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COMBATING FINANCIAL PYRAMID FRAUDS IN UKRAINE

БОРОТЬБА З ФІНАНСОВИМИ ПІРАМІДАМИ ТА ШАХРАЙСТВОМ В УКРАЇНІ

Cherney V.V.,

Candidate of Legal Sciences (PhD in Law),

Senior Lecturer,

*Vice-rector on academic-methodical and research work
National Academy of Internal Affairs (Ukraine, Kiev)*

The article provides an overview of the main areas of combating financial pyramid frauds. The author provides definition of the «financial pyramid», describes its features, and offers an overview of the criminal technologies of preparing, making, and concealing the fraud. The research received a practical result in development of a draft law supplementing the Criminal Code of Ukraine and introducing liability for creation of financial pyramids, which will become an important step in combating the organized crime.

Key words: combating, fraud, financial pyramid, investigation.

У статті представлено огляд основних напрямків боротьби з шахрайством та фінансовими пірамідами. Автор дає визначення «фінансової піраміди», описує свої можливості і пропонує огляд наявних кримінальних технологій підготовки і приховування шахрайства. Дослідження отримало практичний результат у розробці проекту закону доповнень до Кримінального кодексу України і про введення відповідальності за створення фінансових пірамід, що стане важливим кроком у боротьбі з організованою злочинністю.

Ключові слова: боротьба з шахрайством, фінансова піраміда, розслідування.

В статье представлен обзор основных направлений борьбы с мошенничеством и финансовыми пирамидами. Автор дает определение «финансовой пирамиды», описывает свои возможности и предлагает обзор существующих криминальных технологий подготовки и сокрытия мошенничества. Исследование получило практический результат в разработке проекта закона дополнений в Уголовный кодекс Украины и о введении ответственности за создание финансовых пирамид, что станет важным шагом в борьбе с организованной преступностью.

Ключевые слова: борьба с мошенничеством, финансовая пирамида, расследование.

Economic and social development of the state necessitates measures of ensuring security on the financial services market. Special attention should be given to protection of private investors, because the overwhelming majority of common citizens have no experience in investing their money and limited ability to receive compensation of damages inflicted upon them. Criminalization of financial market in Ukraine and other ex-Soviet states was helped by economic disproportions, weakened system of government regulation and control, loopholes in the legal framework, and other objective conditions. Combined with the loss of public trust in the

state's financial institutions, it created preconditions for the widespread occurrence of a new form of fraud committed using financial pyramids under the cover of trust companies, investment funds, and other commercial organizations [5, p. 12].

In the course of pretrial investigation of financial pyramid frauds investigators face difficulties caused by the lack of the necessary experience and sophisticated methodology of investigating these crimes. The problems with proving the guilt stem, first of all, from the fact that organizations providing cover for financial pyramids are usually officially registered and sign legal agreements

with the victims, and the signs of gaining someone else's property are discovered, as a rule, much later after occurrence of criminal consequences. Moreover, modern payment systems, first of all online payment systems, create conditions for gaining and laundering proceeds from crime. As a result, proprietary rights and interests of Ukrainian citizens may suffer, thus creating preconditions for the growing tension within the society.

In the meantime, jurisprudential literature on the whole (with the exception of certain publications) has not developed scientific provisions of combating financial pyramid frauds (in total, 97% of respondents representing law enforcement authorities are convinced that appropriate methodologies need to be developed), which prompted the in-depth studies of a whole number of problems of discovering, investigating, and preventing the crimes of this category.

Although the number of frauds discovered within the structure of crime in Ukraine remains almost unchanged (23.1 thousand in 2006; 20.3 thousand in 2009; 24.8 thousand in 2012), the schemes of gaining possession of individuals' money using financial pyramids that became known to law enforcement authorities cause deep concern by their scale. According to data by the Interior Ministry of Ukraine, in 2008–2012 alone the police conducted pretrial investigation of 223 criminal cases concerning the crimes of this category, in which over 100 thousand individuals were victims (the aggregate damage they suffered exceeds UAH 1 billion). These crimes were perpetrated mostly in the investment sphere (under disguise of providing educational and employment services, investing in a high-return business project, purchasing goods in groups), activities of credit unions, residential construction, insurance sphere, and pretending to provide online financial services. The «new»-generation frauds are distinguishable for the high professionalism of the criminals who cover up their activities using world-renowned brands and business entities domiciled in offshore jurisdictions, use advanced information technologies and special techniques of psychological influence, and receive corruption support from public officials of all levels who are «in» [1].

The Ukrainian legislation provides no clear definition of the term «financial pyramid». Perhaps only the Law of Ukraine *On the Protection of Consumer Rights* prohibits as deceiving the creation, use, or facilitation of development of pyramid schemes when the consumer pays for a possibility to receive compensation provided by involving other consumers in that scheme, not by selling or consuming products. The inconsistency of existing legislative acts regulating activities of business entities on the financial services market allow for creation of financial pyramids under their cover, inflicting huge damages upon people. Moreover, the existing criminal legislation contains no special norm which would criminalize organization of financial pyramids.

To provide legislative improvement of the measures of combating this form of fraud, a draft Law of Ukraine *On Supplementation of the Criminal Code of Ukraine with Liability for Organization of Illegal Lotteries, Prize Drawings, and other Gambling Activities and Creation*

of Financial Pyramids was submitted to the Ukrainian parliament (Resolution of the Verkhovna Rada of Ukraine No 619-V of 8 February 2007). Later, the proposed restrictions on the gaming business in Ukraine were finalized by the Law of Ukraine No 1334-VI of 15 May 2009 *On Prohibition of the Gaming Business in Ukraine*. At the same time, the matter of introducing liability for creation of financial pyramids still remains unresolved.

The need in legislative framework for the measures of combating creation of financial pyramids has recently been proved by developers of the draft Law of Ukraine *On the Amendment of the Law of Ukraine On Telecommunications (No 9232 of 29 September 2011)*. Preparation of the above document was apparently necessitated by the renewal in Ukraine of activities of the infamous and the most large-scale financial pyramid which was founded in the former Soviet Union, MMM. The organizer and founder of MMM Sergei Mavrodi, known all over the former Soviet Union, was sentenced to prison. After serving his time, he founded a virtual financial pyramid named «MMM-2011» (information about how it works can be found on the same-name website). The draft law proposed, in particular, to oblige telecommunication operators to restrict, based on court orders, the access of their subscribers to resources used to provide unlicensed financial services.

As the practice shows, in many cases reported by deceived investors the law enforcement authorities decide against the opening of criminal investigation. For organizations which most often provide the cover for financial pyramids are usually officially registered and conduct lawful business activities. They sign legal agreements with individuals, in which information about the rules of participation in these organizations are provided in a hard-to-understand form. Therefore, the signs of fraud are discovered, as a rule, when the culprits have already disappeared without trace, together with their illicit gains. That's why the public perceives all these shady deals as a sign of corrupted state that proves inefficiency of its criminal policy.

The absence of a special norm complicates the investigative and judicial practice of bringing the persons guilty of preparing and committing a fraud to criminal responsibility. Despite the widespread occurrence of this socially-dangerous phenomenon and the huge losses inflicted upon the public and the state, persons responsible for organization of financial pyramids escape the punishment [4, p. 142-143].

It is worth remembering that certain norms providing liability for creation of financial pyramids have been introduced to the criminal laws of China, Japan, Switzerland, Sweden, Turkey, Estonia, Germany, Denmark, Austria, United States, and a number of other countries. In particular, according to § 168 of the Criminal Code of Austria, «financial pyramid» means winning expectation system where participants are provided an opportunity to receive tangible reward under condition that other participants will be involved into this system on the same conditions; i. e., receipt of tangible benefits fully or partially depends on the behavior of every participant

who comes next. Preparation and organization of this system, activities aimed at increasing the number of participants, facilitation of its functioning by other means are considered criminally-punishable activities.

Analysis of criminal situation in our country and assessment of foreign experience allow for a conclusion that supplementation of the Criminal Code of Ukraine with an article providing liability for organization of financial pyramids will help prevent further multimillion losses among the public.

The draft law that we have developed envisages supplementation of Section VI of the Special Part of the Criminal Code of Ukraine «Crimes against property» with the following new Article 190-1: «Article 190-1. Organization of financial pyramids. 1. Creation of organizations for the purposes of deriving profits from attracting new participants with payment of money for membership as the condition for joining and participating in this organization, and actions aimed at facilitating activities and development of this organization, if they inflicted substantial damages upon the rights and interests of individuals protected by law, or upon the national or public interests, or upon the interests of legal entities, if there are no signs of gaining possession somebody else's property... 2. The same actions committed repeatedly by an organized group via illegal operations using computer equipment, and if these actions have inflicted substantial material damages... 3. The same actions committed by a criminal organization, and if these actions have inflicted material damages in an especially large amount...»

As we see, the objective side of this crime represents the actions aimed at creation, financing, management, consulting, and other forms of support of a financial pyramid. Liability should be provided for both the organizers of a financial pyramid and the persons facilitating its functioning, in particular, organizing seminars and providing logistical, legal, information, and other forms of support.

The financial pyramid means a type of fraud that involves gaining of somebody else's property by deceit and abuse of trust under the cover of an organization the membership in which may be received upon payment of a certain amount of money while the amount of illicit proceeds increases depending on the number of participants involved. These organizations always have strict hierarchy (supreme administrative body, middle- and lower-level executive bodies, «foot soldiers»), because the participants are included to certain groups whose leaders receive money from own group while the top leader receives proceeds from lower links subordinated to him.

The key feature of a financial pyramid as a type of fraud is the absence of intention in its organizers (subjective sign) and real capability (objective sign) to fulfill their promises, and therefore, partial payouts of rewards to participants are made not as a result of the organization's own business (financial) activities but from the membership fees of new participants.

The specific features of a financial pyramid fraud should include: 1) link of the fraud to economic, official, and other crimes; 2) participation in committing

the fraud of organized groups (criminal organizations) acting under the cover of financial institutions (credit unions, insurance companies, trust societies, investment funds) or nonprofit organizations (religious communities, charitable associations, special interest clubs); 3) use of financial market instruments (legal agreements on placing money under trust management, securities sale, etc.) for criminal purposes; 4) non-transparent activities of companies hiding a financial pyramid (their multiple reorganization, change of legal form, registered and actual address, offshore domiciliation, unavailability of directors); 5) creation of an investment profitability legend by using forged documents, PR technologies, and active advertising in mass media; 6) use of techniques of manipulating the victims' conscience [6].

Creators of financial pyramids use criminal technologies that involve establishment of enterprises or acquisition of rights to existing business entities, organization of reconnaissance events, attraction of new participants of a financial pyramid, use of psychological influence [3; 6, p. 9].

After studying a great number of criminal cases we have found out that any fraudulent scheme implemented using a financial pyramid undergoes certain development phases. The first phase («creation») is characterized by active advertising and attraction of new participants (in 80,7% of cases it lasted between three months and one year). The second phase («flourishing») is characterized by large (rushing) inflow of investors. In this phase, «dividends» are paid out from the moneys received from new participants (in 69,9% of cases it lasted between six months and one year). In the third phase («stagnation») the investor inflow rate slows down and their number stabilizes. The amount of moneys paid in already becomes insufficient to make timely payouts on investments. The investors are being persuaded to wait for their dividends, with delays in payouts being explained by the effect of objective circumstances (in 73,3% of cases it lasted between three and six months). The fourth phase («liquidation») sees the increased number of discontent participants who contact the law enforcement authorities (in 65,8% of cases it lasted between one and six months). The organizers of a financial pyramid disappear mostly in this phase, taking measures to conceal the proceeds from crime.

Inquiries into fraud cases begin with receipt of statements from the victims after the active phase of the criminal activity ends. The complexity of these inquiries stems from the large number of statements (in half of all cases, the police gets reports from more than 100 persons at once), the need to simultaneously seize the documents containing signs of material evidence at various organizations and to conduct documentary audits by engaging specialists from the controlling authorities and experts in economics, psychology, mathematical modeling, music studies, and so on. These audits often reveal the evidence of various offenses committed, in particular, in commercial and official business sphere which helps establish subjective signs of fraud, involvement of figurants in a crime, amount of material damages caused, and whereabouts of illicitly-gained property.

As a rule, criminal cases are opened on the basis of numerous reports from the public flowing in after closure of an organization in which they invested their money and disappearance of its management (73%), on the basis of evidence gathered in the course of field investigation against an organization's management (16,4%), and on the basis of findings gathered by official audits of business and financial dealings of an organization's officials (10,6%). In the event of realization of field investigation materials the event of crime, the nature of ties within a criminal group, and the channels of using proceeds from crime are, as a rule, established already at the criminal case opening stage, which helps carry out a coordinated field investigation plan in the initial phase of investigation.

Taking into account the practice of investigating multi-episode fraud cases, particularly in other countries, we have proposed to regulate the status of victim associations (as civic organizations) in the criminal procedure law by enabling these associations to provide evidence and represent interests of all victims during pretrial investigation and in court.

To prove an event of fraud and the involvement of particular persons in a crime it is important to use special knowledge by performing technical criminalistic examination of documents and forensic computer, forensic accounting, and forensic psychological examinations.

In particular, forensic psychological examination allows to prove the fact of psychological influence upon the victims' conscience on part of the organizers of a financial pyramid. The report of forensic psychologists represents an important source of evidence in the cases of this category. In the course of examination the experts analyze the victims' testimonies, video recordings of speeches by members of a criminal organization made on seized video cassettes, study printed out transcripts and methodological recommendations distributed among the club members, and perform experimental psychological study of certain victims [2, p. 97-102].

On the basis of general task we can single out three separate tasks of forensic psychological examination of

psychological influence: psychological study of an object of influence; study of a criminal situation of psychological influence; psychological study of information conveyed in the process of influence, including texts (verbal and written).

When ordering forensic psychological examination of psychological influence in a financial pyramid fraud case, the main questions may be formulated as follows: are there signs of a directed psychological influence upon event participants exerted by organizers or third parties? If so, what particular signs? Have the organizers of mass events (specify the events) used, when conducting these events, the methods and techniques of psychological influence to gain possession of the participants' money? If so, what particular methods and techniques? What bearing upon human psyche does participation in mass events have? Have individuals been limited in their capacity to fully realize and control their actions?

Therefore, criminal schemes of gaining possession of individuals' property by creating financial pyramids are the products of interaction of a whole number of legal, social, and psychological factors determined by a historical phase of social development. This is not only a modern type of fraud but a social phenomenon that requires comprehensive studying within the context of history, sociology, psychology, criminology, criminal law, and other sciences. This type of fraud as a specific phenomenon in contemporary crime is known in many countries, and the actions of criminals often receive transnational dimension. As foreign experience shows, introduction of criminal liability for organization of financial pyramids will help to bring persons guilty of creating them to justice in due time and actually compensate damages inflicted upon the victims of this crime, and become a powerful preventive factor. In our opinion, adoption of the proposed supplements to the Criminal Code of Ukraine (given decriminalization of a number of economic crimes) will become an important step within the system of measures of combating the organized crime, taking into account the world standards.

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