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# Criminal Responses and Financial Misconduct in Twenty-first Century Britain: tradition and points of departure, and the significance of the conscious past

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# CRIMINAL RESPONSES AND FINANCIAL MISCONDUCT IN TWENTY-FIRST CENTURY BRITAIN: TRADITION AND POINTS OF DEPARTURE, AND THE SIGNIFICANCE OF THE CONSCIOUS PAST

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## Abstract

The Financial Services (Banking Reform) Bill 2013/14 (hereafter Banking Reform Bill) is set to introduce a new criminal offence of reckless misconduct by senior bank staff. The introduction of such an offence was recommended in the Final Report of the Parliamentary Commission on Banking Standards (PCBS) *Changing Banking for Good*, published 19 June 2013; as part of a 'package of recommendations to raise standards'.<sup>2</sup> This particular recommendation had been widely anticipated. A short time before this Report, the PCBS Chair, Andrew Tyrie MP, had bemoaned the lack of 'orange jumpsuits' being donned by bankers.<sup>3</sup> Equally, press reportage that 'reckless bankers' could 'face jail' had started to appear from as early as the close of 2011.<sup>4</sup> Government endorsement of the PCBS recommendations followed quickly from the publication of the latter's report. On 8 July 2013 the Government Response to the Report to this effect signalled that this would be achieved by adding amendments to the Banking Reform Bill 2013/14, first introduced in Parliament 4 February 2013. This has now transpired, by virtue of amendments to the Bill introduced on 9 October 2013. Like the initial PCBS recommendation, government support for the new criminal offence was also widely anticipated. Government favour for such a measure had been strongly signalled in the Treasury Consultation *Sanctions for the Directors of Failed Banks*, published in July 2012.<sup>5</sup> It had been signposted earlier still by very public declarations of support from Matthew Hancock, MP, a close ally of George Osborne, the Chancellor of the Exchequer.<sup>6</sup>

At one level, this new criminal offence is intended to be very narrow in application, and enforced only very exceptionally. In other respects, analysis of it through the current proposals<sup>7</sup> show it to be a manifestly important measure which will alter the longstanding

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<sup>2</sup> Parliamentary Commission on Banking Standards Final Report, *Changing Banking for Good*, (London, HMSO, 19 June 2013); see <http://www.parliament.uk/bankingstandards>, accessed 17 November 2013.

<sup>3</sup> See Susanna Rustin 'Andrew Tyrie: fresh from the HBOS debacle, now serious about reform' *The Guardian*, 20 April 2013.

<sup>4</sup> See for example 'Reckless Bank Chiefs Could Be Sent To Jail' *Sky News*, at <http://news.sky.com/story/916019/reckless-bank-chiefs-could-be-sent-to-jail> [accessed 17 November 2013].

<sup>5</sup> HM Treasury *Sanctions for the directors of failed banks* (hereafter, Treasury Consultation), (London: HMSO, 2012).

<sup>6</sup> Matthew Hancock MP, 'The right are right to challenge rewards for failure' Speech, Policy Exchange 12 January 2012, <http://www.matthewhancock.co.uk/campaign/matthew-hancock-mp-right-are-right-challenge-rewards-failure> [accessed 17 November 2013].

<sup>7</sup> On 19 November 2013 the Banking Reform Bill 2013/14 is due to move to the Report Stage. On 26 November 2013, it is timetabled for the House of Lords. See <https://www.gov.uk/government/publications/banking-reform-bill-government-notes-on-amendments> [accessed 18 November 2013].

course of criminal liability for 'financial sector' crime in Britain.<sup>8</sup> It is also part of the discourse of the post-crisis regulatory environment encouraging reflection on the past in configuring responses for the future; including suggestions that too little attention has been paid to 'lessons of history'.<sup>9</sup> In exploring aspects of both these distinctive angles, attention is paid to how nineteenth-century responses were themselves informed by contemporary Victorian understanding of a 'conscious past'. Little work has been undertaken on how Victorian responses to financial crime were influenced by a conscious past and the article considers why the introduction of the reckless conduct in banking offence creates such an appropriate juncture for doing so. This is in the light of our own awareness of how criminal law has responded to financial misconduct for over 150 years, and what new approaches might be required to respond to the regulatory challenges of the early twenty-first century.

**Keywords:** Banking sector reform, criminal liability for misconduct in banking, financial sector crime, criminal law, history and the Victorian legacy.

## Introduction

### ***'Financial meltdown' and the contextual origins of the 'reckless banking offence'***

The origins of the offence of reckless conduct by senior bank staff (or, as it can be found informally termed, the 'reckless banking offence') lie in the global 'financial meltdown' of 2007-8.<sup>10</sup> This is widely regarded as having arrived in Britain on 14 September 2007. It followed from BBC reports the previous day that the North-East lending giant, Northern Rock, had sought emergency financial support from the Bank of England. As early as 7am on 14 September, long queues became visible outside the lender's branches and its telephone switchboard and online facilities became jammed. As the subsequent Treasury Select Committee Report on the failure of Northern Rock explained, Northern Rock's highly risky business model which was 'excessively reliant on wholesale funding', was both regarded as being symptomatic of wide-spread debt finance practices, and would also ensure that the institution could not avoid becoming caught up in the global squeeze on credit which started to solidify during the summer of 2007.<sup>11</sup> Becoming known as the 'credit crunch', this had its own origins in the US sub-prime mortgage crisis, commencing with cuts

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<sup>8</sup> This terminology can be found proposed as part of a broader exercise in definition of 'financial crime' by the International Monetary Fund, *Financial System Abuse, Financial Crime and Money Laundering*, Background Paper, (Washington DC: IMF, 2001), para.7.

<sup>9</sup> This was because banking crises *had* occurred before: see Sir Mervyn King, 'The Today Lecture 2012' BBC Radio 4, 2 May 2012, at [http://news.bbc.co.uk/1/hi/today/hi/today/newsid\\_9718000/9718062.stm](http://news.bbc.co.uk/1/hi/today/hi/today/newsid_9718000/9718062.stm) [accessed 17 November 2013].

<sup>10</sup> See, for example, William James and Matt Scuffham, 'UK's "reckless banking" charge to carry seven-year jail term' *Reuters News*, 1 October 2013; David O. Friedrichs, 'Wall Street: Crime Never Sleeps', in Susan Will, Stephen Handelman and David Brotherton (eds), *How They Got Away With It: White Collar Criminals and the Financial Meltdown* (New York: Columbia University Press, 2012), p.7.

<sup>11</sup> Treasury Select Committee Report, *The run on the Rock* (hereafter, Northern Rock Report) HC 2007-8, 56-1) p.5. Available at <http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtreasy/56/56i.pdf> [accessed 17 November 2013].

in interest rates during 2001-3, pursued by then Chairman of the Federal Reserve, Alan Greenspan, in response to concerns about economic downturn.

Greenspan's strategy had led to lending institutions targeting mortgage provision to low income households in a setting where much encouragement was given to this politically, and where the relaxation of the traditional financial and structural thresholds entailed in home purchasing were cast aside. This encouraged lending activity, bolstered by belief that house price rises would continue to accelerate. This, in turn, was emboldened by patterns of growth from the early part of the decade and long-term patterns showing no national price fall since the Depression years of the 1930s. As lenders embarked on their zealous pursuit of this low income market, investment bankers started to purchase these mortgages from them and package them into debt-based investment instruments/vehicles. These were modelled on patterns of mortgage default rates as well as historic house price patterns. In spring 2007 reports of significant losses started to hit US investment banking, and its 'spill over' effect became manifested in Libor rates confirming banks' reluctance to lend to one another.<sup>12</sup> This prompted the European Central Bank to pump 94 billion euros of liquidity into the European banking system. Subsequently, Mervyn King, then Governor of the Bank of England, insisted that 'lender of last resort' assistance would be made to any bank experiencing short-term difficulties from what then appeared to be extreme, but short-lived conditions.<sup>13</sup>

Northern Rock's difficulties derived from two factors. First, how it had come about that by the end of 2006, 89.2% of its assets were located in residential mortgages. Second, how it was that its continuing expansion of mortgage activity was achieved largely through wholesale borrowing combined with securitisation or 'packaging' of mortgages as collateral for further funds. This course was pursued whilst Northern Rock sought to diversify its assets through expanding its overseas market-base, but without foreseeing that once markets in mortgage-backed securities had closed, it would be left 'absolutely unable to finance...wholly illiquid assets'.<sup>14</sup> Subsequently, the Treasury Select Committee criticised both Northern Rock's 'fatally flawed' business model of using wholesale funding to achieve continuing growth in the mortgage market, and also the then City watchdog, the Financial Services Authority

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<sup>12</sup> The so-called 'inter-bank' lending rate which provides a formal measure of the cost of this inter-bank lending, setting out the average rate banks pay to borrow from one another.

<sup>13</sup> See Mervyn King, Letter to the Treasury, 12 September 2007; also the Bank of England's own reflections on this function actually directed towards Northern Rock, in its news release (jointly with Tripartite partners) 'Liquidity Support Facility for Northern Rock plc', 14 September 2007.

<sup>14</sup> The Northern Rock Report, p.18.

(FSA) for systematically failing in its regulatory duty 'to ensure that Northern Rock would not pose a systemic risk'.<sup>15</sup>

Criticisms of banking intensified following Northern Rock's demise. These criticisms focused particularly on the way in which a number of institutions became identified with the lexicon of being 'too big to fail' on account of being considered a 'systemical institution':<sup>16</sup> an institution whose failure would pose a threat to the overall stability of the financial system underpinning the whole economy.<sup>17</sup> Partial public ownership would follow for institutions including Northern Rock and the Royal Bank of Scotland (RBS), and would narrowly be avoided for others such as Halifax Bank of Scotland (HBOS). The difficulties experienced by these institutions would also influence a further lexicon of the global 'financial meltdown' of the early twenty-first century; that of 'socially useless banking'.

## **1 Current Concerns and Signposting the Significance of a 'Conscious Past'**

As originally conceived by Lord Adair Turner, when FSA Chairman, 'socially useless banking' sought to describe institutions which had become too swollen and too focused on profit-making to be beneficial for society.<sup>18</sup> Lord Turner did subsequently qualify this as being intended to provoke debate on banks' importance to the achieving of benefits for the real economy and thus human welfare; thereby revising his criticism as being of 'economically useless' banking.<sup>19</sup> However, this was a very public rebuke to banking practices. It was also one which became indicative of the very strong identification of the financial crisis with banking malpractice, and of actual misconduct by individual bankers. Following the crisis, bankers would be forced to claim that the sector had engaged in a period of 'remorse and

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<sup>15</sup> Ibid, p.3.

<sup>16</sup> See Treasury Select Committee Report *Too Important to Fail: Too Important to Ignore* Ninth Report of Session 2009-2010; 261, Vols I and II, for numerous references to the 'too big to fail "problem"'. This includes Lord Turner's response to questioning from then Chairman John McFall, II, 2 March 2010, Q460.

<sup>17</sup> Such institutions can often be found referenced as 'systemically important financial institutions, or 'SIFIs', with further delineation as 'domestic' and 'global' systemically important institutions: for an example of the former see Annotated Financial Services (Banking Reform) Bill 2013/14, in discussion of clause 142Y (2), and reflections on the latter in The Financial Stability Board, *Policy Measures to Address Systemically Important Financial Institutions* (Basel: 4 November 2011), and see also Bank of England *Systemic Risk Survey: Survey Results* (2013: H1)

<sup>18</sup> Lord Adair Turner, Speech, Mansion House, London, 22 September 2009.

<sup>19</sup> Lord Adair Turner, 'What Do Banks Do' Speech, Cass Business School, London, 17 March 2010, at [http://www.cass.city.ac.uk/\\_data/assets/pdf\\_file/0006/77136/Adair-Turner-March-2011.pdf](http://www.cass.city.ac.uk/_data/assets/pdf_file/0006/77136/Adair-Turner-March-2011.pdf) [accessed 17 November 2013].

apology'.<sup>20</sup> There would be concerns about how quickly banking appeared to be rehabilitated following this, largely channelled through reportage of how investment banking once again started to generate huge rewards.<sup>21</sup> This did not sit comfortably with how regulators sought to refute claims that opportunities to seek real and lasting reform of the banking sector were not being taken seriously in policy circles, and to insist instead that the 'once-in-a-lifetime' crisis *would* generate the new regulatory directions required in its aftermath.<sup>22</sup>

In this vein, official reports on RBS in 2011 and HBOS in 2013 echoed closely the direction of the 2007 scrutinising of Northern Rock. In 2012, Fred Goodwin, the RBS former CEO, was stripped of his knighthood: and a year earlier, the FSA Board had issued a damning verdict on RBS and its 'extremely risky' practices, as well as on the apparent legal lacuna exposed by the institution's failure.<sup>23</sup> The verdict included the point that it appeared, from the fact that no individual had been found legally responsible for the failure, that 'action cannot be taken under existing rules'. If this was so, then surely rules for the future had to be changed.<sup>24</sup>

The Treasury Select Committee Report on Northern Rock had also signalled a further dimension to regulators' interest in securing appropriate levels of reform in the light of the crisis. In the very midst of the crisis, it had been remarked that 'the most notorious bank run in British history took place in May 1866 at the time of the collapse of Overend, Gurney and Co'.<sup>25</sup> This had been presented very much as a lesson in the causes and consequences of systemic failure.<sup>26</sup> The extent of regulators' regard for history in their search for responses for the future is unclear, and they do not acknowledge the intellectual debates attached to history's possible applications for the present and future.<sup>27</sup> But references to history and allusions to the importance of being 'historically aware' as new directions are being configured *have* continued. Mervyn King's reference in 2012 to how more attention needed

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<sup>20</sup> Mark Garnier, Question 35; Bob Diamond, Oral Evidence, Treasury Committee, 11 January 2011, uncorrected, to be published as HC 612-vi). Diamond was then CEO of Barclays.

<sup>21</sup> Rowan Williams, 'Time for us to challenge the idols of high finance' *Financial Times*, 1 November 2011.

<sup>22</sup> Andrew Haldane and Vasileios Madouros, 'The Dog and the Frisbee' Speech, Federal Bank of Kansas Economic Policy Symposium, Wyoming, 31 August 2012, pp.23-24. Madouros was a Bank of England economist, at <http://www.bankofengland.co.uk/publications/Documents/speeches/2012/speech596.pdf> [accessed 17 November 2013].

<sup>23</sup> FSA Board, *The Failure of the Royal Bank of Scotland* (hereafter, RBS Report), (London: 2011) para.4.10.

<sup>24</sup> *Ibid*, p.6.

<sup>25</sup> The Northern Rock Report, p 8.

<sup>26</sup> Lord Turner, Foreword, *Ibid*, p.6.

<sup>27</sup> For example, John Tosh, *The Pursuit of History: Aims, methods and new directions in the study of modern history* (Harlow: Longman, 2010).

to have been paid to the 'lessons of history' in the lead up to the events of 2007 provides what is, in many ways, an iconic illustration of this.<sup>28</sup> Sometime earlier, post-crisis reflections from the FSA included reactions of Susan Dewar (then Head of Wholesale) critiquing the Hegelian adage that 'if history teaches us one thing, it's that history teaches us nothing'.<sup>29</sup> Although clearly bruised from the failure of Northern Rock and from the stinging criticism it received at the hands of the Treasury Select Committee in 2007, the then City regulator's regard for the past and its significance had marked similarity with the 2007 Report. Ms Dewar insisted that whilst the cyclical nature of scandals *would* continue 'to rock the financial system to its very core' it is vital to try to learn from the past.<sup>30</sup> These reflections from regulators, however such figures regard history intellectually, are ones encouraging engagement with a conscious past as attention is paid to mapping out future directions.

For the significance of this to become more readily apparent there is a requirement to return, initially, to the official reports generated by troubled banks following the crisis. That which reflected on the difficulties experienced by HBOS was conducted under the auspices of the PCBS, and published in April 2013.<sup>31</sup> The PCBS's findings of 'colossal failure of senior management and the Board' were couched in explanations that whilst HBOS had avoided partial public ownership, this was only on account of its purchase by Lloyds Banking Group and taxpayer assistance.<sup>32</sup> It was found that HBOS had avoided actual financial failure *in spite of* its executives being incapable even of understanding – let alone managing – the risks of aspects of its investment business. The PCBS had concluded that this ensured the institution's downfall was an 'accident waiting to happen'.<sup>33</sup> But this report will probably be best remembered for the full-frontal attack on three HBOS executives, serving to illustrate the PCBS's contention that anyone presiding over 'downfall' of this magnitude should be barred from again holding a position in any regulated entity within the financial sector.<sup>34</sup> The personal attack on these three named executives resulted in Business Secretary Vince Cable being tasked with investigating whether disqualification proceedings could be pursued.<sup>35</sup> This very public reckoning for the HBOS executives led its former CEO Sir James Crosbie to 'hand in' his knighthood in April 2013. It is also significant for a further reason;

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<sup>28</sup> King, 'Today Lecture 2012'.

<sup>29</sup> Sally Dewar, 'Tackling financial crime in the current economic climate', Speech, Annual Financial Crime Conference, 27 April 2009, at <http://webarchive.nationalarchives.gov.uk/http://www.fsa.gov.uk/> [accessed 17 November 2013].

<sup>30</sup> *Ibid.*

<sup>31</sup> PCBS, '*An accident waiting to happen: The failure of HBOS* (hereafter, HBOS Report 2013) Fourth Report of Session 2012-13, HL Paper 144/ HC 705.

<sup>32</sup> *Ibid.*, especially paras.107-110; 115-116.

<sup>33</sup> With this providing the PCBS with its title for the HBOS Report 2013.

<sup>34</sup> *Ibid.*, para.141h.

<sup>35</sup> See Graeme Wearden, 'Vince Cable looks at banning former HBOS directors' *The Guardian*, 7 April 2013.



one which relates more directly to this article. It took place as the PCBS was working towards its final report, having earlier (in December 2012) invited views on numerous proposed changes to the regulation of the UK banking system, including 'how the law, including criminal...sanctions, applies to banks and bankers'.<sup>36</sup>

## 2 New Criminal Liability: Initial Stimulus and Concretisation

The PCBS had itself been appointed in July 2012 in the wake of the Libor-fixing revelations. Appearing in June 2013, these revelations re-centred 'banker blame' for the crisis, following a period of some anxiety about just how quickly banking appeared to resume 'business as usual'.<sup>37</sup> This all cast further doubt on the sincerity of the banking community's claims that it had understood that the crisis had undermined public trust in it, and that rebuilding this would require bankers becoming 'better citizens'.<sup>38</sup> The remit of the PCBS was to consider and report on the 'professional standards and culture of the UK banking sector...and to make recommendations for legislative and other action'.<sup>39</sup> This intervention had been necessitated by revelations of how the Libor scandal, alongside those associated with Payment Protection Insurance (PPI) and interest rate swap mis-selling, had demonstrated 'a widespread failure of competence in the banking industry' and also 'a failure of professionalism and ethics'.<sup>40</sup>

The recommendations ultimately made by the PCBS in 2013 were grouped thematically under four broad headings. It was under the heading of 'strengthening individual accountability' that the creation of a new criminal offence of reckless misconduct for senior bankers was located.<sup>41</sup> In accepting this recommendation, the government identified how this would subsist as part of a package of initiatives. Those would cluster around a tough new 'Senior Persons' regime for governing the behaviour of senior bank staff, within a setting where it would become more difficult for bank bosses to avoid liability for breaches occurring within their areas of responsibility. This was together with the introduction of banking standards rules for all bank staff, in order to promote higher standards across this community.<sup>42</sup>

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<sup>36</sup> PCBS, *First Report of Session 2012–13*, HL Paper 98, HC 848, December 2012, p. 7, with other key matters for the Commission's concern identified as 'How banks compete...run themselves...[and]...are supervised and regulated', pp.7;10.

<sup>37</sup> See Williams, 'Time for us to challenge'.

<sup>38</sup> Bob Diamond, Inaugural Today Business Lecture, BBC House, London, 3 November 2011.

<sup>39</sup> See <http://www.parliament.uk/bankingstandards> [accessed 17 November 2013].

<sup>40</sup> Government Response to the Parliamentary Commission on Banking Standards (hereafter, Government Response to PCBS), Cm 8661, London, 8 July 2013, paras1.3; 1.5.

<sup>41</sup> *Ibid*, para.1.5, with the other three headings identified as reforming corporate governance; securing better outcomes for consumers through enhanced competition; and enhancing financial stability.

<sup>42</sup> *Ibid*, para.1.6; 1.54.



Prior to the publication of the PCBS's final report, the Libor scandal had already precipitated new criminal law in England and Wales, through s.91 of the Financial Services Act 2012. This legislation had brought the 'twin peaks' regulatory regime formally into existence, through the inception of the Prudential Regulation and Financial Conduct Authorities (PRA and FCA respectively) to replace the FSA.<sup>43</sup> The 2012 Act also relocated and extended liability for 'criminal market abuse'.<sup>44</sup> This was formerly located in s.397 of the Financial Services and Markets Act (FSMA) 2000.<sup>45</sup> However, the 2012 Act, under s.91, created a new criminal offence of manipulation of 'benchmarks'.<sup>46</sup> As far as the 'reckless banking' offence is concerned, whilst recommendation for it *did* ultimately come from the PCBS, government interest in such an initiative was of longer standing. It had formally first been publicised in 2012, in the Treasury Consultation *Sanctions for Directors of Failed Banks*. The Treasury set out in this a government intention to ensure that 'bank directors and senior management take full account of the downside risks for their institutions' in furtherance of its undertaking to reform banks and to reduce 'risks to the economy and the taxpayer'.<sup>47</sup> The Treasury Consultation also insisted that the FSA Report on the failure of RBS had been significant in this regard. It was noted that at one level, this Report had been focused on 'regulatory sanctions and measures' in redressing 'currently absent' liability for executives and Board members for 'the adverse consequences of poor decisions'.<sup>48</sup> However, it had also 'stimulated interest in the possibility of new criminal sanctions for misconduct in bank management as a further way of shifting the balance between risk and reward for bank directors'.<sup>49</sup> The RBS Report dating from December 2011 had, of course, been published some time earlier than the PCBS's castigation of HBOS. Thus by late 2012, proposals for extending criminal liability were already on the PCBS's agenda. But the Treasury Consultation also made a much more important point for this article's interest in future directions and a conscious past.

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<sup>43</sup> See for example, Hector Sants, 'Delivering "twin peaks" within the FSA', Speech, British Bankers' Association Briefing, London, 6 February 2012, at [http://webarchive.nationalarchives.gov.uk/\\*/http://www.fsa.gov.uk/](http://webarchive.nationalarchives.gov.uk/*/http://www.fsa.gov.uk/). [accessed 17 November 2013].

<sup>44</sup> As commonly referenced by the FSA during its lifetime. See for example, Notice, "FSA secures convictions in first criminal market abuse case", /PN/091/2005 18 August 2005, at [http://webarchive.nationalarchives.gov.uk/\\*/http://www.fsa.gov.uk/](http://webarchive.nationalarchives.gov.uk/*/http://www.fsa.gov.uk/) [accessed 17 November 2013].

<sup>45</sup> By virtue of ss 89 and 90 of the Financial Services Act 2012.

<sup>46</sup> With the origins of this being the Wheatley Review: see Martin Wheatley, *The Wheatley Review of LIBOR – Final Report* (London: HM Treasury, 28 September 2012) at [http://cdn.hm-treasury.gov.uk/wheatley\\_review\\_libor\\_finalreport\\_280912.pdf](http://cdn.hm-treasury.gov.uk/wheatley_review_libor_finalreport_280912.pdf) [accessed 17 November 2013].

<sup>47</sup> Treasury Consultation, para.1.5.

<sup>48</sup> RBS Report, p.9.

<sup>49</sup> Treasury Consultation, para.4.1.

### 3 Established Criminal Liability, New Directions and the Conscious Past

In identifying government interest in new criminal liability sanctions for 'serious misconduct in the management of a bank', the Treasury Consultation acknowledged that such a development would entail crafting an offence which 'would not necessarily involve any element of dishonesty when it is committed'. As such, it would raise a number of complex issues in its introduction and even in its formulation.<sup>50</sup> The Consultation continued to illuminate this by explaining that whilst the criminal law had enjoyed a lengthy and important role in 'providing a sanction for improper behaviour in the financial services sphere', such offences as existed did not 'cover matters such as negligence, incompetence or recklessness or other forms of purely managerial misconduct'.<sup>51</sup> This was illustrated by reference to fraud and related 'dishonesty' offences and to insider dealing and making misleading statements. The offence of fraud under the Fraud Act 2006, and others located within that legislation, embodied the long-standing requirement of proof of dishonesty for criminal liability to arise. In similar vein, insider dealing and 'criminal market abuse' are regarded as very serious criminal offences where the predominant requirement is for misconduct to be intentional/deliberate for liability to arise.<sup>52</sup> With the influencing forces of RBS readily apparent, the Consultation explained that any such new criminal liability would be attached to institutional failure, and would arise *only* in this setting.

From this, the Consultation identified four possible ways in which this liability could be framed.<sup>53</sup> In doing so it also assessed the relative merits of strict liability arising automatically by being a director of an institution which fails; negligence where liability follows from failure in a duty of care resulting in a reasonably foreseeable outcome; incompetence, from the failure to follow professional practices/standards; and recklessness where liability embodies failure to have sufficient regard for the dangers posed to the safety and soundness of the firm concerned or for the possibility that there were such dangers.<sup>54</sup> In signalling government preference for recklessness, the Consultation identified the desirability of fault-based liability, because whilst strict liability was likely to be a strong incentive to failure-avoidance, imposing severe criminal penalties on individuals who were not plainly at fault

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<sup>50</sup> Ibid.

<sup>51</sup> Ibid.

<sup>52</sup> See Michael Ashe and Lynne Counsel, *Insider Trading* (London: Tolley, 1993), pp.71-2; Margaret Cole, Speech, Introduction to the FSA Enforcement Conference, London, 22 June 2010, at <http://webarchive.nationalarchives.gov.uk/http://www.fsa.gov.uk/> [17 November 2013]. Cole was then FSA Director of Enforcement. But it is here noted that acts of market abuse *can* be committed recklessly courtesy of offences now located in ss.89 and 90 of the Financial Services Act 2012 where the thrust of these offences is strongly that of conduct which is intentional/dishonest.

<sup>53</sup> Treasury Consultation, para.4.3.

<sup>54</sup> Ibid.

would be controversial.<sup>55</sup> Furthermore, the ‘egregious character of recklessness’, would surely ‘at the very least...make bank directors think twice before taking certain decisions’.<sup>56</sup> But the Consultation also explained that criminal liability which could be established from banking conduct falling short of being deliberate/intentional presented problems. This was so given that banking inherently and unavoidably involves taking risks, with much of this premised on how investment decision-making was forward-looking and judgement-based, rather than involving the application of exact science.<sup>57</sup> In identifying how ‘defining recklessness or excessive risk taking by bank management requires a clear idea of what would constitute normal or non-excessive risk taking’ the Consultation made some attempt to interface with the necessity of risk-taking for economic and societal well-being, but this was tacit at best, and largely unspoken.<sup>58</sup>

This formed part of the Consultation’s presentation of the key issues arising which both acknowledged that the criminal law had a lengthy and important tradition in sanctioning financial sector misconduct, and also that its use in this context had an equally noteworthy tradition of being difficult to apply. Banking, and particularly that engaging directly with risk-taking (like much complex financial transactional activity), was likely to involve a number of different elements occurring over a period of time, making difficult any process establishing both the persons responsible and the causation.<sup>59</sup> This thereby ensured that investigations and prosecutions would be both time-consuming and very costly.<sup>60</sup> The task of ‘assembling evidence’ would thus be a huge undertaking, in the light of the size and complexity of the financial institutions concerned, and the prosecutorial obligations flowing from the Code for Crown Prosecutors. From this it could be expected that such investigations and prosecutions would run into years rather than months.<sup>61</sup> However, the Consultation’s observation that the existence of such liability was likely to make bank officers ‘think twice’ in making decisions provided early indication that any such liability introduced was likely to be narrowly drawn and enforced only very exceptionally. It was always ever going to arise in the context of institutional failure. The government, in responding to the PCBS recommendation for such an offence, has clarified that liability would only ever apply to senior executives, by aligning it specifically with the introduction of a new Senior Persons regulatory regime.<sup>62</sup> That it is

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<sup>55</sup> *Ibid* para.4.4.

<sup>56</sup> *Ibid*, paras.4.4; 4.1.1.

<sup>57</sup> *Ibid*, para.4.12.

<sup>58</sup> *Ibid*.

<sup>59</sup> *Ibid*, para.4.15.

<sup>60</sup> *Ibid*, para.4.17.

<sup>61</sup> *Ibid*.

<sup>62</sup> Government Response to PCBS, paras.1.6; 2.13-2.16; also the Banking Reform Bill 2013/14, Government Amendments: Senior Managers and Banking Standards, 9 October 2013.

intended to be enforced only exceptionally has also long been apparent from strong intimation in government circles that the value of this initiative attaches to the 'the shadow of prosecution' cast over those entrusted with institutions of 'vital national importance'.<sup>63</sup>

#### 4 Financial Misconduct and Attacks on Victorian Economic and Wider Societal Interests

The importance of new criminal liability being a mechanism for deterring excessive risk-taking with a view to changing 'the culture of finance so it is safer for us all' does suggest the 'reckless banking offence' may not be such a marked departure from the UK legal tradition for applying criminal law to financial sector misconduct in practice.<sup>64</sup> But it is a marked new conceptual direction, where there is an acknowledged longstanding tradition of requiring dishonesty or misconduct which is intentional /deliberate for applying criminal law. It is also the case that the tradition which is acknowledged in the Treasury Consultation is actually part of one of significant length in standing, and dates back over 150 years. This appears to have been a very conscious choice made by the society which discovered 'large-scale illegality that occurs in the world of finance and financial institutions' during the 1840s.<sup>65</sup> Elsewhere it is argued that the historical foundations of much of the substantive and institutional legal machinery that is in place to fight financial crime today descends from the 'inauguration, development, and rapid progress' of 'High Art' crime.<sup>66</sup> Even the Victorians termed this 'financial crime'.<sup>67</sup> There is much convincing contemporary evidence that this phenomenon solidified contemporary perceptions that some financial misconduct necessitated redress which was different from wrongdoing which could be put right by making good 'out of [one's] own property'.<sup>68</sup> Instead of such restitution, what was required was enforcement through processes traditionally underpinned by a communal rejection of wrong-doing.<sup>69</sup>

In recognising that a number of its social and economic interests were being assailed by serious harm arising from financial misconduct, Victorian society's reactions were clear and dramatic. By the 1850s legislation sought specifically to target a number of financial or financially-oriented infractions, with the criminal *cause celebre* trials also emerging during

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<sup>63</sup> Hancock 'Challenging the Rewards of Failure'.

<sup>64</sup> Ibid.

<sup>65</sup> Friedrichs, *Trusted Criminals*, p.156.

<sup>66</sup> See Sarah Wilson *The Origins of Modern Financial Crime in Britain: historical foundations and current problems* (forthcoming, Routledge SOLON, 2014); Evans, *Facts, Failures and Frauds*, p. 1.

<sup>67</sup> Evans, *Facts, Failures and Frauds*, p.5.

<sup>68</sup> *Hansard*, series 3, 146, HC 8 June 1857, Serjeant Kingslake, col.1363.

<sup>69</sup> See Hay and Snyder 'Using the Criminal Law, 1750-1850: Policing, Private Prosecution and the State' in Douglas Hay and Francis Snyder *Policing and Prosecution in Britain 1750-1850* (Oxford: Clarendon Press, 1989).

this decade appearing to have many resemblances with criminal trials found in the financial services arena today, including shared experiences of the difficulties associated with them, as identified by the 2012 Treasury Consultation.<sup>70</sup> Nevertheless, for the Victorians a distinct pattern would emerge in determining that 'certain activities are deemed criminal and not others'.<sup>71</sup> The Victorians separated out wrongs which could be put right through financial reparation from others which could not be so, and in so doing, acknowledged a 'broad spectrum...of actions'.<sup>72</sup> This included ones exhibiting 'varying degrees of intent...and wrongfulness'.<sup>73</sup> This demonstrates that that society was very clearly against criminalising conduct pursuant to 'any of the ordinary transactions of trade'.<sup>74</sup> This was notwithstanding contemporary appreciation that commercial transacting was not characteristically built on 'the strictest standards of personal morality'.<sup>75</sup> Criminalisation would not interfere with 'anything that might be wrongfully done, if it was not done with intent to defraud'.<sup>76</sup> The import of these remarks made in 1857 by Sir Richard Bethell, then Attorney-General, as parliament debated what became the Punishment of Frauds Act 1857 is also strongly evident in Sir George Jessel's retrospective reflection on the legislation in 1877.<sup>77</sup> In this, the then Master of the Rolls remarked that it was incumbent on the law to 'punish people for real frauds, and not make any fictitious ones'.<sup>78</sup>

In 1877 Sir George Jessel had emphasised the importance of appropriately drawn up criminal liability for fraud to illustrate the importance of establishing the office of Public Prosecutor. He insisted that without such an office (eventually established in 1879) there lay the very real danger that important and perfectly adequate law would fall into disuse.<sup>79</sup> This was because the system of private prosecution emphasised the inconvenience and significant expense of bringing a prosecution: a problem embodied in the sentiment that 'what is everybody's business is nobody's business'.<sup>80</sup> Jessel MR's remarks were directed at

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<sup>70</sup> Treasury Consultation, paras.4.14-4.17.

<sup>71</sup> James Taylor *Boardroom Scandal: The Criminalization of Company Fraud in Nineteenth-Century Britain* (Oxford: Oxford University Press, 2013) p. 6, citing Lucia Zedner *Criminal Justice* (Oxford: Oxford University Press, 2004).

<sup>72</sup> David Friedrichs, 'Wall Street', p.6.

<sup>73</sup> *Ibid.*

<sup>74</sup> *Hansard*, series 3, 146, HC 26 June 1857, Sir Richard Bethell, col.506.

<sup>75</sup> Michael Lobban 'Nineteenth Century Frauds in Company Formation: *Derry v Peek* in Context' *Law Quarterly Review* 112 (1996) 287-334, pp.287; 327.

<sup>76</sup> *Hansard*, series 3, 146, HC 26 June 1857, Sir Richard Bethell, col.506.

<sup>77</sup> 20 and 21 Vict c 54, 'An Act to make better Provision for the Punishment of Frauds committed by Trustees, Bankers, and other Persons intrusted with property'.

<sup>78</sup> Parliamentary Papers VIII, 1877 419 *The Report of the Select Committee on the Companies Acts 1862 and 1867* (Companies Report 1877) para.2189.

<sup>79</sup> *Ibid.*, para.2169. The Prosecution of Offences Act 1879 marked the formal beginnings of the shift away from individual victim-funded private prosecution towards state-funded prosecution, which would evolve gradually into the second decade of the twentieth century.

<sup>80</sup> Companies Report 1877, para.2169.

law which required financial misconduct to be accompanied by fraudulent intent for criminal liability to arise, with these discourses helping to uncover how this position would be aligned with the better established one on fraud in civil liability. Novel criminal liability, in serving to distance misconduct from 'ordinary transactions of trade', was spoken about as arising from what is readily recognisable as harm inflicted on another through deliberate falsehood or that practiced from a lack of belief in the truth.<sup>81</sup> It was also directly aligned with concern that if liability were drawn more widely, this would discourage participation from persons on whom entrepreneurial activity relied because they were either prepared to finance risk-taking activity on which the embedding of industrial capitalism depended, or prepared to engage in this themselves.<sup>82</sup> This was a society very painfully aware of the fragility of the capitalist economy, with this being manifestly clear from the railway crisis of the 1840s and the 'commercial distress' of the 1850s. The threat presented by the crisis generated from the railway boom to the new model of speculation central to financing the capitalist project clearly still haunted contemporaries as they grappled with how the latter period of financial instability exposed both the vulnerability of the domestic financial system, and also its susceptibility to external economic forces.<sup>83</sup> The misconduct at the heart of these two decades would make them 'one of the darkest pages in the commercial history of this country'.<sup>84</sup>

## **5 Economy and Society and Harm Inflicted by Non-deliberate Misconduct: Victorian society and its Conscious Past**

It was also a society very clearly aware of how undue tolerance of financial infractions could and indeed would result in 'wide-spread ruin...scattered over the whole of the country, houses have been brought to destruction, families have been plunged from affluence into poverty, the hard earnings of industry, collected by long labour, have been entirely lost'.<sup>85</sup> It had even discerned that it was 'excessive much more than deliberately fraudulent

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<sup>81</sup> This bears resemblances to the famous passage of Lord Herschell's judgment in *Derry v Peek* (1889) LR 14 App Cases. 337, illuminating 'fraud' in the context of the tort of fraudulent misrepresentation.

<sup>82</sup> Wilson, *Origins of Financial Crime*.

<sup>83</sup> See the connections made between the railway boom and crisis and the discovery of 'high art' crime in Evans, *Facts, Failures and Frauds*, pp.2-3; also for his specific reflections on the rise and fall of George Hudson, see particularly pp.6-26. See also Wilson, *Origins of Financial Crime*; Lobban, 'Derry v Peek in Context', pp.287-8, referring to the nineteenth century as a period of 'economic uncertainty' with 'severe trade cycles and a stock market crash roughly every ten years'.

<sup>84</sup> Evans, *Facts, Failures and Frauds*, p.1.

<sup>85</sup> Sir Fredrick Thesiger, Address for the Prosecution, Trial, Royal British Bank Directors 1858, in Evans, *Facts, Failures and Frauds*, p.289. See generally, and particularly parts which formed the dialogue between the members of the Committee and representatives of the provincial banking sector.

adventure which brings on commercial convulsion':<sup>86</sup> In a setting where it would be impossible to eradicate entirely those determined to misuse business structures and a strong appetite for investment to gull and to cheat, it was virtually impossible to identify and locate 'excessive' or unduly risky decision-making within an otherwise lawful enterprise. In recognising that 'breaches of mercantile trust' arising in the latter setting could arise from the very demonstrable commitment of capitalists to the well-being of their businesses, criminalisation was very consciously concerned with conveying messages which were oppositional to any show of tolerance or 'ill-judged sympathy'.<sup>87</sup> Nevertheless, this was also a society which believed that the proper bounds for criminalising financial misconduct required wrongdoing which was deliberate. This is consistent with the adage used today, that 'punishment should be restricted to those who have voluntarily broken the law'.<sup>88</sup> This underpins the 'moral licence' for the administration of criminal punishment, with such sentiments also an evident influencing force for the rationalisation of the criminal law undertaken from the 1820s.<sup>89</sup> This was a society with a strong sense of its own distinctiveness from its own past.<sup>90</sup> It is also one with which we might well identify with today in the early years of the twenty-first century, where the social and economic and also technological transformations of the 'digital age' have ensured we feel intense vulnerability as well as being aware of significant opportunity.

Perhaps extending the proper bounds of criminal liability as envisioned by the 'reckless banking offence' is necessary to protect against the 'unacceptable costs on the rest of society' which the global 'financial meltdown' of 2007-8 revealed banking to be capable of inflicting.<sup>91</sup> Indeed, numerous commentators have reflected on how whilst some of the misconduct exposed from it would amount to criminal conduct under existing criminal law, other instances would not.<sup>92</sup> But Victorian society was also very keenly aware of the harm to

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<sup>86</sup> Boyd Hilton, *The Age of Atonement: The Influence of Evangelicalism on Social and Economic Thought 1785- 1865* (Oxford: Clarendon Press, 1986) p. 123, quoting Benjamin Gregory, *The Thorough Business Man: Memoirs of Walter Powell* (London: Walter Powell, 1871).

<sup>87</sup> Evans, *Facts, Failures, and Frauds*, p.123.

<sup>88</sup> H. L. A. Hart, *Punishment and Responsibility* (Oxford: Clarendon Press, 1968) p.22; cited in Alan Norrie *Crime, Reason and History: A Critical Introduction to Criminal Law* (London: Wiedenfeld and Nicholson, 1993), pp.10-11.

<sup>89</sup> Norrie, *Crime, Reason and History*, pp.10-11.

<sup>90</sup> Chantal Stebbings, 'Benefits and barriers: The making of Victorian legal history' in Anthony Musson and Chantal Stebbings (eds), *Making Legal History: Approaches and Methodologies* (Cambridge: Cambridge University Press, 2012) 71-87, especially pp.72-3.

<sup>91</sup> Bank of England, *The Role of Macprudential Policy: A Discussion Paper* (hereafter, *Macprudential Discussion Paper*), (London: 2009) p.3.

<sup>92</sup> See Justin O'Brien, 'The Facade of Enforcement: Goldman Sachs, Negotiated Prosecution, and the Politics of Blame' in Will, Handelman and Brotherton (eds), *How They Got Away With It*, pp.178-9; see also Rustin, 'Andrew Tyrie', for an interesting perspective on the adequacy of existing criminal liability from the PCBS Chair.



economic and wider societal interests emanating from financial misconduct, including non-deliberately inflicted harm from risk-taking. However, it had configured its criminal liability differently. In acknowledging the novelty of 'high art' crime, Victorians appreciated that financial misconduct was part of a 'broad cultural pattern'; one with 'deep historic roots'.<sup>93</sup> In its consciousness of its own past, Victorian society appreciated that financial misconduct had subsisted within its midst since 'time immemorial'.<sup>94</sup> For contemporaries, the 'high art' crime which appeared during the 1840s both lay on the same broad cultural spectrum as financial misconduct deeply embedded in societal consciousness and memory and yet also represented a point of departure from what was familiar. This can be seen in narrative of David Morier Evans, a financial journalist for *The Times*. In this, Evans depicted the 'railway mania' of the 1840s as marking an entirely new alliance between dishonesty and financial sophistication. This was represented in classic capitalist fraud channelled through company promotion, and also activities beyond this showing a range of magnitude and varying degrees of reprehensibility.

## **6 The 1840s: Transformative Times and an Emerging Victorian Conscious Past**

This was an age defined by a spectrum of financial infractions perpetrated by 'the apprentice boy who robbed a few shillings from the till' and the 'gigantic forger or swindler', and where lying between these points was the 'reckless speculator' who 'would risk everything in the hope of sudden gain, rather than toil safely and laboriously for a distant reward'.<sup>95</sup> In his account of the 1840s as a transformative time, Evans explained that alongside their shared rationale in financial impropriety, all such activities had benefitted from how temptations to crime had become 'infinitely multiplied' whilst impediments had been 'reduced to a minimum'. This had allowed 'high art' crime to become increasingly commonplace.<sup>96</sup> Evans' reflection on 'time immemorial' was attached to embezzlement specifically, but elsewhere his introduction to the novelty of 'high art' crime reminds readers that forgery had been a notable foe for eighteenth-century society.<sup>97</sup> His assessment of the duality of Victorian appreciation of financial misconduct in its pre-industrial past, and its belief that the 1840s marked something genuinely novel, also included an incidence which into the closing years of the twentieth century continued to attract accolades of being the 'best known' British fraud

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<sup>93</sup> Stanton Wheeler, D Weisburd, N Bode, 'Sentencing the White-Collar Offender: Rhetoric and Reality' *American Sociological Review* 47 (1982) 641-59, pp.657-8.

<sup>94</sup> Evans, *Facts, Failures and Frauds*, p.3.

<sup>95</sup> *Ibid*, pp.1-2.

<sup>96</sup> *Ibid*, p.1.

<sup>97</sup> *Ibid*.

ever.<sup>98</sup> In looking firstly at why Victorian familiarity with embezzlement might have been so profound (notwithstanding Evans' references to its associations with 'time immemorial'), criminalisation of embezzlement as misappropriating property *entrusted* by another and punishable by up to 14 years' transportation, had *nineteenth* rather than eighteenth-century origins.<sup>99</sup> As John Styles' respected work reveals, the *illegality* embodied in *legal* understandings of embezzlement prior to the nineteenth century was quite different from 'the violation of a private financial trust' which emerged during this later time.<sup>100</sup>

These earlier understandings of embezzlement had denoted an employee's unauthorised appropriation of his employer's *goods*.<sup>101</sup> Such unlawfulness had thrived during pre- and early industrial Britain, on account of a 'multitude of opportunities for workpeople to defraud their employer with a good chance of escaping detection'.<sup>102</sup> It was the absence of direct supervision characterising this mode of production that proved to be capable of generating very considerable losses for employers.<sup>103</sup> The financial implications for employers could be substantial, and the variety of pilfering possible also extensive.<sup>104</sup> Notwithstanding that embezzlement and associated frauds were both 'illegal and actively condemned by employers', mapping this onto 'criminality' and enforcement was highly complex.<sup>105</sup> Ostensibly, legislation passed in 1749 so that 'what had previously been treated as a breach of contract was made a criminal offence' should have served to manage this path to criminalisation. The realities were commonly more intricate. It was not categorically the case that the relationship between an outworker and his employer was actually contractual, notwithstanding this is how it was often described.<sup>106</sup> Furthermore, although the term 'crime' was widely used in eighteenth-century discourses, it did not have a very precise meaning, particularly in the context of summary offences.<sup>107</sup> From this Styles contended that historians' emphasis on a decisive shift towards criminalisation and 'a once-and-for-all transition *at law* from restitution to punishment' has been misplaced.<sup>108</sup>

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<sup>98</sup> Malcolm Balen, *A Very English Deceit: The Secret History of the South Sea Bubble and the First Great Financial Scandal* (London: Fourth Estate, 2002).

<sup>99</sup> Evans, *Facts, Failures and Frauds*, p.145.

<sup>100</sup> John Styles, 'Embezzlement, industry and the law in England 1500-1800' in Maxine Berg, Pat Hudson and Michael Sonnescher (eds), *Manufacture in town and country before the factory* (Cambridge: Cambridge University Press, 1983), 173-201, pp.188; 175. This provides a discussion of the changing meaning of embezzlement and also the traditional meaning.

<sup>101</sup> *Ibid.*

<sup>102</sup> *Ibid.*, p.175.

<sup>103</sup> *Ibid.*, p.177.

<sup>104</sup> *Ibid.*, pp.175-7.

<sup>105</sup> *Ibid.*, p.181.

<sup>106</sup> Evans, *Facts, Failures and Frauds*, p.145.

<sup>107</sup> *Ibid.*, p.190.

<sup>108</sup> *Ibid.*, p.191.

Instead Styles encourages a view of criminalisation which was much looser and rather signalled a more general shift in enforcement practices from financial forfeiture to physical punishment. This was explained through evidence pointing to continuing practices of requiring outworkers who received an employer's goods in this way to make financial recompense notwithstanding the 'formal' distinction drawn in the Act between this and punishment.<sup>109</sup> Although false reeling became the most prosecuted of all embezzlement offences in the last quarter of the eighteenth century, and further legislation had created a range of 'catch-all' offences for mere possession of suspicious materials, the difficulty in identifying embezzled materials remained manifest.<sup>110</sup> But Styles also noted that attitudes towards enforcement through prosecution varied.<sup>111</sup> He explained how responses became concentrated on a number of extra-legal 'adjustments' made within the employment relationship, which were commonly substituted for seeking recourse to law.<sup>112</sup> Styles' explanation that the meaning given to embezzlement changed during the nineteenth century is very clear and apparent in the parliamentary debates dating from the 1850s relating to criminal liability of a number of professionals who would encounter property belonging to others alongside those acting as trustees under settlements of property.<sup>113</sup> Those who differed from Styles' outworker class by virtue of being in positions of responsibility had always abused these positions, and incurred liability for such violations involving making good a wrong committed 'out of [their] own property'. In the 1850s there was recognition that the new operating context of the 'enterprise economy' had drawn unwelcome attention to how 'great facilities were afforded by the laws of this country' for the improper application of property belonging to others.<sup>114</sup>

Elsewhere, within the broad parameters of the eighteenth century (and as part of a spectrum of wrong-doing), where Styles' pilfering outworkers caused significant hardship to the industries in which they operated, forgery was a capital crime throughout. It remained so until the early years of the nineteenth century.<sup>115</sup> Throughout the eighteenth century, and often in marked contrast with employer recourse to law in the case of embezzlement, Andrew and McGowen explain that forgery was actually an offence which was 'regularly

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<sup>109</sup> Ibid, pp.191-2. This mirrored closely longstanding informal practices of requiring those who could to make financial recompense, and finding 'other ways' of dealing with those who could not, thereby drawing distinctions of the socio-economic status of an outworker

<sup>110</sup> Ibid, p.194; Courtesy of the Wool Act 1774 and General Act 1777.

<sup>111</sup> Ibid, pp.194; 187.

<sup>112</sup> Ibid, pp.182-5. This explains the extensive range of such 'adjustments'.

<sup>113</sup> As set out in parliamentary debates on legislation which became known as the Punishment of Frauds Act 1857.

<sup>114</sup> *Hansard*, series 3, 146, HC 8 June 1857, Serjeant Kinglake, col.1363.

<sup>115</sup> Donna Andrew and Randall McGowen *The Perreaus and Mrs Rudd: Forgery and Betrayal in the Eighteenth Century* (California: University of California Press 2001) pp.22-30.

pronounced' as 'one of the most dangerous threats to the life of a commercial nation'.<sup>116</sup> Almost three-quarters of a century prior to the 1840s, in 1775 contemporary reflection on forgery was that 'though it is not half a century since forgery was rendered a capital offence ...even with the gallows before their eyes, forgers abound more than ever'.<sup>117</sup> It would perhaps become the most vigorously enforced latter-date capital offence, and one in respect of which 'the legislature repeatedly enacted measures to make the prosecution of the crime easier and then bring new sorts of forgery under the protection of the capital code'.<sup>118</sup> Handler has noted that Randall McGowen's work has done much to move historians' interest in forgery away from a rather one dimensional approach which attributes the 'anomalously high number of convicted forgers who were executed' to 'a harsh and unthinking reaction to the emergence of new economic forms, typical of the era of the so-called Bloody Code. Instead, they embrace a more nuanced understanding, exploring the 'dramatic rise in the number of forgery statutes with the financial revolution of the late seventeenth and early eighteenth century'.<sup>119</sup> For Andrew and McGowen 'forgery touched the lives of the wealthy like no other crime', and it was considered by contemporaries to be an assault upon a man's property, and also his reputation.<sup>120</sup>

More widely, Handler's own very learned reflections on forgery have attached much significance to how security of the nation and its capacity to sustain war came to be seen as dependent on its system of finance. Anxiety about protecting the financial system which thus occupied governments led to the creation of many new and often narrowly-focused forgery offences, which were then annexed onto statutes dealing with the revenue and state finance.<sup>121</sup> Although Handler argues that there was no apparent pressure from the commercial classes, commercial dealings were strongly premised on 'face to face' encounters,<sup>122</sup> for which forgery represented a species of 'integrity theft'. As Handler continues (very much in the vein of Andrew and McGowen), forgery exposed the vulnerability of a financial system built on paper. This, for some, itself amounted to a 'fraud

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<sup>116</sup> Ibid, p.22.

<sup>117</sup> Ibid, p.23. This page contains the authors' citation of a London publication of 1775 entitled *The True and Genuine Lives and Trials of the Two Unfortunate Brothers Robert and Daniel Perreau*.

<sup>118</sup> Ibid, pp.22-3.

<sup>119</sup> See Philip Handler 'Forging the agenda: the 1819 select committee on the criminal laws revisited' *The Journal of Legal History* 25(3) (2004) 249-68, pp.249; 251.

<sup>120</sup> Andrew and McGowen, *Forgery and Betrayal*. According to the authors, this was on account of the absence of settled forms and institutions to reduce the risk of forgery, and also because so many credit relationships were personal.

<sup>121</sup> Handler, 'Forging the agenda', p.251. See also Philip Handler, 'Forgery and the end of the "Bloody Code" in early nineteenth-century England' *Historical Journal* 48(3), (2005), 683-702; p.683.

<sup>122</sup> Sarah Wilson 'Tort law, actors in the "enterprise economy", and articulations of nineteenth-century capitalism with law: The Fraudulent Trustees Act 1857 in context' in T T Arvind and Jenny Steele (eds), *Tort Law and the Legislature: Common Law, Statute and the Dynamics of Legal Change* (Oxford: Hart, 2012) 353-82.

on the people' involving government theft of hard-earned wealth and its replacement with worthless notes.<sup>123</sup> The concerns it engendered linked with deeper ones relating to the reliability of exchange and the security of public finance.<sup>124</sup> From all these considerations Handler persuasively argues that in a world 'haunted by debt, financial insecurity, and ruin...severity was a way of holding one's fears at bay'.<sup>125</sup> Consequently, not only were forgers punished more severely than any other type of property offender, but also 'only convicted murderers were less likely to escape the gallows'.<sup>126</sup> The 'enterprise economy' of the nineteenth century would change the culture of commercial transacting manifestly, and require extensive rethinking around generating confidence in such dealings with others. But even in the context of the threats presented to the safety of property and the value of reputation by forgery during the eighteenth century, and its acknowledged growing prevalence during the last quarter of it, only very few cases were ever prosecuted in each year in the Old Bailey.<sup>127</sup> Nevertheless, on account of its perceived seriousness, those who were convicted seldom received pardons, and even in the case of those condemned having 'powerful connections', working hard for commutations in sentence, 'such appeals rarely worked'.<sup>128</sup>

## 7 Beyond Embezzlement and Forgery: 'Gigantic Fraud' and a Sign of Things to Come

It was in the context of forgery that, half a century later, Evans had recalled the mixed blessing of liberalising the law relating to it so that it was no longer a capital crime.<sup>129</sup> There was adulation of this retreat from barbarity, but also shock at how it appeared to have unleashed an escalation in financial misconduct.<sup>130</sup> With this, the nature of eighteenth century society's reaction to forgery, and how for many years it was vested with the sanction which 'will ever be regarded with the greatest awe by the multitude' reveal a Victorian consciousness of its own past.<sup>131</sup> The same can be said of the South Sea Bubble Scandal 1719-20, of which it was said in the early years of the twenty-first century that it would tax 'the skills of many a more recent fraudster'.<sup>132</sup> Its origins are well known, through the creation of the South Sea Company in 1710 with exclusive rights to trade in the South Seas and parts

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<sup>123</sup> Handler, 'Forging the agenda', p.252.

<sup>124</sup> Ibid.

<sup>125</sup> Ibid.

<sup>126</sup> Ibid.

<sup>127</sup> Andrew and McGowen, *Forgery and Betrayal*, pp.22-3.

<sup>128</sup> Ibid.

<sup>129</sup> Evans, *Facts, Failures and Frauds*, p.1.

<sup>130</sup> Ibid. See also Handler, 'Forging the agenda'.

<sup>131</sup> Evans, *Facts, Failures and Frauds*, p.1.

<sup>132</sup> Peter Jay, Book Review, *The Guardian*, 10 August 2002. The review was of Balen, *A Very English Deceit*.

of South America being made perpetual in 1712.<sup>133</sup> The Company's flourish in its trade – mainly in slaves – was brought to a standstill upon the outbreak of war between Britain and Spain in 1718.<sup>134</sup> The origins of 'the financial transaction that laid the foundation of the wild speculation...which has made the South Sea Company a byword in history' arose from the arrangement with the home government whereby part of the government's debt would be converted into company stock.<sup>135</sup> This symbiosis would allow for simultaneous reduction of government debt and increase in the Company's capital. The success of this scheme in the latter regard led to a 'whole series of speculative bubbles' inspired by perceptions that this could be replicated across other commercial enterprises.<sup>136</sup> This climate of wild excitement precipitated the Bubble Act 1720 with its latter parts strongly oriented towards stabilising the Company.<sup>137</sup> The lengthy and rather rambling legislation set out at some length the inconvenience and prejudice to His Majesty and His subjects caused by the frenzy generated. In so doing it indicated (rather than actually defining) a number of trade and commercial 'undertakings and projects of different kinds' causing concern, and which pointed to abuse of the corporate form.

The legislation demanded that a number of activities relating to unauthorised seeking of public subscription, and false representations of stock transferability, and use of the corporate form which had not been authorised (by there being no grant of charter, or through utilising obsolete charters) 'shall be illegal and be deemed public nuisances' and incurring of a penalty.<sup>138</sup> The South Sea Bubble was thus the most spectacular of a barrage of scams and deceptions, and unlike its 'copycat' schemes, this one was state-sponsored. The legislation

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<sup>133</sup> 9 Ann c 21, *inter alia* 'An Act for making good deficiencies and satisfying the public debts; and for erecting a corporation to carry on a trade to the South Seas'; 10 Ann c 30.

<sup>134</sup> Ronald R. Formoy, *The Historical Foundation of Modern Company Law* (London: Sweet and Maxwell, 1923). He explained (see p.25) that during the 30 years' trade right between the Company and Spanish America '4,800 negroes were transported by it yearly'.

<sup>135</sup> *Ibid*, p.26.

<sup>136</sup> John Carswell, *The South Sea Bubble* (London: Alan Sutton, 1960) p.7. The term 'bubble' is a generic one capturing broadly a mismatch between asset prices and their intrinsic value: see George Cooper, *The Origin of Financial Crises: Central Banks, Credit Bubbles and the Efficient Market Fallacy* (London: Harriman House, 2010). In the context of the railway boom, see also Rande Kostal, *Law and English Railway Capitalism 1825-1875* (Oxford: Clarendon Press, 1994) p.12 for reference to them as 'assetless shells'.

<sup>137</sup> The Act's first 17 sections concerned the Crown's authority to create the two marine insurance corporations - The London Assurance Co and Royal Exchange Co – which were to be given the monopoly of marine insurance business. A fuller account of this remarkable Act can be found in Formoy, *Historical Foundations*, p.48.

<sup>138</sup> Prior to incorporation by registration under companies legislation commencing in 1844, incorporation was by way of Royal Charter, with terminology of 'General' and 'Special' Acts of Incorporation also salient for this discussion of the nineteenth-century liberalisation of incorporation. Also, in the only reported case under the Act *R v Cawood* in 1723, the defendant was found guilty of setting the North Sea bubble was fined £5 and was to remain in prison during the King's pleasure. See Bishop Carlten Hunt, *The Development of the Business Corporation in England 1800-1867* (London: Humphrey Milford, 1936); Formoy, *Historical Foundations* for accounts of *Cawood*.

enacted to protect its stability and supremacy (it actually allowed the Company to resume trading on the cession of war with Spain) stands as authority that neither the appetite to cheat and gull, nor the determination to ensure that nothing ever like the South Sea Bubble would happen again, was novel when early-Victorian society encountered 'high art' crime. Indeed, numerous accounts of the South Sea Bubble were available for contemporary consumption in the early part of the nineteenth century. Journalist Charles MacKay's account from 1841 actually listed 86 bubbles declared unlawful by the Bubble Act itself, and also reminded his readers that many continued to appear daily 'in spite of the condemnation of the government and the ridicule of the still sane portion of the public'.<sup>139</sup> MacKay's reflections on the lasting significance of this event from the eighteenth century for nineteenth century society can also be captured in his remark that a pack of South-Sea playing cards was, in 1841, an extremely rare collector's item.<sup>140</sup> Such cards were the work of an ingenious card-maker published during the heady days of 1720, where each card contained, alongside its usual figure, 'a caricature of a bubble company, with appropriate verses underneath'.<sup>141</sup>

## **8 Gigantic Fraud Predating the Eighteenth Century: The South Sea Bubble's Own Historical Context and a Forecast for the Future**

Furthermore, like MacKay, the architects of the Bubble Act 1720 themselves would have been mindful of the *tulpenmanie* of the Dutch Golden Age when considering appropriate responses to the financial destabilisation originating in the scandal surrounding the South Sea Company. Certainly by Victorian times there was an awareness of the speculative mania for tulip bulbs in early seventeenth-century Holland as actually being the first recorded speculative bubble and one with immediate effects which had spread to England, thanks to commentaries on *tulpenmanie* like the one from MacKay published in 1841.<sup>142</sup> Following the introduction of tulips across Europe during the middle of the sixteenth century, MacKay explained that the first root actually arrived in England from Vienna in 1600, but his commentary reflects how the 'rage for possessing them' which had spread wildly would result in 'preposterous prices' being paid for the bulbs themselves and would escalate into a situation whereby lacking a tulip collection became 'proof of bad taste in any man of fortune'.<sup>143</sup> But following an account of how this delicate flower could have become 'so valuable in the eyes of so prudent a people as the Dutch', MacKay explained that the mania

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<sup>139</sup> Charles MacKay, *Extraordinary Popular Delusions and the Madness of Crowds*, 1841 (reprinted London: Wordsworth Editions, 1995) p.53.

<sup>140</sup> Ibid.

<sup>141</sup> Ibid.

<sup>142</sup> MacKay, *Madness of Crowds*.

<sup>143</sup> Ibid, p.75.



increasingly drew in a vast swathe of persons of very modest means.<sup>144</sup> It extended well beyond a speculative market for the bulbs themselves in which 'stock-jobbers' who ever alert to new speculation made use of a variety of means to cause fluctuations in price, and that 'many individuals grew suddenly rich'.<sup>145</sup>

Everyone, including 'nobles, citizens, farmers, mechanics, seaman, footmen, maidservants, even chimney-sweeps and old clotheswomen' dabbled in tulips.<sup>146</sup> It extended beyond Holland as 'foreigners became smitten with the same frenzy'. Money 'poured into Holland from all directions', by 1636 regular marts for their sale were established on the Stock Exchange of Amsterdam and throughout key towns, and in towns without an exchange trading activities became concentrated on the principal tavern.<sup>147</sup> This also led to a parallel industry of speculations offering land for tulip cultivation emerging alongside the market for bulbs themselves.<sup>148</sup> From this codes of law became necessary to support the 'so extensive and so intricate' dynamics of these operations, with this also ensuring that notaries and lawyers devoted themselves 'exclusively to the interests of the trade', with many towns becoming more familiar with their 'tulip-notary; than their public notary'.<sup>149</sup> In 1636, tulips were publicly sold in the Exchange of London, where London jobbers acted with similar resourcefulness and guile as their Dutch counterparts, and at that point MacKay noted that 'everyone imagined that the passion for tulips would last forever' and that the wealthy from across Europe would continue to flock to Holland and pay whatever price was asked.<sup>150</sup>

The following year things would change, when the more prudent Dutch started to see the folly could not last and became disinclined to pay rash prices for tulips. As the conviction that 'somebody must lose fearfully in the end' spread, 'prices fell, and never rose again. Confidence was destroyed, and a universal panic seized upon the dealers'.<sup>151</sup> Losses amongst those from humbler walks of life were extensive and also wide-spread, with merchants 'reduced to beggary' and noble houses 'ruined beyond redemption'.<sup>152</sup> Valiant attempts were made locally in towns to restore public credit but ultimately these mirrored government failure to resolve how the intense gambling frenzy had enabled some to retain their profits whilst leaving many others to 'bear their ruin as philosophically as they

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<sup>144</sup> Ibid.

<sup>145</sup> Ibid, p.79.

<sup>146</sup> Ibid. See Anne Goldgar, *Tulipmania: Money, Honor, and Knowledge in the Dutch Golden Age* (London: University of Chicago Press, 2007) for a historical account of tulpenmanie.

<sup>147</sup> MacKay, *Madness of Crowds*, p.79.

<sup>148</sup> Ibid.

<sup>149</sup> Ibid.

<sup>150</sup> Ibid, p.80.

<sup>151</sup> Ibid.

<sup>152</sup> Ibid.

could'.<sup>153</sup> This became readily apparent when the Amsterdam judiciary ruled that 'debts contracted in gambling were no debts in law'.<sup>154</sup> MacKay's reflections on the continuing favour for, and actual value attached to tulips in the upper echelons in English society into the nineteenth century shows how the eclipse of the Dutch 'Golden Age' had permeated English consciousness.<sup>155</sup> However, even without this insight the Victorians realised that financial impropriety and an appetite for personal gain had been a constant in society since 'time immemorial'. Victorian society was itself being assailed by financial misconduct, and was acutely aware of deeply troubled times in its past which had also revealed financially motivated misconduct, characteristically underpinned by self-interest and secretiveness. Thus, much can be said about its reactions during the 1840s to the discovery of 'high art' crime in the light of this conscious past.

## **Conclusion**

The discovery of 'high art' crime did embody an entirely novel alliance of these age-old elements encouraging impropriety with new opportunities, and contemporaries were aware that the implications of this could be catastrophic. But the nineteenth-century path to criminalisation of what today is likely to be termed 'financial sector misconduct', appears to have been borne from engagement with the past as well as from living through contemporary experiences, and also appears to have been much more moderate and composed than it could have been. In these circumstances, Victorian society's response to the onset and progression of 'high art' crime could have targeted specifically the more grey areas of wrongdoing now being criminalised in the reckless banking offence, across the sweep of entrepreneurial activity. But without the benefit of hindsight and in the face of an entirely new socio-economic context, its approaches to criminalising financial misconduct were measured, whilst also being determined. Armed with understanding of its own past, and gripped by the anxiety of unprecedented financial misconduct, it would have been all too easy for Victorian society to lose sight of the importance of guarding against making 'things crimes which are not crimes in themselves'.<sup>156</sup>

The criminal offence of reckless misconduct in the management of a bank currently before parliament clearly is intended to apply narrowly, and be enforced exceptionally. As the Treasury Consultation noted in 2012, creating a new criminal offence involving recklessness would 'send a very clear signal that society is determined to prevent and deter that conduct',

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<sup>153</sup> Ibid, pp.80-1.

<sup>154</sup> Ibid.

<sup>155</sup> Ibid, pp.81-2.

<sup>156</sup> Sir George Jessel, Companies Report 1877, para.2174.

in a setting where society might have to pay a heavy price for dealing with the consequences of recklessness.<sup>157</sup> In many respects therefore, the new criminal liability has a value which is intended to be principally symbolic. This suggests we are not about to abandon a tradition of 150 years in requiring financial conduct which is deliberate/intended for fixing criminal liability. But in introducing the new misconduct in banking offence we are signaling our preparedness to subject those whose risks are deemed to be reckless<sup>158</sup> to punishment of up to seven years' imprisonment following conviction on indictment.<sup>159</sup> This is a very serious step even if it is one which is largely symbolic. Indeed its seriousness can be illuminated from Law Commission reflections in 2010 on how recourse to criminal law must be confined to 'serious wrongdoing'.<sup>160</sup> The Law Commission *did* include reckless wrongdoing in its references to 'serious wrongdoing'.<sup>161</sup> There is also arguably little difficulty in finding that reckless risk-taking involves a 'harm-related moral failing' required for criminalisation which is appropriate.<sup>162</sup> This is perhaps very self-evidently so in the event of collapse of a financial institution of 'vital national importance'.<sup>163</sup> There are acknowledged difficulties which criminalising reckless risk-taking by bankers will entail.<sup>164</sup> Given this, it would also be wise to reflect on the more general message from the *Criminal Liability in Regulatory Contexts* Consultation. Criminalisation is not always appropriate, something which also emphasises that particular difficulties can pertain to criminalising misconduct arising in business.<sup>165</sup> Thus, combining our experiences of living through the global financial crisis with awareness of our conscious past, as we have been invited to do by regulators themselves, suggests we should welcome this initiative designed to make bankers act more responsibly whilst also being mindful of the context in which banking necessarily operates. It also suggests that in achieving this we must also be mindful of the conscious past of the society which put our tradition of criminal enforcement in place as well as of our own.

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<sup>157</sup> Treasury Consultation, para.4.11.

<sup>158</sup> The Banking Reform Bill 2013/14, Government Amendments: Criminal Sanctions, para.(1).

<sup>159</sup> *Ibid*, para. 4).

<sup>160</sup> Law Commission, *Criminal Liability in Regulatory Contexts* CP No 195, (London: HMSO, 2010), para.1.14.

<sup>161</sup> *Ibid*.

<sup>162</sup> *Ibid* para.4.6.

<sup>163</sup> Hancock, 'Challenging the Rewards of Failure'.

<sup>164</sup> Treasury Consultation, para.4.11.

<sup>165</sup> Law Commission, *Criminal Liability in Regulatory Contexts*, para.A7.