BLP Corporate Crime & Investigations column: October 2016

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Articles | Published on 19-Oct-2016 | England, Wales

Berwin Leighton Paisner LLP's Corporate Crime & Investigations team is led by Aaron Stephens. The team regularly share their views on topical corporate crime and investigations issues with our subscribers.

FCA expresses doubts around the reliability of internal investigations

BLP recently hosted the Fifth Annual American Bar Association (ABA) International White Collar Crime Institute, which featured a high-profile line up of representatives from US and UK regulators and prosecutorial agencies. Of particular note, on Monday 10 October 2016 there was a keynote discussion with Mark Steward (Director of Enforcement and Market Oversight at the FCA) and Andrew Weissmann (Chief of the Fraud Section of the US Department of Justice's Criminal Division), chaired by Nathan Willmott (Head of Financial Regulation, BLP).

New direction for FCA

During the discussion, Mr Steward appeared to articulate a new direction for the FCA, insofar as its reliance on firms' internal investigations is concerned.

It has become standard practice, following discovery of a major issue by a financial services firm, for the firm to conduct (either itself or by external counsel) an internal investigation into what happened and what remedial actions should be taken. A copy of that report (and potentially the underlying work product) is then typically shared with the relevant regulator. The regulator will then use that report, along with any remediation carried out, to assist its own investigations into the facts and whether to take, or decline to take, enforcement activity against the firm and/or relevant individuals.

However, at the ABA Institute Mr Steward expressed considerable scepticism when it comes to the reliability of firms' own investigations, noting an actual or perceived conflict of interest that, in his view, undermines the credibility of internal investigations in principle. He was quick to say that firms are, of course, encouraged to undertake investigations where issues arise in their businesses, and that such investigations may well prove helpful to the FCA, but that in principle the FCA will always carry out their own work rather than placing any reliance on a firm's (or the firm's lawyers') work.

Strict adherence to this policy would presumably require the FCA to devote significant further resources to investigations work, particularly if it means that on every occasion a firm carries out an investigation and notifies the FCA, this will trigger an automatic parallel investigation by the regulator. Many will feel that this is not realistic given the FCA's current resources. It will be interesting to watch how this approach evolves in practice.

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Reform of corporate criminal liability in the UK

The message coming from the UK government and prosecution authorities is clear and consistent. The current law around corporate criminal liability for economic crime is not fit for purpose and should be reformed.

Both Jeremy Wright QC, the Attorney General (see *Attorney General Jeremy Wright speech to the Cambridge Symposium on Economic Crime*), and Alun Milford, the Serious Fraud Office's (SFO's) General Counsel (see *SFO: Control Liability: Is it a good idea and does it work in practice?*), were clear in recent speeches that we should anticipate reform in this area. Indeed, Mr Milford revisited this topic at the ABA International White Collar Crime Institute hosted at BLP on 10/11 October 2016.

While the government has already announced a "failure to prevent" corporate offence for facilitation of tax evasion, Mr Wright QC reiterated the government's desire to extend this offence to all economic crimes, including money laundering, false accounting and fraud (see *BLP Corporate Crime & Investigations column: July 2016*). The recent scandals in the banking sector and the failure to obtain criminal convictions against the corporate or members of senior management have galvanised prosecutors to push for reform in this area. Mr Wright QC seems particularly keen to ensure reforms that would enable the UK to hold its own businesses to account, rather than lose these prosecutions (and the associated fines) to overseas authorities. For more information see *Practice note, Corporate criminal liability in the UK*.

Identification principle

We are all familiar with the current position under English law of the identification principle. This requires evidence that the "directing will and mind" of the corporate has sufficient *mens rea* for the offence before it can be attributed to the corporate entity. While relatively easy in a small company, this task becomes increasingly difficult as the company grows in size and scope and it can be virtually impossible in large multinational corporations or financial institutions to follow the chain of command (and knowledge) sufficiently high to obtain a criminal prosecution. A common criticism of the identification principle is that it incentivises management to distance themselves from the business to provide a layer (or layers) of protection in the event an employee commits a crime in the course of their employment that benefits the corporate. As a result, commentators believe that this leads to a disparity in enforcement actions between smaller and larger companies and a certain tendency for senior management to want to know as little as possible about day-to-day activities.

The government's view is that this is an unsatisfactory state of affairs. It is also out of step with the move in financial services regulation towards more individual accountability, as we have seen with the development of the senior managers regime. The financial regulators are clear that we will not see real behavioural change until individuals have real personal risk. That belief appears to be shared by Mr Wright QC and Mr Milford.

"Failure to prevent" framework

It is clear from his speech that Mr Wright QC considers that the use of the "failure to prevent" framework in the Bribery Act 2010 (BA 2010) has been successful, levelling the playing field for companies. For his part, Mr Milford has long been a proponent of the "control framework" approach to corporate criminal liability. Mr Milford uses the example (outside the economic crime sphere) of the failure to prosecute News International for phone hacking; a

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requirement for an adequate control framework would either have identified and stopped the criminal behaviour early on, or would have led to prosecutions for a "failure to prevent".

In anticipation of the implementation of the BA 2010, and despite concerns over the cost and increasing regulatory burden, responsible corporates refreshed their control frameworks, which led to a focusing of minds of senior management on the bribery risk their business was exposed to. It is likely the same will happen if the "failure to prevent" offence is extended and we consider it unlikely that objections to this development (based on cost, increasing regulation or the effect on the promotion or retention of senior staff) will convince the government to rethink its proposals.

Criminal Finances Bill: changes to the suspicious activity reporting (SAR) regime

Wholesale reform of the SAR regime, which was proposed by the Home Office in April of this year, looks to be off the table according to the government's response to the industry consultation on reform of the money laundering and terrorist financing legal framework published on 14 October 2016 (see *Home Office: Action Plan for anti money-laundering and counter-terrorist finance: consultation on legislative proposals: Government Response*). The government's response made it clear that the SAR consent regime is here to stay (at least for now).

Home Office proposals for reform

In April 2016, the Home Office called for responses to a consultation on reform of aspects of the anti-money laundering and counter-terrorist financing regime, including the proposed reform of the SAR regime. The Home Office's proposals included:

- A shift in focus from the reporting of individual transactions to the reporting of entities that pose the highest risk. In recognition of the strain on reporting officers caused by the absence of materiality thresholds in the current SAR regime, the Home Office proposed that resources should be directed at those individuals and organisations that pose the highest risk.
- Removal of the SAR consent regime, to be replaced by an intelligence-led approach.
- New official safe harbour legislation for information sharing, both between the private sector and the public sector, and between entities within the private sector.

However, in the light of the responses received, the Home Office has now decided that the SAR consent regime should remain. The existing SAR regime will be reformed, and much needed IT and process improvement will be implemented.

Legislative changes will be introduced by the Criminal Finances Bill to:

- Create a power for the National Crime Agency (NCA) to obtain further information from a regulated business following receipt of a SAR.
- Enable senior officers from law enforcement agencies to obtain a court order to extend the moratorium period to up to 186 days from the expiration of the initial 31-day period provided by statute. This will enable officials

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> more time to gather evidence to secure a restraint order or take other enforcement action, particularly where evidence is being sought from overseas via mutual legal assistance.

The response goes on to note that, although the government does not intend to remove the consent regime at this time, it will continue to explore what actions could be taken to prevent the misuse of the consent regime, whilst continuing to provide legal certainty to reporters and retaining the UK's powerful money laundering offences.

New legal gateway

Interestingly, the government has announced that the Criminal Finances Bill will contain a new and expanded legal gateway to enable private sector firms to share information on suspicions of money laundering and terrorist financing with one another, without fear of litigation. There is an existing gateway permitting disclosures between certain types of institutions, but the newly proposed gateway is designed to ensure that law enforcement agencies have access to SARs that provide a full cross-sector view of the threat, and will help firms better protect themselves. There will also be provisions enabling separate firms to file "joint" SARs.

We will have to wait and see the final shape of these information sharing provisions, although it is likely that the Home Office drafters have looked closely at section 314(b) of the US Patriot Act for inspiration. Section 314(b) allows US banks to share information with one another to identify and report activities that may involve money laundering or terrorist financing. Such information sharing is not considered a breach of US banking secrecy or data protection laws. Similar protections appear in the draft Criminal Finances Bill.

For many money laundering reporting officers (MLROs) of regulated firms, the ability to confer with other regulated firms will surely be a welcome development. It is likely to have a calibrating effect across the industry on the suspicion threshold for reporting as contained in the Proceeds of Crime Act 2002, as MLROs will engage in more open discussions as to what constitutes suspicion such that a SAR should be filed. Data sharing is also likely to lead to better quality SARs being submitted to the NCA.

Criticism of SAR regime

The SAR regime has been the subject of criticism of late. In July 2016, the House of Commons Home Affairs Committee reported on the proceeds of crime (see *House of Commons Home Affairs Committee: Proceeds of crime: Fifth Report of Session 2016–17*). The committee noted in the press release which accompanied the report that it found "deep and widespread problems in tackling money laundering and corruption from detection to prosecution and recovery."

The committee alighted on a fundamental issue with the SAR regime as it currently exists: the vast amount of information being conveyed to the NCA in the form of SARs is not translating into an effective control to prevent money laundering and terrorist financing. The committee noted that, of the 381,882 SARs filed in the period October 2014 to October 2015, less than 10% sought consent from the NCA, with the remainder being filed on an "intelligence only" basis. More striking still is the fact that the NCA properly reviewed only some 15,000 of the total number of SARs filed.

For more information see *Practice note, Reporting suspicious activities: overview*.

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