The Wheatley Review
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Friday 7 September 2012

Dear Sirs

GC100 Response to The Wheatley Review of LIBOR: Initial Discussion Paper August 2012

Introduction

I write on behalf of the GC100 group in response to the above Initial Discussion Paper (DP). As you may know, the GC100 is the association for the general counsel and company secretaries of companies in the UK FTSE 100. There are currently over 120 members of the group, representing some 80 companies.

The DP covers several areas. This response concentrates on the DP's comments on strengthening the sanctions against LIBOR manipulation, particularly the suggested option of broadening the criminal offence of misleading statements and practices under s397 of the Financial Services and Markets Act 2000 (FSMA) (paragraph 3.55 of the DP). We do not comment on the specific consultation questions.

Summary

The GC100 is generally supportive of the policy objectives canvassed in the DP of making LIBOR related activities subject to regulation as FSA regulated activities and subject to criminal sanctions.

However, the GC100 strongly opposes amending s397 in the way currently suggested in the DP. It is not necessary or proportionate to substantially broaden the existing s397 offences in order to achieve the policy objectives of making LIBOR manipulation subject to criminal sanctions. Such a change could have significant adverse unintended consequences, as explained below. In the GC100's view, any proposal to amend the existing s397 offences would be a significant matter requiring full consultation and costs/benefits analysis.

There are a number of potentially more appropriate and effective alternatives that would achieve the policy objectives, such as creating a separate offence (for example a new s397A) of misleading statements and conduct specific to LIBOR. The existing s397 offences should be left unchanged.

Section 397 FSMA

Section 397 covers misleading statements (or promises or forecasts) (s397(1)(a) and (c)), dishonest concealment of material facts (s397(1)(b)) and misleading conduct (s397(3)) undertaken for the purpose of inducing another person to take (or not take) certain action in relation to shares and other specified FSMA regulated investments and agreements, or with recklessness as to that outcome.

Section 397 contains two key mens rea components:

(a) the need for dishonesty, intention or recklessness in making the misleading statements or concealing the material facts (in the case of s397(1)); and

(b) the need to show that the statement or conduct was for the purpose of inducing behaviour by another person in relation to regulated investments (in the case of both s397(1) and s397(3)).

These requirements distinguish the s397 offence from:

(a) the civil market abuse regime, which generally focuses on the effect of the relevant conduct, rather than the subjective intention or purpose of the person responsible for the conduct (e.g. ss,118(5)-(8) FSMA). Section 397 is narrower in scope, consistent with the more severe criminal consequences attaching; and

(b) general criminal fraud offences, which do not require a connection to regulated markets or investments and are therefore not routinely the subject of investigation or prosecution by the FSA as regulator of financial markets.

Section 397 as a basis for LIBOR offences

The DP concludes that there is a gap in the existing criminal sanctions regime in relation to LIBOR. It suggests, as one option for bridging the gap, amending s397 by removing the requirement that the misleading statement or action must have been made for the purpose of inducing another person to act, i.e. removing the intention to induce element of the offence summarised in "*Section 397 FSMA*" above.

The GC100 strongly opposes amending s397 as suggested, because, as further described below, it would risk:

(a) undermining the clear connection of the offence to regulated financial instruments and markets;

(b) unintentionally criminalising behaviour beyond LIBOR manipulation;

(c) creating unnecessary legal uncertainty for business; and

(d) creating overlap with fraud offences.

Undermining the connection to regulated financial instrument and markets*:* Section 397 is essentially aimed at statements and actions which can influence investor behaviour in relation to regulated financial instruments and financial markets – for example, false profit figures which encourage an investor to buy a company's shares. Assuming that LIBOR related activities do

become FSA regulated, those activities would not of themselves be done with or for investors. The effect of misdemeanours in the course of such activities would therefore be quite different in nature from those covered by the existing s397 offences, requiring a correspondingly different structure for the relevant offence. The proposed deletion of the intention to induce element to try to achieve this different structure would have the effect of removing the connection to financial instruments and financial markets for the existing s397 offences and thereby significantly widening the scope of the regime.

Widening of criminal regime: If s397 (or any subsection, such as s397(3)) is amended by simply removing the intention to induce element, then knowingly or even recklessly making a misleading statement - about anything, whether or not relating to a listed issuer or a regulated investment - could constitute a criminal offence, regardless of the intended consequences or effect. This would result in a wide range of situations that currently are not subject to criminal sanction being criminalised. The legal and regulatory framework within which companies and individuals operate has a carefully calibrated set of sanctions and remedies for misleading statements – including civil claims for malicious falsehood or defamation, statutory liability for compensation (e.g. ss90-90A FSMA), and regulatory censure and civil penalties for market abuse or breach of the DTRs. The framework deliberately limits criminal liability to those scenarios where criminal sanctions are justified – e.g. for fraudulent representations made dishonestly for the purposes of making a gain or causing a loss (see the Fraud Act 2006) or where the statement has been made knowingly and for the purposes of inducing behaviour in relation to relevant investments by a market participant. This calibrated and proportionate regime would be undermined if making a false statement was criminalised, irrespective of what the false statement related to or what effect it had.

Legal uncertainty: The core ingredients of s397 have been in place since at least 1986 (earlier for s397(1)/(2)). Business and legal advisers are familiar with the provisions and the standards expected of companies. Amendment could introduce legal uncertainty in areas of day to day business activity for a range of companies which have nothing to do with LIBOR or other benchmarks. Indeed, it is questionable whether the suggested change might be incompatible with Article 7 ECHR (retrospectivity), a point which was debated in relation to the potential introduction of a general dishonesty offence by the Law Commission in 'Fraud', 2002.

Overlap with fraud offence: If it becomes an offence merely to make a statement which is known to be misleading in a material particular, then the s397 offence will be significantly broader than the offence of fraud by false representation (s.2 of the Fraud Act 2006), which requires not only (a) knowledge that the statement is misleading, but also (b) both dishonesty, and intention to make a gain or cause a loss. The effect of amending s397 in the way that is proposed would be to render the offence of fraud by false representation largely otiose. Such a dramatic broadening of the criminal law of fraud, and the abandonment of key mens rea elements, would require a very cogent rationale. As the Home Office stated in 'Fraud Law Reform', May 2006[1], in relation to general fraud offences, "dishonesty is a necessary, though not sufficient, ingredient of any fraud"[2].

Any of these outcomes would have potentially serious practical and legal risk management implications for business. They might also be difficult to justify under the Ministry of Justice's Criminal Offences Gateway Guidance on the creation of new criminal offences, under which

[1] Introducing the draft Fraud Bill that was subsequently enacted as the Fraud Act 2006.

[2] The Law Commission consultation paper ('Fraud', 2002), which was the predecessor of 'Fraud Law Reform' referred to the misleading statements offence in the following terms: "*Similarly, the crime of employing misleading market practices is now absorbed into the new statutory framework for regulating the financial services industry, following a long consultation period between the regulator and the regulated. The aim of the consultation was to produce detailed guidance to help draw the dividing line between sharp practice and criminal practice. Given the specialist setting of these crimes, this seems to be the most appropriate way to ensure that they are fair and comprehensive*".

Secretary of State must consider "the formulation of the individual offences proposed, in particular to consider whether they focus on the behaviours being targeted without criminalising behaviour more widely". Nor would changing the existing s397 offences be proportionate to the issue being addressed.

Alternative solutions

There are potentially more appropriate and effective alternatives to achieve the policy objectives. For example:

Create a new criminal offence for LIBOR manipulation, based on parts of s397 or on EU proposals for a benchmark related market abuse offence*:* Rather than amending s397, LIBOR manipulation could be criminalised through the creation of a new offence (for example, as a new s397A) which does not disturb the scope, application or effect of the existing offence. The new offence could be formulated in a way which does not require the false or misleading submission or information to have been made for the purpose of inducing behaviour by others in relation to relevant investments, but instead only to have been made knowingly or recklessly with the intention of manipulating or distorting the calculation of the benchmark. Such an offence could, for example, be based on either:

(a) the existing s397, but with a different purpose test to the one in s397(2)/(3) - i.e. the misleading statement or conduct being for the purposes of manipulating or distorting the calculation of a benchmark (or being reckless as to the same); or

(b) the July 2012 EU Commission proposals for bringing manipulation of LIBOR and other benchmarks within the scope of both criminal and civil market manipulation. The UK is not automatically bound by the relevant EU legislative proposal (Directive on criminal sanctions for insider dealing and market manipulation (CSMAD)). However, it could consider opting-in or, for an earlier and more flexible solution, introducing an equivalent new criminal offence without waiting for the EU proposals to be implemented. This would also avoid the creation of significant disparities between the regimes operating in different EU member states – 'level playing field' issues. (In suggesting this approach, we make no comment on the merits of the EU Commission's proposal or drafting.)

Rely on existing Fraud Act 2006 and other fraud law: The SFO has announced it is satisfied that existing fraud offences are capable of covering conduct relating to the alleged manipulation of LIBOR. To the extent, however, that there are nonetheless concerns as to whether the manipulation of LIBOR would be covered by the Fraud Act offences, then, if these stem from doubt as to whether an inaccurate LIBOR submission would constitute a "false representation", we note that the same issue could arise under the re-cast s397 offence (in demonstrating the misleading nature of the statement).

Reliance on the current criminal law (whether or not taking into account a reformed LIBOR setting process) could be coupled with an extension of the powers/practices of the FSA (and, in the future, the FCA) in relation to the prosecution of fraud (for example through the Financial Services Bill), in certain types of circumscribed situations. Whilst we do not consider that the FSA/ FCA should become a general fraud prosecutor, it might be possible to link additional prosecutorial powers/practices to criminal conduct which impacts the FSA/FCA's statutory objectives in relation to market confidence or financial stability, for example.

Any of these solutions seems preferable to amending s397 as suggested in DP.

We would be delighted to discuss these issues further with you.

Please note, as a matter of formality, that the views expressed in this letter do not necessarily reflect those of each and every individual member of the GC100 or their employing companies.

Yours faithfully

Mary Mullally
Secretary, GC100
0207 202 1245