ARNOLD & PORTER (UK) LLP

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UK Economic Crime Group
Enforcement Update

Justice Committee response to the Draft Guidelines for sentencing financial offenders

In November, the Common Select Committee on Justice (Justice Committee), in its role as a statutory consultee, reported on the Sentencing Council's draft Sentencing Guidelines for fraud-related offences (The Committee's Ninth Report of Session 2013–14, Fraud, Bribery and Money Laundering Offences Guideline: Consultation examines proposed new sentencing guidelines on fraud-related offences published by the Sentencing Council). The draft guidelines contain separate sentencing guidelines for fraud; possessing, making or supplying articles for use in fraud; revenue fraud; benefit fraud; money laundering; bribery and corporate offenders. They represent the first set of guidelines for the sentencing of organisations convicted of financial crime and for individuals convicted of bribery and money laundering.[1]

The position of the victim has been given greater importance in the criminal justice system over the past few years and this continues to gather pace in the field of financial crime. The new draft guidelines place greater emphasis on the effect of the offence on the victim, rather than solely focusing on the financial loss, which may be difficult to calculate in some circumstances, particularly where there has been market manipulation or misinformation given to the financial markets, or widespread fraud where only a few cases go to trial. This focus on the victim is also important where the pure financial loss may be relatively small, but due to the victim's circumstances may have resulted in significant financial and/or psychological harm for that individual. It was recognised that further work may need to be done to identify the levels of detriment suffered by an individual victim in order for it to be properly factored into the appropriate level of sentence.

The Justice Committee held the view that large commercial organisations who knowingly perpetrate fraud on the public should face tough penalties. In making such penalties more meaningful, the Justice Committee proposes that fines for corporate offenders should be primarily calculated on a percentage of turnover, or other indication of financial value, whilst also factoring into the fine the harm done to the victims. This could help avoid fines being too lenient for large wealthy corporations. No specific percentage was recommended, but it was suggested that it should be sufficiently high to act as a deterrent.

The Justice Committee also recommended that there should be incentives built into the guidelines for offenders to make early voluntary reparation, thereby improving the chances

1 *See* Attorney General's guidelines on disclosure for investigators, prosecutors and defence practitioners 2013, *available at* https://www.gov.uk/government/publications/attorney-generals-guidelines-on-disclosure-2013.

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of victim compensation. The mechanics of these two principal recommendations have yet to be worked out and the calculation of appropriate fines may prove difficult for those corporations that are based overseas where the availability of financial information about the organisation may be limited.

G4S and Serco

The SFO announced in November that it has opened a criminal investigation into the conduct of two global securities companies, G4S and Serco, following claims that both overcharged the UK Ministry of Justice for electronic tagging services of released offenders. It is alleged that both companies had charged for offenders that were in fact found to be either overseas, back in prison, or deceased. An audit, conducted by PricewaterhouseCoopers (PwC), alleged that the overcharging dated back as far as the commencement of the contracts in 2005. Capita has since taken over the contracts.

Olympus and Gyrus

In September, Gyrus Group Limited and Olympus Corporation, the Japanese parent company, were charged by the SFO with offences under section 501 of the Companies Act 2006 of having made a statement to an auditor that was misleading, false or deceptive. Gyrus Group faces four charges and Olympus Corporation faces one charge, spanning a period of April 2010 to March 2011. This case follows the successful conviction in Japan of the parent company, Olympus, for which it was fined 700 million Yen (£4.5 million) and the conviction of three former directors. The case relates to the hiding of substantial losses during the course of its acquisition of Gyrus Group Limited (in the region of £1.7 billion), which was uncovered by the former Olympus CEO, Michael Wood.

This is not the first time the SFO has prosecuted a corporate body for offences under the Companies Act. As recent as December 2010, BAE Systems pleaded guilty to the offence of failing to keep accurate accounting records under the 1985 Act. It is, however, the first time the SFO has prosecuted an overseas parent company for such offences.

LIBOR update

The three defendants, Tom Hayes, Terry Farr and James Gilmour, in the conspiracy to defraud the case brought by the SFO have all pleaded not guilty to the charges of manipulating the LIBOR at Southwark Crown Court in December. Mr. Hayes, who is facing eight counts of fraud, is expected to face trial in January 2015, lasting 12 weeks. The Farr and Gilmour trial is set for September 2015, due to last six weeks and they face two charges and one charge, respectively. The SFO has notified a further 22 individuals that they may be investigated. Whilst the extent of the prosecution is yet to be seen, the one true certainty is that the future of the Agency may well be defined by its performance in this case.

The US Justice Department has also brought charges in respect of LIBOR manipulation against Mr. Hayes, another UBS trader, and three former ICAP brokers. No plea has been entered yet. UBS, ICAP and other financial institutions have settled manipulation charges with the relevant authorities. Mr. Hayes is reported to be cooperating fully with the SFO, and given the pace of proceedings now in this jurisdiction, it would appear that any extradition to the US would be unlikely, for now at least.

The Financial Conduct Authority (FCA) has also imposed fines for misconduct relating to the LIBOR matter.

In October, the FCA fined Cooperatieve Centrale Raiffeisen-Boerenleenbank B.A. (Rabobank) £105 million for "serious, prolonged and widespread" misconduct. The FCA found that Rabobank's poor internal controls encouraged collusion between traders and LIBOR submitters and allowed systematic attempts at benchmark manipulation. Rabobank failed to fully address these failings until August 2012, despite assuring the FCA in March 2011 that suitable arrangements

were in place. The misconduct was found to be the most serious identified in the LIBOR matter. Traders and submitters were found to have treated LIBOR submissions as a potential way to make money, with no regard for the integrity of the market. Rabobank received a 30 percent discount for its full cooperation with the investigation.

In the same month, ICAP Europe Limited (IEL) was fined £14 million for the misconduct. IEL brokers were found to have colluded with UBS to manipulate the Japanese Yen LIBOR for the benefit of traders, which the FCA attributed to "significant failings in culture and controls" which allowed misconduct to flourish. The misconduct was also found to extend to brokers taking corrupt bonus payments as a reward in assisting with this market manipulation.

The European Commission has also been active in clamping down on market manipulation. It recently fined six banks 1.7 billion Euros for operating cartels in interest rate derivatives, although a 10 percent reduction was given to the banks for agreeing to settle and Barclays was given immunity for bringing the matter to light. What struck the Commission during the course of the investigation was not only the manipulation of the LIBOR and Euribor benchmarks, but also the extent of collusion between banks in the manipulation of those benchmarks. The Commission believes these fines send a signal that it is prepared to investigate and fine to ensure healthy competition and transparency, thereby protecting the integrity of the markets. The Commission is now investigating the foreign exchange markets.

Other key SFO prosecutions

The SFO has charged Smith & Ouzman Limited, a UK based printing company, two directors, an employee and an agent with offences of corruptly agreeing to make payments totalling nearly £0.5 million, contrary to Section 1 of the Prevention of Corruption Act 1906. This is a pre-Bribery Act case and the trial is expected to take place in November 2014.

Whilst prosecutions under the Bribery Act may seem slow to take off, one has to bear in mind that the Act is not retrospective and the US Foreign Corrupt Practices Act has had many more years on the statute books. There may also be two further factors, namely, the "investigative pipeline" where it will take time for cases to come to court and a policy of choosing cases carefully to "road test" the new legislation.

Despite the intention of the SFO's Director, David Green QC, to improve the performance of the SFO and see more corporate prosecutions, the SFO has just seen one of its highest profile bribery prosecutions collapse. The trial of Victor Dahdaleh collapsed in December after the SFO decided not to offer evidence after one witness changed his evidence and two further witnesses, lawyers at the US firm Akin Gump, declined to testify. The SFO alleged that Mr. Dahdaleh paid bribes in Bahrain totalling £38 million to win contracts between Alba (Aluminium Bahrain) and western businesses. It emerged during the course of the trial at Southwark Crown Court that the SFO had effectively delegated its investigation in Bahrain to Akin Gump. This firm was also acting in a US civil case against Mr. Dahdaleh, in what would appear to be a conflict of interest. The collapse of this case will no doubt increase the spotlight on the SFO and its ability to prosecute large, complex cases involving multiple jurisdictions, and the pressure will be mounting to achieve a successful prosecution in the LIBOR matter.

Lloyds Banking Group

In December, the FCA imposed a fine of £28,038,800 on Lloyds Banking Group for serious sales incentive failings. This is the largest fine the FCA (or its predecessor, the Financial Services Authority) has ever imposed for retail conduct failings. The size of the fine was increased by 10 percent due to the numerous warnings the FCA had made to the industry on incentive schemes; and the fact that Lloyds TSB had been fined relatively recently in 2003 for the unsuitable sales of bonds. FCA found that both Lloyds TSB and Bank of Scotland had higher risk features in their financial incentive schemes which were not properly controlled.

Whistleblowing: Developments

Transparency International has recently published International Principles for Whistleblower Legislation, which calls for greater protection and oversight of government surveillance. It identifies three key principles for whistleblowing in both the public and private sectors, namely: i) accessible/reliable reporting routes; ii) robust protection; and iii) appropriate disclosure mechanisms which promote reforms that correct legal/policy gaps and prevent future wrongdoing. It remains to be seen whether the increased protection for whistleblowers in the Enterprise and Regulatory Reform Act 2013, which came into force in June 2013, will live up to these ideals.

Disclosure Guidelines

In December, the UK Attorney General published revised Guidelines on disclosure in criminal proceedings. The Guidance is for investigators, prosecutors and defence practitioners, and replaces the previous regime contained in the 2005 and 2011 Guidelines. The Guidelines are high-level and principle based. They are intended to operate alongside the Judicial Protocol on the disclosure of unused material in criminal cases.

The Guidelines were drafted following the recommendations of Lord Justice Gross in his September 2011 "Review of Disclosure in Criminal Proceedings" and take account of Lord Justice Gross' and Lord Justice Treacy's "Further review of disclosure in criminal proceedings: sanctions for disclosure failure," published in November 2012. They form part of the disclosure regime contained in the Criminal Procedure and Investigations Act 1996, which aims to ensure that investigations are conducted in a fair, objective and thorough manner. Disclosure of material, including unused material, is an essential part of this process.

In summary, the UK Law Enforcement Authorities have shown an increased appetite to deal with economic crime and it will be interesting to see how Deferred Prosecution Agreements are utilised in 2014.

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