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A large, 3D green arrow points upwards from the bottom center. It is surrounded by several smaller, semi-transparent blue and purple arrows that also point upwards, creating a sense of growth and upward movement. The background is a bright blue sky with scattered white clouds.

TalkingPoint: ASSET TRACING AND RECOVERY PROCESSES

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FW moderates a discussion focusing on asset tracing and recovery between Jerry Oldham at 1stWEST Financial Corp., Christian Hay at Collas Crill, and Simon Charlton at Deloitte.

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CEO
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Jerry Oldham is co-founder, chairman and CEO of 1stWEST Financial Corporation. Mr Oldham has an extensive investigations and corporate due diligence background, and a broad senior management resume in commercial banking and corporate and real estate finance. He frequently serves as a consultant or expert witness in litigation and settlement negotiations involving complex corporate finance, real estate, banking, and lending practice issues, having assisted in the settlement of hundreds of lawsuits. He can be contacted on +1 (303) 670 3443 or by email: j.oldham@1stWEST.com.

Christian Hay
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Christian Hay is a partner at Collas Crill. He is head of the firm's Dispute Resolution team in Guernsey. Mr Hay has broad experience of dispute resolution matters, specialising in financial services and property/construction sectors. He has acted on some of the largest and most significant pieces of litigation to come before the Guernsey Courts in recent years and regularly advises banks, trust companies and other financial services businesses on contentious issues. Mr Hay can be contacted on +44 (0)1481 734 290 or by email: christian.hay@collascrill.com.

Simon Charlton
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Simon Charlton is a managing director at Deloitte. He leads the firms Forensic and Dispute practice in the Middle East. Throughout his career Mr Charlton has focused on financial fraud and anti-corruption investigations, compliance activities, asset tracing and recovery, and dispute resolution. He has worked extensively on multi-jurisdictional investigations, liquidations and reorganisations, conducting investigations and assisting in the identification, freezing and recovery of assets. Mr Charlton can be contacted on +971 507 124 719 or by email: scharlton@deloitte.com.

FW: To what extent are you seeing a rising demand for asset tracing and recovery services? What are the underlying drivers?

Oldham: We have seen an increase in demand for these services since the beginning of the most recent economic recession. Any downturn in the economy puts pressure on the balance sheets of banks and borrowers. The main driver, as has always been the case, is a creditor's need to have facts at hand about the asset composition of a borrowing entity and its principals, and all relevant debt guarantors and co-makers to determine if the existing defaulted loan has sufficient assets and asset value to pursue collection and, if there is a deficiency, were any assets, or liquidated asset values, transferred to associated parties of the defaulted entity to the detriment of the creditor. Also, asset searches are performed on the relevant guarantors and co-makers in the case of a likely deficiency to determine if they are worthy of pursuit legally for the amount of the deficiency.

Charlton: In the MENA region we are seeing an increase in demand for asset tracing and recovery services. There are a number of factors driving this. First of all, we have seen the effects of the Arab Spring and moves by governments to recover funds allegedly misappropriated by kleptocratic leaders over long periods of their tenure. In addition, government owned organisations and private corporations appear to have decided that sweeping matters under the carpet is no longer a viable alternative. There is a demand for a greater level of transparency and governance, a move against bribery and corruption and a desire to improve margins, particularly in light of the global financial crisis and to hold people accountable. This means that cases are now being investigated and actions taken to recover funds where in the past these situations may have been ignored.

Hay: We have seen a marked increase in demand for dispute resolution services generally over the past two or three years. This has led to a clear increase in two very specific types of asset tracing and recovery work. First, insolvency-related tracing and recovery applications have become much more prominent. These matters can range from simply winding up a local company on lenders' instructions, to extending foreign asset protection regimes – such as administration orders – to quickly secure local assets, to obtaining asset disclosure and production orders in support of trustees' and liquidators' investigations. Second, the 'mirror injunction', in which the local courts will make orders in support of foreign – commonly UK – proceedings to protect local assets

and often to obtain disclosure from institutions to trace assets, seems to have become an increasingly used tool for onshore litigators.

FW: Is the demand for asset tracing and recovery more associated with criminal or civil proceedings in the current market?

Charlton: I have always thought criminal action is about the individual whereas civil litigation is about the money. In civil code countries, where penalties for crimes are based upon some set scale, the recovery of assets is not always paramount and often the aim may be to seek some form of incarceration of guilty individuals. However, in civil litigation the aim is often to recover losses or misappropriated assets. The two can, however, merge where civil litigants can file a criminal complaint and await its outcome before pursuing a civil claim for damages and recovery of assets based upon the outcome of a criminal proceeding. Presumably, in some of the cases of recovery against deposed leaders, it will be interesting to see on what basis recovery is sought – will it be civil, criminal or through some supra-national organisation and sanction, for example UN resolution?

Hay: Guernsey and Jersey are both on the EEC White List of so-called 'offshore' jurisdictions, they are not jurisdictions where white-collar crime or money-laundering are commonplace. That is not to say that it doesn't happen here but, on balance, asset tracing and recovery is probably more frequent in the civil arena than it is in a criminal context – certainly the sum of the amounts involved is greater. With regard to regulatory action and criminal prosecutions, both Guernsey and Jersey have a raft of up-to-date, Financial Action Task Force (FATF) compliant rules and regulations. Taking Guernsey, for example, the Guernsey Financial Services Commission (GFSC) is the island's regulatory body for the finance industry and the Guernsey Border Agency (GBA) is responsible for all cross-border financial crime activities.

Oldham: I would say civil proceedings are more prevalent in the current market, in terms of the number of situations calling for asset searches, because of the sheer number of debt defaults and deficiencies, as the purpose of asset searches is primarily to provide information to assist the creditor in the collection of its debt. However, in a criminal case the purpose is often the same as a result of the interest by the prosecution in making damaged parties whole, if possible. In the US, some of the better known ponzi scheme cases involving criminal convictions are examples of this situation.

FW: What considerations should parties make when weighing up the cost and benefits of asset tracing?

Oldham: It is simply a matter of trading off the desired amount to be collected against the cost to the damaged party of hiring a reputable firm to perform the asset searches. Obviously, legal fees associated with the collection effort also have to be factored into the cost equation, as does the likelihood of a successful outcome based upon an estimated collection. If the creditor has a judgment in hand, this is an easier equation to balance and analysis to make.

Charlton: Asset tracing can be a very expensive exercise which often takes time. It may involve multiple proceedings in a number of jurisdictions. The objective which needs to be considered is recovery. Tracing is somewhat of a theoretical exercise which may support certain 'tracing' claims for misappropriated assets, but what really matters is the ability to recover assets. Causes of action may be in one jurisdiction while assets sit in another. The enforceability of judgements in jurisdictions where assets reside is a critical factor. It is not just the cost of tracing that has to be considered but ultimately the cost of enforcement and recovery. Also, if the claim is not a pure tracing claim, it makes sense to target assets in jurisdictions where freezing orders are obtainable and have teeth, and in doing so consider the costs of obtaining these. For example, undertakings in damages and security or bonds may be required and these can sometimes be prohibitive. Careful consideration needs to be given to the type of claim, who are the necessary parties to capture assets and where should claims be brought.

Hay: Asset-tracing can be a painstaking and expensive business, requiring the services of not only legal specialists, but also forensic accountants and possibly private detectives and other professionals. What is more, in many cases it can be difficult at the outset, and without spending a significant amount of funds, to give any assurance that any assets exist which will be both traceable and available to meet the claim. It is a commercial decision for businesses as to whether or not it is worth expending such costs in the hope that the asset tracing measures bear fruit. In short, businesses should ask themselves a number of questions. What are the amounts potentially recoverable? How likely is it that they will be recovered? How much will it cost to try and trace them? And can I afford to lose the monies invested

in seeking to trace the assets if indeed no assets are then recovered?

FW: In your opinion, how difficult is it to accurately trace the movement of cash and assets in fraud-related cases?

Charlton: Due to its fungibility and speed of movement, tracing cash is difficult. Very often targets will convert assets into real property and seek to disguise ownership through structures in offshore jurisdictions and the use of instruments or vehicles, such as revocable or star trusts or anstalts. Obviously, movable or immovable real property is easier to locate but even those may be converted into cash and or put into ownership structures to disguise ownership. In addition, parties may seek to leverage assets to defeat creditors and those searching for assets by granting charges or obtaining mortgages over real property. Speed of action, surprise and availability of evidence and data can be key elements in successfully tracing assets.

Hay: The process varies greatly, depending on the sophistication and means of the people involved. As with many facets of enforcement, it can often seem like an arms race in that while the tools which can be used to trace assets become increasingly sophisticated, the people seeking to disguise or disseminate funds and other assets also become increasingly sophisticated in their approach. Clearly there have been great strides made in the past two decades or so in technology and communications, particularly with the advent of the internet. There has been great innovation in the types of financial instrument that are now accessible to all manner of types of investor. Such complexity, it has been argued, has led to greater opportunity for financial fraud, which is unsurprising in certain cases where only a handful of people are deemed to be able to understand exactly how such instruments work.

Oldham: Although it can be difficult, there are accounting experts that perform this function daily. If it is an alleged criminal fraud case, and the parties are in a pre-trial discovery mode, then there are accounting firms that specialise in this forensic research and are quite good at tracing the movement of cash with proper access to the relevant data.

FW: How important is it to have access to information on banking records, including in offshore jurisdictions?

Oldham: This can be essential. Obtaining these records is a part of the routine legal discovery process before trial if it is a case at this stage of the research. Fraudsters will obviously work hard to hide cash, which is always the challenge to overcome. If such an attempt to hide assets – cash or otherwise – is discovered, however, then the likelihood of conviction is obviously increased.

Hay: Banking records are the bread and butter of any tracing exercise from both a practical and a legal perspective. The speed and ease with which financial transactions can now be executed means that there will frequently be no other evidence of the movement and ownership of assets other than what is retained by banks. The trail can get cold very quickly, and the practical job of locating the subject assets made almost impossible, once the chain of transactions is broken by a single bank's records not being made available. From a legal perspective, the various common law rules relating to recovery in civil actions mean that it is vital to have complete and unimpeachable evidence of the flow of funds through the relevant accounts if you are to have any prospect of successfully recovering assets.

Charlton: In a pure tracing claim, access to banking records is often vital. Access to this information is a key factor to be considered. In order to obtain information in some jurisdictions, separate causes of action may be required in other ancillary proceedings. In others, criminal authority assistance may be available, and in some, third party discovery may be an option. For example, in the US, discovery of information may be available to support foreign proceedings under USC 1782. A word of caution, however, in obtaining information: its provenance must be considered. Information should be obtained legally and in such a way that it is usable. In some jurisdictions, seeking information may itself be a criminal offence. If the aim is to identify and seize assets, and prove ownership by an individual against whom claims for damages are made, then access to banking records may be less important, although they would remain a potentially good source of information.

FW: What are the elements of the original loan that contribute to the cause and effect of asset search needs and requirements?

Hay: Loan recoveries are a relatively minor, albeit growing, part of our asset tracing and recovery practice. However, it is impossible to overstate the importance of

good security documentation when embarking on a loan recovery matter. Ideally, the lender will have physical security, or at least the right to take physical security, over sufficient of the borrower's assets so as to make tracing and recovery unnecessary. This can be easier said than done. Many offshore financial centres have local principles and practices surrounding the taking of security that are not easily understood and complied with by those who do not specialise in the jurisdiction. It is important to brief locally to make sure that your security is effective. More generally, good security documentation will make the parties' rights and obligations on breach sufficiently clear, so as to cause fewer problems in executing the enforcement procedure.

Charlton: In terms of specific tracing claims in respect of loans drawn down, obviously the fungibility of funds makes cash tracing difficult. Tracing into real property would be key, for example, if loans are drawn down for a specific asset.

Oldham: The better the initial credit underwriting and asset valuation up front, the less likely that a lender will find itself in a workout or deficiency, all other economic factors being equal. Furthermore, a thorough background investigation of all relevant parties to the loan will greatly assist in obviating the risk of doing business with previously convicted felons or perpetrators of fraud schemes against former lenders and investors.

FW: What differences arise when asset tracing in common law versus civil code countries?

Hay: Obtaining injunctive relief in the Channel Islands is done in a very similar way to how it is done in the UK. One aspect of the common law which does differ, however, is that Guernsey has an underdeveloped equitable jurisdiction and as such the courts are not able to grant orders for specific performance. One of the most effective ways of tracing assets in foreign jurisdictions is by means of various international agreements, such as the Hague Convention on Taking Evidence Abroad in Civil and Commercial Matters. Many of the most common code countries are party to that convention. In criminal matters the now near-universal anti-money laundering and proceeds of crime obligations, means that there is unlikely to be much difference in practice in most matters between civil and common law jurisdictions.

Oldham: Most of our work in this area is conducted in

the US, which has no law to block an effort to search for physical assets in a loan default. For any work in foreign country, it is important to obtain specific legal advice before beginning such work.

Charlton: There may be differences in ability to access information, causes of action and remedies available. The ability to obtain freezing orders and the security and bonding requirements thereon may often be very different. For example, in some countries like the US, pre-trial restraining orders are not easy to get while in others freezing orders, which on their terms have extra territorial effect, may be available ex parte as claims are filed. The role of the criminal authorities may also differ. For example, in some countries criminal complaints can be made whereby civil litigants may then seek to piggy back on those. What should also be considered is the interplay, reciprocity, and comity between jurisdictions. For example, judgements obtained in England may well be enforceable through recognition in many of the traditional offshore centres, which are overseas territories associated with the UK, whereas English judgements may not be enforceable in certain countries at all.

FW: Which jurisdictions do you see cropping up most frequently in asset tracing cases? Do you think there is any link with perceived corruption or lack of financial monitoring and control in those jurisdictions?

Charlton: As the global markets become more integrated and money moves more freely, this is becoming a global phenomenon. The start of an exercise could be almost anywhere. Very often transfers of cash are dollar denominated at some point, so dollar clearing centres often play a role. In addition, people seeking to hide assets or disguise ownership may use the traditional offshore centres. The number of offshore centres is growing and, as the traditional centres impose stricter controls and regulations, these newer centres may come to the fore.

Hay: Jurisdictions with poor reputations from a regulatory point of view do regrettably crop up on a regular basis, particularly in matters involving anti money-laundering offences. However, in cases where we have traced assets simply in order to satisfy a judgment, in circumstances whereby the plaintiff might not have made a conscious effort to hide such assets, there is no real science to where the assets have been located, other than perhaps the usual financial centres or home and related jurisdictions of the defendants.

Oldham: Since loan defaults may occur 'anywhere and everywhere' the business of borrowing is taking place,

in our view this issue is not jurisdictionally dependent or unique.

FW: Asset tracing is only part of the story. What challenges are involved in taking the process into a successful recovery phase? What methods are experts utilising?

Charlton: Recovery is key. Tracing is only part of the story and the ability to recover assets once traced is critical. As quickly as methods are unearthed and broken through there are new methods being put in place to protect and hide assets. One recent development has been the evolution of star trusts. Recovery is often a lengthy and litigious process and a key element is securing assets early so that any tracing claim can be proven, leading to a successful recovery at the end of the process.

Hay: Whether or not clients choose to do so prior to locating any target assets, or whilst such tracing is taking place if they wish to enforce against such assets, they will need to follow the relevant procedure to do so in that jurisdiction. In terms of enforcement of a judgment of the Royal Court, Guernsey has reciprocal enforcement legislation in place with England and Wales, Scotland, Northern Ireland, the Isle of Man, Israel, Italy, Jersey, Netherlands, Netherlands Antilles, and Surinam. If assets are located in any of those jurisdictions, the judgment of the Royal Court will, subject to certain conditions, thereafter have effect as if it had been given by the court of the foreign jurisdiction where the assets are located. Jersey also has reciprocal enforcement legislation in place with England and Wales, Scotland, Northern Ireland, the Isle of Man, and Guernsey. This legislation broadly operates in the same way as that in place in Guernsey.

Oldham: The key to recovering on a default where there is a deficiency is getting a judgment against the debtor, which may involve a trial, or may not. In the US, default judgments are frequently granted in situations wherein the loan documents grant such authority to the courts in the event of a loan default. Otherwise, the time it takes to accomplish this is critical and can significantly impact the ultimate collection, because relevant assets can be more difficult to locate with the absence of time. It is best to establish what the asset base is of all relevant parties as soon as the lender suspects it will begin a workout discussion or law suit, to help blunt the potential asset dislocation issue. Once the judgment is obtained, then the process of domesticating and filing the judgment in all relevant jurisdictions wherein the judgment debtor owns assets is most important, so the judgment collection process can begin in a timely manner. ■