BRIEFING

DO BELIEVE THE HYPE: THE £59.5M FINE FOR LIBOR-FIXING REFLECTS AN UPWARD TREND IN FSA PENALTIES

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The fine of £59.5m imposed by the FSA on Barclays for its role in the Libor scandal was the biggest it has ever imposed. The publicity has enabled the FSA to portray itself as a ruthless regulator prepared to hand out ever-tougher penalties. But does this posturing reflect the reality? In this briefing we suggest that the evidence demonstrates that there has indeed been an upward trend of fines imposed by the FSA. The trend can be linked to a shift in policy taken in 2008, when the FSA announced it would pursue "credible deterrence". For now, the penalties in the UK remain far lower than those issued in the USA. But the aim of the FSA, and its successors, is to narrow the gap.

CREDIBLE DETERRENCE

Back in 2008 the FSA announced a new tough approach to its regulatory function. It declared that it would use fines, prohibition and criminal prosecution to achieve "credible deterrence". The CEO summarised the policy in this way: "*wrongdoers must not only realise that they face a real and tangible risk of being held to account, but must also expect a significant penalty*". In 2009, the CEO continued his theme: "*there is a view that people are not frightened of the FSA… this is a view I am determined to correct. People should be very frightened of the FSA*". As we will see below, the announcement of this policy has been more than just hot air. The introduction of "credible deterrence" has coincided with a significant increase in the penalties imposed by the FSA.

FINES AGAINST INDIVIDUALS: AN UPWARD TREND

The evidence suggests an upward trend for fines imposed by the FSA against individuals. The number of fines against individuals has increased from a total of 22 imposed in 2008/09 to a total of 50 fines imposed in 2010/11. From this high point the figure in 2011/12 has fallen back to 39. But the overall trend is upward, particularly when the size of the fines involved is taken into account. The aggregate level of fines has increased considerably, rising from a paltry total of £1.4m imposed in 2008/09 to £8.6m imposed in 2010/11. Most recently, the year 2011/12 saw a high point: an aggregate of £19.8m. The median fine against individuals for 2011/12 was £100,000.

FINES AGAINST FIRMS: AN UPWARD TREND

The number of fines imposed against firms has oscillated somewhat over the last ten years. 20 fines were imposed by the FSA against firms in 2011/12. This is only slightly higher than the number of fines imposed during the period of so-called "light touch" regulation in 2002-2009. A clear trend is therefore difficult to discern.

What is clear, and more alarming for firms, is the increasing size of the fines imposed. Before 2008 the aggregate of fines imposed was around £13m. This figure steadily rose to £26m in 2008/09, then to £31m in 2009/10. In 2010/11 the highest aggregate level of fines yet seen was achieved: some £90m. The most recent figures for 2011/12 show aggregate fines worth £58.7m. This reduction does not, we suggest, detract from the overall upward trend. (The figure of £90m for 2010/11 was somewhat unusual. In that year two fines totalling some £40m were levelled against J.P. Morgan and Goldman Sachs. These were the largest ever imposed by the FSA, and distorted the picture.) The overall trend is one of increasing aggregate fines. This is supported by the marked increase in the average level of fines. Back in 2008/09 the average was around £0.75m. That figure has risen to £3m for the year 2011/12.

FSA: NO MATCH FOR UNCLE SAM

The fines imposed by the FSA are, in general terms, far smaller than those imposed by the equivalent regulatory bodies in the USA, namely the Securities and Exchange Commission ("SEC"), the Office of Foreign Assets Control ("OFAC") and the Commodities Futures Trading Commission ("CFTC"). To take a few examples, in June 2009 the SEC imposed a penalty of $67.5m on an individual (Angelo Mozilo) for his misconduct in the sub-prime crisis. In October 2009, $92.8m was imposed on Raj Rajaratnam for his role in insider dealing. In 2010, Goldman Sachs agreed to pay $550m for the mis-selling of financial products. Similarly large fines have been imposed by OFAC. In 2009 OFAC imposed total fines of $772m, of which two of the fines were $217m and $536m, far in excess of any penalty yet imposed by the FSA. So far in 2012, OFAC has imposed fines of $621m, including the widely publicised $619m fine imposed on ING for sanctions breaches. As we will see below, the CFTC recently imposed a $200m penalty on Barclays for its role in the Libor scandal.

THE BARCLAYS LIBOR-FIXING FINE

An illuminating example of the trend in fines imposed by the FSA, which also illustrates the differences with the regime in the USA, is the fine recently imposed on Barclays for its role in the Libor fixing scandal. The penalty of £59.5m far exceeded the £33.3m fine previously imposed by the FSA against J.P. Morgan in 2010. This exemplifies the ongoing trend of increasing fines. It is, on any view, a substantial sum, but there are two obvious points to be made. First, the fine imposed by the FSA was far smaller than the fine imposed by the CFTC and the Department of

Jersey: PO Box 711, 2 Mulcaster Street, St Helier, Jersey JE4 OPR, Channel Islands, GB T. +44(0)1534 871701 F. +44(0)1534 615988
London: 218 Strand, London WC2R 1AT T. +44(0)20 7125 0417
E: info@stephenplattassociatesllp.com www.stephenplattassociatesllp.com

Justice. The total fine imposed by these bodies was $360m, around four times the FSA fine. Secondly, the fine represented only a tiny fraction of Barclays' profits for the year 2011. The fine represented 1% of global profits (which were £5.88bn in 2011) or 4% of UK profits (£1.42bn in 2011).

The point is that there is a lot of potential headroom for increased penalties. All the indications suggest that the FSA will increase the penalties which it levies and 'catch up' with its equivalents in the USA.

REVISED PENALTY FRAMEWORK

The majority of penalties so far imposed by the FSA were imposed before the "revised penalty framework" was introduced in 2010. The revised penalty framework was designed to improve transparency, to aid consistency and, importantly, to increase the level of penalties. It applies to conduct on or after 6 March 2010 and seeks to link the penalty to the amount of illicit financial benefit. The maximum penalty is up to four times the illicit benefit, or up to 20 per cent of relevant revenue (for firms) or up to 40 per cent of annual benefits of employment associated with the subject activities (for individuals). Only four penalties have so far been imposed under the new regime but the anecdotal evidence suggests it is operating as the FSA intended. The largest fine ever imposed on an individual by the FSA was recently imposed on Rameshkumar Goenka, who was ordered to pay $6.5m for manipulating share prices.

PREPARING FOR THE FUTURE

The FSA will be dissolved in 2013. It will be replaced by the Financial Policy Committee, the Prudential Regulation Authority and the Financial Conduct Authority ("FCA"). These organisations, no doubt keen to make their mark, will pick up where the FSA left off. Moreover, it appears that the role envisaged for the FCA, which includes consumer protection, will bring it more into line with the role of the CFTC. The more a regulator sees its purpose as being to protect the consumer, rather than to protect the broader system, the greater role deterrence has to play and the greater the potential for US-style penalties. For these reasons we believe the steady rise in penalties imposed by the UK regulator will continue. Avoiding or mitigating such a penalty will become ever more important. This can be achieved through:

- A detailed knowledge of the current regulatory landscape both at home and, where relevant, abroad. This is particularly important if the firm conducts business with the USA. As is well known, sanctions violations are treated extremely seriously and the penalties can be huge.
- A corporate structure which reduces the risk of regulatory breaches through a combination of effective oversight, up to date policies and procedures, and mandatory training
- An ability to identify regulatory breaches when they occur, and the adoption of a realistic approach for dealing with them, including a risk-based appraisal of whether to self-report and, if so, a strategy for mitigating the consequences.
- A strategy for dealing with the changes in the regulatory framework when the FSA is dissolved.

Stephen Platt

Jersey: PO Box 711, 2 Mulcaster Street, St Helier, Jersey JE4 OPR, Channel Islands, GB T. +44(0)1534 871701 F. +44(0)1534 615988
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E: info@stephenplattassociatesllp.com www.stephenplattassociatesllp.com