

# The Limitation of the Law in Relation to Financial Crime: Back to Basics

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The philosopher Plato is popularly credited with observing ‘good people do not need laws to tell them to act responsibly, while bad people will find a way around the laws’. It might be equally possible to observe that if ‘bad people’ find a way around the legal structures and frameworks, this does not imply the correct solution is to cast a larger net with which to catch them all. For as more laws are enacted and brought onto the statute book, the potential for those rules being transgressed becomes greater, further expanding the scope of criminality. Certainly, societies operate within legal frameworks. Laws are brought into being by the political majority but with the aim of protecting the interests of all members.<sup>1</sup> Those who do not adhere to the culture or values of that society will find themselves on the wrong side of the law. However, legislative intervention within society is not cost free. We can create a society that is completely free of crime, but this would require total control by the state (the totalitarian country of North Korea would provide a good example here). The other extreme of no government-imposed rules or structures would produce a society, wherein individual behaviour is bounded only by each person’s moral compass. Somewhere in between these polar extremes, a balance has to be struck. This balance is between the number of ‘fish’ allowed to swim through the holes in the net against the costs and expense of either tightening the net or of casting an even larger one. This idea of balance finds expression in the underpinning legal foundations of proportionality and subsidiarity. These are essential concepts permeating all legal measures: regulatory and law enforcement responses must be proportional to or in balance with the harm caused by the offence while the measures taken should be the minimum required: the proverbial ‘do not use a sledgehammer to crack a nut’. This criterion sits at the heart of legislation, balancing a satisfactory outcome for society against the required interventions.<sup>2</sup> Alongside criminal law, similar concepts underpin the principles of good regulation. There is a public duty placed upon the policy makers to ensure that regulations are fair and proportional to the problem; targeted to avoid unintended consequences; and consistent to avoid uncertainty in their interpretation

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1. G.B. Vold, *Theoretical Criminology* (Oxford University Press: New York, 1958).

2. See, for example, P.C. van Duyne, J. Harvey and L. Gelemerova, ‘The Monty Python Flying Circus of Money Laundering and the Question of Proportionality’ in G. Antonopolous (ed.), *Illegal Entrepreneurship, Organized Crime and Social Control: Essays in Honour of Professor Dick Hobbs*, Chapter 10 (Switzerland: Springer, Studies in Organized Crime, 2016) 14.

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and application.<sup>3</sup> Naturally, for any system to be transparent, the regulators themselves should also be open to external scrutiny about their own objectives and associated actions, irrespective of whether they are operating in a prescriptive rules based approach (such as in the United States) or one that is more persuasive in approach (such as historically in the United Kingdom).<sup>4</sup>

Within the sphere of financial crime, rather than carefully weighing up the evidence about which rules had been circumvented and for what reason, there is an observed tendency to respond to deficiencies or misdemeanours with a call that ‘something must be done’. An approach that is inconsistent with these basic proportionality tests. It is possible this response is due to a combination of the high profile nature of the financial sector and of repeated large-scale losses.<sup>5</sup> However, the result is that the rules and associated costs rise for all regulated institutions, the majority of which were blameless. Financial institutions continue to be in the firing line, most recently criticised for weak systems of compliance and controls that seemingly enabled the laundering of significant amounts of ‘illegal’ funds from Russia into the London property markets. For example, Deutsche Bank, fined £163 million by the UK’s Financial Conduct Authority in 2017 for failing to maintain adequate Anti-Money Laundering (AML) controls from 2012 to 2015. The problem is that the fines (levied for failure of controls rather than for laundering) could easily fall upon a wider number of banks with the risk that institutions anticipate and begin to provision against them. The result will be that such fines simply become absorbed into the cost base of these institutions, increasing the operational costs that will be passed through to the customers. Further, that compliance related fatigue results in banks opting for the simpler approach of blanket de-risking. De-risking is the process of regulated entities declining relationships with customers they consider too risky, for instance, charities, money transmitting businesses or politically exposed persons (PEPs). Consequently, banks might decline potentially profitable and legitimate business opportunities. This observation was also made by *The Economist*<sup>6</sup> that reported on banks de-risking ‘money transfer firms handling remittances to poor countries, and charities that work in conflict zones’ and of closing down correspondent banking relationships for banks in, for example, Africa and Latin America, affecting their ability to clear hard currency transactions. Examples of the unintended consequences of widening the net or of reducing the size of the holes.

The four papers comprising this special edition of the *Journal of Criminal Law* consider various dimension of both financial crime and of financial market regulation. The collection explores regulatory and criminal law development in both the formal and the informal financial markets. The authors provide detailed and reasoned analysis of recent developments in their particular fields and draw attention to the challenges for both the regulators and for those subject to the rules. In so doing, they consider the purpose and application of the rules, the reasonableness of their objectives and the, sometimes, unintended consequences that have occurred.

Drawing a historical perspective on the development of financial sector obligations in response to changing international requirements, Turner and Bainbridge provide an excellent overview of the history and development of money laundering legislation in the UK and its relation to both EU laws and international mandates. They take as their focus the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (‘MLR 2017’) that came into force on 26 June 2017. The paper draws attention to the increased detail and associated additional burden the regulations

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3. R. Baldwin, R. and M. Cave, *Understanding Regulation: Theory Strategy and Practice* (Oxford: Oxford University Press, 1999) 77; C. Kirkpatrick, ‘Regulatory Impact Assessment’, in Crew, M. and Parker, D. (ed.), *International Handbook on Economic Regulation*, Chapter 11 (Edward Elgar: London, 2006) 236.

4. P. Mascini, Why was the enforcement pyramid so influential? And what price was paid? (2013) 7 *Regulation and Governance* 48–60.

5. J. Harvey and R. Bosworth-Davies, ‘Drawing the Line in the Sand: Trust, Integrity and Regulatory Misdemeanour’ (2016) 29(3) *The Security Journal* 367–84.

6. *The Economist*, ‘Financial de-risking ‘Forget Whiter than White’ Leader, 8–9 and ‘Financial De-risking: The Great Unbanking’ (2017) *The Economist* 53–54, Print edition 8 July.

place upon the regulated sector, asking whether the measures represent a proportionate and effective response to the perceived threat of money laundering and terrorist financing to national security. They pay careful attention to the incremental changes introduced with respect to customer due diligence and beneficial ownership, setting out both how the requirements have altered and the consequent implications of such changes. They find that while the policy documents explicitly mention the need for proportionality (referencing both the EU and the UK Home Office and Treasury); this recognition becomes lost in translation as provisions make their way through the layers of policy and regulation. The complexity of layering is important, as it implies that ostensibly clear and reasonable guidelines at the international level become a complex soup of instructions by the time they are translated, sometime later and via multiple intermediary steps, to the front-line operational level and the end user. The implications of their paper are that approaches to AML fail the proportionality test due to the increased discretion built into the system. Rather than reducing cost, it has instead increased uncertainty<sup>7</sup> with the unintended consequence of increasing internal procedures by which to demonstrate compliance.

Another new piece of UK legislation, The Criminal Finances Act 2017, is the focus of the contribution by Sproat, specifically the introduction of the new investigative powers provided by Unexplained Wealth Orders (UWO) in the recovery of the proceeds of crime and in particular the apparently large sums that end up invested in the London property market. Sproat draws our attention to the implications of their introduction, in particular, the reversal of the burden of proof, another underpinning requirement of criminal law. So rather than it being the responsibility of the prosecution services to prove the criminal origin, beyond reasonable doubt, these Orders require instead that an individual or company explain the origin of assets that appear to be disproportionate to income. As they are still relatively new, they have not yet been the subject of widespread academic investigation. The Orders apply specifically to PEPs and to those associated with serious crime and whilst appearing successful in Ireland,<sup>8</sup> they appear to have been only moderately successful in Australia.<sup>9</sup> Taking a similar top-down approach to Turner and Bainbridge, Sproat considers in detail the potential application of these orders. He argues that evidence from the UK, if not elsewhere, suggests the issues of legalities, attitude and resources could potentially inhibit their use. His analysis moves from what is known to date of the potential sums of money that might be available to the authorities for recovery to the detail of what might be achieved in practice at an operational level once various 'implementation hurdles', such as a lack of investigative resources, are negotiated. From this contribution, we could conclude that additional powers may not prove as effective as might be hoped.

Ryder's contribution broadens the scope of discussion contrasting the different approaches to enforcement of financial crime legislation in the United Kingdom with those in the United States. The paper provides a detailed mapping of the history and development of corporate prosecution, historically an area of challenge for the authorities both in the United States and in the United Kingdom. As the impact of prosecution and major financial penalty reaches far beyond the company to impact on its suppliers, customers and employees, there has been an increasing adoption of Deferred Prosecution Agreements (DPAs). These, it could be argued, were a somewhat pragmatic response to the unintended consequences of the legislation. Commencing his discussion with the observation that while much has been written on broader financial market crime, for example, fraud, Ponzi schemes and losses arising from the actions of rogue traders, there remains a paucity of research focused on those misdemeanours perpetrated by the financial institutions themselves. He argues that the impact of DPAs has been to reduce personal liability of those controlling minds of a corporate and hence has failed in terms of

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7. See also A. Bello and J. Harvey, 'From a Risk-Based to an Uncertainty-Based Approach to Anti-Money Laundering Compliance' (2016) 30(1) *The Security Journal* 24–38.

8. C. King, 'Following the Money Trail: Civil Forfeiture of Criminal Assets in Ireland', in P.C. van Duyne et al. (eds), *Human Dimensions in Organised Crime, Money Laundering and Corruption* (Wolf Legal Publishers: Nijmegen, 2013) 267–291.

9. N. Reurts, 'Unexplained Wealth Laws: The Overseas Experience', in *Unexplained Wealth Orders: Thoughts on Scope and Effect in the UK*, Briefing Papers, January, (The White Collar Crime Centre, 2017).

providing a deterrent. Recognising the continued deviance of companies and limited evidence of cessation of financial market scandals, he concludes by proposing recommendations for the authorities in both jurisdictions that would enhance deterrence through combining civil redress against companies with criminal liability of senior executives. Perhaps we have here an argument for enhancing the effectiveness of rules already in place.

Complementing the work of Turner and Bainbridge, the final contribution in this special edition from Goldbarsht provides detail of the evolution of the Financial Action Task Force (FATF) and of the mechanisms of mutual evaluation through which it exerts its influence, in particular on the financing of terrorism. The particular area of enquiry for Goldbarsht is outside of the formal financial system and considers the policing of informal mechanisms of money transfer from Australia. He takes as a starting point the concern that the demands of the FATF had become so onerous that widespread de-risking of geographic areas by banks had led to the unintended consequence of financial exclusion. Where provision of formal regulated banking is no longer an option, the gap in service provision has historically been met through informal mechanisms. His paper starts with an overview of the history and development of the different types of informal system, collectively the money or value transfer services (MVTs), before turning to the challenges faced by Australia in complying with the requirements of the FATF in countering the financing of terrorism. It concludes by drawing attention to the unintended consequences of the attempts by the FATF to tighten regulation of the MVTs providers. This has evidently reduced access to these services, driving take up of other, more vulnerable forms of transfer such as pre-payment cards, potentially moving activity from an area that could be monitored to one that is more opaque: another unintended consequence of tightening rules.

In their various different contributions, the authors of these papers have explained the inconsistency in application of rules and the consequent system vulnerabilities that arise. So rather than calling for ever tightening rules and frameworks, the conclusion from this collection is that those subject to the rules are coping with consequences that were neither considered nor intended at the time the original statutes were brought onto the books. A more effective approach might instead be to revisit first principles and consider the original objectives for the existing rules within the various areas discussed here and to recognise that it is perfectly acceptable for some fish to swim through the net.