



Financial Crime & Punishment

Standard Note: SN/BT/6872

Last updated: 29 September 2014

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Section: Business & Transport Section

This note gives a broad outline of how financial crimes are defined and who is responsible for their policing.

Many of the penalties levied on financial service firms are for breaches of rules rather than crimes. The rules are drawn up by the financial regulators – in the retail market this is now mainly the Financial Conduct Authority and appear in the Handbook.

Statute offences also exist and these can be enforced by several agencies.

This note gives a brief guide to the main agencies involved in the enforcement of financial law and their powers.

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1 Introduction

The enforcement of law in the field of financial services is surprisingly complicated. It involves a matrix of law and rules overseen by different bodies, agencies or regulators. It often contradicts a 'common sense view' of what actually is a crime. For example, while very few individuals have faced any sanction arising out of the 2008 financial crisis, and I came as a surprise to many that the manipulation of financial benchmarks like LIBOR on which £billions depend was not, until recently, a specific offence, an inaccurate mortgage application by an individual keen to get on the housing ladder, is classified as 'mortgage fraud' and subject to potential penalties.

The situation is further complicated by the division between the regimes that apply to financial services firms, banks, insurance companies, financial advisers etc, and those which apply to all other non-financial companies.

This note attempts to outline the main distinctions between the types of offences and describe the main agents responsible for either discovering crime or enforcing the 'law' within financial services broadly defined.

A backbench business committee debate on 3 November 2015 on the wider subject of [corporate economic crime](#), included much information of interest to the narrower subject described here.

2 The main agents

2.1 Financial Conduct Authority (FCA)

The FCA was established by the *Financial Services Act 2012*. It replaced the previous Financial Services Authority which was established by the *Financial Services and Markets Act 2000*. The FSA is an independent (of government) regulator. It has its own rule making capacity and it is funded by industry levies, not by general taxation.

One fixed point to remember is that the FCA only regulates people or firms conducting regulated activities. Hence they can act against someone providing mortgages but not (until 1 April 2014) against a consumer credit provider. It is the activity – whether it is an authorised activity or not - that defines the scope of their responsibilities. The list of activities that come within its remit is set by government, partly in the Act but mainly by secondary legislation, namely *the Financial Services & Markets Act 2000 (Regulated Activities) Order 2001* (and subsequent amendments.¹ Although much amended following the legislation enacted after the financial crisis, the governing primary legislation remains the [Financial Services and Markets Act 2000](#) normally referred to as FSMA.

The overwhelming bulk of 'law' which the FCA administers is not statutory law but its own rules. The overwhelming bulk of punishments are fines, either on a company or on individuals, rather than criminal sentences. The FSA rulebook is contained in its [Handbook](#).

Compared to the number of rules, there are relatively few, though often broadly drawn, cases where the FSMA stipulates an offence.

¹ See Schedule 2 *FISMA*

FISMA 'offences'

The first is a very general one called 'the general prohibition'² Firms and individuals cannot carry out 'authorised activities' without authorisation this is the 'general prohibition' and is punishable by, in the worst case, by a fine and up to two years in prison.

The second, is activities that come under the general heading of 'market abuse'.³

Market abuse frequently encompasses insider dealing offences in connection with share trading, but is drawn more broadly to include 'qualifying investments'. Confusingly, the FCA's only has powers to impose civil penalties on individuals for market abuse actions. However, the FCA can prosecute (except in Scotland) three offences of insider trading under the authority of the Criminal Justice Act 1993. The offences are those of:

- Insider trading;
- Money laundering
- Offences under Schedule 7 to the Counter Terrorism Act 2008 (terrorist financing or money laundering)

Part XXVII of FSMA establish three specific (miscellaneous) offences. Section 397 establishes a range of offences of making misleading statements or giving misleading impressions with respect to securities or in relation to the operation and compilation of financial benchmarks. These offences are punishable with imprisonment of up to 12 months.

Section 398 establishes a general offence of misleading the regulator punishable with a fine.

Section 399 includes offences committed in relation to the competition authorities.

The FCA therefore has a dual role. On the one hand it has a *rule* setting role on the other it has a *law* enforcing role. The FCA regularly fines firms and individuals if they break its rules and sometimes presses for criminal action in conjunction with the police or Serious Fraud Office. The FCA does have an extensive legal team in-house and its own Regulatory Decisions Committee to come to a view and it consults broadly with the police and others in making these decisions.

According to a spokesman at the FCA, a *simplified* guide to the decision process is that the decision to prosecute would be influenced by the motive of the act – the *mens rea* - equivalent. If the motivation was for financial gain then prosecution was more likely. In other cases, often a firm will 'confess' to the FCA that it has not applied rules effectively enough and the FCA is likely therefore to treat this as an administrative failing, albeit one that might have benefitted the firm. In this case, the fine will reflect the seriousness of the case and whatever benefit has accrued as a result.

The key would seem to be whether the FCA decides that an offence has been committed under the [Fraud Act 2006](#). This includes offences of 'fraud by false representation' (S2); fraud by failing to disclose information (S3) and fraud by abuse of position (S4). However, the FCA would only prosecute under this Act if the offence was ancillary or incidental to something they were already looking at.

² Section 19 *FISMA*

³ Section 118 *FISMA*

The FCA produces a more detailed guide to the way it operates in its [Enforcement Guide](#). At the very highest level it states that its enforcement activity is informed by the following principles:

- The effectiveness of the regulatory regime depends to a significant extent on maintaining an open and co-operative relationship between the FCA and those it regulates.
- The FCA will seek to exercise its enforcement powers in a manner that is transparent, proportionate, responsive to the issue, and consistent with its publicly stated policies.
- The FCA will seek to ensure fair treatment when exercising its enforcement powers.
- The FCA will aim to change the behaviour of the person who is the subject of its action, to deter future non-compliance by others, to eliminate any financial gain or benefit from non-compliance, and where appropriate, to remedy the harm caused by the non-compliance.

Section 12 of the Guide is the section on *Prosecution of Criminal Offences*. The introductory section states that:

12.2 The FCA's general policy is to pursue through the criminal justice system all those cases where criminal prosecution is appropriate. When it decides whether to bring criminal proceedings in England, Wales or Northern Ireland, or to refer the matter to another prosecuting authority in England, Wales or Northern Ireland (see paragraph 12.11), it will apply the basic principles set out in the Code for Crown Prosecutors.¹¹ When considering whether to prosecute a breach of the Money Laundering Regulations, the FCA will also have regard to whether the person concerned has followed the Guidance for the UK financial sector issued by the Joint Money Laundering Steering Group.

[...]

12.4 In cases where criminal proceedings have commenced or will be commenced, the FCA may consider whether also to take civil or regulatory action (for example where this is appropriate for the protection of consumers) and how such action should be pursued. That action might include: applying to court for an injunction; applying to court for a restitution order; variation and/or cancellation of permission; and prohibition of individuals. The factors the FCA may take into account when deciding whether to take such action, where criminal proceedings are in contemplation, include, but are not limited to the following:

- (1) whether, in the FCA's opinion, the taking of civil or regulatory action might unfairly prejudice the prosecution, or proposed prosecution, of criminal offences;
- (2) whether, in the FCA's opinion, the taking of civil or regulatory action might unfairly prejudice the defendants in the criminal proceedings in the conduct of their defence; and
- (3) whether it is appropriate to take civil or regulatory action, having regard to the scope of the criminal proceedings and the powers available to the criminal courts.⁴

⁴ FCA Enforcement Guide chapter 12

Section 7 of the Guide lists all the offences by penalty type. It is a very long list. A summary of the more significant offences and the punishments (set out above in this note) they attract can be found in the following table:

Offences	Legislation	Maximum penalty
Carrying on (or purporting to carry on) a regulated activity without authorisation or exemption in breach of the general prohibition in s. 19 FSMA.	s. 23 FSMA	2 years imprisonment and/or a fine on indictment
Making false claims to be authorised or exempt	s. 24 FSMA	6 months imprisonment and/or a fine on summary conviction
Offering new securities to the public before publishing a prospectus in accordance with the Prospectus Rules	s. 85(3) FSMA	2 years imprisonment and/or a fine on indictment
Communicating an invitation or inducement to engage in investment activity in breach of the financial promotion restriction in s. 21 FSMA	s. 25 FSMA	2 years imprisonment and/or a fine on indictment
Performing functions in breach of a prohibition order	s. 56(4) FSMA	a fine not exceeding level 5 on the standard scale on summary conviction
Failing to co-operate with, or giving false information to, FCA appointed investigators	s. 177 FSMA	2 years imprisonment and/or a fine on indictment
Misleading the FCA in purported compliance with any requirement made by the FCA	s. 398 FSMA	an unlimited fine on indictment

Source: Pannone

In addition to the above, the FCA is also able to prosecute criminal offences pursuant to other legislation, including the following:

Offences	Legislation	Maximum penalty
Insider dealing offences	s. 52 of the Criminal Justice Act 1993	7 years imprisonment and/or a fine on conviction on indictment
Making of misleading statements and impressions	s. 89 and 90 Financial Services Act 2012	7 years imprisonment and/or a fine on conviction on indictment
Making of misleading statements and impressions relating to benchmarks	s. 91 Financial Services Act 2012	7 years imprisonment and/or a fine on conviction on indictment
Breaches of the Money Laundering Regulations 2007	MLR	2 years imprisonment and/or a fine on conviction on indictment
Terrorist financing or money laundering	Schedule 7 Counter Terrorism Act 2008	2 years imprisonment and/or a fine on conviction on indictment

Source: Pannone

The FCA has also issued a two part publication *Financial Crime: a guide for firms* [Part 1](#) and [Part 2](#) in April 2014 and 2013 respectively. Part 1 is by sector based, part 2 thematically based.

In oral evidence to the Treasury Committee, the FCA Chairman, John Wheatley, responded to a question about FCA enforcement activity:

Q7 Jesse Norman: You are clearly fining a lot more than you were and in much higher numbers. What about going after people who are responsible individually? What is happening with that? Are you commenting on your very widespread idea that some of the banks have got off scot free and when they pay fines it is ultimately the corporations who pay them, not the people who did the misdeed?

Martin Wheatley: Yes, I think that is a fair point. There is a significant widespread desire to see individuals—not just corporates—censured and fined. We have had this debate before in the context of the Banking Commission. The complication is very often the offences. Obviously if they are fraud, that is something the SFO can take forward, but if they fall short of fraud, there has to be a specific rule that has been breached. We found in a number of cases there was no a specific rule that would have applied to the individual who was below the level of the senior person's regime. That has been the construct. We are hoping that our proposals under the senior managers' regime will give us greater ability to take action against individuals.

Q8 Jesse Norman: You want to drive towards the situation where named individuals are responsible for business lines of activity, and if things occur in those business lines for which they should have exercised, or had, some nominal responsibility, they themselves could potentially be culpable.

Martin Wheatley: We want to move to situations where, as you say, the responsible manager will be held to have failed if he has not executed sufficient control and the individual will be fined as well. That would be a structure that we hope we will be delivering as part of our current consultation.

Q9 Jesse Norman: In other words, it is still the FCA's policy to shoot first and ask questions later?

Martin Wheatley: No. Our policy is very much that we are evidence-based. When we see something awry in the market, we will gather the information that we need to gather. We will take appropriate actions on that, which range from supervisory actions right through to enforcement actions.⁵

More information about the FCA's enforcement activity can be found in its Enforcement Annual Performance Account. The latest edition for 2013/14 can be found [here](#). It includes the following section on criminal sanctions and market abuse:

In 2013/14 we secured one criminal conviction for market abuse. We have secured four restraint orders under the Proceeds of Crime Act 2002 (POCA) to protect assets valued at over £806k. We also published a number of market abuse outcomes (discussed below).

Recovery of proceeds

21. We obtained four confiscation orders against individuals with a value over £2.6m. We participate in the Asset Recovery Incentivisation Scheme, which means that of the money confiscated, half goes to the Home Office while the other half is divided between the investigating, prosecuting and enforcement agencies. During the year we received 37.5% of the confiscation proceeds, as we act as both the investigator and prosecutor in insider dealing cases. This money is used to drive up performance on asset recovery and to fund initiatives to fight financial crime. In 2013/14, we received

⁵ [Oral Evidence](#), Treasury Committee; HC 635; 9 September 2014

around £700,000 through the scheme, which was used to purchase forensic and investigative equipment, contribute to ongoing investigations, support secondments to other regulators and provide software and staff training. In addition, confiscated money was used to support FCA educational and awareness work to prevent UK consumers from falling victim to financial crime.⁶

In the same period, fines for non-criminal actions included £1.37million on four individuals.⁷

For information about fraud and offences, readers are directed to look at the Library Paper written for the *Fraud Bill* (RP06/31).

2.2 Serious Fraud Office

When the FSA decides that an offence is serious enough, action is frequently taken by it in conjunction with the Serious Fraud Office (SFO).

It is difficult to tell where the boundaries of one organisation start and others end. At the risk of saying the obvious the SFO appears to become involved when the offence is considered serious. 'Serious' is explained in part on its website:

SFO's criteria for taking on a case

- By law we can investigate only those cases where there is evidence to show that serious or complex fraud, and corruption has taken place.
- To determine the seriousness and complexity of a particular matter then it may be useful to ask yourself the following questions:
- The key factors we consider before taking on a case:
- Does the value of the alleged fraud exceed £1 million?
- Is there a significant international dimension?
- Is the case likely to be of widespread public concern?
- Does the case require highly specialised knowledge, e.g. of financial markets?
- Is there a need to use the SFO's special powers, such as Section 2 of the Criminal Justice Act?

Serious and complex: what do we look for?

In addition to the above criteria we look for factors such as:

Is it serious?

- Whether the fraud will impact on the integrity of the financial market
- Whether there is a wider group than shareholders or creditors who have lost money as a result of the alleged fraud
- Whether the fraudsters have targeted financial institutions and government (local or central) or other public serving authorities

⁶ FCA; [Enforcement Annual Performance Account 2013/14](#)

⁷ FCA; [Enforcement Annual Performance Account 2013/14](#)

Is it complex?

- Whether the case involves multiple countries
- Whether the evidential material to be obtained during the course of the investigation will be found in multiple locations (within the UK or in other countries)
- Whether the case involves multiple and complex financial transactions - e.g. involving many companies, accounts, Trusts and countries
- Whether the investigation will need to involve a large accountancy analysis ⁸

An illustration of the complex nature of the boundary between the SFO and the FCA can be found on the SFO's website. As an example of its action it cites action against boiler room scams, but this is something which the FCA also regularly tackles. This implies that the SFO takes over from either the police or the FCA when things turn serious, but it is very difficult to say exactly when this happens.

2.3 Economic Crime Directorate (ECD)

Several of the police forces have their own ECD units. The City of London Police force is pre-eminent amongst them; its website says:

The City of London is the world's leading business and financial centre. Over 450 international banks are sited here, the City of London is the recognised world centre for the insurance industry and home to the headquarters of countless international corporations.

[...]

The Economic Crime Directorate (ECD), led by Detective Chief Superintendent Steve Head, is dedicated to preventing and investigating fraud at all levels. Its reputation for success is considerable - in 2007 seventy five per cent of crime investigated by the unit were cleared up.

City Police is the acknowledged lead force within the UK for economic crime investigation. Its expertise is sought internationally, for example in 2005 it contributed to fraud investigations taking place throughout Europe and Asia.

Latest estimates suggest that fraud costs the nation a staggering £30 billion a year. When the Government announced a National Fraud Review, City of London Police was invited to participate at the highest level - evidence of the Force's outstanding reputation in this area. This has enabled the Force to play an influential role in determining how fraud will be more effectively investigated in the future.⁹

Again, it is difficult to predict what crimes will come before the ECD and which would be purely FCA work. As was mentioned above they do consult and one suspects that a significant amount of intelligence passed between them. Obviously the police act only when they suspect a law is being broken – there are no 'rule' confusions here as in the FCA. But, since many cases will start with the FCA, who will have the knowledge of the case and the experience of the subject matter, then the ECD is unlikely to be the main agent in all cases.

⁸ [SFO website ret'd 2011](#)

⁹ [City of London Police](#)

It might need to be involved at some level, for example providing 'assisted entry to premises or locking people up' etc, but the FCA may retain the key prosecutorial role.

Clearly the police will have to step in if the crime is not within the FCA's jurisdiction. So:...

Hussein Ahmed-Alie and Grant Goss intercepted mail orders from clients to a gold acquisition company. City of London Police investigation ensures the pair exchange precious metal for prison bars.¹⁰...

is a police operation. Obviously, each ECD will primarily be responsible for its own geographical area and liaise with other forces as necessary.

2.4 National Fraud Intelligence Bureau

This is not a prosecuting body in its own right, rather a repository of knowledge which police and others can access. Its website says:

In 2006 the Government commissioned a National Fraud Review to assess the impact and scale of fraudulent activity across the UK. The review recognised that attempts to tackle fraud were being undermined by the lack of a joined-up approach to reporting, recording and analysing fraud. This was tied to the lack of a central repository for reports of fraud. These findings led to a new three-pronged approach to combating fraud:

The formation of the **National Fraud Authority (NFA)**, an umbrella government organisation to co-ordinate and oversee the fight against fraud.

The **City of London Police** was named the National Lead Force for fraud, giving them responsibility for setting up a centre of excellence for fraud investigation across the UK.

The creation of the National Fraud Reporting Centre (now branded as **Action Fraud**) and the **National Fraud Intelligence Bureau (NFIB)**.¹¹

The interesting feature on the website is its list of partners. This is a good list because it brings together many of the other agencies involved in this work. It can be found [here](#).

¹⁰ Ibid

¹¹ [National Fraud Intelligence Bureau website](#)