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Taking Immediate Action: Responding to Cross-border Fraud in China

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Taking Immediate Action: Responding to Cross-border Fraud in China

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How It Happens?

It was an ordinary Tuesday morning in February when Mandy, a senior accountant in MCA Corporation Ltd, a major US machinery manufacturing company, received 2 emails from company's CEO Steve Green. This email address was not Mr. Green's usual one but Mandy did not pay much attention to this since Mr. Green did on occasion use alternative email addresses.

The email came with the subject '**Urgent and Confidential**'. The first line of Mr. Green's email stated "**Below information is highly confidential, please communicate with me via this email and do not copy in anyone else**". Mandy read on. According to the email, Mr. Green was currently in China conducting a top secret M&A deal and was being supported by a firm named Elite Consulting. The email attached two bills from Elite Consulting requesting immediate payment of in total USD\$4,320,000. As prompt and efficient as Mandy always is, she wired the amount on the same day to the Chinese bank accounts that was indicated in the email.

The next morning, Mandy was shocked to see Mr. Green pass by her office thinking 'shouldn't he be in China?' All of sudden, the unfamiliar email address with nobody else copied, the mysterious consulting firm, top secret communications, urgent payment to China all pointed to MCA having been the victim of a fraud.

Incidents on the Rise

The above scenario, with slight variation, has become relatively common in the last 18 months. In addition to the above scams international companies increasingly need to be wary of cross border fraud involving phishing attacks, trade financing frauds, money laundering and many others.

Cross-border fraud involving China is strongly on the rise. The victims of the cross-border scams suffer millions of dollars in losses every year to criminals who operate across borders and behind shell companies. These sophisticated criminals are difficult to catch and funds can be difficult to trace.

What to Do?

The key question is how to react when becoming the victim of a cross-border scam? The short answer is 'ACT IMMEDIATELY'. In most cases companies should take following actions:

Step 1- Immediate Action to Preserve Funds

Liaise local bank and local police immediately upon realizing the scam occurred. Despite being in a panic, the first action is to use whatever network you have to reach out simultaneously to the local bank as well as law enforcement agencies to try to informally freeze the funds. This step is critical because once the funds have been cashed out or laundered, they will become extremely difficult to trace.

Call your lawyer since they are more familiar with local practices. Lawyers can often effectively liaise with relevant parties.

Step 2 - Recovery Strategy

Once the funds have been “informally” frozen (Because it is highly unlikely that an international company will have the time to seek an assets preservation order from PRC courts), there are following options together with their pros and cons:

Option1: Official route:

The official route includes mutual assistance request by two routes: police cooperation and mutual judicial assistance:

Police route:

a. Interpol is a multilateral international police cooperation. Most Interpol members maintain a National Central Bureau. It is possible for a victim to report the case to the Bureau (usually the national police headquarters), which will then transfer such request to the counterpart's Central Bureau with a request to take action. (i.e. File the case or freeze the bank account). However, this process can only begin once the police in the initiating country have decided to open the case.

b. Different from Interpol, the police liaison office is a bilateral police cooperation model. Major countries dispatch police liaison officer(s) to serve in their embassy abroad. Victims can approach the police liaison officer with the support of the local police authority and transfer the assistance request to the national headquarters of the police authority.

The better approach will normally depend on circumstances of an individual case. Interpol tends to focus on higher profile cases and may be more difficult to approach. In most cases, the police liaison office tends to be more accessible.

Judicial route:

The police route is more efficient than the judicial route as the police can take direct action while judicial assistance will be far more involved and may include investigations, prosecution's and criminal proceedings. It should be noted that in most countries, the police do not have a role in recovery of criminal assets. In China, the police only have the right to freeze bank accounts but do not have the right to allocate/ transfer the proceeds of such bank account. Therefore, judicial assistance will always be necessary.

It should be noted that many countries have signed bilateral judicial assistance treaties. For example, China and Australia's treaty allows assistance in respect of collecting evidence, locating and identifying persons, search and seizure of proceeds of crime, serving documents, conducting inspections or examining sites or objects, notifying results of criminal proceedings, etc.

To seek judicial assistance, the victim will need to apply to his/local Central Authority (the ministry of justice of attorney general's office for a transfer of the request and such request will require supporting materials such as (a) purpose of request and description of assistance sought; (b) name of competent authority conducting the investigation, prosecution or proceedings; (c) description of the nature of the crime. The above requests and supporting documents will need to be translated into the language of the country from which assistance has been sought. The requested Central Authority will then forward the request to the local police to take measures such as filing case, freezing the account and investigating.

In most cases it will not be police or judicial route but rather a mix of the two.

Option 2: Commercial Negotiation.

Unfortunately, in many cases the above process is too time consuming or encountering pitfalls (see below). It means companies may consider commercial negotiation as distasteful as this may be. Such measures should only be considered after the above actions have been effectively and promptly taken as this will provide leverage. A possible criminal investigation and cash frozen may make the perpetrator or his agent accept to return the funds.

Pitfalls in Taking Action

The above may indicate that there is a clear process which is easy to commence. The reality is that there are several pitfalls which may be encountered. They include:

Overseas police do not want to file a case

In one case we dealt with involving unauthorized funds being transferred from overseas company's bank account to a number of different bank accounts in China.

The overseas police merely conducted a preliminary investigation and showed reluctance to further investigate. This meant the Chinese police would not provide assistance as no case had been commenced overseas.

Formalities can delay action

Formalities are an element which can drag the process. One example is the power of attorney (POA). If a POA is prepared overseas, it will usually take at least 2 weeks to notarize, legalize and courier to China. Accordingly, if the victim has a Chinese entity, it will save time to precede the POA with the local entity of the aggrieved overseas company. In addition, unlike common law jurisdictions, the time required to obtain an injunction order in China varies depending on the police authority as Chinese law does not have specific time limits on such orders.

Summary

CFOs and financial departments in companies working internationally should be aware of the tactics that sophisticated scammers commonly use to defraud their victims. Awareness and effective management procedures can go a long way towards preventing such scams by having a clearly defined process for verifying and paying accounts and invoices. However, even the best prepared company with state of the art IT protection may still face an issue. In case such an event arises then it is of absolute priority to secure the funds and then implement a strategy aimed at their recovery.

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