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F. Services Pl.

Prime Minister 2

C. Clacheat/Lomas
cc/BG
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See particularly paras 14-18
and para 21 (very encouraging).

A meeting is being arranged.

DLT
9/12

PRIME MINISTER

FRAUD

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I thought you might
find it helpful to have a
synopsis, etc

Your Private Secretary's letter of 20 November asked for a paper on Fraud. This paper is attached. It has been prepared by the DTI in consultation with other Departments concerned. It takes a broad, rather than a legalistic view of what constitutes fraud. So it covers the whole range of our responsibilities for enforcing the law on probity and proper conduct of business activity, focusing in particular on the financial services sector. It does not cover the Police.

2. We have been concerned that our discharge of responsibilities should match public expectations of the required response to the problem. The legislative action in the Insolvency Act and the forthcoming Financial Service Bill are important elements. But we both need to make sure that we have adequate manpower to implement what is on the statute book.

3. There are four main areas where we propose extra manpower:-

a) The DTI's Inspector of Companies needs more staff to be able to handle the increased number of cases requiring action by his inspectors, including cases coming to him from the Fraud Investigation Group. Last year the Inspector had to consider 474 cases and accepted 120 for investigation; over the next two years the figures are likely to rise to 690 and 215 respectively. Seventeen

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Downskelter
this is
enough

extra staff are needed over this period (an increase of 50 per cent).

for an 80% increase in investigations.

- b) The DTI's Inspector General of the Insolvency Service needs more staff if his expert investigators are to make more impact on uncovering (and securing prosecution of) the wrong-doings which underlie the 12,500 compulsory liquidations and bankruptcies currently handled annually by the Service. In addition the procedures for disqualification of directors which Parliament obliged us to introduce into the Insolvency Act are more manpower intensive than the proposals we put. With current levels of cases the Service expects annually to have to handle returns covering 55,000 individuals involved in compulsory and voluntary liquidations and out of these to identify the perhaps 6,000 to 9,000 potentially disqualifiable directors and then to decide which of them to take to court for a disqualification order. An extra 152 posts in the Service are needed over the next 2 years (a 10 per cent increase). Efficiency measures should help to offset these increases by 125 posts over the same period and these savings have already been taken into account in the DTI Manpower target for 1 April 1988.
- c) In order to take the cases identified by the DTI's Inspector of Companies and the DTI's Inspector General of Insolvency Services through to prosecution and in order to handle cases coming direct from the new Securities and Investments Board the DTI Solicitors Department needs to be strengthened by 26 over the next two years (a 40 per cent increase in the DTI's prosecution staff).

d) The Director of Public Prosecutions has a major role to play once criminal cases have been detected. The DTI refers the more serious of its cases to the DPP. But he also receives cases from many other sources of which the most important is the Police. These tend to be the cases which attract most public attention and their handling has an important bearing on public confidence in enforcement procedures. Paragraphs 14-18 of the paper outline the extent of the DPP's manpower needs, namely 9 extra lawyers plus support staff (an increase of 75 per cent on current lawyer strength in the DPP's Fraud Division). Extra accountants and company investigators will be needed as part of the support staff.

4. The paper refers also the work of the DTI's Companies Registration Office - public disclosure is an important protection against fraud. The growing volume of work there is more than matching efficiency gains. The additional 100 staff agreed by the Treasury in 1984, which were due to be reviewed in the autumn of 1986 (and which are not provided for in our manpower target for 1 April 1987) will therefore need to be retained.

5. Many of the extra staff will be lawyers and company investigators. People with the necessary qualifications are much in demand. We have faced difficulties in attracting and retaining suitable staff. We must not hesitate to offer terms which allow us to meet our needs. We are, at the same time, trying to recruit a total of 300 extra lawyers for the Crown Prosecution Service.

6. We shall, of course, be discussing with the Chief Secretary the implications of these proposals for manpower and gross running costs limits. The DTI's manpower ceilings will need increasing by 255 at 1 April 1987 and 295 at 1 April 1988. The DTI's running cost limit needs to be increased by £2½m for 1986/87. No addition to the DTI's PES provision for 1986/87 will be needed since the additional gross cost should be met by the forecast increases in receipts at the CRO and the Insolvency Service. The DPP is still discussing with the Treasury the manpower and running cost provisions for his Department in the form in which it will exist from 1 April 1986 with the creation of the Crown Prosecution Service; no net increase in lawyer manpower is envisaged.

7. We are sending a copy of this minute and paper to the Chancellor of the Exchequer, the Lord Chancellor, the Attorney General, the Chancellor of the Duchy of Lancaster, the Home Secretary and Sir Robert Armstrong.

L. B.

PM

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P M

Department of Trade & Industry

Law Officers Department

9 December 1985

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This paper examines the present arrangements for combating fraud, including the achievements of the Fraud Investigation Group (FIG), describes the further improvements in hand, including those to be promoted by the Financial Services Bill, and notes that the report of the Roskill Commission on the conduct of fraud trials is expected shortly. The paper is mainly concerned with fraud where the victims are in the private sector (or abroad), not fraud against Government Departments, eg tax or state benefit fraud. (The Revenue Departments operate under their own legislation which, generally speaking, gives them greater investigating powers than the police.)

BACKGROUND

2 There is no statutory offence of fraud: most prosecutions are for offences against the Theft Act which covers obtaining money by deception. Fraud is not easily defined: whereas the aggrieved creditor is likely to cry fraud even when there was only recklessness, it can be hard to persuade juries of fraudulent intent.

3 There is widespread concern that 'financial fraud' is a serious problem damaging the City's reputation, largely generated by a few spectacular cases, especially when a prosecution appears delayed. There is also a widespread suspicion that a lot of fraud escapes detection or prosecution altogether, and that this may encourage its growth. Increasing public concern over fraud is likely to be a continuing source of embarrassment for the Government.

4 Although the present arrangements for combating fraud are complex they are an integral part of the regulatory pattern. They involve Government Departments (Trade and Industry, Treasury, the Home Office, the Lord Chancellor's Department, the Law Officers and the Director of Public Prosecutions), the Bank of England, Registry of Friendly Societies, the Police, professional bodies (such as the Law Society, the Institute of Chartered Accountants in England and Wales) and existing self-regulatory bodies (such as the Stock Exchange and Lloyd's). The growth of financial conglomerates poses special problems for regulators, and some of these relate to the prevention of fraud. A group established under DTI Chairmanship including the Treasury, Bank of England and the Securities and Investments Board, to ensure cooperation and coordination between regulators will consider these problems and a report will be made to Ministers by the end of the year.

DTI'S RESPONSIBILITIES IN RELATION TO FRAUD

5 The DTI's powers and responsibilities can be divided broadly into 7 categories:

- (a) wide general responsibilities to investigate fraud and misconduct, carried out by companies registered in Great Britain (and certain other Northern Ireland and foreign bodies deemed to be companies for the purposes of the Companies Act) whatever the nature of their business - with specific responsibilities through the duty placed upon official receivers to



investigate causes of the failure of companies against which winding up orders are made;

- (b) a power to petition the court to wind up a company on public interest grounds;
- (c) powers to apply to the court for the disqualification of company directors;
- (d) the operation of the Companies Registration Offices where companies are required to file accounts and other documents relating to their business primarily in order to enable creditors and prospective creditors to assess their credit-worthiness;
- (e) general responsibilities towards consumers;
- (f) far more specific responsibilities to protect those dealing with certain traders subject to special regulation, eg insurers, dealers in securities;
- (g) powers dealing with the qualification of auditors (and after the Insolvency Act has come into operation) insolvency practitioners - although action against their misconduct remains primarily a matter for the professional bodies concerned.

6 The responsibilities of the other departments and bodies concerned, although as important, tend to be more specific than those of the DTI eg the Registry of Friendly Societies is concerned with the solvency of building societies and those insurers who carry on business as friendly societies, the Bank of England with deposit institutions other than building societies. The Stock Exchange and Lloyd's (which has its own Act) deal with the regulation of their markets. Combined with the widespread concern over the Johnson Matthey Bankers affair and the problems at Lloyd's in the early 1980s there is a growing wave of criticism that the as yet unpublished Financial Services Bill will be inadequate, either because it will propose an inherently inferior substitute for statutory regulation on the model of the US Securities and Exchange Commission, or because whatever the merits of self-regulation they have to be backed up by a more vigorous and extensive scale of Government investigation and prosecution than has ever taken place, or it is alleged, is ever likely to be mounted.

OBJECTIVES

7 In exercising its existing powers and in designing improvements the DTI has the following objectives :

- (a) to deter offenders generally: the DTI needs to be seen as an effective prosecutions department;
- (b) wherever practicable to protect the public from the consequences of offences already committed:



- (c) where the risk of repetition is serious, to "disable" the offender (eg by imprisonment or disqualification).

8 The main improvements - some undertaken by bodies other than the DTI - are described below.

ACTION TO INCREASE SCALE OF DTI INVESTIGATION

9 Ministers are considering whether to increase the number of DTI specialists and other staff handling company fraud and insolvency work. At present around 500 complaints per year lead to 100 enquiries under Section 447 of the Companies Act. The number of complaints is expected to rise. The intention is that the Department should be able to investigate and take effective action on an anticipated increase in company fraud cases and that Official Receivers should be able to devote more time to investigation of company and bankruptcy cases believed to conceal fraud and to deal with disqualification work expected to result from the new powers under the Insolvency Act 1985. (See para 10 below) There are, however manpower and expenditure implications as well as the practical obstacles to recruiting specialist lawyers and investigators of the required calibre.

NEW INSOLVENCY ACT

10 The Insolvency Act will introduce the following relevant changes :

- ?
- (a) it will enable the Secretary of State or Official Receiver to apply to the court for the disqualification of a company director for unfitness after he has been involved in only one receivership or insolvent liquidation; [disqualification reports would probably be justified in some 3000 cases a year but because of resource implications and possible political considerations it is proposed to set as a realistic target 1000 applications a year, but this will require some extra staff]
- (b) where a company in insolvent liquidation has been judged by the court to have been trading wrongfully the liquidator may be able to recover part of the deficiency from the directors concerned; and
- (c) various considerations of procedure made possible by the Act will enable better use to be made of specialist manpower directed to the investigation of fraudulent trading and other criminal activities and investigation of directors conduct for disqualification purposes. (see (a) above).

BENEFITS TO COME FROM THE FINANCIAL SERVICES BILL

11 The Financial Services Bill will include several measures to help deter, detect and punish fraud:



- (a) it will extend the requirement to be authorised to all kinds of investment business; contravention will be a criminal offence, one relatively easy to prove;
- (b) it will supplement the Government's resources by private sector resources of the Designated Agency (the "Securities and Investments Board") and the Self-Regulating Organisations, paid for by authorised businesses;
- (c) it will enable the Designated Agency to recruit the necessary number and quality of staff, free from Government constraints over staff numbers, salary levels and costs;
- (d) it will draw upon the expertise of practitioners to spot fraud and malpractice more easily and to tackle it more quickly;
- (e) it will retain and extend existing criminal offences in this area while placing greater reliance on civil sanctions where the standard of proof is less demanding and the scope for rapid action greater;
- (f) in particular it will allow the Secretary of State or the Designated Agency to go to court to get injunctions and "restitution orders" (which will recover illegitimate profits for investors who have suffered loss);
- (g) there will also be a range of intermediate sanctions falling short of withdrawal of authorisation, and civil remedies for investors;
- (h) compensation schemes funded by authorised businesses will protect investors and provide a spur to vigorous enforcement. (Reputable businesses will be keen to encourage enforcement in order to reduce claims on the compensation schemes);
- (i) wider investigation powers will be extended to cover all investment businesses, to question and to obtain documents; the Designated Agency will be able to use its powers against authorised businesses and connected persons, while the Secretary of State will be able to use the powers more widely; there will also be wider powers to investigate insider dealing;
- (j) prosecutions will be reserved to the Secretary of State and DPP, but the Designated Agency will be able to use its resources to assist with investigations; and
- (k) statutory obstacles to the exchange of information between various regulators of financial services (including the Bank of England) will be removed.



EFFORTS TO IMPROVE COMPLIANCE AT CRO

12 One important protection against fraud is public disclosure. Last year, the Public Accounts Committee severely criticised the DTI for having allowed large numbers of companies to be in default of their obligations under the Companies Act to file annual returns and annual accounts. The Committee strongly disapproved of reductions in staff numbers at CRO at a time when new companies were being incorporated at an unprecedented rate. Mr Tebbit secured extra staff resources for this work and gave it a new priority. Since then there has been a steady improvement in compliance levels, though there is still a long way to go before it reaches an acceptable level. Despite big improvements in productivity, if the register continues to grow at the current rate, more staff will be needed to maintain a high level of compliance and ready access to the information by the public.

INCREASED VIGILANCE BY AUDITORS

13 The DTI is seeking to persuade the auditing profession that their members should be more ready to report fraud. Where they discover or suspect fraud by employees they should continue to report it to the management, who are responsible for dealing with it. Where it looks as if company directors are themselves involved the auditors should be prepared to report it to the DTI.

FRAUD INVESTIGATION GROUP

14 The Fraud Investigation Group (FIG) was established on a formal basis in January this year. The term FIG is the collective name for two divisions in the office on the DPP, and it also describes the mechanism employed for dealing with certain major frauds. Under the Chairmanship of the Controller of FIG, it aims at close and early cooperation between police, investigators from the DTI, lawyers in the DPP's office, accountants and other appropriate experts. The objective is to concentrate on major offences and major offenders, to terminate unfruitful enquiries as soon as possible and to investigate those cases likely to proceed to trial as effectively and quickly as possible.

15 One or more of the following elements are usually found in FIG cases :

- (a) frauds on Government departments or local authorities;
- (b) large scale shipping or currency offences;
- (c) frauds on foreign governments;
- (d) an international dimension;
- (e) frauds on nationalised industries and public limited companies;



- (f) frauds by persons connected with Lloyd's, the Stock Exchange and other commercial exchanges; and
- (g) the involvement of well-known public figures.

16 At present 34 cases are being dealt with on a FIG basis. Of them, 11 have been committed for trial, of which one concluded successfully at Oxford Crown Court and another is now proceeding at the Central Criminal Court.

17 A third division in the DPP's office deals with non-FIG frauds, but such is the volume of serious frauds reported that a number of these non-FIG cases have to be dealt with by the two FIG divisions. The increase in this volume can be gauged by the fact that in November 1984, the Director had 26 serious fraud cases awaiting trial while he now has 77.

18 The Director of Public Prosecutions has expressed grave concern as to the adequacy of his present manpower resources to meet these increased demands on his Fraud Division and the Solicitor General shares that concern. At present, the average case load for a professional officer on one of those Divisions is 34 active cases. Accordingly, the Director has sought Treasury authority for an increase of 9 in the number of professional officers (together with a corresponding increase in support staff) for those Divisions. This request has been made in the context of the Director's proposal to the Treasury as to future manpower requirements following re-structuring of his Department to form the Headquarters of the Crown Prosecution Service. If authorised the result would not be an increase in the overall strength of his legal staff but a smaller reduction that would otherwise have resulted from the re-distribution of prosecution business and the delegation to local offices of work presently undertaken by the DPP.

LLOYD'S

19 Considerable progress has been made by the Council of Lloyds's over the better regulation of the Lloyd's market and it would be mistaken to interpret Mr Davison's recent much publicised resignation as chief executive as implying that these reforms will be abandoned. Lloyd's main insurance business is not within the scope of the Financial Services Bill because - as explained in the White Paper - it consists almost entirely of non-life insurance, which does not fall within the Bill's definition of investment business. However underwriting agents at Lloyd's do necessarily undertake other investment business as part of their insurance business - managing names insurance funds and soliciting new names - and this will be specifically exempted in the Bill, since they are matters for Lloyd's itself to regulate.

THE NEW BANKING BILL

20 The Police have now confirmed that they have discovered evidence of fraud upon Johnson Matthey Bankers in 1981 though concern about fraud amongst banks more generally is not as acute as it is for other financial sectors. The new arrangements



being proposed in the forthcoming White Paper on banking supervision, while not being directed at fraud as such, should make it harder to perpetrate and also reduce the risk to depositors when it does occur. In particular, new arrangements for disclosure of information between the Bank of England, auditors and other supervisors should help to detect fraud at an earlier stage. Rules about the amounts lent to individual borrowers or related groups of borrowers should help protect depositors where fraudulent losses do occur.

FRAUD TRIALS

21 The Roskill Committee is expected to present its report to the Lord Chancellor and the Home Secretary before Christmas. There is reason to suppose that it will recommend wide-ranging measures to reform the criminal proceedings relating to fraud trials. This is likely to have a significant effect on the climate in which these matters are discussed and to present the Government with a considerable opportunity for effective action. DTI Ministers regard it as essential that the report is published before the second reading of the FS Bill.

CONCLUSION

22 The constantly changing pattern of fraud requires a flexible response from the authorities, including legislative change. The forthcoming Financial Services Bill will form a major part of this response and contains the legislative improvements already stated this year with the Insolvency Act. The increasing scale of fraud poses a serious resource problem for Government - in terms of staff numbers, quality and cost. The DTI is therefore, in parallel with the Solicitor General, putting forward proposals for increases in resources to deal with this problem.

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