

Corporate crackdown

As a result of the Criminal Finances Act 2017, there are new risks for directors, officers and their insurers.

Jonathan Newbold & Marlene Henderson investigate.

The recent implementation of the Criminal Finances Act 2017 (CFA 2017) marks the latest legislative crackdown on corporate financial crimes. CFA 2017 has extended the powers of law enforcement agencies to recover the proceeds of crime (including tax evasion, money laundering and terrorist financing) and introduced a strict corporate accountability. The additional scrutiny on corporations and their senior management team is likely to have a knock on effect for directors and officers (D&O) policy holders and their insurers.

CFA 2017, which came into force on 30 September 2017, is fine tuning the approach towards financial crime and extending the powers set out in the Proceeds of Crime Act 2002. The driving force behind CFA 2017 was growing concern about levels of tax evasion and a lack of accountability by senior management.

What does CFA 2017 cover?

In short, and most significantly for businesses, there are two new offences under CFA 2017. By virtue of Pt 3 of CFA 2017, companies and partnerships incorporated or operating in the UK will be held criminally liable for any failure to prevent 'an associated person' from facilitating UK or non UK tax evasion, even where the company and its senior management were not involved or aware of the tax evasion. 'Associated person' under CFA 2017 has been widely defined as a 'staff member or external agent or person performing services for or on behalf of the company' and in practice could extend to anyone connected with the business provided they are acting as an associated person of that business.

The sanctions if a company or partnership is found guilty of failing to prevent the facilitation of UK tax evasion offences can be an unlimited (ie a potentially hefty) fine and/or a criminal prosecution.

There is an important defence businesses can fall back on. The business can avoid liability if it can show it had reasonable prevention procedures or can demonstrate that it was not reasonable in the circumstances to expect the company to have any prevention procedures in place.

Practical measures

HMRC has issued guidance naming six



general principles on the reasonable steps companies should follow including regular risk assessments, commitment from top level management, training and monitoring. In practice, the steps that are taken should be proportionate to the size and type of company and it will be for the management team to assess the risk they face and decide what reasonable and proactive controls are required to prevent its staff, agents and service providers from facilitating tax evasion. Financial and legal sectors have been flagged as the high risk sectors for tax evasion but it seems that as a minimum all organisations (including SMEs) will be expected to undertake a risk assessment to assess the risk of tax evasion and facilitation in their day to day work.

Impact on D&O and corporate entity liability policies

The CFA imposes a new strict vicarious liability on corporate bodies but no vicarious responsibility on the individual persons. However, the CFA is likely to indirectly impose additional duties upon the directors and officers to implement and adhere to internal procedures to prevent tax evasion. This creates a potential exposure for both D&O insureds and insurers as a breach of CFA 2017 will amount to a 'wrongful act'.

For insurers, CFA 2017 increases the prospect of claims and investigations against the corporate entity which will fall for consideration under the corporate entity liability policy. There is also a potential risk that directors may face claims by investors and shareholders for failing to discharge their statutory duties in respect of the prevention of tax evasion and this could trigger cover under the D&O policy depending on the policy cover for claims made by connected persons. However, this type of recovery by an entity against the individuals is not without difficulties as demonstrated in the case of

Safeway v Twigger [2010] EWCA Civ 1472, [2010] All ER (D) 245 (Dec) where Safeway brought proceedings against several former directors and employees responsible for infringements of the Competition Act 1998 for the fine and investigation costs incurred by the company. The Court of Appeal considered this claim infringed the *ex turpi causa* rule (the rule that prevents a claimant from recovering a loss suffered as a result of his own illegal act) and unanimously barred Safeway from bringing a claim against its employees. The court in this case did not have to deal with a strict liability offence. Perhaps it will depend on whether CFA 2017 is considered sufficiently morally reprehensible and important to public policy to engage the *ex turpi causa* rule.

If HMRC investigates using its powers under CFA 2017 any sanctions will be levied against the corporate entity but the enquiries could be directed at individuals within senior management particularly if the business elects to enter into a deferred prosecution agreement. Management liability policy holders will seek to rely on insurers to advance defence costs although any HMRC fines or penalties will not typically be covered by the policy. There may also be cover under the D&O policy for internal investigations or pre-investigation costs into suspected tax fraud depending on the terms and conditions of the policy. Clearly any director who is knowingly and deliberately involved in criminal financial crimes such as the facilitation of tax evasion is likely to be captured by the standard exclusion in any D&O policy for fraudulent or dishonest acts. However, the exclusion will not necessarily bite if a company or partnership is found to be in breach of CFA 2017 despite having no awareness or knowledge and then seeks to hold its directors and officers, who were also unaware but failed to do more, responsible.

Comment

This piece of legislation reflects the regulatory appetite to tackle financial crime and businesses need to consider carefully the adequacy of their current prevention procedures and policies. For larger risks, we expect insurers will be making increasingly detailed enquiries into the procedures and processes prospective insureds have in place to prevent financial crime before coming on risk. Corporate entities (irrespective of size) will need to engage with the legislation and HMRC guidance to avoid potential liability. **NLJ**

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