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WHITEPAPER

The Future of U.K. Enforcement of Financial Crimes: Four Clues for 2015

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A handful of recent developments provide valuable clues to how U.K. enforcement of financial crimes may play out in the future. Companies falling under the jurisdiction of U.K. authorities—which, given the breadth of the jurisdiction established by the U.K. Bribery Act, includes the vast majority of multi-national companies—would do well to pay attention and to make proactive adjustments to their business conduct programmes.

CLUE #1:
Jail Time for Executives Convicted of Financial Crimes

On 4 August 2014, three former U.K.-based executives of a specialty chemicals company were sentenced to jail for their part in a bribery scheme. These sentences have been widely analysed, with some commentators stating that the sentences were too harsh and others that they were too lenient given the crimes. Either way, the most remarkable fact is that the executives will go to jail at all, since jail time for executives in significant financial crimes cases is rare.

Looking across the pond to the U.S., the Department of Justice (DOJ) and Securities and Exchange Commission (SEC) have become very adept at obtaining multi-billion dollar settlements with alleged offenders, but the cases rarely include jail time—in part because so many are settled before trial. The recent $16.5 billion dollar settlement with a major U.S. bank stemming from alleged mortgage-backed securities fraud is a good example. Huge fines were paid, but there were no personal penalties for the bank's executives.

The American public and many commentators are increasingly frustrated that no individuals have been sent to jail for the abuses that sparked the financial crisis. The U.K. case cited above stands in stark contrast. The U.K. Serious Fraud Office (SFO) not only settled the criminal case against the company (resulting in a relatively modest $12.7 million in fines), but went on to prosecute individual executives and senior managers involved in the bribery.

Testimony in the case of the specialty chemicals company showed that the bribery was a calculated business decision. Indeed, the judge heard extensive testimony about the "good character" of the defendants. That four "good" people were knowingly involved in bribery—or failed to stop it once they became aware of it—reveals how improper conduct can be rationalised away as a necessary "part of doing business."

The essential role of individuals in corruption was not lost on the judge. In his sentencing remarks, the judge stated, "The corruption was endemic, ingrained and institutional" and that, while companies are separate legal entities, they are not automated machines. Rather, "decisions are made by human minds. It follows that those high up in the company should bear a heavy responsibility under the criminal law." In this light, jail time serves both as a punishment and as a warning to others.

Given the judge's remarks and the precedent set by the sentences, company leaders (whether they are of "good" or "bad" character) now will have to consider the real risk of prison time as they plot their course of action to address corruption risk.

CLUE #2: Multi-National Cooperation in Investigations

Another key feature of the case against the specialty chemicals company officials is the degree of cooperation with authorities in other countries. The case began with a referral from the DOJ in 2007 and ultimately involved U.K. cooperation with American, Swiss, Indonesian, and Singaporean authorities. As U.S. officials have emphasised, cooperation of foreign governments makes it substantially easier to obtain the evidence needed to successfully prosecute a case against a company with operations around the world.

For the SFO, which generally is considered underfunded and has been criticised in the past for failing to successfully prosecute financial crimes, cooperation with foreign governments is likely going to be an important—and on-going—element of future cases. Not only will cooperation lower the cost of successful prosecution (helpful to prosecutors with limited budgets), but it will increase the overall likelihood of success.

For example, local authorities are often the only ones able to require companies to produce sensitive company records. With the cooperation of those local authorities, U.K. prosecutors are now much more likely to end up with the evidence they need to prove a crime has occurred. This, like the prospect of jail time, alters the risk/reward calculation of executives contemplating financial crimes and acts as a deterrent.

CLUE #3: Deferred Prosecution Agreements Authorised

Recent legislation authorising U.K. authorities to use Deferred Prosecution Agreements (DPAs) has provided an important new tool to the SFO and other U.K. authorities. Most importantly, the Code of Practice guidance that governs the use of DPAs sets up significant incentives for companies to "self-report" potential violations of the law and to cooperate fully with the government if investigated—including cooperating in the future prosecution of individuals.

Alun Milford, the General Counsel of the SFO, said earlier this year that, "if we hear of the misconduct from the company, which then goes on to co-operate in a transparent and proactive manner, then plainly the public interest factors pointing against prosecution will be more substantial and more weighty. In some cases, they will make all the difference." In a speech on 2 September 2014, he also stated that without cooperation, it was "difficult to imagine" that a DPA "would ever be appropriate."

As U.S. experience has shown, DPAs can allow authorities to utilise scarce resources more efficiently by deferring prosecution instead of bringing a case and taking it to a lengthy (and expensive) trial. DPAs also can result in significant fines, which then can be used to help fund further enforcement activities. Given the potential benefits to both the government and the organisation under scrutiny, it seems only a matter of time before DPAs become a common feature of the U.K. enforcement landscape.

CLUE #4: "Whistleblower" Bounties Rejected

After a lengthy study by a commission formed by the Bank of England and the U.K. Financial Conduct Authority (FCA), the commission rejected U.S.-style "bounties" for individuals who report financial crimes to government authorities. With U.S. bounties, whistleblowers who provide critical evidence in certain types of cases are offered up to 30 per cent of any recovery by the government that exceeds $1 million. As the U.S. Attorney General, Eric Holder, recently stated, large bounties are seen as a way to "improve the Justice Department's ability to gather evidence of wrongdoing while complex financial crimes are still in progress—making it easier to complete investigations and to stop misconduct before it becomes so widespread that it foments the next crisis."

By contrast, the FCA is concerned that large government awards will act as an incentive for employees to bypass their internal reporting systems and report straight to the government. In rejecting bounties, the FCA explicitly stated that it did not want to undermine internal reporting programmes. Internal reporting generally allows an organisation to identify and address problems earlier, thereby minimising the length and severity of improper conduct.

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In addition, if an organisation learns of a potential violation when an employee raises a concern internally, it is better positioned to self-report the issue and cooperate with the authorities—which, through the DPA process, should result in a more favourable outcome for the organisation and a more efficient use of resources by the government.

In exactly the way the FCA would want, a major U.K. retailer recently informed the FCA that it had overstated earnings. The self-reporting occurred after the company received an "alarm bell" from an internal whistleblower and then investigated the allegation. The FCA has announced that it will be looking into the matter. Given the high profile nature of the case, as well as the fact that the retailer self-reported the overstatement and appears to be opting for transparency and cooperation, the case seems to be a good candidate for a DPA. Even if a DPA does not result, the case stands as vindication of the FCA's preference for internal reporting over bounties.

For forward-looking organisations, the key upshot of the rejection of bounties is the emphasis the FCA put on internal reporting. As a result, such organisations will want to ensure that they have effective mechanisms in place for employees to raise concerns and be protected from retaliation. Indeed, it is expected that later this year, the U.K. commission that studied bounties will publish proposals that would require firms to do so.

PREPARING FOR THE FUTURE: Prevent Misconduct Before it Begins With an Effective Business Conduct Programme

Each of these developments underscores the need for businesses to have an effective business conduct programme that encourages a healthy, "speak-up" corporate culture. Organisations should consider taking the following five steps to ensure that their programme best mitigates their risk:

1. **Establish a robust business conduct programme that blends the right content, technology, and expertise to best support a strong corporate culture.** According to the Ethics Resource Centre's most recent U.S. National Business Ethics Survey, "when companies value ethical performance and build strong cultures, misconduct is substantially lower. In 2013, one in five workers (20 per cent) reported seeing misconduct in companies where cultures are 'strong' compared to 88 per cent who witnessed wrongdoing in companies with the weakest cultures." A strong culture backed by an effective business conduct programme is an organisation's best approach to mitigating risk.
2. **Report any potential violations of the law to the appropriate authorities promptly, and cooperate fully in any investigation.** Particularly with the potential for DPAs, having a robust business conduct programme will be essential to receiving reduced penalties—or even to avoiding prosecution altogether, as Morgan Stanley did in the U.S. Similarly, full cooperation with the investigating authority will be central to being a candidate for a DPA.
3. **Offer employees a variety of ways to raise concerns internally.** All organisations should have a whistleblower hotline service to augment reporting to managers, human resources, the compliance office or legal team. When issues are raised, ensure that they are investigated promptly and thoroughly. If they are not, the odds that the reporter will turn to a government authority or news outlet will be greatly increased. Indeed, one study indicated that 84% of external whistleblowers tried raising their concern internally first.
4. **Distribute "speak up" policies companywide.** Ensure employees are trained on their duty to report and managers are trained on how to handle reports and prevent retaliation. When employees feel empowered to report without fear of retaliation, employers are much more likely to learn of nascent issues—and have the opportunity to address them internally before they grow into scandals.

5. **Ensure active oversight by your board of directors.** Boards need to better understand their role in ensuring proper business conduct—including ensuring that financial crimes are not seen as "part of doing business"—and in holding executives accountable. For many boards, this role will be unfamiliar territory and they will benefit greatly from detailed, specialised training about their roles and responsibilities. Similarly, company executives in many organisations will need to spend more time ensuring that a solid business conduct programme is in place and championing an ethical culture.

The legal and compliance landscape is changing quickly—it's up to organisations that are subject to U.K. laws to strengthen their compliance programmes to meet these new challenges.

ABOUT THE AUTHOR

Andrew Foose, J.D., vice president of NAVEX Global's Advisory Services Team, is a former senior trial attorney in the U.S. Department of Justice's Civil Rights Division. Andy is recognised amongst leading experts on conducting lawful and effective internal investigations and has trained thousands of attorneys, compliance officers, auditors and human resource professionals on best-practice investigative techniques and on how to write effective, comprehensive investigative reports. He currently works with organisations ranging from large multi-national companies to smaller non-profits to assess their ethics and compliance programmes and to provide guidance on ways to enhance programme effectiveness and efficiency.

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