

## Deterring Economic Crime: Introducing a Failure to prevent fraud

The UK is a global epicentre for fraud and money laundering. Our best guestimate places the cost of fraud and money laundering at £350 billion, which is equivalent to our annual health and education budgets combined.

In June of 2022, the Law Commission recommended that the Government reform its corporate liability regime and introduce a new 'failure to prevent' offence. Failure to prevent offences hold companies criminally liable if they fail to prevent their employees (or any associated person) from engaging in certain criminal activities, unless they can demonstrate that they had reasonable measures in place to prevent such crimes from being committed.

In response to the Law Commission's recommendations, the Government brought forward new amendments to the Economic Crime Bill, which reforms the rules for holding companies liable (known as the 'identification doctrine') and introduce a new offence for companies that fail to prevent fraud. While these are all welcomed, the current proposal by the Government falls short as the new failure to prevent offence only applies to large companies as defined in the Companies Act 2006.

**Recommendation:** Lord Garnier intends to introduce an amendment limiting the Government's exemption of SMEs from the failure to prevent fraud offence to only micro companies, so that almost all businesses are encouraged to ensure they have appropriate prevention mechanisms in place, so they are not used as a vehicle for fraud.

### Why we need good failure to prevent provisions

'Failure to prevent' clauses were first introduced in the Bribery Act 2010 and were then expanded to the Criminal Finances Act 2017 with the failure to prevent facilitation of tax evasion offence. This means that businesses must prevent their employee, or any person associated with them from facilitating tax evasion.

Failure to prevent offences are particularly effective to combat economic crimes because they ensure that the burden of proof is on a business to prove it has reasonable procedures in place, rather than the burden being on the prosecutor to prove it did not, as under the criminal provisions for anti-money laundering regulations. 'Failure to prevent' offences are hailed as an effective tool to combat economic crimes, for the following reasons.

**'Failure to prevent' acts as a deterrent.** The threat of strict liability for companies who engage in fraud can act as a strong deterrent and encourage a culture shift. A strong example can be found in the 1974 Health and Safety legislation, which made construction site managers and their companies guilty of an offence if it was committed with the consent, connivance, or neglect of a senior officer. This meant that construction companies and their directors could be held criminally liable for deaths or injuries on their sites. According to Minister Hollinrake, this resulted in a 90% drop in deaths and serious injuries.

### Why the Government's amendment does not go far enough

**Only very large companies are covered.** The Government's proposed amendment to the Economic Crime Bill introduced a failure to prevent fraud offence which only covers large corporations to 'avoid disproportionate burdens on SMEs and support economic growth'. However, it is unclear on what basis this decision has been made:

- **Given the existing framework, the SME carve-out is misdirected.** As worded, the offence already contains a defence for a company to argue that it was not reasonable to expect the body to have any prevention procedures in place. It is open to the Government to

make clear in guidance issued for the offence, what reasonable procedures would be proportionate for SMEs, and, in what circumstances, it would be reasonable not to have them at all.

- **The SME exemption would create discrepancies with other existing regimes**, including for offences such as those for failure to prevent bribery or the facilitation of tax evasion—which do not contain the same exemptions for SMEs. In the UK, SMEs represent 99% of all businesses and account for almost half of the UK’s turnover.
- **These policies can protect SMEs.** Having policies against committing fraud may also help companies of all sizes avoid becoming a victim of fraud. In 2022, 64% of UK businesses **experienced** fraud, corruption or other economic crime - much higher than the global average of 46% and second only to South Africa. Public sector bodies in the UK, meanwhile, **lose** £33-58 billion a year from fraud. SMEs are far more likely to be victims of fraud – so encouraging them to adopt preventative procedures would help reduce it.
- Government **research** on SME adoption of preventative procedures in relation to the Bribery Act found that the average cost to an SME was £2,730. In addition, the Government acknowledges **in its impact assessment** that the exclusion of SMEs would ‘reduce the possible benefits and the potential for culture change’. You can read more about the SME carveout in the **‘Spotlight on Corruption and CIFAS’ Q&A on the issue**.