FRAUD ADVISORY PANEL

FRAUD ADVISORY PANEL REPRESENTATION 02/17

RESPONSE TO CORPORATE LIABILITY FOR ECONOMIC CRIME CALL FOR EVIDENCE PUBLISHED 13 JANUARY 2017

The Fraud Advisory Panel welcomes the opportunity to comment on the *Corporate Liability for Economic Crime* call for evidence published by the Ministry of Justice on 13 January 2017, a copy of which is available from this link.

This response of 23 March 2017 reflects consultation with the Fraud Advisory Panel's board of trustee directors and interested members from the investigations and legal process group. This group brings together representatives from the public, private and third sectors who are involved in fraud investigations and the legal system.

We are happy to discuss any aspect of our comments and to take part in all further consultations on the issues we've highlighted in our response.

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The Fraud Advisory Panel (the 'Panel') is the UK's leading anti-fraud charity.

Established in 1998 we bring together fraud professionals to improve fraud resilience across society and around the world.

We provide practical support to almost 300 corporate and individual members drawn from the public, private and voluntary sectors and many different professions. All are united by a common concern about fraud and a shared determination to do something about it.

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MAJOR POINTS

1. It is clear that although the UK has had the ability to prosecute companies under the current directing mind and will test for corporate criminal liability, this has been little used. When it has been used this has tended to be against Small or Medium Sized Enterprises (SMEs), and not large multi-national organisations. As such the current law is not only ineffective but tends to operate unfairly against SMEs.

2. Changes to the system of corporate criminal liability are long overdue. In broad terms we are in favour of adopting option 3, which broadly replicates the Bribery Act 2010. The failure to prevent corruption offence under the Act appears to be effective both in terms of the ability to be used to prosecute companies of all sizes and also in terms of providing an incentive for companies to improve their corporate governance. Any proposal for additional, broader, changes to the directing mind and will test would need to be carefully examined by the Law Commission.

RESPONSES TO SPECIFIC QUESTIONS

A. THE COMMON LAW RULES AND THE ISSUE TO BE ADDRESSED

Q1: Do you consider the existing criminal and regulatory framework in the UK provides sufficient deterrent to corporate misconduct?

3. No. The existing criminal law framework has rarely been applied to companies due to the difficulties in proving that the 'directing mind and will' of the commercial organisation had the necessary fault element or 'mens rea' for the offence. The exception to this has been the UK Bribery Act failure to prevent offence which has had a significant impact in terms of incentivising companies in all sectors to assess the bribery risks they face and take steps to prevent them and a lesser impact in terms of investigations, Deferred Prosecution Agreement (DPA) settlements and prosecutions.

4. Where the existing criminal and regulatory framework applies to individuals, and where members of a company's senior management face a prosecution, it can be a more effective deterrent than the prosecution of a company as a legal entity. However, it has proved very difficult to gather evidence against individual members of senior management to prove their roles in an alleged fraud in a number of serious cases. As such the criminal law framework has been relatively ineffective in both prosecuting and deterring corporate misconduct.

5. The alternative of regulatory action against individuals and corporates in regulated sectors can also act as a deterrent, and the recent changes to FCA rules (in particular the Senior Management Regime) may improve the level of deterrence. At this stage it is too early to tell whether or not these changes have or will deter corporate misconduct. However this framework does not apply to all companies and, even if effective, it will not and cannot deter corporate misconduct outside the regulated sector.

Q2: Do you consider the identification doctrine inhibits holding companies to account for economic crimes committed in their name or on their behalf?

6. Yes. Although the 'directing mind and will' test is more easily applied to SMEs it presents difficult hurdles when applied to larger multi-national businesses. The identification doctrine is not fit for purpose when applied to such large modern companies and it hinders criminal action being taken against such companies. It also tends to be used disproportionately, and thus unfairly, against SMEs. The more relevant question here is whether companies need be dealt with under the criminal law or whether they need to be better and more energetically regulated, or both.

Q3: Can you provide evidence or examples of the identification doctrine preventing a corporate prosecution?

7. Evidence is best provided by the prosecution agencies. Further evidence can be obtained by looking at criminal prosecutions in other jurisdictions, such as the US, which adopt a wider definition of corporate criminal liability, and comparing those cases with the action taken in the UK against companies involved in the conduct, where a UK jurisdictional nexus existed.

Q4: Do you consider that any deficiencies in the identification doctrine can be remedied effectively by legislative or non-legislative means other than the creation of a new offence (option 1)?

8. No. Amending the identification doctrine alone could only be done by legislative means and would significantly increase the risks of criminal liability for all companies, in relation to all criminal offences. This would be a disproportionate outcome and impose significant costs on all companies, with limited prospects of incentivising compliance or deterring crime. In any event such a change would require a careful consideration by the Law Commission of the classes of people whose actions should be ascribed to the company – subcommittees of the Board? Senior management? Subsidiaries? All employees? Agents? – and how to ensure that other different corporate structures are not then created to limit the risks of corporate criminal liability and how to incentivise compliance.

Q5: If you consider that the deficiencies in the identification doctrine dictate the creation of a new corporate liability offence which of options 2, 3, 4 or 5 do you believe provides the best solution?

9. All of the options bear similarities, but as option 2 imposes full criminal liability for the substantive offence, this may be an overly onerous burden to place upon companies and not incentivise them to admit guilt and risk debarment.

10. Further, as option 5 would only impose regulatory liability and may not be able to capture sectors that do not have regulators or effective regulators, this option may be seen to be the least likely to either punish crime or effectively deter crime.

11. Options 3 and 4 are the most similar and likely to be more palatable for business than either options 1 or 2. Both penalise lack of supervision or failure to prevent crimes. Whilst option 3 appears to replicate the successful Bribery Act model, placing the burden of proof on the company to show that the measures it put in place were adequate; option 4 places the burden

of proof on the prosecution to show that they were inadequate. While companies may prefer the burden of proof to rest with the prosecution, it may be difficult, if not insurmountable, for the prosecution to prove a negative (that the procedures were not adequate) and to prove these beyond reasonable doubt. As such option 3, leaving it to companies to prove on the balance of probabilities that the procedures were adequate, may be seen to be fairer, and to incentivise good behaviours, in that it leaves it with the company to show what it did to assess its own risks, what policies and procedures it implemented to deal with these risks, and why these were adequate.

12. It is unclear at this stage for either option 3 or 4:

    a. if it would need to be shown that the company had benefited or intended to benefit from the economic crime, and

    b. what offences companies should be held liable for having failed to supervise or prevent. Imposing duties on companies and making them criminally liable for breach should only be done where there is a clear benefit accruing or intended to accrue to the company and a clear need to prosecute them.

13. As such option 3, if limited to a select number of economic crimes, such as fraud, theft or false accounting, where a benefit has been gained or intended to be gained by the company, by the actions of its employees or associated persons, combined with an adequate or reasonable procedures defence, is likely to be the optimal option to produce a deterrent effect and a change in corporate culture.

Q6: Do you have views on the costs or benefits of introducing any of the options, including possible impacts on competitiveness and growth?

14. All options will to some extent increase the cost of corporate compliance, particularly if they each include some form of defence of adequate or reasonable procedures to incentivise the creation of policies and procedures to prevent the criminal acts. However these costs, particularly in relation to option 3, are unlikely to be significantly greater than those already imposed on them and are likely to be outweighed by the benefits accruing to good governance and the criminal justice system.

15. Without similar or comparable regimes in other jurisdictions, such as the US system of vicarious liability, to penalise corporate misconduct linked to economic crime there is a risk that these additional compliance costs could make companies subject to this legislation less competitive.

16. Conviction under any of the options, including regulatory intervention under option 5, will also risk companies being debarred from public procurement contracts, and may even lead to mandatory debarment under option 1.

Q7: Do you consider that introduction of a new corporate offence could have an impact on individual accountability?

17. No. Prosecution or settlements under section 7 of the Bribery Act do not preclude actions being taken against individuals, in fact the guidance on DPAs incentivises companies to assist in the

identification of wrongdoing individuals. If a similar model is used in relation to economic crimes or fraud then this should have no adverse impact on individual accountability and may in fact bring to light more readily the activities of individuals and result in an increase in prosecutions against individuals.

Q8: Do you believe new regulatory approaches could offer an alternative approach, in particular can recent reforms in the financial sector provide lessons for regulation in other sectors?

18. Yes. However the recent changes in the financial services sector have had little time to bed in and their full impact has yet to be evidenced. New regulatory approaches would also only impose regulatory liability which may not be seen as sufficiently punitive. Furthermore such changes may not be able to capture sectors that do not have regulators or effective regulators.

Q9: Are there examples of corporate criminal conduct where a purely regulatory response would not be appropriate?

19. If the corporate entity has been involved in criminal activity, it should be dealt with under the criminal law. If the company has been involved in regulatory breaches then it should be dealt with under the regulatory regime. If it has been involved in both then it should be dealt with under both.

20. The real question is what activities should companies be held criminally liable for and what should merely incur regulatory liability. The answer to this may be threefold:

    a. companies can and should be held liable for crimes where Board level or senior figures have participated in the crime, on behalf of the company, intending to benefit the company;

    b. companies could also be held criminally liable for failing to prevent employees or associated persons committing substantive crimes where either they have a duty imposed upon them to stop such activity or where there has been an intention that the company should benefit from the crime and they are able to control and influence this behaviour but have failed. Accountability in the criminal courts would arise due to their responsibility for the perpetrators, the intended benefit, and the failure to have proper systems and controls in place; and

    c. a purely regulatory response may be more appropriate in cases where no actual crimes have been committed, but there has nevertheless been a systemic or control failing identified.

B. THE BRIBERY ACT MODEL OF A CORPORATE FAILURE TO PREVENT

Q10: Should you consider reform of the law necessary do you believe that there is a case for introducing a corporate failure to prevent economic crime offence based on the section 7 of the Bribery Act model?

21. Yes. However there would need to be a benefit accruing or intended to accrue to the company from the economic crime. There would also need to be proof that the perpetrator of the crime

was acting on behalf of or for the company, and that the company was in a position to be able to deter such activity. It also needs to be made clear what crimes the company can or should be held liable for. See answer to questions 5 and 11.

Q11: If your answer to question 10 is in the affirmative, would the list of offences listed on page 22, coupled with a facility to add to the list by secondary legislation, be appropriate for an initial scope of the new offence? Are there any other offences that you think should be included within the scope of any new offence?

22. Cautiously yes. A policy decision needs to be taken as to what additional crimes, if any, companies should be held liable for failing to deter employees or other associated persons from committing. Any such new liability for companies must be based on evidence that companies would be able to influence their associated persons and employees and should be made to influence them, failing which they should be held criminally liable. Any such new liability should be cautiously approached.

23. Where the mens rea, or mental element, of an offence requires an individual to have the intent to commit a crime or recklessness about whether a crime is committed, such as for fraud or false accounting, there is an argument that an employer / employee would be able to understand these terms, objectively measure them, and could put processes in place to stop or at least monitor them.

24. However where an offence requires a low level of knowledge or participation, such as 'suspicion' or 'reasonable grounds to suspect' or an 'agreement' to commit a crime at some future stage, such as money laundering or conspiracy to defraud, then it becomes increasingly difficult to see how a company could either monitor or enforce compliance.

Q12: Do you consider that the adoption of the failure to prevent model for economic crimes would require businesses to put in place additional measures to adjust for the existence of a new criminal offence?

25. Yes. Assuming that a defence of adequate or reasonable procedures is also created and assuming that the company is not in a sector that is regulated and imposes duties to have systems and controls to deter financial crime.

Q13: Do you consider that the adoption of these measures would result in improved corporate conduct?

26. Cautiously yes. It appears that the enforcement of the US FCPA and the UK Bribery Act has increased the focus that companies place on anti-bribery and corruption measures. This in turn has resulted in policies and procedures being created or improved which, along with other measures, has led to improved detection of crimes and increased self-reporting to prosecutors. The adoption of the failure to prevent model for economic crimes would likely have similar results, over time.

C. EXTRATERRITORIAL JURISDICTION

Q14: Do you consider that it would be appropriate for any new form of corporate liability to have extraterritorial reach? Do you have views on the practical implications of such an approach for businesses?

27. Yes. A number of laws have extra territorial application. Fraud can have an international dimension, and companies can also operate internationally. Such extraterritorial application would also maintain a consistent approach with that adopted under the UK Bribery Act.

D. CORPORATE CRIMINAL LIABILTY REFORM AND THE REGULATED FINANCIAL SERVICES SECTOR

Q15: Is a new form of corporate liability justified alongside the financial services regulatory regime? If so, how could the risk of friction between the operation of the two regimes be mitigated?

28. Yes – as long as there is a clear demarcation between what amounts to criminal behaviour and what is solely regulatory. Criminal prosecutions and regulatory interventions operate side by side in the US and the UK already. Any possible friction would be dealt with under the pre-existing guidance in the Prosecutors' Convention 2009, which sets out the responsibilities of prosecutors where a suspect's conduct could be dealt with by criminal or civil/regulatory sanctions and/or where more than one prosecuting authority and investigating body share the power to take action.

Q16: What do you think is the correct relationship between existing compliance requirements in the financial services sector and the assessment of prevention procedures for the purposes of a defence to a criminal charge?

29. The financial services compliance requirements closely resemble the 6 principles of adequate procedures under the Bribery Act guidance. These have co-existed since the Bribery Act and the FCA *Financial crime: a guide for firms* came into force.

30. Both sets of guidance are generic high level requirements. Prevention procedures amounting to a defence to any new criminal offence could be set out in a like fashion to the Bribery Act *Guidance to help commercial organisations prevent bribery*.