular, it is proposed that the Working Group could benefit from presentations on these topics from international lending institutions (such as the World Bank) and from the International Federation of Consulting Engineers, with whom UNCITRAL has worked successfully in the past.

70. In similar fashion, Working Group III (Transport) could benefit from a presentation similar to that given during the Colloquium, which outlined the potential for commercial fraud in the area of maritime trade and bills of lading. The discussion could be of particular interest to the Working Group given the efforts of the draft instrument on the carriage of goods [wholly or partly] [by sea] (A/CN.9/WG.III/WP.32) to close off various avenues of opportunity that have proven fertile ground for the perpetration of commercial fraud.

71. It was also suggested that the risks of commercial fraud arising in electronic commerce is a topic that the Commission may wish to address in due course. For example, an analysis of existing legislative and other electronic commerce texts

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[6] *Official Records of the General Assembly, Forty-ninth Session, Supplement No. 17* and corrigendum (A/49/17 and Corr.1), annex I.

(such as model contracts and model protocols) may be undertaken, so as to consider whether they are sufficiently robust to assist in the prevention of fraud. It may also be possible to consider a regulatory regime that could govern conduct in situations where, for example, a fraudster misuses a web site to defraud its victims and law enforcement agencies seek to have an Internet service provider shut down that web site. The experience of such agencies in analogous fraud situations, in which the interaction between criminal law enforcement and commercial contractual rights, duties and liabilities have been addressed, may also be instructive in this regard.