

Corporate Fraud in the Covid-19 crisis: changing risks and protecting your business

The UK Government's coronavirus (Covid-19) response has had profound effects on every business sector. The UK is on "lockdown". Corporations and businesses, whose activities are underpinned by technologies such as verified transactions, encrypted communications and secure server networks, are having to find ways to conduct their core functions remotely, separated from colleagues and support departments, in circumstances where each person is, generally, unmonitored.

There are very few - if any - corporate entities that had the practical and technological infrastructures in place prior to this crisis taking hold, which would have enabled them to adapt seamlessly to this dramatic transformation in working practice. A global pandemic and its economic impact will not have been the subject of frequent risk management meetings. Instead, most companies now find their business network under unchartered strain and vulnerable to financial exploitation.

[Nick Johnson QC](#) and [Sophie O'Sullivan](#) look at how the risks have changed and what changes need to be made by a business in response.

2. Conventional protections to guard against fraud and financial abuse

In the corporate environment, effective anti-fraud policies are founded upon systemic, entrenched procedures which work to insulate the company against unreasonable risk and exposure to avoidable financial loss. Strong verification processes underpin commercial confidence in the deals and transactions undertaken both within that specific business and across the industry sector.

Adequate internal systems which work to protect businesses against fraud have three core functions:

1. To protect the business or corporation from taking on unreasonable risks making it vulnerable to financial loss or abuse
2. To guard against the degradation of the industry through the rot of financial crime
3. Systemic protections against fraud and financial abuse often underpin corporate insurance policies, collateral debt agreements, covenants and trading credit lines. If businesses cannot be seen to maintain systemic safeguarding of these processes, it may invalidate these vital agreements.

It is a sad reality that at times of unprecedented financial volatility, market decline and looming global recession, financial and insurance institutions will be looking to reduce their exposure as far as possible. As part of this, they will likely scrutinise with care any of their clients who may be breaching their contractual terms through unapproved, quick-fix anti-fraud procedures that have been rushed in out of necessity to keep their business going in these extraordinary times.

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Should a business find itself a victim of fraud when at that time it had in place ad-hoc and unapproved anti-fraud procedures, it may find its actions are in breach of its financial covenants and outside the auspices of its insurance policies and financial support agreements. This may, depending on the value of the fraud, cause serious financial hardship or even ruin.

Examples of commonplace internal anti-fraud systems adopted by businesses and corporations which are now under threat or practically defunct as a consequence of the global lockdown include:

ID verification procedures

When considering a new client or business connection, vast swathes of businesses satisfy their 'Know Your Business'/'Know Your Customer' checklists by confirming the identity and financial solvency of their prospective clients through due diligence steps such as visiting their business address, verifying their identity through meeting in person and cross-referencing these in-person visits with documentation they have been provided with, phoning the published business landline or contacting interested third parties.

These are basic identification verification procedures which perform a vital function in preventing companies from fraud. With nearly all offices closed, in-person meetings banned and most office landlines being left unanswered, the mechanisms by which businesses can verify the identify and veracity of prospective clients or deals has narrowed dramatically.

Dual sign-off of invoices and financial documents

Many companies undertake multiple verification sign-off procedures for invoices or other financial agreements. This simple process ensures collective responsibility - and knowledge - of the financial undertakings being made by the company/business and guards against any one employee being able to act contrary to, or independent of, the interests of the whole.

Use of original title documents and bills of lading

International trade still heavily relies on the physical movement of title documents to effect transfer of ownership of goods and payment to the seller is often made only upon receipt of the bill of lading. In the normal course of business, these original documents are sent by the seller to the buyer to facilitate the transfer of the asset and payment.

Sometimes, businesses will use a bank or other third party to hold the title documents during transportation of goods as a further security measure. Now that most banks and office buildings are closed and courier services have been restricted, consequently, these vital documents have no mechanism by which they can be received as very few companies will send title documents or bills of lading to a home or personal address.

THE TEAM

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Nick specialises in complex financial and business crime disputes, together with cross-over regulatory and civil work. He is ranked at Silk Band 1 for Financial Crime by **Chambers & Partners 2020** and as a Leading Silk in the **Legal 500 2020**, praised in particular for his compelling advocacy, strategic skill and affinity with clients.

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Inspection of goods

Physical inspection of goods to confirm type, quantity and quality of product is a central term of many contracts of sale as well as a legal obligation required of many companies providing international transportation of goods services to guard against excise fraud. At the most basic level, businesses are unable to travel to the point of loading and are therefore unable to verify the goods being transported; their transactional due diligence has been fundamentally impeded.

In a swirling financial crisis, demand is falling at an exponential rate. This is only serving to increase the pressure upon businesses to find ways to satisfy their contracts and deliver goods on time in order to retain liquidity in circumstances when they are transacting 'blind' and, as such, most vulnerable to fraud and exploitation.

3. New and evolving corporate vulnerabilities to fraud

The economic repercussions of Covid-19 have meant that businesses feel under great pressure to maintain financial liquidity. This often means that offers of new trade or other business opportunity are hard to resist. With the Government signing off a bailout unprecedented in the history of modern business, it is hard to think of times that are as fiscally fraught as now and, as a result, we are reacting quickly to opportunities around us. But with this haste to survive comes serious risk of fraud.

Those intent on committing financial offences are adapting their methods to exploit the strain and rapid transformation in business practices: Action Fraud (the UK's National Fraud and Cyber Crime Reporting Centre), the Financial Conduct Authority and Ofcom, to name only a few, have already published articles warning against the rise of coronavirus-linked frauds which are resulting in massive financial losses.

The following are core examples of coronavirus-linked frauds affecting businesses now:

Mandate Fraud

Mandate fraud takes place when an employee is deceived into changing a regular payment mandate (such as a direct debit, standing order or bank transfer) when contacted by an individual/entity purporting to be an organisation the target company make regular payments to such as a supplier, membership or subscription organisation.

Businesses no longer have the same verification systems at their disposal. With nationwide remote working and the increased risk of un-secure wifi networks being used by employees, it is easier than ever for email addresses to be hacked and communication purporting to be from the genuine supplier or client to be received. Moreover, the victim employee dealing with the payment mandate request is likely to be contacted directly and not have the published business information available to them to verify the provenance of the call/request. Employees will find that they are unable to adopt their standard security processes, such as using established contact details to verify that the change in instruction has come from a legitimate source or obtaining group sign-off for the decision to alter the payment details.

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Nick has specialised in financial crime cases for around 20 years and frequently acts as leading counsel in the full range of fraud cases, appearing in major tax, carousel, boiler room, pharmaceutical, diversion, financial markets and property frauds, prosecuted by agencies such as the SFO, HMRC, MHRA and Trading Standards.

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CEO fraud

CEO fraud typically starts with an email being sent by a fraudster to a member of staff in a company's finance department. The member of staff will be told by the fraudster - who is purporting to be a company director or CEO - that they need to quickly transfer money to a certain bank account for a specific reason. The employee does as directed and money is sent out of the company into the fraudster's bank account. This fraudulently obtained money is generally quickly disseminated into a series of mule accounts and the primary account used to receive the company funds is closed. The money becomes untraceable and asset recovery is rare with this type of offence.

The disbandment of offices and the ubiquity of remote working has exposed secure business networks to such abuse and hacking. Companies that would ordinarily have in place anti-fraud procedures such as monitored computer systems and antivirus software or internal verification procedures for financial instruction find these protections are not available to them at this time.

Ransomware

Ransomware is a specific type of malware (software created with a malevolent intention, such as to damage software or steal data) in which the data on a victim's computer is locked (generally encrypted and inaccessible to the victim user) and payment is demanded before the ransomed data is decrypted and access is returned to the victim. Ransomware is often transmitted through malicious email attachments, infected software apps, infected external storage devices and, more relevant now than ever, remote desktop protocols (RDPs provide remote display and input capabilities over network connections for applications running on a server).

Similarly, as we are all working remotely, using network systems and company software in ways that few businesses envisaged or planned for, most are scrabbling to update and enhance their technological facilities. As workers find they are obliged to work out of the office, often without the domestic infrastructure to work securely, our networks and devices are ripe for this kind of infiltration and exploitation.

4. What you can do to protect your business from fraud in these extraordinary circumstances

Risk Assessment

Anti-fraud controls need not only to be effective but low-friction so as not to deter legitimate business and this can best be achieved by risk assessment. Ensure that your company's risk matrix is updated to reflect your current working practices and exposures. This will increase visibility of risks, assist management decision making and help your risk management teams to develop relevant and pragmatic risk mitigation plans.

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As far as possible, do not diminish your business verification procedures and risk assessment systems. Isolated workforces and the difficulties we are all now presented with in obtaining dual/group sign-off for financial undertakings are particularly vulnerable for all manner of phishing and corporate fraud.

Clear Communication & Authorisation

Make sure that your entire workforce is aware of these new risks and how they operate.

Maintain regular, secure paths of communication with your staff to guard against isolated, unverified actions being taken by individuals. Consider what alternative methods of dual sign-off (eg, Adobe Sign) and client due diligence can be adopted. Such methods would guard against mandate and CEO fraud particularly.

Effective controls rely on motivated staff who have a clear understanding of what to do and, crucially, are trusted and supported through the changes. Clear messaging is key.

New Business & Transactions

With regard to new counter-parties and transactions, identify what parts of your internal due diligence procedures have been affected and to what extent: if your conventional methods of KYC verification have been compromised because of the lockdown, identify what these compromises are and apply alternative methods to give your business reassurance.

Identify what aspects of your company network and computer systems have been compromised (or may be) by remote working: ensure the computer systems and networks you and your colleagues are using are secure and that all antivirus software is up-to-date and installed on all the devices used by your company staff.

Consider increasing your accounting controls if you see that remote working has created vulnerability in this area of your business. Purchasing discipline should not be lessened.

Insurance

Finally, ensure that your insurers and financial backers know what anti-fraud and risk assessment procedures you are now adopting. Develop, as far as possible, transparent working practices to guard against any risk of invalidated contracts through hastily adapted working practices. The short-term prospect of new business is unlikely to be worth the financial exposure of unverified transactions.

TESTIMONIALS

Nick Johnson QC

“A first choice for complex criminal matters...he’s very hard working, and is one of the finest advocates you’ve ever seen – his ability to cross-examine is excellent.”

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5. Conclusion

These extraordinary circumstances bring new perspectives as well as challenges. Whatever the pressures, it is vital to take a breath, reflect, re-assess the risks posed by the new climate and adapt to meet these immediate and changing risks of fraud.

Some of the potential longer-term effects upon business of the Covid-19 crisis will be discussed in a separate paper by the OTC Business Crime & Regulatory Team.

Find Out More

This article was written by [Nick Johnson QC](#) and [Sophie O'Sullivan](#), members of Outer Temple Chambers' Business Crime & Regulatory Team. The team would be pleased to discuss any related matter with you in the strictest of confidence.

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