CORRUPTION WATCH

March 2019

Corporate Crime Gap

How the UK Lags the US in Policing Corporate Financial Crime

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Executive Summary

The UK has a serious problem holding its companies to account. If you're a big multinational company and you're caught engaging in serious economic crime such as financial fraud or money laundering in the UK, there's a very good chance that you won't be found criminally liable. If you're unlucky, you might be let off with a relatively small fine.

A company committing an economic crime in the US is far more likely to be hit with heavy criminal, civil and regulatory penalties than one in the UK. There is no reason to suppose that this is because US companies are more criminal than UK ones. Indeed, many of the companies that have been penalised in the US are British banking institutions.

The UK is effectively outsourcing its corporate financial crime enforcement to the US. As a result, the UK is missing a key opportunity to provide real deterrence for financial wrongdoing in its own yard, and ensure the integrity of its own financial markets. Large fines for financial crime from UK financial institutions or for financial crime committed in the UK or with major impacts on the UK economy, meanwhile, which could be going to the UK Treasury, are instead going into the US Treasury.

Corruption Watch conducted an in-depth analysis of the enforcement of major corporate fraud and money laundering cases in London and New York over the past ten years. We found that:

When banks in London and New York were implicated in manipulating the London based inter-bank lending rate, or Libor:

- The UK did not bring a single corporate criminal prosecution. The US brought criminal enforcement actions[1] against seven of the big banks, and imposed nearly £1.6 billion in criminal fines.
- UK regulators did go after nine banks and imposed almost £760 million in non-criminal fines. However, US regulators did the same and imposed fines of £2.6 billion – more than *three times* that of the UK.
- Taking the total fines issued (criminal and non-criminal), the US brought in £4.1 billion compared to the UK's £760 million – almost *five and a half times* more than that of the UK.

When banks in London and New York were implicated in rigging the foreign exchange market, or Forex, we saw a similar result, despite the fact that London represents 40% of the Forex market compared to New York's 20% share:

- The UK did not bring a single corporate criminal prosecution. The US brought criminal enforcement actions against five of the big banks, and imposed nearly £1.8 billion in criminal fines.
- UK regulators went after six banks and imposed almost £1.4 billion in non-criminal fines. However, US regulators went after 12 banks and imposed fines of over £4.6 billion – again more than *three times* that of the UK.
- In total, the US brought in, through combined criminal and regulatory fines, £6.4 billion compared to the UK's £1.4 billion – over *four and a half times* that of the UK.

Where banks in London and New York have been implicated in money laundering and sanctions violations, the discrepancy between the two jurisdictions is at its most staggering:

- The UK has not brought a single successful corporate criminal prosecution against a UK bank for money laundering or sanctions violations. The US, on the other hand, has brought criminal enforcement actions against six of the big banks and imposed almost £3 billion in criminal fines.
- UK regulators have gone after 12 banks, and have imposed just over £260 million in non-criminal fines. However, US regulators went after 31 banks and managed to impose nearly £6 billion in non-criminal fines – over *22 times* that of the UK.

- Taking the total fines issued by the US (criminal and non-criminal), the US has imposed almost £9 billion, which is more than *34 times* the total of the UK fines.

- The US has extracted almost £1.7 billion in fines from UK-headquartered institutions, while the UK has only extracted £81 million in fines from UK-headquartered institutions.

When banks in London and New York were implicated in the sale of toxic mortgages during the financial crisis:

- No one brought any successful criminal prosecutions against any of the banks.

- However, US regulators did go after three of the biggest UK banks for the sale of investments globally that contained US toxic mortgages – and imposed non-criminal fines of almost £6 billion against those banks.

In summary, in the past decade, in response to scandals relating to Libor, Forex, toxic mortgages and major money laundering:

- The UK has failed to bring a single successful corporate criminal prosecution, and has imposed just under £2.5 billion in non-criminal fines.

- In comparison, the US has brought close to 20 successful criminal enforcement actions against New York and London banks, and has imposed more than £25 billion in both criminal and non-criminal fines – over *ten times* that of the UK.

In the face of major corporate financial wrongdoing, the US has managed to bring over £22 billion more into its public purse than the UK. Of that, over £10 billion was from UK-headquartered firms.

Statistics such as these serve to make people feel that large financial institutions are above the law in the UK. They also raise serious questions as to whether the integrity of the UK financial system can be maintained if it is not policed and regulated sufficiently.

Why are the US authorities so much more successful at holding corporations accountable for economic crime than those in the UK?

Primarily, this is because the UK has a much higher bar for proving corporate criminal liability than the US. In the UK, something called the 'identification doctrine' means that prosecutors have to trace corporate fraud or money laundering back to an individual 'directing mind' at the company – a standard that is notoriously difficult to meet. In the US, however, corporations are vicariously liable for the actions of all their associates.

Justice is not being done in the UK. It shouldn't be the case that other countries are able to find UK-headquartered companies, or large multinational banks that commit wrongdoing in the UK, or wrongdoing that has major impact on the UK economy, guilty of breaking the law when the UK can't and won't do so itself.

Some parts of the UK government claim that corporate liability reform for economic crime is unnecessary because it introduced a new regime in 2016 called the Senior Managers and Certification Regime (SMR). However, the SMR does very little to hold corporate bodies criminally liable for financial wrongdoing. Were a financial crisis to happen again tomorrow, or another Libor scandal, there is no UK law in place which would ensure that large financial institutions would this time face significant criminal penalties.

What's needed to fix this problem is for the UK to reform its corporate liability regime by:

- Firstly, making it an offence for companies to fail to prevent economic crimes from being committed. Companies should be held accountable where their procedures are so weak that economic crime occurs in their name and on their watch, especially where they profit from that crime; and

- Secondly, reviewing the 'identification doctrine' and looking at the options for abolishing it.

Corporate liability isn't the only thing holding back an effective UK response to corporate financial crime. Our analysis also found that US regulators are significantly more likely to impose high regulatory penalties than their UK counterparts and that the criminal and regulatory systems in the US work much more effectively together to properly penalise financial misconduct.

The UK urgently needs to commission an independent review of whether its regulatory regime is imposing sufficient sanctions that provide real deterrence against corporate financial crime, and whether its regulatory and criminal regimes are coordinated in an effective way.

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Introduction

"[It] has not always been possible [in the UK] to bring corporate bodies to justice for the criminal acts of those who act on their behalf and for their benefit. [...] the weaknesses in our current law result in other jurisdictions holding British companies to account when ours has not..."

Then-Attorney General Jeremy Wright QC, 2016[2]

"I can go after Main Street; I just cannot go after Wall Street, and that is unfair, because we know there are cases where it is corporate culture, corporate demand for hitting sales targets ... that will often make employees take action."

Lisa Osofsky, Director of the Serious Fraud Office, 2018[3]

Ten years on from the global economic crash of 2008, British public trust in the financial industry and big business is low. The government has failed to bring corporations to account for their role in the crash or in subsequent financial scandals. No corporation has been criminally prosecuted successfully for its actions during the crash, for involvement in the Libor scandal, or for rigging Forex rates, and only modest regulatory penalties have been imposed.

This is despite the significant cost to the UK public purse of the financial crisis. The Labour government of the time injected £137 billion of public money to stabilise the financial system. As of October 2018, £23 billion remains outstanding.[4] Meanwhile the program of austerity introduced in 2010 to reduce the country's budget deficit and national debt in the wake of the financial crisis has led to large-scale cuts to public services across the board.

According to a recent opinion poll, the British public is frustrated with this lack of accountability. A YouGov survey from August 2018 found that two-thirds of the public do not trust banks to work in the best interests of British society.[5] This was little changed from a YouGov survey in 2013, when 73% of the public described the reputation of banking as bad.[6] In the 2018 survey, more than 7 in 10 (72%) thought that banks should have faced harsher penalties for their role in the financial crisis.[7]
This stands in stark contrast to the US, where corporations have been held to account in a variety of fraud and financial crisis related wrongdoing cases with heavy penalties.

The same story holds true for money laundering by large banks. The US regularly imposes criminal as well as regulatory fines on large banks for laundering significant quantities of money. In contrast, the UK has never yet imposed criminal fines on a bank for large scale money laundering and has imposed only modest regulatory fines.

Findings

Corruption Watch compared[8] the numbers of cases and size of criminal, civil and regulatory penalties in London and New York between January 2008 and December 2018 relating to the following economic crimes by banks:

- manipulation of the Libor rate;
- manipulation of the Forex market;
- involvement in money laundering; and
- involvement in alleged mortgage fraud that precipitated the financial crisis.

We used London and New York because they are similarly sized and similarly powerful financial centres. The two cities vie for the top spot as the world's largest and leading financial centre. According to the Global Financial Centres Index, which compares the competitiveness of financial centres, New York was – as of September 2018 – only just ahead of London.[9] The Financial Action Task Force (FATF) meanwhile described London in its December 2018 UK evaluation as "*the world's largest financial centre*" and "*the leading centre*" for international bank lending, derivatives, money markets, international insurance and international debt securities.[10]

Libor manipulation

What is the Libor rate?

The London inter-bank offered rate, or Libor, is the globally accepted benchmark interest rate used to determine how much it will cost banks to borrow from each other. The rate determines the cost of everything from student loans to credit cards, corporate loans and mortgages.[11]

It is calculated for 10 different currencies in London through daily submissions by major global banks with a significant presence in the London money market and is used as a reference point for $10 trillion in loans to consumers and companies and another $350 trillion of derivatives.[12] It is considered the most important benchmark in the world for short-term interest rates.[13]

What was the problem?

Regulatory authorities in both New York and London started to receive reports of potential manipulation of the Libor rate by banks for profit during 2007.[14] Speculation about the integrity of the rate did not become public until April 2008, when the Wall Street Journal reported that "*one of the world's most important barometers of the world's financial health could be sending false signals.*"[15]

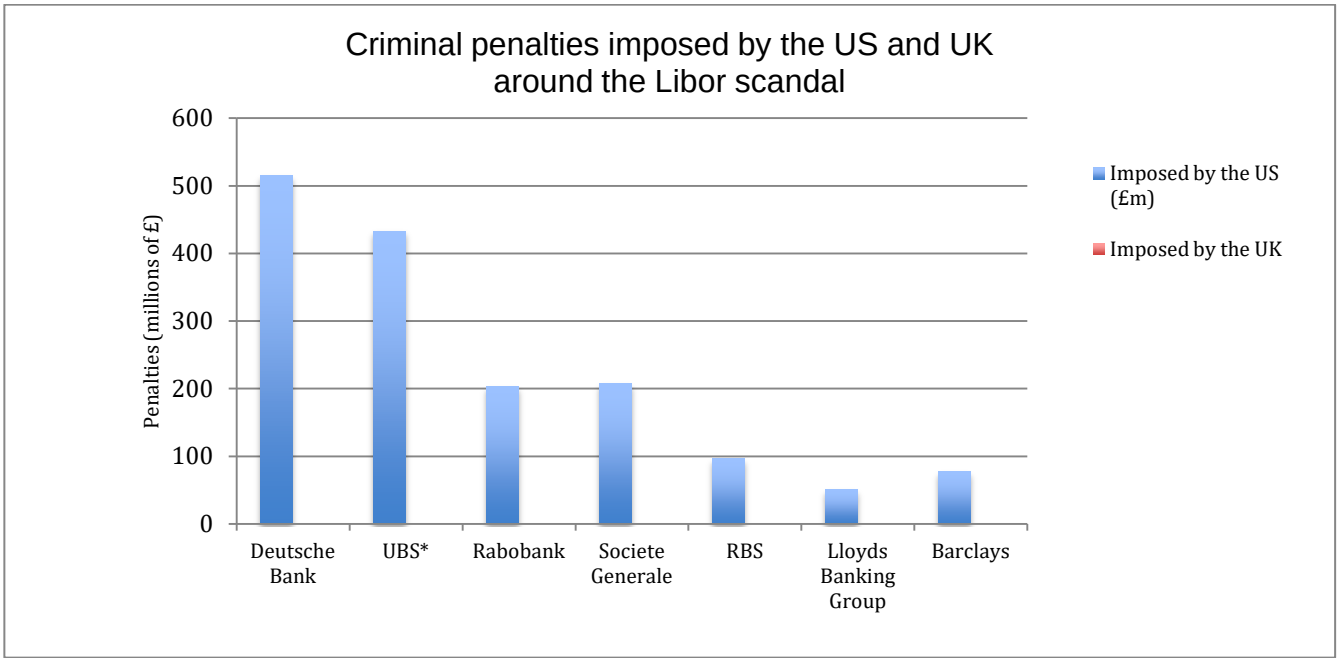
While the rate-rigging started in 2003, manipulation of the rate became symptomatic of financial crisis related wrongdoing, when it emerged that the UK bank Barclays had manipulated the rate downwards to make itself appear less risky and insulate itself from the crisis.[16]

How did UK and US authorities respond?

The UK financial regulator at the time, the Financial Services Authority (FSA), opened a formal inquiry in early 2010.[17] US regulators started investigating as early as 2008,[18] and in February 2012 it became clear that the US Department of Justice (DOJ) had opened a criminal inquiry, which is still ongoing.[19]

Criminal proceedings

The graph below shows the criminal penalties that the UK and US authorities imposed on banks in London and New York for their role in manipulating Libor.



* UBS paid an additional fine for breaching a 2015 Deferred Prosecution Agreement (DPA) issued in relation to Libor manipulation for further deceptive and collusive conduct in Forex markets.

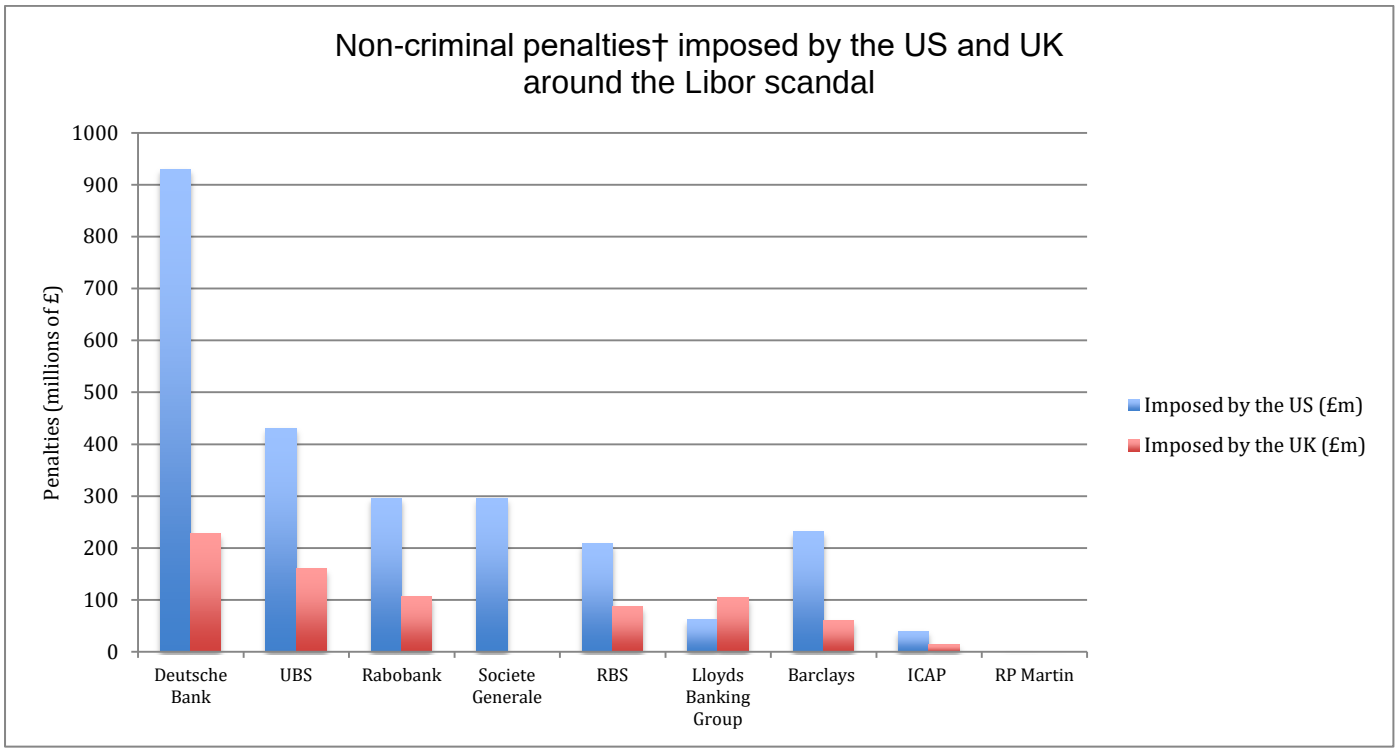
In the UK, the Serious Fraud Office (SFO) brought no corporate criminal prosecutions against institutions involved in manipulating Libor. This is despite the fact it has brought prosecutions against 13 individual traders, of whom 5 have been convicted.[20] Some of the individuals have claimed in their defence that their employers knew what they were doing.[21] The former UK Attorney General, Jeremy Wright, has described Libor as one of the cases where the UK has not prosecuted corporates as a result of "*weaknesses in our current law*" and noted the "*clear implications for the reputation of our justice system.*"[22]

In the US, however, authorities acted swiftly and brought criminal penalties against a number of institutions, with a total of £1.6 billion of fines imposed on seven banks. In announcing one Libor criminal enforcement action, then Assistant Attorney General of the DOJ, Lanny Breuer, said, "*our message is clear: no financial institution is above the law.*"[23]

Of the £1.6 billion that the US regulator extracted from these seven banks in criminal fines, over £220 million was from the UK-headquartered financial institutions Royal Bank of Scotland (RBS), Lloyds Banking Group (Lloyds) and Barclays.

Non-criminal proceedings

The US regulatory authorities, and in particular the Commodities Futures Trading Commission (CFTC) meanwhile repeatedly imposed significantly higher regulatory penalties on banks than their UK equivalent, the FSA, which is the predecessor to the Financial Conduct Authority (FCA), for the same conduct. The graph below shows the non-criminal penalties – i.e. civil or regulatory penalties – that the UK and US authorities imposed on banks in London and New York for their role in manipulating Libor.



† The US authorities impose both civil and regulatory penalties - as they have done here; the UK authorities only impose regulatory penalties. The majority of the fines in the US were paid to the US regulator, the CFTC, and in the UK to the FSA, the predecessor to the FCA.

So although UK regulators did go after nine banks and imposed almost £760 million in non-criminal fines for Libor manipulation, the US regulators did the same and imposed fines of almost £2.5 billion – more than *three times* that of the UK. Of the £2.5 billion that the US regulator extracted from these nine banks in non-criminal fines, over £500 million was from the UK-headquartered financial institutions RBS, Lloyds and Barclays (meanwhile the UK regulator only extracted £250m from these same firms).

While criminal penalties brought by the DOJ were double the regulatory penalties imposed by the UK, combining criminal, civil and regulatory penalties, US authorities extracted more than *five times* the amount that the UK did.

Foreign exchange market

What is the foreign exchange market?

The foreign exchange market, or Forex, is one of the largest markets in the world with a daily average turnover of $5.3 trillion.[24] To put it in perspective, its daily turnover is nearly double the UK's annual economic output or GDP.[25]

40% of the trading takes place in London.[26] By comparison, only 20% of Forex trading takes place in the US.[27] According to FATF, the UK is the world's leading Forex market with nearly twice as many US dollars traded in the UK as in the US, and more than twice as many Euros traded in London than in the Eurozone.[28] Participants in the Forex market include banks, retail investors, hedge funds, central banks, commercial companies, and investment management firms.

What was the problem?

"The price mechanism is the anchor of our entire economic system. Any rigging of the price mechanism leads to a misallocation of capital and is extremely costly to society."

Professor Tom Kirchmaier, London School of Economics[29]

In June 2013, while the Libor scandal was still unfolding with several regulatory fines already imposed in the UK,[30] Bloomberg reported that, according to five dealers who knew the Forex market well, some of the world's biggest banks were manipulating benchmark foreign exchange rates used to set the value of trillions of dollars of investments. According to the Bloomberg report, the UK's FCA was already aware of the allegations.[31]

In September 2013, one of the four major banks involved in the Forex market, UBS, approached the DOJ with information about the rigging in the hope of gaining immunity from prosecution.[32] By October 2013 the UK's FCA, the US DOJ and Switzerland's market regulator had all opened probes.[33]

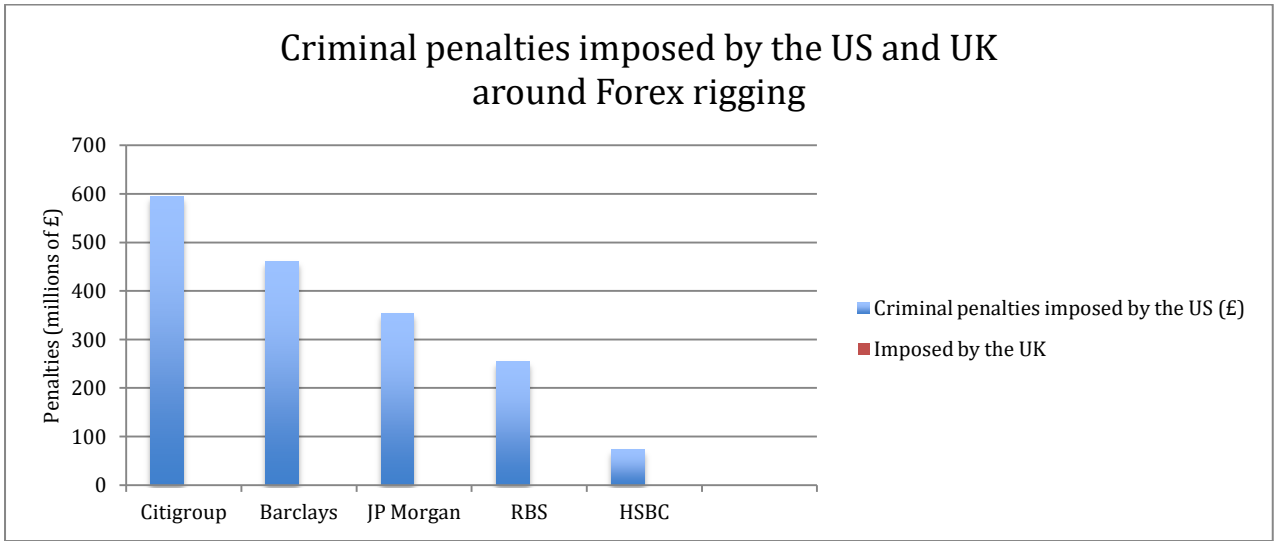
The US Federal Bureau of Investigation (FBI) said the Forex scandal involved criminality "*on a massive scale*".[34] Traders in US and UK banks were found to be colluding in online chatrooms, in groups with names like *The Cartel, A Team,* and *3 Musketeers.*[35] Prosecutors and regulators found that banks had been coordinating their trading of US dollars and euros over a period of five years to manipulate the benchmark rates set twice daily in an effort to increase their profits.[36] The DOJ for instance found that HSBC had made $46.4 million profit from manipulating Forex rates.[37]

Perhaps most egregiously, the DOJ found that two of the banks implicated, UBS and Barclays, had engaged in "*deceptive FX trading and sales practices*" while under non-prosecution agreements for Libor related wrongdoing.[38] The UK's FCA also highlighted that Forex manipulation had occurred despite its own "*well-publicised action in relation to Libor*".[39]

How did UK and US authorities respond?

Criminal proceedings

Despite the UK's dominant role in the Forex market, criminal penalties against companies caught-up in the Forex scandal happened solely in the US, as shown in the graph below.



The UK's SFO opened a criminal investigation into Forex manipulations but closed it in March 2016 after one and a half years, having reviewed half a million documents. The agency said that it had "reasonable grounds to suspect the commission of offences involving serious or complex fraud," but that the evidence *"would not meet the evidential test required to mount a prosecution for an offence contrary to English law."*[40]

While the SFO didn't explicitly state that the UK's corporate liability laws were to blame, commentators suggested it was likely to have been a factor. Alison McHaffie, a partner at the firm CMS Law, said the decision by the SFO to drop its criminal investigation showed

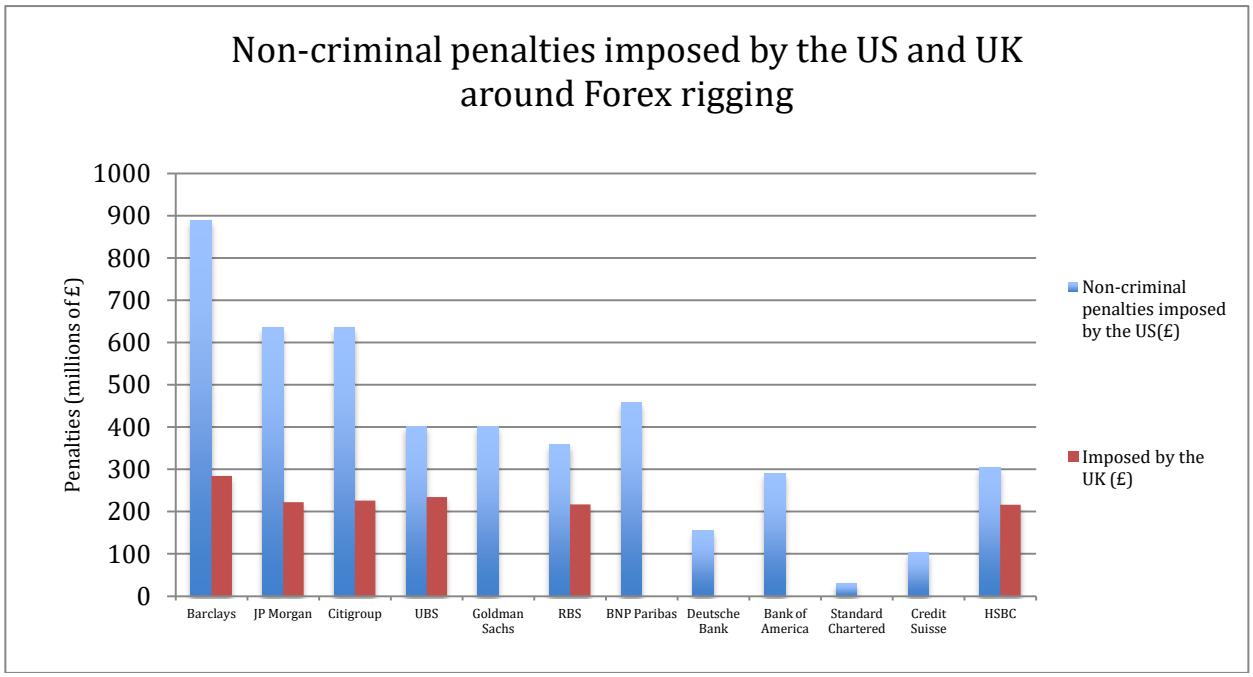
> *"the difficult job the SFO has in demonstrating criminal activity … without a change in the law on corporate criminal responsibility. This means it is always easier to impose regulatory fines against the firms themselves rather than criminal prosecutions."*[41]

In the US by contrast, the DOJ forced guilty pleas from the banks (with the exception of HSBC), rather than entering into any form of settlement and imposed fines totalling £1.736 billion.[42] Then US Attorney General Loretta Lynch, commented on announcing the DOJ criminal penalties:

"The penalty these banks will now pay is fitting considering the long-running and egregious nature of their anticompetitive conduct. It is commensurate with the pervasive harm done. And it should deter competitors in the future from chasing profits without regard to fairness, to the law, or to the public welfare."[43]

Non-criminal proceedings

Again, the US authorities imposed significantly heavier regulatory fines than their UK counterpart. The graph below shows the non-criminal penalties that the UK and US regulators imposed on banks in London and New York for their role in manipulating Forex rates. The US civil penalties include those imposed by the DOJ, CFTC, New York State Department of Financial Services (NYDFS), Federal Reserve and Office of the Comptroller of the Currency (OCC).



As can be seen in the graph, both countries imposed fines on a number of banks, with a large degree of overlap between the banks fined in the two places.

The total of all the corporate fines, both regulatory and criminal in the US and UK, came to around £7.8 billion. Of this, only £1.4 billion came from fines issued by UK enforcers, meaning £6.4 billion went to the US. This means that the US authorities have collected almost five times the amount of Forex fines than the UK, and this is despite the fact that the UK has double the amount of Forex trading in its jurisdiction than the US.

Penalties brought by the US were therefore far more substantial than those brought by the UK authorities, though the FCA touted its penalties as record-breaking for the agency.[44]
Of the £6.4 billion that the US regulator extracted from these 12 banks, almost £2.4 billion was from the UK-headquartered financial institutions Barclays, RBS and HSBC (meanwhile the UK regulator only extracted just over £700m from these same firms).

Money laundering and sanctions

How big a problem is this?

The UK's National Crime Agency (NCA) has said that while there is no reliable estimate of money laundering through the UK, "*given the volume of financial transactions transiting the UK, there is a realistic possibility the scale of money laundering impacting the UK annually is in the hundreds of billions*."[45]

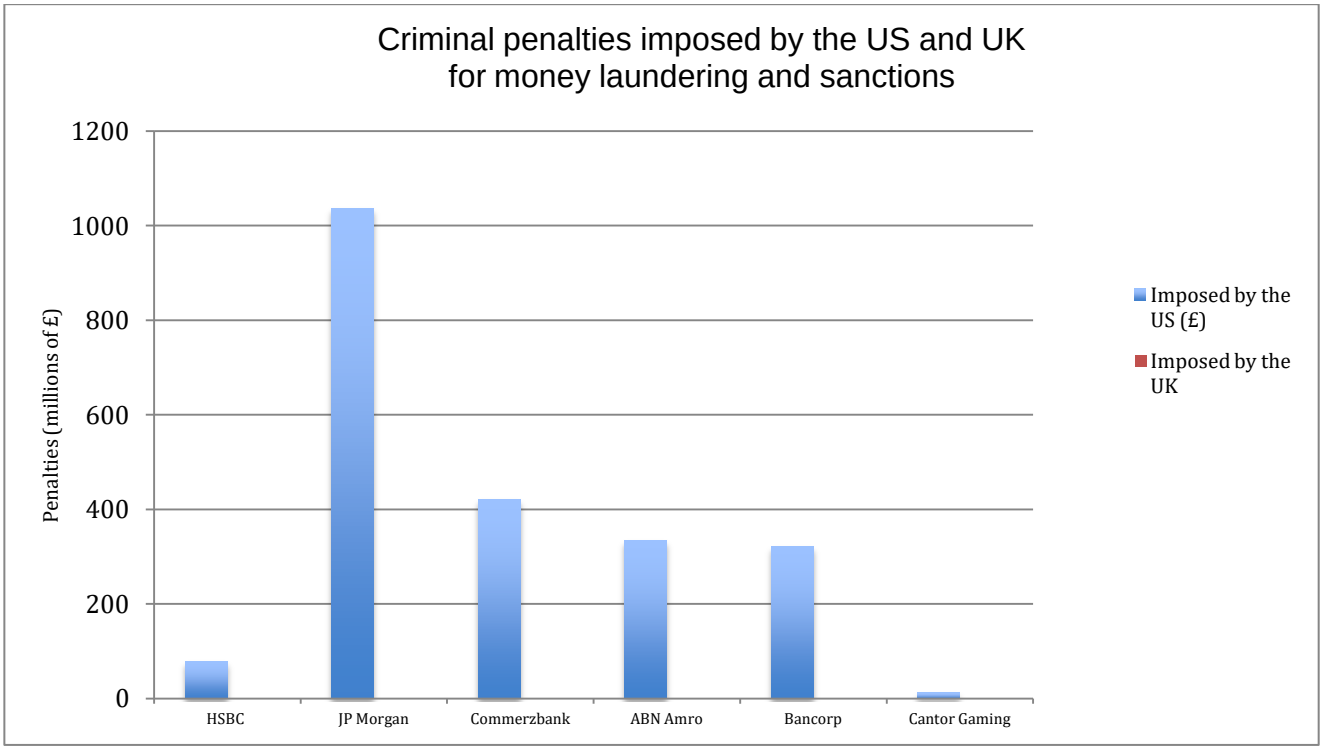
The NCA has also suggested that money laundered through British banks and their subsidiaries globally is likely to be "*many hundreds of billions of pounds*."[46]

The US Treasury estimates that domestic financial crime, including tax evasion, generates proceeds for laundering in the region of $300 billion.[47] In order to ensure a fair comparison, Corruption Watch has again only focused on money laundering enforcement actions taken in New York, that relate to banks based in New York or where a significant element of the money laundering took place through their New York branch, to compare with those taken in London.

How did UK and US authorities respond?

Criminal proceedings

The graph below shows the criminal penalties that the UK and US authorities have imposed on banks in London and New York[48] for their role in money laundering and sanctions violations over the past 10 years. The US proactively enforces its economic sanctions regime and frequently takes enforcement actions against banks for sanctions breaches and money laundering compliance failures at the same time.



US authorities imposed criminal fines – primarily through forfeiture extracted under DPAs or Non Prosecution Agreements (NPAs) – against New York banks worth almost £3 billion under its Bank Secrecy Act and economic sanctions legislation.[49]

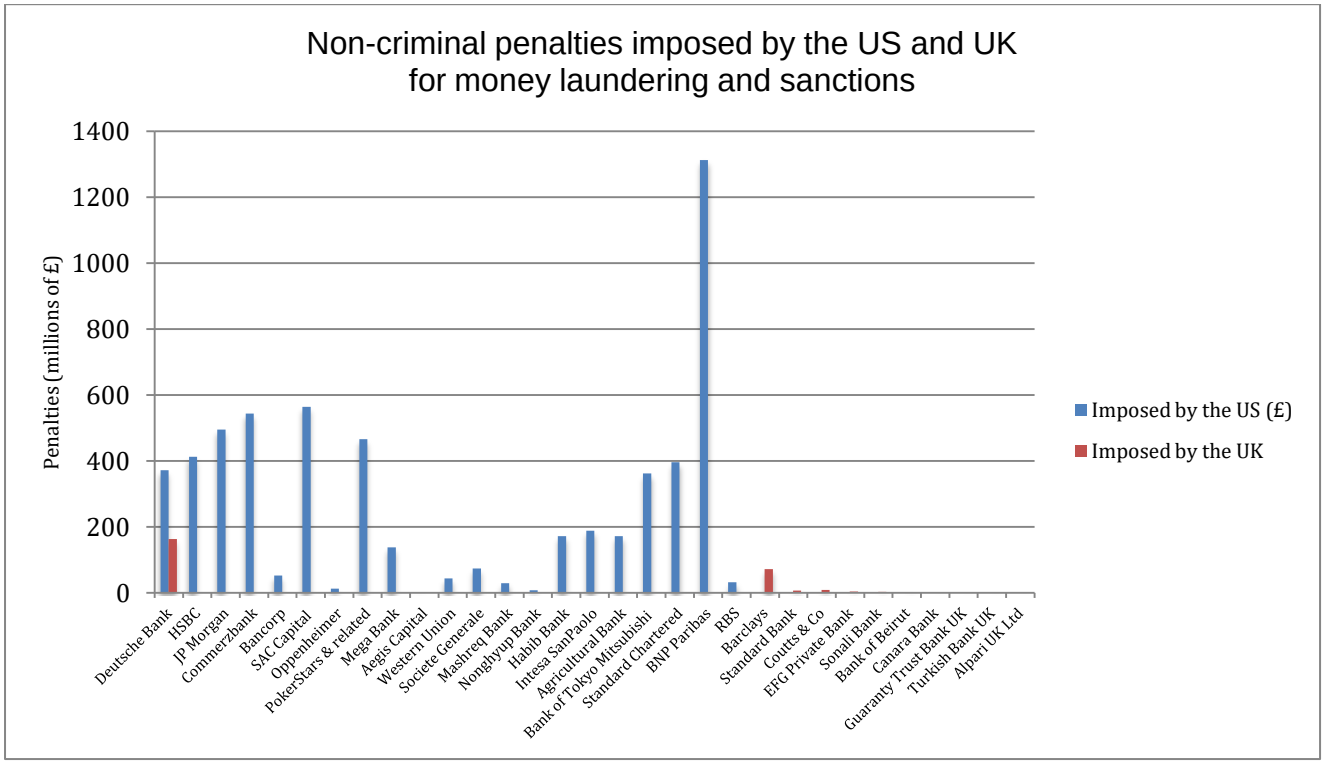
UK authorities meanwhile have not imposed any criminal penalties on London banks for their role in aiding corporate money laundering or evading economic sanctions over the past 10 years. While the 2018 FATF evaluation found that the UK achieves 1400 convictions annually for money laundering, these were almost universally for petty drug-related crimes.[50]

Neither the UK's FCA nor HM Revenue and Customs (HMRC), the two regulators with responsibility for regulating the largest number of firms, have yet to bring any corporate prosecutions for failure to have adequate money laundering procedures required under the Money Laundering Regulations, introduced in 2007 and updated in 2017.[51]

Similarly, with financial sanctions, since a new law came into force in April 2017 – the Policing and Crime Act, which introduced greater powers to fine those who breached sanctions – the UK has brought only one modest enforcement action for such breaches. In February 2018, it fined Raphael Bank £5,000 in relation to an Egyptian financial sanctions target.[52] This is despite 133 suspected breaches being reported to the Office of Financial Sanctions Implementation (OFSI) during 2017-2018, with a total worth of £1.4 billion.[53]

Non-criminal proceedings

The graph below shows the non-criminal penalties that the UK and US authorities have imposed on banks in London and New York for their role in money laundering and sanctions violations over the past 10 years.



The same pattern emerges as for other forms of economic crime: civil and regulatory fines on New York banks far outstrip those on London banks. However, when it comes to fines imposed for money laundering and sanctions violations, the discrepancy between the US and the UK is at its most staggering.

US non-criminal fines for money laundering and sanctions violations total almost £6 billion, whereas UK fines come to less than £0.3 billion. This means that the US authorities have imposed non-criminal fines for New York related money laundering that are worth over 22 times more than the fines issued by the UK authorities.

Taking the total fines issued by the US (criminal and non-criminal), the US has imposed almost £9 billion, whereas UK fines come to less than £0.3 billion. This means that the US authorities have imposed (in total) fines that are worth over 34 times more than the total fines issued by the UK.

Of the £9 billion that the US authorities extracted, almost £1.6 billion was from the three UK-headquartered institutions HSBC, Standard Chartered Bank and RBS. Meanwhile, the UK regulator extracted nothing from these three firms, and only acquired £81 million in fines from the UK-headquartered institutions Barclays Bank and Coutts & Co.

Financial crisis and toxic mortgages

What was the problem?

In early 2008, the US housing market crashed, sparking a string of events that led to full-blown financial crisis in the Autumn of 2008.[54] In September 2008, the collapse of the Lehman Brothers and the near collapse of American insurance giant, AIG, caused global panic.[55] Stock markets plummeted around the world, and the global economy went into recession. The political, economic and regulatory effects are still reverberating ten years on.[56]

As the official US Financial Crisis Inquiry Commission found in its final report in January 2011, the reason the US housing market sparked the financial crisis was that *"trillions of dollars in risky mortgages had become embedded throughout the financial system, as mortgage-related securities were packaged, repackaged, and sold to investors around the world."*[57]
These securities, often called 'toxic mortgages', were bought by pension funds, financial institutions and other investors all around the globe.

The Commission found that:[58]

- the financial crisis was avoidable;
- the crisis was caused by widespread failures in financial regulation and supervision and a dramatic failure in corporate governance and risk management;
- excessive borrowing, risky investments and lack of transparency put the financial system "*on a collision cause with crisis*"; and
- "*there was a systemic breakdown in accountability and ethics*."

While the crisis was sparked by the crash in the US housing market, UK financial institutions were deeply implicated in the misselling of mortgage-related securities to investors globally, as subsequent regulatory action by US authorities has found. US prosecutors alleged that UK-headquartered banks such as Barclays "*systematically and intentionally misrepresented*" the nature of the loans that formed the basis of securities sold to investors.[59]

How did UK and US authorities respond?

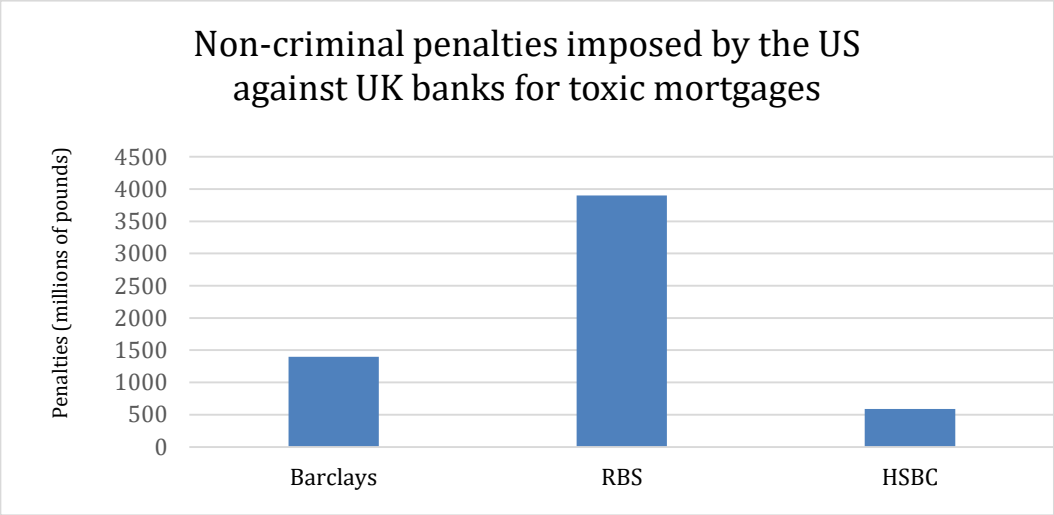
Criminal proceedings

No banks in either New York or London have been found guilty of any criminal charges relating to toxic mortgages and the precipitation of the financial crisis.

In the US, only one bank – one of the smallest in New York, Abacus Federal Savings Bank – was indicted for fraud in relation to toxic mortgages. However, the bank and two of its former executives were acquitted by a jury in 2015 on all charges.[60]
Similarly, in the UK, only one case has ever been prosecuted against a bank for financial crisis-era misconduct. That case – against Barclays – was dismissed by a crown court judge in June 2018, although the trial of individual executives is currently ongoing.[61]

Non-criminal proceedings

Although no criminal proceedings against banks for their role in precipitating the financial crisis have stuck, the US has issued a significant number of civil and regulatory penalties against banks for financial crisis related wrongdoing. According to the Conduct Costs Research Project, banks were fined £65.84 billion in the US for mortgage misselling between 2012-2016.[62] Between 2017-2018, the DOJ alone brought-in at least an additional £18 billion in fines against New York banks for their role in selling toxic mortgages.[63]



In comparison, the UK did not bring any non-criminal proceedings, despite the fact that UK financial institutions were found responsible in the US for wrongdoing that triggered the financial crisis and despite the significant economic impact the financial crisis had on the UK. UK-headquartered banks that paid penalties to the US DOJ for their role in misselling of mortgages include RBS (£3.9 billion), Barclays (£1.4 billion) and HSBC (£587 million).[64]

The DOJ cases were brought under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). This Act provides civil liability for violation of certain criminal statutes relating to financial institutions. It allows the DOJ to bring cases on the basis of 'a preponderance of the evidence' – a standard that allows prosecutors to prove a case only to the extent that there is a greater than 50% chance of it being true.[65] Prosecutors have said it was difficult to prove these financial crash-era fraud cases to a criminal standard of beyond reasonable doubt.[66]

Isn't it the CEOs we want in the dock?

Individual versus corporate accountability

Following the financial crisis, there was public outcry to see CEOs in the dock for the wrongdoing that led to the crisis.[67] But so far there has been no real accountability for senior management. While 324 people have been convicted in the US of financial crisis related crime, none of them were from a senior level in the major financial institutions.[68] Prosecutors have said it was difficult to find the evidence of senior level criminality.[69] However, as one US commentator put it,

> "*without holding real people on Wall Street accountable for their wrongdoing in the years leading up the financial crisis, the message that their behaviour was unacceptable goes undelivered*."[70]

In the UK, the picture is pretty much the same. A 2013 UK Parliamentary Committee on Banking Standards found that

> "*top bankers dodged accountability for failings on their watch by claiming ignorance or hiding behind collective decision-making. They then faced little realistic prospect of financial penalties or more serious sanctions commensurate with the severity of the failure with which they were associated.*"[71]

A 2011 report by the FSA Board looking into the failure of the British bank, RBS (which was bailed out by the UK government to the tune of £45.5 billion), said that lack of adequate laws based on 'strict' liability – i.e. laws that hold a person criminally accountable without having to prove that they intended to commit an offence – were to blame for the absence of enforcement in the UK.[72]

As a result of the Parliamentary Committee on Banking Standards' recommendations, the UK introduced two measures to improve individual accountability:

1. A new criminal offence under Section 36 of the Financial Services (Banking Reform) Act 2013 which made it an offence to take a management decision resulting in the failure of a financial institution, with a maximum custodial sentence of seven year's imprisonment and a fine (the Section 36 Offence).[73]

2. The SMR – a new regulatory regime.[74] That regime – which was introduced in March 2016 and currently applies to deposit takers, investment firms and insurers – is being rolled out during 2019 to apply to all firms regulated by the FCA.[75] The SMR has overhauled regulatory expectations on accountability and governance. Under it, senior managers can face civil sanctions for misconduct where a breach occurs in a regulatory area for which they are responsible if they cannot prove to regulators that they took all reasonable steps to avoid the breach.[76]

The UK's new Section 36 Offence has been criticised widely for being ineffective. One senior criminal litigator described it as a "*paper tiger*", with barriers to prosecution incorporated in it that "*might prove insurmountable*."[77] To convict a senior manager, prosecutors have to prove that the manager not only caused a financial institution to fail, but also was aware of the risk that his/her decision might cause it to fail.[78] Furthermore, it is only triggered where an institution fails and not where other wrongdoing causes losses or harm.

While the SMR is still in its early days, initial signs as to whether it is being used to hold senior managers to account are not promising. Since the regime has been introduced, FCA penalties against individuals have fallen to their lowest levels for five years. Since March 2016, the annual total level of fines against individuals imposed by the FCA has been £0.9 million.[79] This compares with £4.2 million in 2015/2016; £6.7 million in 2014/2015; and £3.9 million in 2013/2014.[80]

One clue as to why the SMR may not be delivering on its potential can be found in a further part of the Parliamentary Committee's observations, which received less attention from the UK government. The Committee stated that:

> "*Effective enforcement action against firms represents an important pillar of the overall approach to enforcement. In many cases, it serves as the gateway to enforcement action against responsible individuals, which is also necessary. It can draw*

> *wider attention to a failure, providing incentives for firms to strive to maintain high standards, and establishes penalties when banks depart from those standards … It would run contrary to the public interest if the idea were to gain currency that banks can be too big or complex to sanction."*[81]

While the Committee did not look at criminal enforcement against firms, it did suggest that the regulators should review their penalty setting framework "*to allow for a further substantial increase in fines.*"[82] As the figures in this report suggest, this does not appear to have happened in any meaningful way.

The evidence from academic analysis shows that the most effective way of deterring corporate crime is to ensure multiple approaches, both regulatory and criminal against both firms and individuals.[83] That would suggest that in order to change corporate behaviour, ***both*** corporate fines ***and*** the serious prospect of prosecution for senior executives are needed.
The parts of the UK government that argue that the UK doesn't need corporate liability reform because it now has the SMR[84] are therefore mistaken. Focusing solely on individual regulatory accountability is not enough. That is because as the Committee on Banking Standards pointed out, it is often by taking criminal and regulatory action against firms that the evidence to prosecute individuals is uncovered.

Furthermore, while it is essential that individuals, particularly at a senior level, must be held to account and face a realistic prospect of being prosecuted for wrongdoing, there is no evidence that only undertaking individual regulatory actions on their own will change corporate culture.

Having a strong system of criminal law incentivises companies to put good corporate governance structures in place, as the Bribery Act has demonstrated.[85] Ensuring that companies are fined effectively for wrongdoing, including by removing a significant amount of the benefit they received from it, and ensuring that they have independent monitors imposed where found guilty of wrongdoing, are also essential steps to prevent and deter corporate economic crime.

But the current UK corporate liability laws don't allow for big companies and banks to be prosecuted for economic crime, and the regulators aren't imposing significant enough penalties to fill the gap. The bottom line is, were another financial crisis to happen today, it is not clear what legal mechanism prosecutors could use in the UK, whether criminal or civil, to penalise financial institutions for reckless behaviour.

Introducing a 'failure to prevent' offence in relation to economic crime, however, would enable banks to be held to account for such wrongdoing as misselling toxic investments and money laundering, as well as the rigging of rates like Libor and Forex, and would help solve the UK's justice gap for corporate economic crime.

How can the UK better hold its companies to account?

Recommendation 1: The UK needs to reform its corporate liability laws to ensure that large companies can be prosecuted by i) introducing a 'failure to prevent economic crime' offence and ii) commissioning a Law Commission review of the identification doctrine.

The US has been so much more successful in holding companies criminally liable for economic crimes than the UK has because it has much stronger corporate liability laws.

The weakness of the UK's corporate liability regime, which is based on the 'identification doctrine' (i.e. the requirement that prosecutors must trace corporate liability back to an individual 'directing mind' at the company), has been long recognised by experts, international review bodies and the government itself.

In a 2010 consultation, the UK's Law Commission stated that the identification doctrine

> "*can make it impossibly difficult for prosecutors to find companies guilty of some serious crimes, especially large companies with devolved business structures.*"[86]

It found that the doctrine "*gives a perverse incentive*" for directors of large corporations to insulate themselves from knowledge of what their employees are doing, and that the doctrine

> "*may simply be an inappropriate and ineffective method of establishing criminal liability of corporations.*"[87]

In a 2016 consultation on a new corporate tax offence, the government acknowledged that the current corporate liability regime undermines incentives for good corporate governance and lets the worst offenders off the hook. It outlined in the consultation how

> "*the criminal law currently renders corporations that refrain from implementing good corporate governance and strong reporting procedures hard to prosecute and offers no incentive to invest in such procedures. It is those corporations that deliberately turn a blind eye to wrongdoing and preserve their ignorance of criminality within their organisation that the current criminal law most advantages.*"[88]

In December 2018, meanwhile, FATF noted that

> "*the UK's ability to pursue criminal prosecutions against legal persons is limited by practical challenges in proving such cases.*"[89]

The UK's two main prosecutors, the Crown Prosecution Service (CPS) and the SFO have both acknowledged on various occasions the difficulties that the identification doctrine poses to their ability to bring corporate prosecutions.[90]

Criminal law should apply to everyone. It is deeply damaging to public trust if financial institutions are perceived to be above the law. Ensuring that the criminal law can be used to tackle corporate economic crime is also essential to change corporate behaviour. It would send the clear signal that the UK government and the justice system consider certain types of behaviour morally wrong and worthy of serious condemnation.[91] The moral stigma of engaging in conduct that could be penalised through criminal law is likely to concentrate minds in a corporate setting and incentivise good corporate governance.

Passing legislation that provides for vicarious liability or for a 'failure to prevent' offence applying to economic crime would help prosecutors in the UK catch misbehaving corporations that are currently off the hook.

The UK has already introduced 'failure to prevent' offences for bribery and tax evasion. It makes little sense for the other economic crimes such as fraud and money laundering not to have a similar standard for holding companies to account. One of the UK's most senior judges, Sir Brian Leveson, who is Head of Criminal Justice, suggested recently before Parliament that "*the ability to say 'You've not taken steps to prevent' is to my mind absolutely critical.*"

He went onto state that extending the failure to prevent model to other economic crime would, in his opinion, "*be in the public interest.*"[92]

A failure to prevent offence ensures that a company can be criminally prosecuted for wrongdoing where it cannot show that it had sufficient procedures in place to prevent those crimes from happening. As an offence, it encourages companies to put in place good corporate procedures and raises corporate governance standards.

At the same time, the UK also needs to review how the 'identification doctrine' is impacting on the ability of prosecutors to hold corporations to account in a way that is fair and holds all companies, whether large or small, to the same standard. A Law Commission review of how the identification doctrine could be reformed or abolished is long overdue.

Stronger accountability for corporate misbehaviour is essential to bringing back public trust in business and the financial sector. Reforming the UK's corporate liability regime to ensure it is fit for purpose will also enable the UK to protect the integrity of its financial markets and to prevent further financial scandals.

Recommendation 2: The UK should commission an independent review of how its criminal and regulatory systems work together and whether its regulatory penalties are sufficiently frequent or high enough to provide real deterrence

In the US, prosecutorial and regulatory bodies often cooperate and coordinate closely and release simultaneous announcements on penalties they will impose on financial institutions. In the UK, the situation is far less clear-cut. Regulators and prosecutors rarely appear to take co-ordinated action, or announce financial penalties in conjunction. The exception to this was the recent DPA between the SFO and Tesco. The day it was announced, the UK's FCA also announced that it would require Tesco to establish a compensation scheme worth around £85 million plus interest for those investors affected by its market abuse.[93] This was the first instance of such coordinated action. Notably, the FCA did not impose an additional penalty for market abuse on Tesco.

The establishment of the UK's new National Economic Crime Centre may help ensure that there is more coordinated action between criminal prosecutors and regulators, as the FCA, SFO and CPS are all under the same roof. However, it is essential that an independent review looks at the barriers to effective coordinated regulatory and criminal enforcement.

Most importantly, the review should look at whether UK regulators are imposing penalties frequently enough and of sufficient size to create real deterrence. It isn't currently clear that the UK regulatory penalties are doing so. In July 2015 for instance, the UK's FCA found that despite fines it had imposed in 2012 and again in 2014 for benchmark rigging in Libor and Forex markets, UK firms were still "*failing to fully manage benchmark risks*."[94]

In December 2018, a draft FATF report evaluating the UK's anti-money laundering and terrorist financing regimes included criticism from private sector representatives that the number and amount of penalties imposed by the FCA were low, raising

> "*questions about their dissuasiveness, particularly in light of systemic AML/CFT failings identified at some large multinational UK firms over the last decade.*"[95]

The criticism was deleted however from the final published report as was a recommendation for the FCA to consider the level of fines it was imposing for money laundering breaches.[96]

In 2013, the Parliamentary Committee on Banking Standards noted that

> *"the credibility of enforcement has been damaged by a legacy of fines that were pitiful compared to the benefits banks gained from the misconduct."*[97]

Yet nearly six years on, its words do not appear to have been fully heeded. An independent review must look at what level of regulatory penalties provide credible deterrence, and lessons to be learned from the US experience.

Conclusion

Since the financial crash, US prosecutors and regulators have held New York banks to account for rate rigging, money laundering and other economic crimes and have raised almost £6.4 billion in criminal fines and almost £20 billion in non-criminal fines.

In the UK however, authorities have brought no successful criminal prosecutions relating to the same conduct. Indeed, the only criminal fraud case brought by the SFO against a corporation in relation to financial crisis-era conduct failed.[98] The UK authorities have raised nothing in criminal fines, and have accrued less than £2.5 billion in non-criminal fines.

Total criminal penalties imposed on New York and London banks

	Imposed by the US	Imposed by the UK
Libor manipulation	£1.6 billion	£0
Forex fixing	£1.8 billion	£0
Money laundering & sanctions violations	£3 billion	£0
Toxic mortgages and the financial crisis	No banks found criminally liable	No banks found criminally liable
TOTAL	£6.4 billion	£0

Total non-criminal penalties imposed on New York and London banks

	Imposed by the US	Imposed by the UK
Libor manipulation	£2.6 billion	£0.76 billion
Forex fixing	£4.7 billion	£1.4 billion
Money laundering & sanctions violations	£6 billion	£0.3 billion
Toxic mortgages and the financial crisis	£6 billion	£0
TOTAL	£19.3 billion	£2.46 billion

Under the current system, the UK effectively outsources enforcement of financial crimes to the US. By doing so, the UK:

- fails to provide credible deterrence for financial wrongdoing;
- fails to protect the integrity of its markets;
- fails to provide real incentives for good corporate governance in the UK; and
- effectively allows the US Treasury to take money from criminal and regulatory penalties that could legitimately be going to the UK Treasury if the UK were to take action.

The UK needs to update its corporate liability regime to make it easier for prosecutors to get convictions, and review its regulatory penalty regime. The British public is rightly outraged that no banks or bankers were held criminally accountable for precipitating the financial crisis, for rigging the Libor and Forex rates, or for money laundering scandals and sanctions violations, and that only paltry fines have been paid.

Justice is not currently being done. Corporate liability reform is essential to ensure that companies can be found criminally liable for wrongdoing and regulatory penalties must be reviewed to ensure they provide real incentive for companies to operate on the right side of the law.

Appendix 1

Methodology

The challenge of comparing UK and US law enforcement efforts is the large disparity in the two countries' economies. The US has a far greater number of companies that get caught up in economic crime, and far more law enforcement resources to tackle the problem. To mitigate this issue, we focussed on banks that have a 'significant presence' in New York, which we defined to mean banks that:

- have their US operations headquartered in New York;
- are listed on the New York stock exchange;
- locate their investment banking division in New York; and/or
- had their penalties enforced by New York authorities, including the DOJ's Criminal Division and the US Attorney's Offices in the Southern and Eastern Districts of New York.

This meant ignoring prosecutions and regulatory actions in large parts of the country, but meant a comparison to London could be more honestly made.

This also meant that for our analysis of penalties relating to toxic mortgages, we *only* included the fines of three UK-headquartered banks (given that their involvement in toxic mortgages in the US caused such damage to the UK economy). For our analysis of penalties relating to money laundering, we made the assumption that New York and London, as similarly sized financial centres, have roughly the same amount of money laundered through them, and so the broader definition could be applied.

Where a fine was issued in US Dollars, we converted it to British Pounds using the historical exchange rate that applied at the close of the date that the fine was issued.

Sources

For the UK, we collected data on enforcement actions from a variety of sources, including:

- Press releases issued by the SFO.
- Press releases issued by the FCA (and its predecessor, the FSA).
- News reports.

For the US, we collected data on enforcement actions from a variety of sources, including:

- Press releases issued by the DOJ.
- Press releases issued by the CFTC.
- Press releases issued by the Board of Governors of the Federal Reserve System.
- Press releases issued by the OCC.
- Court documents published by the NYDFS.
- Press releases issued by the Financial Crimes Enforcement Network (FinCEN).
- Press releases issued by the FBI.
- Press releases issued by the US Attorney's Offices of the Southern and Eastern Districts of New York.
- News reports.

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Glossary

Commodities Futures Trading Commission (CFTC)
Crown Prosecution Service (CPS)
Deferred Prosecution Agreement (DPA)
Department of Justice (DOJ)
Federal Bureau of Investigation (FBI)
Financial Action Task Force (FATF)
Financial Conduct Authority (FCA)
Financial Crimes Enforcement Network (FinCEN)
Financial Services Authority (FSA)
Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA)
Foreign exchange (Forex)
HM Revenue and Customs (HMRC)
International Emergency Economic Powers Act (IEEPA)
Lloyds Banking Group (Lloyds)
London based inter-bank lending rate (Libor)
National Crime Agency (NCA)
New York State Department of Financial Services (NYDFS)
Non-Prosecution Agreement (NPA)
Office of Financial Sanctions Implementation (OSFI)
Office of the Comptroller of the Currency (OCC)
Royal Bank of Scotland (RBS)
Senior Managers and Certification Regime (SMR)
Serious Fraud Office (SFO)
Trading With the Enemy Act (TWEA)
United Kingdom (UK)
United States of America (US)

Endnotes

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