Two-way crimes, parallel economies and professional enablers: Dissecting corruption in the EU's financial sector

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Abstract

The European Union is in the midst of developing an anti-corruption strategy to achieve the multi-part goal of pre-empting corruption, improving oversight, strengthening enforcement and reducing the damage that corruption causes to public institutions, companies, communities and citizens. To further this undertaking, we have identified areas and sectors that are especially prone to corruption. This entailed a three-step process of identifying a broad list of high-risk areas, narrowing these to six areas for in-depth study and examining the character, causes and consequences of corruption in these six sectors.

One of these areas is the financial sector. A significant portion of corruption in the EU either originates from the financial sector or is inflicted upon it; sometimes the line between perpetrator and victim is blurred. As the most serious corruption-related crimes, money laundering and tax evasion involve many types of people and organisations including banks, investment advisors, wealth managers and organised crime groups. With the help of professional enablers such as lawyers, notaries, accountants and real estate agents, organised crime groups have built a 'parallel criminal economy' in the EU. This complex and overlapping landscape complicates interdiction, as the epicentre of any particular corrupt act is not always easy to pinpoint.

Keywords: European Union, anti-corruption, corruption risks, financial sector, financial regulation, organised crime, financial crime.

Introduction: towards a new EU anti-corruption strategy

Two thirds of EU citizens and EU-based companies believe corruption is widespread in their country (Eurobarometer, 2024). Citizens' pessimistic views on corruption have remained unchanged for the past two decades, indicating that most Europeans are unsatisfied with official measures to stop it or that corruption is not declining – or both. The economic costs of corruption in the EU are estimated at up to EUR 990 billion per year (Fernandes et al., 2023), reducing the EU's gross domestic product by about 6 % annually (Greens/EFA Group in the European Parliament, 2018).

A significant portion of this corruption originates from, or is inflicted upon, the financial sector. Corruption in the financial industry is everywhere and is being committed at every level of society – from individual scammers on laptops to unscrupulous banks and investment houses, to international money-laundering and terrorism-financing networks. It is an enormous, ever-evolving industry that is both perpetrator and victim of corruption. Serious corruption crimes include money laundering, tax evasion, hidden assets, consumer fraud, terrorism financing and cybercrimes.

As the financial sector becomes more decentralised, unwieldy and IT-driven, the opportunities to become a perpetrator and/or a victim continue to grow. As an example of such two-way crimes, banks both condone and are victimised by money laundering, tax evasion and other crimes.

Sensing the need to better tackle these problems, the EU is developing an anti-corruption strategy. As part of this effort, the European Commission released the study, 'High-risk areas of corruption in EU Member States: A mapping and in-depth analysis' (European Commission: Directorate-General for Migration and Home Affairs et al., 2024). The study's goal is to provide a deeper knowledge base regarding the sources of corruption in EU Member States and explore particularly vulnerable areas. The study feeds into tasks anticipated in the Commission's joint communication on the fight against corruption (European Commission, 2023).

The Commission's study identified six areas that necessitate urgent responses – those responses being, improvements in regulation, oversight, investigation, enforcement and prosecution. In addition to the financial sector, these high-risk areas are public procurement, construction and infrastructure, healthcare, defence and security, and sports. Though virtually all areas of society can expect some degree of corruption, many experts expressed the view that these areas already are, or are likely to become, more prone to serious crimes.

This paper, which focuses on the financial sector, is an excerpt of the Commission's study, published by the Directorate-General for Migration and Home Affairs in November 2024. As a follow-up, work began in autumn 2024 on a report for the Commission on successful measures to mitigate corruption. Scheduled for completion in 2025-2026, the report will outline and analyse measures in Member States that could be replicated EU-wide.

The nature of corruption in the financial sector

An interplay of crimes

The EU's financial sector is a diverse, continuously evolving industry that provides an increasingly complex set of financial services and informational tools to commercial and retail customers. Financial companies include investment and commercial banks, insurance companies, investment houses, money managers, mortgage and other lenders, fintech and cryptocurrency companies, payment services and foreign exchange firms.

As the financial sector is becoming more decentralised and unwieldy, the opportunities to become a perpetrator and/or a victim continue to grow. Corruption enablers, including lawyers, notaries, accountants, real estate agents and other professionals, sell their expertise to help criminals hide their money, avoid paying taxes and evade detection. Organised crime groups (OCGs) have built a 'parallel global criminal economy' in the EU, which lies at the heart of much of the corruption.

Perhaps more than any other area, assessing the types and methods of corruption in the financial sector is just as important as examining the perpetrators and venues. Granted this, money laundering and tax evasion are the most serious corruption-related crimes in the EU and those that receive the most attention of policymakers and criminal justice agencies. These crimes involve many different types of people and organisations, including banks, investment advisors, OCGs and professional enablers. This complex and overlapping landscape complicates the corruption assessment, as the epicentre of any particular corrupt act is not always easy to pinpoint. Further, the 'financial sector' does not have a precise definition, and the terms 'financial corruption' and 'financial crime' often are interchanged by practitioners and researchers.

Corruption costs

Estimating the scale and costs of corruption is challenging because much available research and many statistics combine financial and economic crimes. It can be difficult to differentiate the cost of crimes that utilise or victimise the financial sector from the cost of economic crimes in general. The European Union Agency for Law Enforcement Cooperation (Europol) notes that corruption in the sector remains systematically under-investigated (Europol, 2020).

Moreover, transferring criminal proceeds online and using cash for lower-level bribery can make it difficult to detect financial flows and uncover corruption (Europol, 2020). For this and other reasons (including the fact that more than 60 % of OCGs in Europe use 'corruptive methods to achieve their illicit objectives'), less than 2 % of OCGs' proceeds are seized each year (Europol, 2023b). Making matters more difficult, nearly 70 % of criminal networks operating in the EU use at least one form of money laundering to fund their activities and conceal their assets (AML Intelligence, 2023). The lines between the illicit and licit world become increasingly blurred (Europol, 2023a).

OCGs are drawn to the EU, among many reasons, because of its strong economy and high standard of living. Europe is an attractive terrain for investment in real estate (Cotici, 2024). They also target countries and jurisdictions with gaps in international anti-money-laundering (AML) standards and law enforcement cooperation (Europol, 2023a).

The European Public Prosecutor's Office (EPPO) had 226 active money-laundering cases at the end of 2023, making up 5 % of its total caseload (EPPO, 2024). The European Union Agency for Criminal Justice Cooperation (Eurojust) recorded 2 870 money-laundering cases in 2016–2021, representing 12–14 % of all cases. The annual total doubled during this period. The top five Member States involved with these cases are Germany, Spain, France, Italy and the Netherlands (Eurojust, 2022).

Given these shortcomings, kleptocrats and their family members use European banks to launder their criminal proceeds, along with their reputations. Even when malpractice is identified, national authorities often do not take appropriate action, according to Transparency International, which stated that the European Central Bank's supervision of banks' AML activities is 'very limited' because many issues are handled by national authorities (Martini, 2019).

Causes of corruption in the financial sector

Upperworld and underworld

There are large gaps in understanding the nexus between corruption and money laundering, as well as the structures and mechanisms that allow these crimes to be committed, according to the Basel Institute on Governance. In general terms, it is known that secrecy jurisdictions and service providers such as financial intermediaries, lawyers, bankers and accountants 'have emerged as constant actors in corruption and money-laundering cases of all types, all over the world' (Costa, 2021).

These players make up webs of cross-border links and financial transactions that 'disguise illicit connections between corrupt political elites and the businesses that thrive by bribing these individuals', according to the Basel Institute. These transnational networks also include offshore companies, corporate vehicles, intermediaries, service providers and financial institutions that conspire to move illicit assets and hide them from the public and law enforcement. These financial and legal service providers manage these networks and lower the transactional costs of international corruption (Costa, 2021).

Offshore financial centres are uniquely skilled to simultaneously ensure the ownership and non-ownership of assets. This means they guarantee the indirect and mediated control of assets by their ultimate beneficiaries, all the while disguising the connections between offshore financial centres and their beneficial owners. This is done via service providers, surrogates, frontmen and cross-border chains of offshore vehicles.

In addition, these structures simultaneously occupy both the 'upperworld' of formality and the 'underworld' of informality. This is achieved by switching between the legal facade of their business and political activities and the hidden financial infrastructure that helps to disguise their illicit transactions (Costa, 2021).

Aided by globalisation and under-regulated online platforms, money launderers can quickly move illicit funds in and out of the EU, from and to anywhere in the world. About 70 % of OCGs operating in the EU use basic money-laundering techniques, while the rest work with professional money-laundering networks or underground banking systems that operate in multiple jurisdictions (Europol, 2020; Europol, 2023a). Various investigative agencies describe money laundering as perhaps the most widespread financial crime in the EU.

Outmatched regulators and black holes

Because of the industry's complexity, enormous size and the number of transactions it handles, suspicious and illegal transactions can be difficult to identify, monitor and remedy. The inadequacy of mechanisms to watchdog transactions can lead to fraud, bribery, money laundering and other types of corruption (Ragazou et al., 2022). Europe's financial industry has shown signs of improvement with regard to the fight against corruption in recent years, but considerable challenges remain. One reason is executives' limited ability to thoroughly evaluate and comprehend market trends and corruption indicators (Zafeiriou et al., 2023).

Another major reason, according to Europol, is the low-risk and high-reward nature of financial crimes, which makes them 'very attractive' to OCGs. Additionally, the complexity of these crimes and the sophisticated expertise required to commit them makes them difficult to detect and investigate. This problem has grown worse because of technical innovation and the digitalisation of financial transactions. Because of this, 'many of these crimes are now even less visible than before and more challenging to investigate' (Europol, 2020).

In particular, Eurojust said it is challenged by differences in national laws used to identify predicate offences for money laundering. Other challenges include the increased use of cryptocurrencies, shell companies that hide the identity of beneficial owners of criminal assets, difficulties in identifying who is a victim and who can apply for compensation, and difficulties tracing money transfers to and from the EU (Europol, 2022).

New concepts of financial services, including fintech, artificial intelligence (AI), virtual international bank account numbers (vIBANs), and decentralised finance such as cryptocurrencies and blockchain, are increasingly being exploited by criminal networks to launder money and commit fraud and other crimes (AML Intelligence, 2023).

Risks to citizens also are on the rise. An estimated 58 % of banking customers in the EU regularly carry out transactions via online tools such as websites and apps. These platforms provide significant benefits to customers and companies alike. However, many customers lack the technical knowledge and experience to protect them from cybercriminals who use phishing and malware to burrow into their online accounts (Europol, 2020).

These risks to consumers have been fuelled by the huge expansion of online shopping. The proliferation of digital payment systems and the reduced ability to verify customers due to cross-border trade are making fraud prevention more complex. 'No merchant, bank or payment service provider has all the data necessary to determine whether a transaction has been executed by the customer or a fraudster' (Forster, 2019).

The industry is not free of political corruption. There are 'significant' risks of corruption in the context of financial companies that do business with public banks or sovereign wealth funds, according to Association Europe-Finances-Régulations (Montigny, 2016).

Consequences of corruption in the financial sector

Parallel underground societies

Financial crime is a 'highly complex, significant threat that affects millions of citizens and thousands of companies in the EU every year', according to Europol. These crimes destabilise economies and undermine social security systems, depriving society of prosperity, economic growth and employment. 'Although indirect, the impact these crimes have on society cannot be underestimated' (Europol, 2020).

Financial crimes, especially money laundering, not only infiltrate the legal economy but also foster the growth of a parallel underground society dominated by OCGs. 'Vulnerable demographics, and especially vulnerable youngsters who are lacking trust in societal institutions and confidence in the rule of law, are the perfect target pool for such parallel underground society' (Europol, 2023a).

Fraud is one of the main ingredients, to a lesser or greater extent, in virtually every type of financial crime. Its economic impact is 'staggering', stated the International Criminal Police Organization (Interpol), noting that tech-savvy fraudsters stay one step ahead of law enforcement by exploiting new vulnerabilities and 'circumventing security measures' (Interpol, 2024).

Both the volume and methods of financial fraud are increasing and diversifying significantly. Financial fraud, which Interpol calls a 'pervasive, global threat', is a predatory crime perpetrated in anonymity and across borders. In Europe, the most prevalent types are investment fraud, business email compromise, romance fraud and telecom fraud. A hybrid scheme known as 'pig butchering' combines romance and investment fraud, often using cryptocurrencies. Victims of these swindles are often hesitant to come forward. Another new type of scam is the 'rug pull', when a cryptocurrency outfit suddenly abandons their investors (Interpol, 2024).

Within banks and other financial companies, the 'fraud tree' has three main branches: asset misappropriation, corruption and tax evasion. All of these, individually or in unison, can be a cause of another type of fraud: the misstatement of financial statements. 'All the aspects of the fraud tree have become widespread in the past ten years in both the business and banking worlds'. Moreover, corruption and fraud in banking are 'complex problems that confound researchers' (Zafeiriou et al., 2023).

A growing area of fraud is internet and cross-border card swindles, which reached EUR 1.8 billion as of 2016, according to the European Central Bank. That year, three fourths of all fraud losses on cards issued in the single euro payments area (SEPA) were from 'card-not-present payments' – namely, payments made by post, telephone or over the internet (Forster, 2019).

Many investment fraud schemes are now carried out exclusively online or via advertising on social media platforms. These schemes use tools such as foreign exchange trading platforms, binary options and online crowdfunding. Advance-fee fraud schemes, in which people are promised a large sum of money in return for a small upfront payment, are increasingly being perpetrated with alternative payment methods such as online vouchers (Europol, 2020).

Other tools used by fraudsters and money launderers are digital or 'neo' banks. These virtual financial institutions have no physical branches and are growing quickly. With IBANs, international payments can be made quickly while masking the identity of the master account, issuer and country of origin. This makes suspicious transactions tougher to detect and adds extra steps to investigations. In all EU Member States, digital payments are being used for money laundering (Europol, 2023a).

Another major risk area is value added tax fraud. Based on investigations by the EPPO, OCGs finance value added tax fraud schemes with illicit funds from other criminal activities. These groups easily can be set up in any country and recruit people with local connections and knowledge of the local market and law. They choose EU Member States with weaker detection and investigation capabilities, spot loopholes and use professional enablers, high-level brokers and financial channels outside the formal financial system (EPPO, 2024).

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