

**Labour's
Policy
Review**

Labour's Policy Review: Tackling Serious Fraud and White Collar Crime

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A One Nation approach to fighting economic crime

The City of London is the world's second largest financial centre. It bolsters the UK's international standing and is a major engine for economic growth. It owes its success to the quality of the professionals who work there and to centuries of stability and the rule of law. As we rebuild our economy, we cannot afford this reputation to be tarnished by fraud, corruption and market manipulation.

A well-policed City is not just essential for our economy, but for the health of our democracy as well. Nothing does more to fuel cynicism and resentment about politics than the perception that there are elites who are above the law and who rig the system for themselves. *This is why Shadow Home Secretary Yvette Cooper has said that a future Labour government would bring in an Economic Crime Bill to tackle fraud and market manipulation.* As Ed Miliband has said, the Government needs to be on the side of the businesses that play by the rules and that means standing up to those who break them. This is why it is essential that we have an up-to-date law on corporate criminal liability, robust penalties and properly resourced law-enforcement agencies that are staffed by the best.

However under the current Government, the Serious Fraud Office is going backwards, with conviction rates down by over 20 per cent since 2010 and a series of costly blunders, including unauthorised golden goodbyes to senior members of staff totalling £1 million. And they have recently announced their intention to water down the Anti-bribery Act passed by the last Labour Government.

Labour has always believed that white collar crime should be treated very seriously. As part of the Policy Review, we want to learn from what works in other jurisdictions, so that a financial centre on the scale of the City has fraud prosecutors to match.

Fraud in the UK

White collar crime is not victimless. It affects all parts of society, from big businesses to vulnerable individuals. Fraud costs the UK economy £73 billion a year, according to the Home Office's National Fraud Authority ⁱ.

Victims often struggle to get redress. Researchers at the University of Portsmouth's Centre for Fraud studies estimate that only 1.5 per cent of frauds are ever reported and only 0.4 per cent ever receive a criminal sanction.

Prosecuting a company for fraud is difficult under English law. With a few exceptions such as the Bribery Act, a prosecutor traditionally has had to show that a "directing mind and will" of the company was guilty of the offence. Generally, this means that a board member or senior manager would have to have been personally involved in the offending conduct.

This principle, known as the identification doctrine, has been widely criticised by legal experts: "Only the very senior managers will be likely to fit the description as the directing mind and will of the company. This illustrates one of the major shortcomings of the identification doctrine - that it fails to reflect the reality of the modern day large multinational corporation ... [I]t produces what many regard as an unsatisfactorily narrow scope for criminal liability." ⁱⁱⁱ This has led the Law Commission to conclude that "it may simply be an inappropriate and ineffective method of establishing criminal liability of corporations." ^{iv} The judiciary have shown a clear willingness to expand the situations where companies are liable for the acts of their employees in the scope of their employment. ^v As a result the authority of the identification doctrine is highly uncertain. It is a clear example of where legislation would be helpful.

ⁱ 'Annual Fraud Indicator 2012', Home Office, March 2012 p8 <http://www.homeoffice.gov.uk/publications/agencies-public-bodies/nfa/annual-fraud-indicator/annual-fraud-indicator-2012?view=Binary>

ⁱⁱ 'Fraud and Punishment', University of Portsmouth, 2012, p3, para1.6

ⁱⁱⁱ Smith & Hogan, 12th ed, 2008, p249

^{iv} Law Commission Consultation, Criminal law in a Regulatory Context, August 2010, p104, http://lawcommission.justice.gov.uk/docs/cp195_Criminal_Liability_consultation.pdf

^v Supply of Ready Mixed Concrete (No.2), Re [1995] 1 A.C. 456; Meridian Global Funds Management Asia Ltd v Securities Commission [1995] 2 A.C. 500;

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Professor Barry Rider, University of Cambridge:

"[T]here is convincing authority for the proposition that the acts of an employee even acting contrary to the express instructions of his employer and without legal authority, might nonetheless be attributed to the employer if the unlawful act was executed by the employee within the scope of his employment. As Lord Templeman put it "an employee who acts for the company within the scope of his employment is the company..."* Notwithstanding that the House of Lords and Privy Council have accepted this principle of merger in cases of restrictive trade practices and financial regulation, it does not appear to be widely acknowledged or utilised in practice."^{vi}

*Re Supply of Ready Mixed Concrete (No 2) (1995) 1 All ER 135 at 142.

These legal obstacles are compounded by the weakness of the SFO as an investigator and prosecutor of complex fraud. An independent report by Her Majesty's Crown Prosecution Service Inspector (HMCPsi), published in December 2012, found that 'the SFO appears to be suffering considerable resourcing problems'^{vii} and also identified serious failings in case-handling and selection as well as a lack of transparency in its civil settlements. The SFO's limitations as a fraud prosecutor have meant that other agencies have had to step in. These include the CPS Fraud Division and the Financial Services Association (FSA) Enforcement Division. This has created confusion over who is supposed to do what, preventing the rationalisation of counter-fraud agencies that the SFO was originally supposed to achieve.

If a case does get to conviction stage, the criminal fines imposed by courts in England and Wales are weak by international standards. The highest fine for fraud from an SFO case is £2.2 million compared to \$3 billion (£1.9 billion) in the US. The authorities can also confiscate assets that are the proceeds of crime, but here too, the authorities' track record is very patchy. Since 2008, the SFO has collected just £13 million of the £73 million in confiscation orders it secured from the courts .

^{vi} B. Rider, K.Alexander, L.Linklater and S. Bazley, Market Abuse and Insider Dealing (2nd Ed,2009) Tottel

^{vii} Report to the Attorney General on the inspection of the Serious Fraud Office, November 2012, Her Majesty's Crown Prosecution Service Inspector, p19 http://www.hmcp.si.gov.uk/documents/reports/THM/SFO/SFO_Nov12_rpt.pdf

^{viii} Source: written answer by the Attorney General to a question by Jeremy Corbyn MP <http://www.publications.parliament.uk/pa/cm201213/cmhansrd/cm121023/text/121023w0001.htm>

The UK's international reputation is at stake

Last summer it emerged that for years banks had been rigging the London Interbank Offered Rate (LIBOR) - a key interest rate used for \$400 trillion worth of financial products worldwide. Astonishingly, the SFO initially declined to investigate and handed the matter over to the FSA, a regulator that lacked the powers to bring criminal charges. The FSA investigated the matter jointly with the US Department of Justice (DoJ). The DoJ extracted £230m in fines from Barclays, dwarfing the £60m that the FSA accepted for the same offences. Months later, once the scale of the scandal became public, the SFO was eventually shamed into investigating.

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This was just one of several instances in recent months where US prosecutors have taken a lead in investigating British banks. US federal and state prosecutors imposed \$1.92 billion (£1.17 billion) in fines on HSBC for offences including laundering money from Mexican drugs cartels. The UK-based bank Standard Chartered was fined \$327 million after US authorities found it had broken US sanctions on Iran, Burma, Libya and Sudan. As Professor Alan Riley of City University has said with reference to the LIBOR scandal "the great investigative power here is not in Britain, it is in the United States." ^{ix}

The Government's response

The Government's main initiative to boost the effectiveness of economic crime prosecution has been to introduce a form of US-style plea bargains, known as 'deferred prosecution agreements' (DPAs). Typically, a company with some sort of fraud or bribery on its books would investigate the alleged wrongdoing, cooperate at an early stage with prosecutors, sign a statement outlining their wrongdoing, pay a fine and agree to implement compliance procedures.

DPAs are a favourite tool of US prosecutors, who have had far greater success in holding companies to account. Self-reporting also helps to spread the cost of investigation between the authorities and the company. One major concern,

^{ix} Newshour, BBC World Service, 12th July 2012

however, is that the carrot-and-stick approach of US plea-bargaining only works when companies fear the stick of the prosecutors. This is certainly the case in the US. It is not the case in the UK. For that reason, there is good reason to doubt whether importing DPAs in isolation will work.

Fraud prosecution in the US

Criminal law: Instead of the doctrine of “directing mind and will”, the US has the principle of “respondeat superior”. The US Attorney’s Manual states that a ‘corporation may be held criminally liable for the illegal acts of its directors, officers, employees, and agents. To hold a corporation liable for these actions, the government must establish that the corporate agent’s actions (i) were within the scope of his duties and (ii) were intended, at least in part, to benefit the corporation.’^x

This sets the threshold for prosecuting corporates far lower than in the UK. Companies facing the prospect of criminal prosecution know that co-operating with prosecutors is an effective and usually successful way to try to avoid a criminal conviction and all its collateral consequences. This is not the case in the UK, where the threshold for prosecutors is higher, reducing the incentive for companies to co-operate. Even supporters of bringing deferred prosecution agreements to the UK admit that this is a problem.

Jonathan Fisher QC:

“In the US ... the law is strikingly different [to the UK]: a company is held vicariously liable for the acts of its employees and the prospect of acquittal is remote. This is not a problem under the Bribery Act 2010, where a company that fails to institute adequate anti-corruption procedures is liable for the acts of its employees. But in other economic crime cases, prosecutors have to prove a director’s personal wrongdoing... Unless the Government addresses this critical point, the DPA initiative will be a damp squib.”^{xi}

^x Jonathan Fisher QC, ‘Will US-style deals be a damp squib?’, Times, May 24th 2012.

^{xi} General Considerations of Corporate Liability, US Attorney’s Manual, 9-28.200 http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/28mcrm.htm#9-28.200

Penalties: When comparing the treatment of the same company for violation of similar measures, US fines are significantly higher, for example: BAE Systems was fined five times as much in the US (\$400 million, £250 million) as in the UK (£30 million) for bribery and corruption-related offences. The highest fraud fine imposed by the SFO was £2.2 million against Seven Trent Water Ltd, 1000 times lower than the highest US fraud fine (\$3 billion, or £2 billion, against GSK).

While the Sentencing Guidelines fine range is not binding on the court, it does provide a corporation with a clear sense of what sort of fine it may face if it decides to fight the case in court, as well as a clear framework for discussions between the prosecutor and company counsel. This results in fines sufficiently severe and certain to have a real deterrent value and to push companies under investigation towards co-operating with prosecutors. In addition, fines in the US can be reduced if the corporate has a good compliance program or cooperates with US authorities.

The gap between US and UK fines was a cause of concern for counter-fraud officials in the US. They fear that it weakens the international united front against economic crime. The British judiciary has also voiced support for a more robust approach. Criticising what he saw as the weak bribery fine agreed by the SFO with a company called Innospec, Sir John Thomas, president of the Queen's Bench division of the High Court, said: "As fines in cases of corruption of foreign government officials must be effective, proportionate and be dissuasive in the sense of having a deterrent element, I approach sentencing on the basis in this case that a fine comparable to that imposed in the US would have been the starting point, such a fine being quite separate from and in addition to depriving Innospec Ltd of the benefits it had obtained through its criminality."

The focus of this document is corporate financial crime. However, we are also examining the case for correcting the anomaly whereby the maximum sentence for an individual convicted of money-laundering is 14 years but for fraud, it is only 10 years.

^{xii} See: United States Sentencing Commission Guidelines Manual, 2012, chapter 8.

^{xiii} R v Innospec Ltd [2010] Lloyd's Rep. F.C. 462; [2010] Crim. L.R. 665, para 32

Proceeds of crime: In the US, assets confiscated by prosecutors as proceeds of crime are put into the DoJ's asset forfeiture fund. Wherever possible, confiscated money is returned to victims. Sometimes in fraud or corruption cases there are no identifiable victims. At the end of the year, law enforcement agencies can bid for what is left to spend on improving their asset forfeiture operations. The uses of this money are restricted to asset forfeiture, so that prosecutors' objectives are not skewed by the prospect of direct financial gain. However, this system does result in hundreds of millions of dollars being spent each year on financial investigators, forensic accountants and computers. As a result, the leading fraud divisions in the US criminal justice system bring in many times the salaries of the individuals who work for them.

Recruitment: In the US, it is common for lawyers to switch from private to public practice and back again during their careers. Prosecutors' offices benefitted from stints of service from lawyers with hands on experience of defending corporate clients, while ambitious private sector lawyers were keen for the prestige and trial experience that came with working at flagship teams such as the US Attorney's Office for the Southern District of New York or the Fraud Section of the Criminal Division in Washington, DC.

Although there has been no shortage of senior staff deserting the SFO for the lucrative private sector, its appeal to ambitious young lawyers is limited. This is chiefly because of its forlorn reputation and because young and talented SFO lawyers fail to get the extensive trial experience that US federal prosecutors enjoy. Salaries are obviously lower in the SFO than in private practice, but this is also the case in the US.

Marcus Asner, a partner in the white collar practice of Arnold & Porter LLP, spent over four years as a litigation associate at Cravath, Swaine & Moore before joining the US Attorney's Office in the Southern District of New York in 2000. After nine years with the US Attorney's Office, he joined Arnold & Porter as a white collar partner in 2009:

"My four years at Cravath helped me tremendously as a prosecutor; I came into the job far more seasoned than I might otherwise have been, had a much deeper understanding of how companies work, and was much better at dealing with judges and opposing counsel. Like most of my colleagues at the SDNY, I joined the government (despite the huge pay cut) both because I wanted to represent the United States in court, and because I wanted

the incomparable trial and investigative experience. My nine years as a prosecutor has proven invaluable in my present work, in part because of the trial and investigative experience, but also because I have a much better understanding about how investigations and prosecutions actually work, which I think helps me a great deal in representing clients.”

Developing this agenda

Drawing on lessons from the US, we will consider how best a Labour government could transform the UK's enforcement record on economic crime by:

- Exploring the scope to update further the UK's laws on corporate criminal liability so that they no longer insulate companies from any meaningful chance of prosecution.
- Looking at ways of firming up the UK's penalties regime for white collar crime so that they are more in line with other jurisdictions.
- Exploring the potential to expand the SFO's recent practice of recruiting lawyers from the private sector for specific cases.
- Consulting with stakeholders to determine whether more of the proceeds of crime could be ploughed back into law enforcement so that future victims of fraud have the best chance of recovering what belongs to them.

Such measures would help to ensure that white collar crime prosecution become a profit centre for the criminal justice system, as it is in the US.

Above all, the One Nation economy that Labour aims to build, and a financial sector that works for everyone, can only be secured with the backstop of a robust and respected system for prosecuting white collar crime.

Case Study 1: Australia

In 1995, Australia introduced criminal liability for companies found to have a 'criminal corporate culture'. Section 12 of the Criminal Code Act states that a body corporate may be found guilty of any offence if an employee, agent or officer of that body corporate, acting within the actual or apparent scope of their employment, or within their actual or apparent authority, commits the physical element of an offence.

If intention, knowledge or recklessness is an element of the offence, this must be attributed to the body corporate if that body corporate 'expressly, tacitly or impliedly authorised or permitted the commission of the offence'. This permission can be established if 'corporate culture' existed within the body corporate that directed, encouraged tolerated or led to non-compliance; or if the body corporate failed to create and maintain a corporate culture that required compliance. 'Corporate culture' is defined as 'an attitude, policy, rule, course of conduct or practice existing within the body corporate generally'. The statute is similar to the UK's Bribery Act 2010.

Case Study 2: EU cartel fines

The European Commission regularly fines companies that break EU rules on cartels a percentage of relevant sales. The percentage is between 0-30%. This figure is then adjusted upwards or downwards according whatever aggravating or mitigating factors are present. Examples of aggravating factors are repeat offending and obstructing investigations. A mitigating factor would be if the company only played a limited role in the offence or co-operated with the investigation. Considerable leniency is also shown to companies who come forward to the Commission and self-report. An overall cap on fine is set at 10 per cent of turnover.

Case Study 3: The Netherlands

The Netherlands has a long history of holding corporate entities to account. For most of the 20th century they could be prosecuted for economic and fiscal offences. In 1976, a general rule was introduced into the Dutch criminal code that every criminal offence can be committed by a legal entity. In 2003, the Dutch Supreme Court ruled that corporate companies can be prosecuted whenever the offence can be reasonably attributed to it. Relevant factors for whether an offence can be attributed to a corporate include where the offence was committed within the scope of the company's activities; where the corporate entity benefitted from it; and where it was committed by an employee of, or a person working on behalf of the corporate entity. It can also be prosecuted where it is deemed to have 'accepted' the conduct that led to the offence. Not taking reasonable care to prevent such conduct can amount to 'acceptance.' It is a defence to argue that the corporate took reasonable care to prevent the offending behaviour, for example by having rigorous compliance procedures. In the Netherlands, administrative fines on companies are far higher than criminal fines. The main purpose behind prosecuting companies is to demonstrate the importance of having proper compliance systems in place.