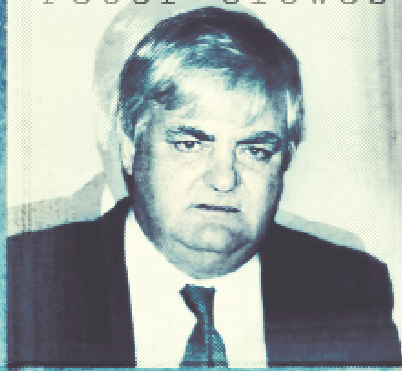
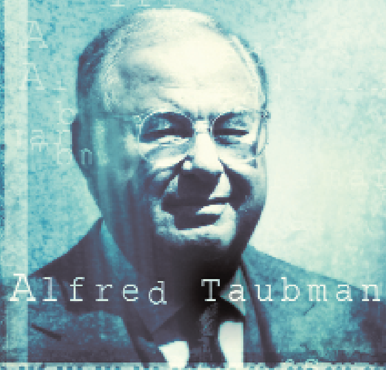
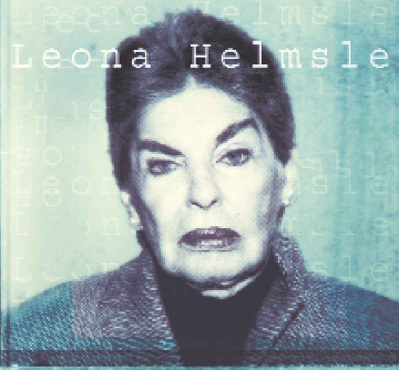
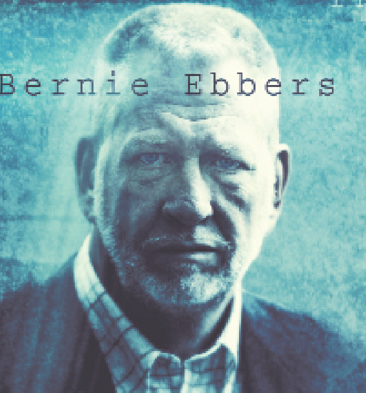
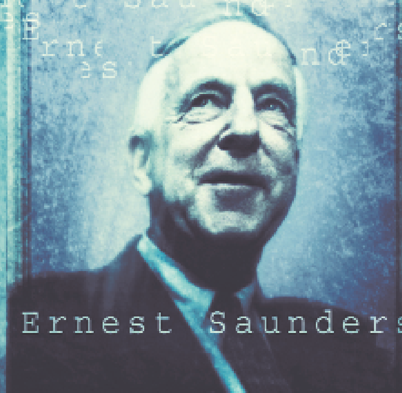










Financial regulators are imposing increasingly harsh penalties on firms and directors that fail to protect their investors' interests, writes **Neil Hodge**. But do the punishments always fit the crimes?

WATCHDOG WATCH

On July 13 the former chief executive of WorldCom, Bernie Ebbers, was jailed for 25 years for his part in the scandal that brought down his telecoms company. It was a wake-up call for every business leader in the US.

Ebbers, once called "the symbol of 21st-century America" by Bill Clinton, was found guilty of fraud and conspiracy in March after an $11bn accounting swindle was uncovered at WorldCom in 2002. The 63-year-old was also found guilty of seven counts of filing false documents.

As she passed sentence, federal judge Barbara Jones said that he was "clearly a leader of criminal activity in this case", adding that "a sentence of anything less would not reflect the seriousness of the crime".

Ebbers was also forced to surrender most of his assets, including $5m in cash, to resolve a civil lawsuit brought by shareholders. The settlement left his wife with about $50,000 and a modest home in Jackson, Mississippi.

The company's collapse was the biggest bankruptcy in US corporate history. About 20,000 people lost their jobs and the shareholders lost $180bn when it filed for bankruptcy protection. Ebbers was the first of six former WorldCom executives and accountants to be sentenced. The other five had pleaded guilty and co-operated in the case against their former boss.

The US financial watchdog the Securities and Exchange Commission (SEC) has sharpened its teeth over the past few years. It has needed to. Two decades ago the biggest fine it could slap on a company was the laughable sum of $100 a day – and only then for a failure to file reports on time. Until 1984, the SEC had to rely on court injunctions to enforce compliance with securities laws. Since then, a whole series of scandals have encouraged the legislators to increase its ability to punish errant companies. The $10m fine it imposed on Xerox in 2002 was the largest civil penalty for an issuer in a financial fraud action. Two years later it forced Banc of America Securities to pay the same amount, merely for being unco-operative.

But the WorldCom settlement – $2.2bn, including a $750m fine – has raised the stakes to another level entirely, especially in view of the fact that the SEC has also got far tougher with

ALFRED TAUBMAN

In the mid-nineties, leading auction houses Sotheby's and Christie's conspired to fix their commission rates. Taubman, Sotheby's chairman, was jailed for a year in the US and fined $7.5m in 2002 for his part in the scheme, which is said to have cost art sellers more than $400m. Passing sentence, judge George Daniels said: "His was not a crime motivated by desperation and need but by arrogance and greed."

Sir Anthony Tennant, Christie's chairman at the time of the collusion, cannot be extradited to the US for an anti-trust case, but faces arrest if he returns there.

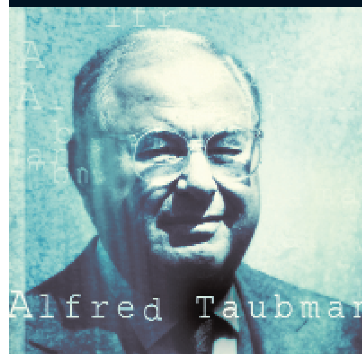


Illustration: Tim Ashton

individuals. In the three years to 2003, the number of company directors it barred from holding office more than quadrupled.

The SEC's push for better corporate governance and greater accountability seems to have prompted its counterparts on the other side of the Atlantic to toughen up, too. The UK's Financial Services Authority (FSA) has been wielding a bigger stick lately, for example. Its largest punitive action to date is the £17m fine it slapped on Shell in August last year for breaching listing rules and overstating the extent of its oil reserves. The regulator has been busy handing out penalties ever since. In May it fined Abbey £800,000 for mishandling claims from customers that they had been mis-sold endowment mortgages. The next month it fined Citigroup Global Markets £13.9m for both "failing to conduct its business with due skill, care and diligence" and "failing to control its business effectively on the European government bond markets".

In October the former chief executive of software firm AIT, Carl Rigby, was jailed for three and a half years for misleading the market. It was the FSA's first successful contested prosecution under the Financial Services and Markets Act 2000 and was widely seen as a warning that the FSA is no soft touch.

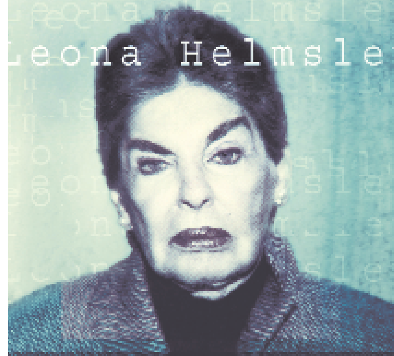
Yet justice has not always been seen to be done. Because UK companies and oversight bodies prefer regulation through principles rather than rules, watchdogs have often tended to make deals. If the firm at fault immediately puts its hands up and tries to right its wrongs – usually without admitting responsibility – there is usually a minimum of naming and shaming.

One such deal occurred last Christmas Eve. The FSA brokered an agreement with a group of financial services firms to compensate clients who'd been mis-sold a split-capital investment trust because they hadn't been told that the share classes could be worthless at the end of the trust's life. It's estimated that 50,000 people lost at least £600m through these vehicles, which the FSA had deemed "relatively secure". The authority and 18 of the 22 firms involved agreed a package of £194m for private investors who'd held certain products at any time between July 2000 and June 2001. (Another of the implicated providers, Teather & Greenwood, later agreed to contribute £300,000.) This settlement was £23m more than the figure the 22 firms had said they were prepared to pay, but nearly £156m less than what the regulator had deemed an "acceptable amount" in May 2004.

The FSA denies that it was strong-armed into reducing the fund by such a huge amount, although it admits that "private investors may be the losers". The deal also meant that none of the 19 firms would admit to any wrongdoing, and that the FSA would not pursue any regulatory breaches or impose extra penalties on those involved. With the exception of a couple of token individuals whom the watchdog wanted to make examples of (one was 71 years old and chose to retire), the other fund managers involved in the fiasco are likely to have been given "private warnings" at the most.

The FSA's handling of the affair was widely derided as a fudge. According to Vincent Cable, shadow chancellor for the Liberal Democrats, it was "no way to establish a principle of deterrence for mis-selling. Given that the FSA has been thought to be rather weak in its handling of things such as endowment mis-selling, this was an opportunity to be tough. But that has not happened."

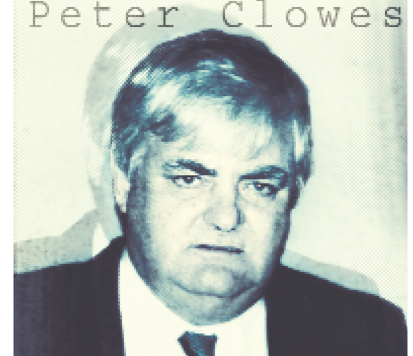
Furthermore, the FSA's attempts to take a harder line on poor corporate governance and mis-selling backfired massively



LEONA HELMSLEY

The property tycoon who once said "only the little people pay taxes" was sentenced to 16 years and fined $7m for fraud and tax evasion. The case centred on the lavish redecoration of her home in the mid-eighties. The costs ran into millions, but many of the bills went unpaid. Some of the contractors sent invoices to the press to show that her personal expenses were being written off as business costs. Charges against her husband, Harry, were dropped because of his poor health, but she was convicted on 33 counts.

Following her release on appeal after serving only 18 months, she retained control of the Helmsley empire, inheriting $1.7bn when Harry died in 1997.



PETER CLOWES

Clowes was sentenced to ten years in 1992 for his role in one of the UK's most notorious savings industry scandals. Thousands of investors lost their life savings when his investment company, Barlow Clowes, was closed by the DTI in 1988. It cost the government £150m to compensate the victims. Months after his early release in 1999, he was back behind bars after being caught claiming unemployment benefits while working.

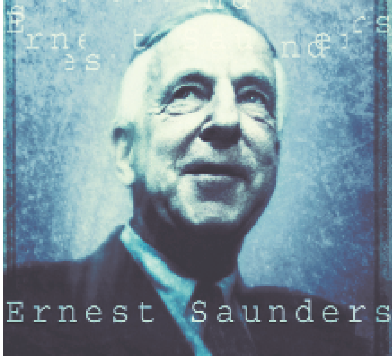
John Connolly, the auditor for Barlow Clowes who was officially reprimanded for lacking professional competence, is now one of the UK's highest-paid accountants in practice in his capacity as CEO of Deloitte.

ONE THAT GOT AWAY: AZIL NADIR

Nadir started as a rag-trade entrepreneur, became the darling of the City and ended up as a fugitive from the fraud squad. He expanded his Polly Peck empire during the eighties and the firm's share price rocketed. But in 1990 his own stockbrokers lodged a bankruptcy petition against him. Polly Peck collapsed the next year, after the Serious Fraud Office began to probe Nadir's finances. He fled the country in 1993, facing 66 charges of theft from the company, and sought refuge in his native northern Cyprus, which has no extradition agreement with the UK.

In 2003 he vowed to return, claiming that the charges were "baseless", but the case hasn't been dropped. He's thought to be still living in Cyprus.

Photographs: original pictures from Reuters, Getty and Empics



ERNEST SAUNDERS

Along with Anthony Parnes, Jack Lyons and Gerald Ronson, the former Guinness CEO was convicted of illegally boosting the firm's share price during its 1986 takeover of United Distillers.

Their scheme came to light when US arbitrageur Ivan Boesky was arrested and named them as part of a plea bargain. Saunders was jailed in 1990 for five years but his sentence was cut in half on appeal. He was released after ten months when doctors found that he was suffering from pre-senile dementia associated with Alzheimer's disease.

Saunders then became a successful consultant, helping to promote Carphone Warehouse before its flotation. He later claimed that the symptoms diagnosed as dementia were the result of taking a "cocktail of tranquillisers and sleeping pills".

NICK LEESON

The Singapore-based trader at Barings Bank brought down one of the world's oldest financial institutions by racking up an unauthorised debt of £860m on the futures market. He went on the run in 1995 when the bank found the hole in its finances, but he was soon arrested in Germany and extradited back to Singapore. While he was in prison, his wife left him and he was diagnosed with colon cancer.

Following his release after four and a half years, Leeson made a living on the after-dinner speaking circuit. His book, *Rogue Trader*, netted him an estimated £200,000 and was made into a film. Now living in Ireland with his second wife and son, he is the commercial manager of Galway United Football Club. He recently published a second book, *Back from the Brink: Coping with Stress*.

at the start of the year. It was forced to overhaul its enforcement procedures when the Financial Services and Markets Tribunal, the independent body that hears appeals against FSA decisions, upheld only part of the regulator's endowment mortgage mis-selling verdict against Legal & General and ordered the £1.1m fine to be cut by nearly half.

The UK accounting and auditing profession has long been criticised for its failure to detect, act on or inform investors of potential problems in company accounts. Prem Sikka, professor of accounting at the University of Essex, says that accountancy regulation in the UK is "ludicrous".

Sikka points out that Robert Maxwell's former auditor, Coopers & Lybrand, was fined only £1.2m and forced to pay costs of £2.1m for failing to flag up the late media tycoon's fraudulent activities, while much of the responsibility was "pinned on a dead auditor". Two deceased auditors took most of the blame for audit failures at Polly Peck, while the Cyprus-based conglomerate was fined only £75,000. In June 2004, Bird Luckin, the former auditor of hotel chain Queens Moat Houses, was fined a paltry £17,000 for allowing the company to portray a £1bn loss as an £90m profit in 1991 by recognising the following year's earnings in the current year, capitalising its maintenance expenditure and showing that loss-making properties had somehow generated a profit.

The FSA's attempts to take a harder line on poor corporate governance and mis-selling backfired massively at the start of the year

Sikka says that one of the main barriers to effective regulation is the sheer number of watchdogs in existence. The UK's accountancy profession, for example, has 22 bodies overseeing different aspects of auditing and accounting. Some of these have only recently started investigating companies' accounts before investors lose their money, rather than waiting for grievances to be registered. For example, the Financial Reporting Review Panel (FRRP), once widely seen as a sleepy guardian of published accounts, took a more proactive approach in 2004 – a full 15 years after it was established. Previously the panel, which has the power to make UK-listed companies restate their accounts, would wait until receiving complaints, usually from individual investors, before looking into a particular set of figures, or would feel compelled to act only if the media reported potential problems. Now it reads annual reports as they are published and conducts random compliance checks.

The FRRP's investigatory powers are still restricted to the statutory accounts. The panel is prohibited from considering other financial material provided in the accounts, such as directors' reports or the chairman's statement. It can ask directors to explain apparent departures from normal accounting requirements and try to "persuade" them to use a more appropriate treatment. But the FRRP has yet to prosecute a single case in court and its £2m legal fund has never been touched.

There are also questions as to whether the composition of the FRRP is truly independent and capable of acting in the best interests of stakeholders. Ian Brindle, its deputy chairman, is a former chairman of PwC. Of the other 24 panel members, eight are either partners or former partners of the big four – the very firms it is supposed to be scrutinising. A further seven are either former or current finance directors of companies such as BAE Systems, Tesco and Barclays Bank, whose accounts are among those that the panel is supposed to check.

It would seem, therefore, that financial regulation in the UK is not as effective as it might first appear. Sikka sums up the problem neatly. "The UK is infamous for having gentlemen's agreements issued through private warnings instead of proper regulation," he says. "It really is a case of chaps regulating chaps. Proper accountability and transparency are still a long way off." **FM**

Neil Hodge is a freelance business journalist.