REGULATORY BEST PRACTICE GROUP

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An Independent International Research Institute

Fine Outcomes

Making better use of regulatory fines

Second edition 2015

January 2015

Fine Outcomes

Second edition 2015

"I can also announce that further awards from the Libor banking fines have gone to good military causes, with money for Combat Stress to help veterans with mental health issues and funds for Christmas boxes for all our troops on operations this year and next…Those who have paid fines in our financial sector because they demonstrated the very worst values are paying to support those in our armed forces who demonstrate the very best of British values."

Chancellor George Osborne – March 2013

"This latest banking scandal shows why we still need big reform and cultural change in our banks. But the fines levied on banks for foreign exchange manipulation should now be used for a wider good…So in next month's Autumn Statement George Osborne should use £1 billion of the fines from the banks for an immediate boost to our health service."

Shadow Chancellor Ed Balls – November 2014

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European Policy Forum
49 Whitehall
London SW1A 2BX
Tel: 020 3174 3199
Fax: 020 3137 2040
info@epfltd.org
www.epfltd.org

Fines

Background

1. This study considers fines levied by financial and economic regulators; the incentives which apply, the effect of the fines and the relative merits of fines compared with other forms of measure including direct consumer redress.

2. Regulators have had concurrent competition powers with the OFT and now with the CMA, but this study is limited to those fines imposed under sectoral powers and does not extend to enforcement actions imposed under competition powers.

3. Current enforcement frameworks of five key regulators – Financial Conduct Authority, Ofcom, Ofwat, Office of Rail Regulation and Ofgem – place an emphasis on fines to address regulatory breaches.

4. A number of issues arise including:

   i. the methodology for assessing and levying fines;
   ii. the uses to which fines are put;
   iii. patterns of fines across the sectors and recent trends;
   iv. other forms of penalty, redress or compensation and their comparative merits.

5. The objective of this study is to examine the role of fines in the regulatory structure and to offer some suggestions on future policy approaches drawing on a comparative examination of current practice. This is the second edition (2015) of a study first published in 2013.

The powers of the regulators

6. Britain's economic regulators were established at the outset of privatisation. The "independent" model of regulation which they represent is admired internationally and has been transplanted to many other countries.

7. To fulfil their statutory duties at arm's length from Government, regulators have powers including to impose sanctions on companies and in some cases upon individuals.

8. These enforcement powers have been developed in regulatory statutes in the absence of an overarching cross-sectoral framework. Despite similarity in the statutes, this has allowed a level of variation to develop within the powers and approaches of the five regulators featured in this report.

9. Under the 2013 Enterprise and Regulatory Reform Act, the sectoral economic regulators acquired a competition primacy duty. The Act stipulates that the CMA has effective oversight of the concurrency regime, and may exercise competition functions "in respect of the case rather than a regulator"[1]. This change may affect the landscape significantly if regulators begin to make more use of their competition powers.

10. The Financial Services Authority and its successor the Financial Conduct Authority (**FCA**) have the power under the Financial Services and Markets Act[2] to impose a financial penalty or to publish a public censure against an approved person or firm. The FCA also has the power to vary or cancel an authorized person's permission[3] and similarly has the power to prohibit individuals who are not fit and proper from carrying out functions in relation to regulated activities[4]. The FCA can ultimately prosecute a range of criminal offences in England, Wales and Northern Ireland[5].

11. Importantly the FCA has the further power to apply to the court for a restitution order or alternatively has the administrative power to require restitution[6]. FCA retail enforcement actions therefore include

[1]Enterprise and Regulatory Reform Act 2013, section 51

[2]Financial Services and Markets Act 2000, sections 63, 66, 123, 131, 205 and 206

[3] Financial Services and Markets Act 2000, section 45

[4] Financial Services and Markets Act 2000section 56

[5] Financial Services and Markets Act 2000, sections 401 and 402

[6] Financial Services and Markets Act 2000, section 382 and section 384

a redress element for consumers, with most redress packages secured without the need to seek restitution orders. In the five years leading up to 2013/14 the FCA's Enforcement Annual Performance Accounts indicate that, when considering retail enforcement cases, the regulator secured in excess of £325 million in redress for consumers with the use of formal powers. The figure for voluntary undertakings on behalf of firms, without the issuance of a formal order, is much greater – by the end of financial year 2013/14 the total amount paid out to customers who were mis-sold PPI is estimated to be £14.3 billion.

12. The FCA is currently undertaking a consultation upon its regulatory framework for individuals, with a view to encouraging the individualisation of both scrutiny and punishment[7]. One key proposal is the introduction of a Senior Managers Regime (SMR) that will require firms to "regularly vet" Senior Managers on their fitness and propriety. Importantly, this new regime will apply to both executive and non-executive directors in equal measure.

13. HM Treasury has undertaken a Review of the fairness, transparency, speed and efficiency of the FCA and PRA's enforcement decision making. Published in December 2014, the Review has a range of suggested improvements that focus "primarily on the referral and settlement decision-making stages"[8]. The FCA have indicated that they will heed and take action upon the recommendations emerging from the Review as they look to begin a review of their enforcement policy in 2015.

14. The powers of **Ofgem** are set out in the Gas Act 1986, the Electricity Act 1989 and the Enterprise Act 2002. It also has powers under the Utilities Act 2000, the Competition Act 1998, the Unfair Terms in Consumer Contracts Regulations 1999 and the Business Protection from Misleading Marketing Regulations 2008. The regulator has the power to impose a financial penalty[9], the power to make interim orders and under its principal objective and enforcement powers has accepted other measures in lieu of penalty, notably consumer redress.[10] Ofgem has imposed nominal penalties on regulated utilities to take account of voluntary redress packages for consumer packages.

15. Ofgem has undertaken a full review of its enforcement function. Its penalty policy has been updated as part of this process[11], and now includes details about how it will administer consumer redress (following these powers being granted in the Energy Act 2013). The new consumer powers are broad and enable Ofgem to order companies to take actions such as paying consumer redress where it considers it necessary to remedy the consequences of a licence breach and/or to prevent a similar breach in the future.

16. In the rail sector, under the Railways Act 1993, where the **Office of Rail Regulation (ORR)** is satisfied that a licence holder is contravening a condition of its licence, it must issue an enforcement order, unless the act is covered by one of a number of exceptions[12]. An order *"may include a reasonable sum"* to be paid by the licence holder for failure to comply with the order.

17. The ORR uses these powers to issue contingency penalties with specified targets and a corresponding sliding scale of fines. However the ORR may also levy a financial penalty for breach of licence even if it does not issue an order. The ORR is currently consulting on a Review of its Enforcement Policy and Penalties Statement[13], with a decision and amendments expected in March 2015.

18. The Water Industry Act 1991 empowers the regulator **Ofwat** with its enforcement sanctions. Ofwat is under a duty to impose an enforcement order where it believes that there has been, or is an on-going breach of obligations, except where the breach is "trivial"[14]. Where there has been a breach the regulator can impose a financial penalty[15]. The Water Act 2014 strengthens Ofwat's powers by extending the period after which the regulator can pursue a breach from 12 months to 5 years[16].

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[7] FCA Consultation Paper CP14/13/PRA CP14/14

[8] FCA, Review of enforcement decision-making at the financial services regulators: final report, December 2014

[9] Gas Act 1986, section 30, and Electricity Act, section 27

[10] Gas Act, section 28 and Electricity Act, section 25

[11] See: Decision on Ofgem's Statement of Policy in respect of Financial Penalties and Consumer Redress, November 2014

[12] Railways Act 1993, section 55

[13] ORR, Enforcement policy and penalties statement review - consultation on options for improvement, December 2014

[14] Water Industry Act, section 18

[15] Water Industry Act, section 22A

[16] Water Act 2014, section 26

19. *In extremis* and with the consent of the Secretary of State, Ofwat can apply to the High Court for a special administration order. The High Court can only make a special administration order where (a) it is satisfied that there has been or is likely to be a contravention of a principal duty or an enforcement order that is serious enough to make it inappropriate for the company to continue to hold its appointment or licence; or (b) the company is or is likely to be unable to pay its debts.

20. **Ofcom** is the regulator for the UK communications industries, with responsibilities across television, radio, postal, telecommunications and wireless communications services. Ofcom acts under a number of Acts of Parliament and other legislation. These include the Communications Act 2003, the Wireless Telegraphy Act 2006, the Broadcasting Acts 1990 and 1996, the Digital Economy Act 2010 and the Postal Services Act 2011.

21. **Ofcom** has a number of broad fields of regulatory oversight with separate powers for each field. First, under the Communications Act 2003 it is responsible for enforcement of broadcasting standards, as outlined in the Broadcasting Code. Ofcom's sanctions procedures stipulate that when a broadcaster has deliberately, seriously or repeatedly breached the Code, Ofcom has the power to impose a statutory sanction. There are a range of sanctions including issuing a direction, making a broadcasting correction, imposing a fine and ultimately revoking the licence. It is also responsible for the implementation of the EU Electronic Communications Directives, and is the regulator and competition authority for telecommunications in the UK.

22. Secondly, Ofcom also has responsibilities to enforce consumer protection laws[17]. Ofcom has a range of regulatory remedies available to correct the behaviour of operators. These include issuing notifications, securing formal undertakings from companies, imposing a financial penalty and seeking an injunction or order from the courts.

23. Finally under the Wireless Telegraphy Act 2006 Ofcom is responsible for regulating legal use of the UK radio spectrum and preventing illegal broadcasting. Under the legal framework Ofcom has the power to seize equipment, to issue suspension notices against manufacturers and marketers of illegal apparatus, and if necessary to bring criminal proceedings. Since 2011 Ofcom has had the power to issue fixed penalties for breaches[18]. However, it must be noted that these penalties are fixed amounts set by general criminal law, and as such Ofcom does not have flexibility in the amount issued. Consequently, these penalties will not be considered within this report.

24. Ofcom's penalty and redress powers are packaged together (e.g. in ss96A-96C and ss128-130, Communications Act). However it could, for example, issue only a Section 129 notification for persistent misuse or a Section 96C notification for breach of a condition, which provide only for remedial actions and not a penalty. Therefore, in practice, redress powers and penalties can be demarcated and exercised separately.

25. From the outline of the legislative frameworks it is evident that the broad 'tool kit' of sanctions available to the regulators is largely similar: regulators have the ability to compel regulated companies to carry out a certain course of action, whether through enforcement orders, notifications or censures. Furthermore, as one of the heavier tools in the kit, regulators all share the power to impose financial penalties.

26. However there is a significant level of disparity surrounding the specific powers conferred in relation to financial penalties. It is evident that some of the regulators have more flexibility over these powers than others.

27. Furthermore the ability to impose financial penalties and enforce consumer redress packages separately is currently enjoyed by the FCA, Ofcom, and Ofgem. In contrast to this, the enforcement actions of the ORR and Ofwat currently merge financial penalties and consumer redress packages as they do not have the direct power to compel customer redress as distinct from a financial penalty.

[17] Communications Act 2003

[18] The Wireless Telegraphy (Fixed Penalty) Regulations 2011

Regulatory guidelines

28. The variation in specific powers of enforcement is reflected in the differing approaches set out in the regulators' guidelines as to how they implement their enforcement frameworks. This is particularly noticeable with the most visible sanction available to regulators: financial penalties.

29. The **FCA** enforcement guide book[19] outlines a list of factors which the regulator will rely upon when establishing whether to impose a financial penalty. These include the nature, seriousness and impact of the suspected breach and the conduct of the individuals involved. If the breach was deliberate, frequent or sustained and resulted in a significant benefit to the company then a financial penalty is likely to be imposed.

30. The FCA guidelines state that the penalty-setting regime is based on three principles:

    i. Disgorgement: to ensure that a company does not benefit from breaches
    ii. Discipline: to ensure that a company is penalised for wrongdoing.
    iii. Deterrence: aiming to prevent future breaches.

31. This has led to a five stage process as to how the FCA determines the level of a financial penalty: the first stage is to strip the company of any benefit attained from the breach. The second is an additional figure to reflect the seriousness of the breach and is based on taking a percentage of the income from the misconduct. The third step is to take account of any aggravating or mitigating factors. The fourth stage is an adjustment if the FCA does not believe that the resulting penalty would achieve credible deterrence. The fifth stage is a discount for early settlement (if applicable).[20].

32. In parallel with financial penalties, the FCA will use its restitution and redress powers to secure redress packages in retail actions or secure redress through settlement without the use of formal powers, for consumers who have lost out financially due to the breach.

33. The Penalty Policy of **Ofgem** [21] sets out the criteria when deciding whether it would be appropriate to impose a penalty. Ofgem will seek to impose a financial penalty and/or make a consumer redress order that reflects the seriousness of the contravention or failure, ensures that the regulated person does not benefit financially from the contravention or failure, and deters future misconduct by the regulated person under investigation and other industry participants.

34. The **ORR** guidelines take account of both the six penalty principles set out in the Macrory report *Regulatory Justice: Making Sanctions Effective*[22] and the five principles of good regulation[23]: *proportionality* in applying the law and securing compliance; *targeting* of enforcement action; *consistency* of approach; *transparency* about how we operate and what the industry may expect; and *accountability* for our actions in line with best practice in regulation. The ORR enforcement framework has one main objective: to change the behaviour of the company so as to deter non-compliance.

35. Where it is decided that a financial penalty is to be imposed the ORR guidelines set out three principles for consideration.

    i. Proportionality
    ii. Adjustments for mitigating and aggravating factors
    iii. Financing duty

36. In assessing proportionality the issue is one of seriousness, looking at the actual and potential harm to third parties and the culpability of the offender, including whether the licence holder had acted negligently, recklessly, knowingly or intentionally.

37. The ORR enforcement framework sets out five levels of seriousness, with a corresponding range of penalties up to a statutory cap of 10% of the annual turnover of the company. The penalty ranges are indicative ranges as might apply to the monopoly track.

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[19] The Financial Conduct Authority Handbook DEPP Chapter 6.2 : Deciding whether to take action

[20] The Financial Conduct Authority Handbook DEPP 6.5 Determining the appropriate level of financial penalty

[21] Decision on Ofgem's Statement of Policy in respect of Financial Penalties and Consumer Redress, November 2014

[22] Macrory, *Regulatory Justice: Making Sanctions Effective*, 2006

[23] *Economic enforcement policy and penalties statement*, July 2012

i. De minimis breaches normally result in no penalties.
ii. Less serious breaches carry penalties up to £2 million.
iii. Moderately serious breaches warrant a penalty of £2 - £10 million.
iv. Penalties for serious breaches fall within the range of £10 million and £25million.
v. Very serious breaches lead to fines over £25 million up to the statutory cap.

38. The adjustments for mitigating and aggravating factors allows reductions for any steps which have been taken to remedy the breach or for co-operation with the ORR, while allowing increases for the inappropriate involvement of any senior directors or repeated and continuing infringement. The list is not exhaustive and other factors can mitigate or aggravate the offence and sanction.

39. The ORR has a financing duty to act in a manner which does not make it unduly difficult for a network licence holder to finance its activities. The enforcement guidelines make it clear however that where the ORR has decided it is appropriate to impose a financial penalty "it would be inappropriate not to do so just because this would make it difficult for an inefficient operator to finance its functions."

40. **Ofwat** also takes account of the *Macrory* principles, which are outlined in the guidelines "*Ofwat's Approach to Enforcement"*.

41. In determining whether financial penalties are the correct sanction, the 2010 revised guidance simply states that if Ofwat is "satisfied that a contravention or failure of service standard has occurred or is occurring [it will] decide if a financial penalty should be imposed and the level of that penalty"[24]. A decision to impose a penalty will be taken in light of an assessment ofthe seriousness of the offence and the policy objectives of securing compliance and increasing the deterrence effect across the sector.

42. As with its legislative powers, **Ofcom** has a different set of guidelines for each of its regulatory frameworks[25]. The guidelines for **broadcasting breaches** state that a sanction will normally be imposed when Ofcom considers that a broadcaster has "seriously, deliberately, repeatedly, or recklessly breached a relevant requirement". The regulator will decide which sanction is appropriate "after considering all the evidence and the representations of the broadcaster".

43. If it is decided that a financial penalty is appropriate then Ofcom will determine the amount of the penalty with consideration to a number of factors, as set out in the *Penalty Guidelines*, with a view to achieving the central objective: effective deterrence. These factors include the degree of harm caused, the duration of the breach, any gain resulting from the breach, any steps taken to remedy the breach and the extent to which the contravention occurred intentionally or recklessly, including the extent to which senior management knew. This list is not exhaustive and Ofcom will also take account of previous similar action, the level of co-operation from the company, and any mitigating actions taken by the company. This latter point means businesses have an opportunity, and an incentive, to offer ways in which they can recompense those affected.

44. The guidelines for **consumer and competition breaches** highlight that where the regulator has investigated a breach and decided that a financial penalty is appropriate it will first issue a Section 96A notification. This can propose a fixed amount penalty in respect of a past contravention and where the contravention is ongoing a fixed penalty or a daily penalty until the breach is remedied. Ofcom may also issue a penalty for "persistent misuse" of an electronic communications network or electronic communications services.Ofcom will consider any written or oral representations made, and any steps taken to ensure compliance or to remedy the consequences of the breach in deciding whether to confirm the penalty. The amount of penalty will be set in accordance with the Penalty Guidelines, as outlined above.

45. The outline of enforcement guidelines highlights a notable degree of conformity between the regulators in relation to the factors which are considered when determining the amount of penalty.

[24] *Statement of policy with respect to financial penalties*, 2010

[25] Ofcom has set out its guidelines for Broadcasting Standards in the *Procedures for the consideration of sanctions in breaches of broadcast licences*; the guidelines for consumer and competition regulatory enforcement are contained in the *Enforcement Guidelines; Ofcom's guidelines for the handling of competition complaints and complaints concerning regulatory rules*; where is has been decided under the above three guidelines that a financial penalty is to be imposed, this is in accordance with the *Penalty Guidelines s392 Communications Act 2003*.

Common factors across the regulators are the need for disgorgement of benefit, and a consideration of the seriousness of the breach. There is also significant overlap in the guidelines as to when a financial penalty should be imposed, or which factors should be considered in deciding whether a financial penalty is appropriate, with most regulators explicitly or implicitly taking on board the *Macrory* principles.

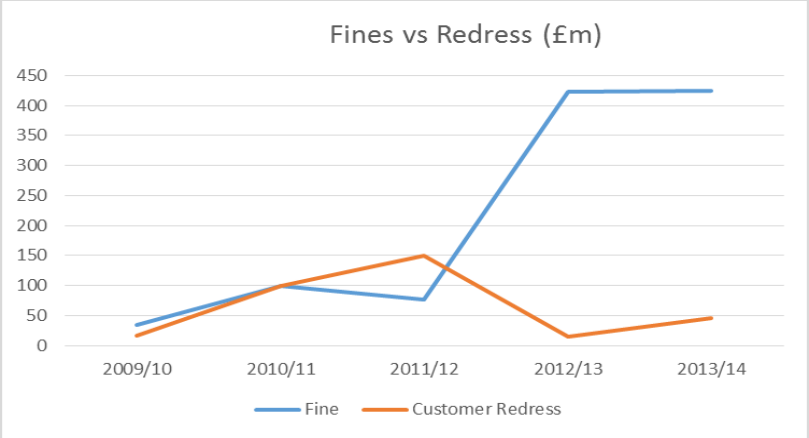
Use of sanctions

46. As financial penalties are only one of the sanctions made available to regulators under the legislative frameworks, it is first worth placing fines into context alongside the other sanctions available. This study looks only into the financial penalties imposed under regulators' sectoral powers and not those under competition legislation.

47. The FSA/FCA's policy has changed through time. In the three years up to 2011/12, the FSA imposed a total of just over £208 million of financial penalties. In the same period the regulator secured consumer redress packages through formal powers in excess of £260 million. In the latest two year period however the balance between financial penalties and customer redress packages has shifted, with the regulator imposing £848 million in fines, and £59 million in redress packages. Table 2 illustrates this shift through time.

48. However, this reduction in redress must be set alongside the voluntary undertakings by firms that are negotiated by the FCA without the issuance of a formal notification. These actions of supervisory-led redress have led to massive payments to consumers who have claimed to have suffered detriment. The PPI scandal has led to £14.3 billion being paid out by 2014. The failings in the way some banks sold Interest rate hedging products (IRHPs) has led to £600 million being paid back to customers by 2014, with a further £1.1 billion expected in the future[26].

Table 2
Comparison of the FSA/FCA's customer redress vs financial penalties



49. As illustrated in Table 3 the FCA experienced the most dramatic increase in the use of financial penalties. Penalties issued by the FCA dwarf penalties issued by the other regulators.

50. The FCA's 2013/14 Enforcement Annual Performance Account outlined a change in its approach, suggesting that the FCA is now increasingly focussed upon "early interventions". In practice this means engaging with unacceptable behaviours far earlier than it "normally would in the course of an ordinary, disciplinary investigation"[27]. These interventions often result in a voluntary agreement with the firm, without using the FCA's formal statutory powers of investigation or discipline.

51. This resulted in the FCA being involved in 21 early interventions across a range of sectors with the results varying from "redress exercises to systems and controls changes in wholesale and retail

[26] FCA Annual Report 2013/14
[27] FCA Enforcement Annual Performance Account 2013/14

firms"[28]. However, because in many cases formal action was not taken, not all interventions are published. Moreover, most that are publicised have involved a redaction of the names of the firms involved. This makes this policy difficult to analyse in detail.

Table 3 – Record of Financial Penalties

Regulator	Year	Number of Penalties	Value of Penalties
Ofcom			
	2013/14	11	1,127,500
	2012/13	12	1,129,000
	2011/12	12	3,569,120
	2010/11	4	449,750
	2009/10	8	527,898
	2008/09	23	8,098,500
FSA			
	2013/14	46	425,000,000
	2012/13	51	423,000,000
	2011/12	59	76,400,000
	2010/11	83	98,500,000
	2009/10	46	33,600,000
Ofgem			
	2013/14	4	11,000,002
	2012/13	3	500,001
	2011/12	9	19,700,000
	2010/11	1	15,000,000
	2009/10	1	2,000,000
	2008/09	1	1,800,000
ORR			
	2013/14	1	53,100,000
	2012/13	1	1,500,000
	2011/12	-	-
	2010/11	1	3,000,000
	2009/10	-	-
	2008/09	1	14,000,000
Ofwat			
	2013/14	-	-
	2012/13	-	-
	2011/12	-	-
	2010/11	-	-
	2009/2010	-	-
	2008/2009	3	45,542,000

[28]FCA Enforcement Annual Performance Account 2013/14

52. The FSA/FCA also secured in total 31 criminal convictions and issued 243 prohibitions of individuals in the years 2009 – 2014. The number of criminal convictions per year has remained fairly constant through time whilst the number of individual prohibitions has fallen from a high of 71 in 2010/11, to 26 in 2013/14. This drop in prohibitions matches a drop in individualised fines through time: in 2010/11-2011/2012, fines of over £23.3 million were issued to individuals for market abuse, whereas in the two most recent years – 2012/13-2013/14 – individual fines totalled £8.6 million. This is illustrated in Table 4.

Table 4 - *The FCA's punishment of individuals over time*

	Prohibitions	Total Individual Fines (£m)	Criminal Convictions
2013/14	26	3.6	5
2012/13	43	5	13
2011/12	47	15 (market abuse only)	5
2010/11	71	8.3 (market abuse only)	5

53. The regulator **Ofgem** has made wide use of the various sanctions available. Over the past three years the energy regulator has concluded a number of investigations against regulated utilities with the publication of an open letter or with the decision to accept binding commitments from the company.

54. Ofgem has furthermore made use of financial penalties, with a particularly high level of fines for the year 2011/12, when financial penalties totalled £19.7 million. In recent years however the regulator has accepted consumer redress measures in lieu of a financial penalty: for example, in July 2014 Ofgem imposed a nominal financial penalty against Eon of £1 to take account of a £12 million consumer redress package.

55. The **ORR**'s duty to take enforcement action has led to nine actions being taken by the rail regulator since 2007/2008. Four of these actions resulted in financial penalties, totalling £72.5 million over the period. The others resulted in final orders, with binding action plans.

56. An interesting development within ORR regulation is the use of contingency penalties which are imposed for failure to achieve the targets outlined in the final order. In 2012 an ORR judgement against Network Rail included payment of a penalty should the company fail to meet its commitments, set on a sliding scale of £1.5 million for each 0.1 of a percentage point that it falls below its target.

57. This enforcement order led to the especially large £53.1 million fine levied on Network Rail in 2014. Network Rail failed to deliver its given performance targets for the long distance sector – it was 5.1% short of its punctuality target of 92%. The original fine of £76.5 million was moderated due to the mitigating circumstances of extremely harsh winter conditions.

58. The regulator **Ofwat** has in recent years tended to move away from the use of financial penalties. In the two financial years of 2007/08 and 08/09, Ofwat imposed £74.3 million in financial penalties. In contrast, from the year 2009/10 onwards no penalties were imposed, with sanctions instead consisting of voluntary consumer redress packages and price reductions for the next pricing cycle.

59. Finally, with regard to the communications regulator **Ofcom**, the enforcement of sanctions has varied within each of the regulated fields. Within the broadcasting framework there have been 59 penalties imposed for breaches of the Broadcasting Code in the years 2008/09 to 2013/14. At the same time there have been 11 financial penalties for consumer and competition breaches and no penalties for illegal use of radio spectrum.

60. In the most recent 2 years, Ofcom has been targeting businesses that disturb telephone subscribers by making silent and abandoned calls. Homeserve were fined £750,000 in 2012/13 and TalkTalk were fined £750,000 in 2013/14 for misconduct in this area. Added together these two fines represent 75% of the total financial penalties imposed in the period.

61. Across the regulated sectors, therefore, it is evident from the record of enforcement action that a wide range of sanctions are now relied upon by the economic regulators within their respective regulatory frameworks.

62. It is also evident that there is wide use of non-financial sanctions, but that these sanctions take different forms depending on the regulator. They range from price cycle reductions, to revocation of licences and binding undertakings.

63. This shift away from financial penalties and diversification of their enforcement techniques differs across sectors. Ofwat and Ofgem accept measures in lieu of financial penalties. In contrast to this, the ORR's introduction of contingent penalties led to an especially large fine of £53.1 million in 2013/14. However, the ORR's consultation upon its Economic Enforcement Policy and Penalties Statement may prove to be an opportunity to greater integrate elements of recompense into its techniques.

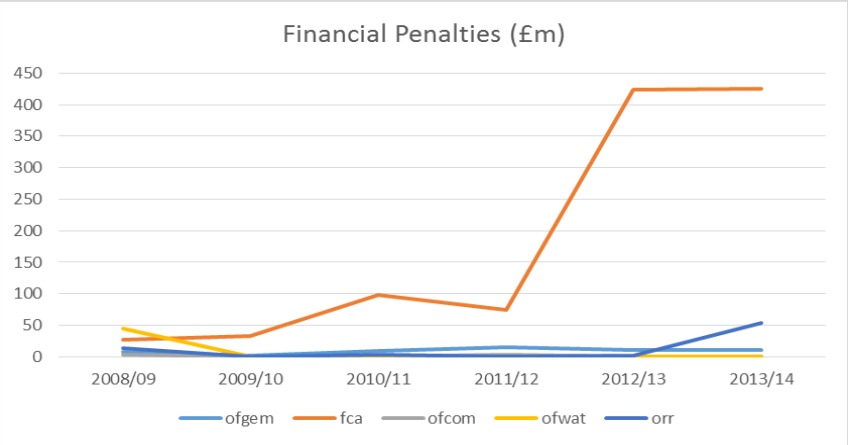
Financial Penalties

64. The outline of enforcement actions highlights that the degree to which regulators rely upon financial penalties varies between regulators. This is unsurprising given the different objectives which each of the regulators are looking to achieve in imposing financial penalties.

65. The varying use of financial penalties is illustrated in Table 5, which outlines the recent trends in fines by each of the regulators.

66. It is immediately apparent from this table that the FCA's use of financial penalties has been much greater than the other regulators, and that there has been a huge increase in the level of financial penalties imposed in recent years.

Table 5 – *Comparative Trends*



67. Furthermore, the figures and charts analysed here do not take into account (because it has not yet been incorporated into the official Annual Report) the FCA's decision in November 2014 to fine five banks – Citibank, HSBC, JPMorgan, The Royal Bank of Scotland, and UBS – a combined total of over £1.1 billion for attempted manipulation of foreign exchange rates. This figure could increase further as Barclays is still under investigation. This combined penalty is the largest ever meted out by the regulator, and will appear in next year's Annual Report.

68. Table 5 highlights that the increase in FCA fines is not reflected across the board, with decreases in the fines levied by Ofwat for example. This is offset by an increase in non-financial or consumer-focused sanctions.

69. This imbalance across sectors may be explained by the scale of the financial services sector. It is much greater than that of the other sectors examined. In 2011, financial and insurance services contributed £125.4 billion in gross value added (GVA) to the UK economy, 9.4% of total value added[29]. This is

[29] ONS, United Kingdom National Accounts, The Blue Book, 2013 Edition

nearly four times larger than the GVA of the energy industry and over five times the size of the GVA of the telecommunications industry in 2011.

70. Therefore, the scale and volume of the FCA's fines – when compared to those of the regulators - must be set against the financial sector's relative size vis-à-vis other sectors.

71. Furthermore, when put in the context of global financial regulation, the FCA's use of financial penalties is dwarfed by those levied in the USA.

72. In the United States, fines on banks have become the norm, with a wide range of federal and state level bodies having the statutory power to levy a financial penalty upon firms. The Office of the Controller of the Currency, a federal level regulator, issued fines of just under £1 billion to American banks in 2013/14. The Department of Justice also often metes out huge penalties: earlier this year it fined the Bank of America $16.65 billion (£10.36 billion) for mortgage fraud leading up to and during the financial crisis. Of this fine, over a third was to be paid in the form of customer redress.

73. There are increasing calls for supranational consultation over levying fines, with the option of allowing fellow regulators to block proposed penalties if they were likely to do too much damage to the companies. In a recent speech at a British Banking Association conference on Financial Crime and Sanctions, Andrew Bailey, Head of the Bank of England's Prudential Regulation Authority, called for regulators to employ a "cards on the table approach between authorities", encouraging greater transparency and communication among financial regulators.

74. Indeed, in the period studied in this report, US authorities imposed over £8 billion in fines on foreign banks, and have very recently fined BNP Paribas over £5.5 billion. There is concern that this sort of unilateral imposition will create an unbalanced international environment.

What happens on appeal?

75. Fines and other enforcement measures imposed by the regulators are subject to appeal.

76. In the case of financial services, since 2010 appeals are referred to the Upper Tribunal (Tax and Chancery Chamber), established by the Tribunals, Courts and Enforcement Act 2007. Prior to this, appeals were heard by a dedicated appeals body, the Financial Services and Market Tribunal. In the past two years, the Tribunal has issued 23 Decisions. 21 of these were upheld in substance by the Tribunal. 2 decisions were made in favour of the applicants and directed the FSA to take no action and discontinue proceedings (one of which was subsequently appealed by the FSA and overturned in their favour).

77. When pertaining to appeals on financial penalties, those involved in the operation of the financial services enforcement systems tell us that in practice that they consider the Tribunal to make relatively minor changes to the fines by the regulator itself. In 2013/14, the Tribunal heard three appeals of financial penalties. Two were upheld – at £100,000 and £150,000 respectively – whilst one was reduced from £3 million to £2.7 million.

78. The Tribunal's approach to appeals has been said to exhibit a significant level of trust in the competence of the FCA's Regulatory Decisions Committee to set the correct level of penalty.

79. In the case of the economic regulators appeal lies to the Administrative Court by way of judicial review. To date there has only been one judicial review that has proceeded to a full hearing on the subject of a financial penalty imposed by the regulators. This review was of a £105,000 fine imposed by Ofcom upon DM Digital Television Limited, and here the Court found for Ofcom.

The issues at stake

80. What is the purpose of the enforcement and fining systems operated by regulators?

81. The differing rationales of fines are illustrated well in the FCA's five steps for penalties: i) Disgorgement, ii) Seriousness of the breach, iii) Mitigating and Aggravating Factors, iv) Adjustment for deterrence and v) Settlement discount.

82. At one level therefore fines are intended to be credible deterrence – an attempt to adjust trends of behaviour in regulated sectors and prevent future non-compliance. There is clearly also a punitive element - to deter requires a punitive sanction and a number of regulators have set out how they attempt to calibrate this. The level of penalty is linked in all regulatory frameworks to the conduct of the companies and seeks to annul any commercial incentive to breach regulations. However the crime and punishment perspective of fines is increasingly looking out-of-date in the modern commercial regulatory environment, with most breaches being non-intentional oversights rather than deliberate acts.

83. Another element of fines, though more visible in the penalties of the economic regulators, is to provide some recompense to society or to those affected by the misconduct. This has proved a challenging issue for regulators, who have in some instances developed parallel systems of explicit consumer redress alongside traditional fining and enforcement sanctions.

84. The question on whether to fine or seek customer redress is interconnected with the decision as to where financial penalties levied for misconduct end up. The decision in turn has incentive effects. One option is for fines to be **retained by the regulator** concerned and used in its general work. This provides an obvious and perverse incentive for regulators to increase fines especially if the result is a net increase in their operational funding; that is to say if it is not sterilised by adjustments from public funds or from other levies on industry used to finance the regulator concerned.

85. Because of these incentive difficulties the trend in recent years has been to shift the payments so that they are **retained by HM Treasury** and not taken into account in the financing of the regulator concerned. While this effectively sterilises the fines and removes the more obvious perverse incentives it does not answer directly some further problematic issues arising from fining policy.

86. It has also created the situation whereby financial penalties can represent money being taken out of the industry, at the expense of investment, to be given to HM Treasury. This is particularly applicable in the case of fines imposed on Network Rail by ORR. However, Government may choose to re-invest these funds back into the sector. For example, following the ORR's decision to impose a £53.1 million penalty on Network Rail in 2014, the Government decided to re-invest the funds into Wi-Fi improvements for rail passengers[30].

Fines become routine

87. One challenge which arises is that **fines may become routine**. There are indications that in the United States, where financial penalties on financial services businesses are longer established and tend to be larger than those in the United Kingdom fines are seen as a cost of doing business. Large international banks expect that they may be found guilty of breaches of financial services regulatory norms, that the financial costs involved will be factored into the cost of doing business, and that in some cases due to the prevalence of fines and the wide range of financial services businesses caught by them there is no particular moral oblique in being seen to have been fined.

88. This is of particular concern given that fines are only beneficial to consumers, under the current regime, where they have preventative effect and incentivise future compliance by the regulated companies.

Passed through to consumers

89. Another challenge facing regulators is how to ensure that fines are not in **practice passed through to customers** in higher prices or reduced standards of service. This challenge is difficult especially where the regulator concerned does not operate any form of price control. In such circumstances it may be only press and public attention which can be expected to be effective in preventing those guilty of infringements from passing through the costs.

90. This issue arose recently in the United Kingdom when banks which are partially owned by the taxpayer were fined in relation to the Libor scandal.

[30] ORR, Enforcement policy and penalties statement review - consultation on options for improvement, December 2014

91. In these cases the risk was not simply that the fine could be passed to the consumer but that if it remained with the owner that would be the taxpayer, in the role of taxpayer-shareholder, and the fining policy would mean that taxpayers money would end up back in HM Treasury as a financial penalty: a form of round-tripping which would appear at the same time to be self-defeating and also lacking any moral power or credible deterrent effect.

92. To address this question the Chancellor of the Exchequer announced that *"I can also announce that further awards from the Libor banking fines have gone to good military causes, with money for Combat Stress to help veterans with mental health issues and funds for Christmas boxes for all our troops on operations this year and next…Those who have paid fines in our financial sector because they demonstrated the very worst values are paying to support those in our armed forces who demonstrate the very best of British values."*[31]

93. Similarly, following the FCA's imposition of £1.1 billion of fines on five banks following their manipulation of the foreign exchange rate, the Shadow Chancellor suggested that "*this latest banking scandal shows why we still need big reform and cultural change in our banks. But the fines levied on banks for foreign exchange manipulation should now be used for a wider good…So in next month's Autumn Statement George Osborne should use £1 billion of the fines from the banks for an immediate boost to our health service."*[32]This suggestion was adopted by the Chancellor who incorporated it into his 2014 Autumn Statement.

94. This approach however may still not establish an ideal set of incentives. Clearly the NHS and charities, especially service charities, enjoy high esteem in public opinion and can be considered worthy recipients. They are however not closely related to those in the markets who have suffered loss as a result of financial misconduct. One of the consumer bodies described the recent shift of fines revenue to military charities as a political, rather than an economic solution, which failed to follow the rational argument that the people to benefit should be those who had suffered detriment.

Impact on shareholders

95. Levying fines on firms has an impact on its shareholders, as it is a cost borne by them. This is particularly pertinent in the case of financial services as FCA fines are arguably now of a scale and volume to potentially hamper a bank's ability to grow its dividend. An increase in the scale and volume of fines could therefore undermine shareholder appetite to provide capital to these banks – capital on which further economic growth may depend. For example, in the wake of the recent FOREX manipulation scandal, and the imposition of a £216 million fine, HSBC shares dropped by almost a percentage point overnight.

96. It could be argued that shareholders should be aware of what they are investing in, and should bear the responsibility, and thus the cost, of transgressions. However, effective oversight of culpable individuals may be hindered by poor disclosure, or a lack of transparency. In these cases, where shareholders have in place satisfactory systems of corporate governance and in the absence of negligence it would seem appropriate for the regulator to pursue punishment of the accountable individual executives rather than banks as corporate entities.

Forms of compensation

97. An alternative advocated by a large number of consumer representatives is for the revenue from fines to be directed much more closely towards to the consumers who have suffered from the breach. There has been a steady growth in the number of consumer compensation schemes across the sectors, putting the consumer interests more centrally in the enforcement framework. A notable example is the Delay Repay scheme within the rail sector which secured a total compensation package of £9,549,000 for consumers in 2011/12 alone[33].

98. The effectiveness of direct compensation to consumers will be impacted by the level of consumer awareness. In the case of rail the level of awareness over entitlement to compensation for late

[31] Rt Hon George Osborne, Chancellor of the Exchequer, Budget Speech 2013

[32] Rt Hon Ed Balls, Shadow Chancellor of the Exchequer, Speech to the Labour Party's East of England regional conference, 2014

[33] Department for Transport, *FOI Request: Compensation figures paid to passengers by train operating companies*

services is low, an ORR report suggests[34]. This inevitably weakens the impact of Delay Repay and related schemes. Companies should therefore be under an obligation to notify consumers, in line with the obligation on airlines to notify passengers of compensation entitled for late flights under EC Regulation 261/2004. Train operators have taken a step in this direction with public address announcements in trains now encouraging consumers to take action.

99. The diversion of revenue from financial penalties to consumers would not necessarily need to be in the form of cash payments. This approach would not be feasible for all sectors: Ofcom noted that in the case of broadcasting standards breaches, it would be very difficult to quantify the detriment and even more difficult to identify the consumers who had been affected. In the cases where it is not possible to identify those consumers directly affected the revenue could be passed to consumers through benefits in kind, such as enhanced infrastructure investment.

100. There are already precedents for this type of remedy: in June 2014, Ofwat came to a settlement with Thames Water worth £86 million. Of this £2 million was put into a fund to assist customers who were struggling to pay bills, £5 million was put aside to support local programs enhancing resilience and eco-diversity, and £79 million was deducted from Thames' regulated capital value. This will result in lower bills for customers for several years.

101. Similarly in December 2013 Ofgem imposed a nominal penalty of £1 on Scottish Power to recognise that the company had agreed to make payments of £8.5 million consumer to benefit consumers as an acknowledgement that it did not reach expected standards in its approach to sales. The vast majority of this - £7.5 million was paid directly to vulnerable customers identified through Scottish Power's "Warm Homes Discount Scheme". £1 million was set aside to recompense those customers directly affected by Scottish Power's miss-selling. Innovatively, any money not paid out – whether through un-cashed cheques or funds not claimed – will be put into the Energy People Trust. This Trust sponsors charities that support people affected by fuel poverty.

102. The fear for consumer bodies with this approach is that companies must not be permitted to reap public relations gains from such enforcement action. This is particularly applicable in those sectors, such as rail, where there is poor consumer awareness over consumer rights and companies' compliance records. Where this approach is adopted, consumer bodies believe, the consumer redress package or infrastructure investment must be specific and visible: revenue must be targeted at a certain class of consumers or into a specific project, and not into company funds for discretionary application.

103. It is also sometimes suggested by consumer representatives that greater impact could be made on the behaviour of companies if regulators were prepared to make greater use of individual criminal powers and sanctions. However it was noted that the role of management, the importance of corporate responsibility and the nature of some regulatory breaches, will mean that company fines will often be more appropriate.

The EU context

104. This discussion on fines, and the issues raised within this paper, is not limited to the UK.

105. A paper by Bruegel, entitled *Do European Fines deter price fixing?*[35], questions whether the objective of cartel fines, "to ensure the maximum level of deterrence while introducing the least possible market distortion", is currently being secured.

106. The analysis found that the wholly deterrent rationale of cartel fines was insufficiently realised in the fines imposed by the European Commission. The report concluded that "increases in fines are not necessarily the best way to go. Targeting the corporate executives who are responsible for cartels could be a medium to long term objective which could complement corporate fines and ensure a higher level of deterrence."

[34] ORR, *Passenger compensation and refund rights for delays and cancellations*, 2014

[35] Mario Mariniello, *Do European Union Fines Deter Price Fixing?*, Bruegel policy Brief, May 2013

107. In other words, there have been calls for similar diversification of enforcement tools at the EU level, even where the objective of the fining regime has been identified solely as for deterrence.

108. The call for greater use of individual fines directly reflects the calls of consumer bodies here in the UK, and the shift towards greater diversification is in parallel to the greater diversification of tools applied by the UK regulators.

109. The EU discussion is not examined in depth within this paper but it again highlights that the issues at stake are common concerns throughout fining regimes.

Greater diversification

110. The common theme emerging from both the recent trends in regulators' fines and the calls by consumer councils is the need for regulators to diversify their enforcement actions.

111. This diversification relates not only to the nature of the fine, and whether it there should be greater use of personal fines, compared to corporate fines. It also relates to the purpose of fines: the balance between deterrence and recompense.

112. There is variation between the regulators as to the balance of scales between these two elements, but in recent years there has been a shift, most visible in Ofwat, in regulators' approach to fining.

113. The greater use of nominal fines and fines being waived in lieu of recompense measures, whether cash or infrastructure investment, illustrates a growing diversification within fining policy beyond a narrow deterrence focus.

114. Given this emerging trend, it could be argued there is benefit in the economic regulators separating financial penalties from consumer redress measures. This would ensure a more formal diversification between the deterrence / punitive and consumer recompense elements of financial penalties. The trend is that the regulators seem to be heading in that direction, with the FCA, Ofcom, and Ofgem now having powers to distinguish between the two elements, and the ORR are consulting on their redress guidelines.

115. It must be noted that there are redress measures for some breaches of consumer law in the Consumer Rights Bill as proposed amendments to Part 8 of the Enterprise Act 2002, under which regulators have some powers. This may be a further helpful move towards bridging the gap in rights for consumers to be provided with direct redress where businesses breach consumer law.

116. Notably it is felt in the consumer world that these recompense packages can have a much greater deterrence effect than fines. The PPI scandal and ensuing redress for consumers, which has led to banks setting aside £14 billion, was highlighted as a prime example where focusing on consumer redress, rather than financial penalties, had resulted in the biggest change of behaviour.

117. Furthermore, one consumer council felt this approach to be tricky, with the potential to harm consumers. On one hand by removing their fining powers, it could weaken the team which oversees consumer recompense during negotiations, and on the other hand it could lead to companies trying to limit consumer redress packages as much as possible, due to concerns about getting hit twice.

Conclusions

118. Fines by Britain's regulators have become of major significance in recent years. Between 2008/09 and 2013/14 Britain's major regulators - the Financial Conduct Authority, formerly the Financial Services Authority, Ofcom, Ofgem and Ofwat and the Office of Rail Regulation - have imposed penalties totalling over £1.2 billion.

119. This report has asked some questions about the use of fines. What is their primary purpose? Some regulators use them for punishment of wrongdoing or for deterrence. Others have changed their emphasis from financial to non-financial sanctions. Some regulators have explicitly told offending companies that they can give redress to their customers instead of paying a fine which ends up in the consolidated fund at HM Treasury.

120. As this report shows, regulators have differing statutory frameworks which affect the penalties they can levy. The McCrory guidelines, however, represent a general approach arising from the recommendations of a report commissioned by the then Chancellor of the Duchy of Lancaster, John Hutton, which secures some measure of consistency.

121. The Department for Business, Innovation and Skills should factor this into the work on improved joint working between the regulators, especially as it currently analyses its response to the "Streamlining Regulatory and Competition Appeals: Consultation on Options for Reform[36]".

122. If regulators are looking to change a system in which large sums of money are transferred from utility businesses to HM Treasury's consolidated fund, the Chancellor of the Exchequer himself is clearly aware of this difficulty. In recent financial market infractions, he has ensured that fines have gone to military causes, with money for combat stress and funds for Christmas boxes for troops on operational duty. Moreover, in the recent Autumn Statement 2014, the Chancellor promised that the £1.1 billion paid by the banks involved in foreign exchange manipulation would be handed to the NHS, following an earlier recommendation by the Shadow Chancellor.

123. These changes show that the financial penalties of the traditional model look increasingly outdated and irrelevant. A particularly striking issue arises when banks which have been rescued with tax payer funds are fined for misconduct. The risk is that funds given out of one pocket by the taxpayer roundtrip back into another pocket of HM Treasury.

124. Relatively little work has so far been done on the effect of financial penalties on the businesses which are subject to them.

125. Do corporate executives treat fines as a grave matter in circumstances where these have become relatively common occurrences (routine)? Especially in the financial sector fines may be seen as a routine cost of doing business in a heavily regulated area where many banks and financial institutions have infringed both misconduct and mis-selling rules.

126. Are regulatees sufficiently concerned by reputational risk to adjust their behaviour and hence reduce future infringements?

127. If fines are failing to make any significant impact on firms, their reputations or their revenues, and increasingly becoming a series of monetary round trips to HM Treasury, the system has clearly become an ineffective and worthless means of enforcement. In light of such fears consumer bodies have been calling for a shift in focus within the fining regime to put individuals at both Board and executive level under the spotlight.

128. The obvious benefit of a fining system in which the proceeds are remitted to HM Treasury is that it avoids conflicts of interest for regulatory authorities. Because they do not receive a benefit from the fines themselves they have no incentive to ramp up an unnecessarily onerous penal regime designed to boost their budgets. Yet notwithstanding this clear benefit, opinion is moving towards a system in which fines are replaced by consumer redress packages. Instead of paying a fine to HM Treasury a utility business may be required to invest in a particular area of its operation, to enhance customer benefit; to adjust its tariff to benefit customers; or even to compensate customers directly who have been affected by an infringement.

129. The transformation of fines into customer benefits means that a newer form of penalty, one which is seen to give some behaviour redress to customers, is more likely to be used as a regular feature of the regulators' tool kits.

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[36] Streamlining Regulatory and Competition Appeals: Consultation on Options for Reform, Department for Business, Innovation and Skills, June 2013, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/229758/bis-13-876-regulatory-and-competition-appeals-revised.pdf

130. Regulated businesses would not welcome the unlimited expansion of these powers. There are obvious incentives on regulators to become active in identifying infringements if the result can be to improve perceived benefits to customers. A well-desired appeal for them may be one way of checking any such impulses.

131. The common theme which emerges from this report is that there would be benefit in a wider range of techniques to punish infringements and misconduct.

132. Financial services regulation is the pioneer in this field with a larger number of cases and a greater volume of fines. Lessons suggest that shifting from fining corporate institutions to fines on guilty individuals may be a more focused, effective and persuasive remedy. It singles out those guilty of wrongdoing. Of its nature it requires a high standard of proof. It guards against fines becoming anonymised and routinised in large corporations. It provides a clear warning to others not to commit wrong doing. It is also self-policing as the higher standards of proof in practice provide guard against any perverse incentives for regulators to make a general increase on fining of companies.

133. Similarly, the ORR requires Network Rail's management incentive plan to support the delivery of the company's regulated outputs: under the current management incentive plan, the pot available for bonuses under the long term incentive plan relates to a measure of the company's financial performance, from which any financial penalty is deducted. This could be strengthened by deducting fines revenue directly from the bonus pot, rather than the period turnover.

134. Additionally , given that all those appointed to public Boards (and in financial services into significant executive roles too) must pass the 'fit and proper' test, there could be benefit in establishing a system for monitoring and registering details of the individuals responsible for the breach in terms of executive responsibility. Executives who fail these tests could face the ultimate sanction of being banned from working in a particular regulated market.

135. It is also desirable for regulators to continue the shift which has become apparent from fines paid to HM Treasury to the greater use of nominal fines or fines being waived in favour of recompense measures. These may be cash to customers or investment in infrastructure. Direct compensation will always be the most appropriate and proportionate response to a breach which causes direct harm on identifiable consumers. Where it is not possible to identify individual consumers then collective redress through measures such as price reductions or additional investment in infrastructure, for the group or class of consumers most likely to be impacted presents a much more rational and forward thinking approach to enforcement than the transfer of fines to HM Treasury. There are already many examples of regulators taking such steps.

136. Consumers would need to know that they were benefiting from enforcement action, in order to strengthen deterrence and prevent offending companies gaining a false public relations advantage from the remedial measures.

137. The emerging phenomenon that fines are diverted to charitable good causes such as military charities makes political sense but suffers from an obvious disconnect. It does not benefit these whose interests have been damaged by licence breaches or mis-selling. It should be replaced by sustainable long term approaches. In the medium and long term consumer bodies are developing a more detailed methodology to deploy funds as closely as possible to the groups of consumers who have been damaged by misconduct.

Summary of changes since the first edition

138. In the time following the publication of the first edition of this study there have been some notable relevant developments that have been brought out throughout the text.

139. First, **Ofwat** and **Ofgem** have increasingly been accepting measures in lieu of a financial penalty. Indeed, Ofwat have not issued a fine in over five years. However, this does not necessarily mean that they will not do so in the future, as decisions are taken on a case by case basis and it is still within their statutory remit. Ofgem, whilst still tabling fines of over £31 million since the start of 2011/2012, have begun to address the issue of customer redress, and now have the power to compel customer redress as separate from a financial penalty.

140. In the last year, both Ofwat and Ofgem have imposed nominal £1 fines in recognition of wider compensation for customers – be it through lowering bills, recompensing consumers directly, or investing in resilient local infrastructure. This sort of targeted penalisation is much preferable to fines being transferred to HM Treasury, and represents a step in right direction.

141. **Ofcom** has seen both the number of fines and the total amount levied in 2013/14 stay very close to the figures from 2012/13. Financial penalties still seem to be used as the primary deterrent to aberrant behaviour. As has been previously stated, Ofcom may find it difficult to diversify into individualised compensation for breaches of broadcasting standards as it would be very hard to quantify detriment and even more difficult to identify individual customers. However, it could be argued that more could be done to find novel ways of keeping the money within the system, rather than transferring it to HM Treasury.

142. This is particularly true when considering telecoms breaches, where it may be easier to identify the individual customers affected. For example, with the ongoing investigation into and the punishment of companies conducting nuisance calls, Ofcom imposed a fine of £750000 on TalkTalk. It could be argued that a parallel system of consumer redress, targeted at those who were subject to the abandoned calls, would be very effective here.

143. The **ORR**, with the advent of contingency penalties for missing pre-agreed targets, levied an especially large fine this year of £53.1 million. The last substantial financial penalty meted out to Network Rail was in 2008/09. The penalty was injected back into the sector in the form of funding Wi-Fi improvements for rail passengers.

144. At the **FCA** an ongoing consultation into changing its regulatory framework for individuals, with a view to encouraging the individualisation of both scrutiny and punishment, is significant. Punishing individuals rather than firms may be a more nuanced way of allocating responsibility for ethical standards, and prove to be a better deterrent. A move towards this sort of approach is seemingly favoured by Mark Carney, Governor of the Bank of England, who addressed the issue in November 2014, suggesting that "standards may need to be developed to put non-bonus or fixed pay [of Senior Managers] at risk"[37]. On the other hand, the volume and scale of FCA fines on firms has rocketed in the last two financial years. This looks set to continue through to next year at least, with the FCA fining five banks a record £1.1 billion in November 2014 for manipulation of the FOREX rate.

145. This upturn in fines has corresponded with a downturn in the amount of compelled customer redress given. In the years up to and including 2011/12 the figures for fines and redress were broadly in parity. Since then fines have become much more significant than redress. However, this must be set against the substantial figures for voluntary undertakings on behalf of firms in providing redress for customers.

146. Nevertheless, the effect of ramping up the scale and volume of fines remains the same, and there is still an inherent risk that fines become the norm for banks - like they are in the US - if the stratification between formalised redress and fines continues. This may degrade the long-term credibility of such methods if fines become factored into the "costs of doing business".

Recommendations

1. **Fining companies in breach of regulatory requirements and then sending the revenue to HM Treasury no longer carries public credibility. It should be phased out.**

2. **Where senior corporate executives are responsible for regulatory breaches, they rather than the company itself should be subject to financial penalty. Additionally breaches and those responsible should be monitored and registered. Executives who fail these tests could face the ultimate sanction of being banned from working in a particular regulated market.**

3. **Especially where taxpayers are involved in the business, executive bonuses should be targeted and financial penalties initially met from bonus pools, before targeting general corporate resources.**

[37] Mark Carney, "The Future of Financial Reform", speech given at 2014 Monetary Authority of Singapore Lecture.

4. **Many regulators are already shifting their emphasis from fining companies to requiring them to give customer redress. This approach should be expanded especially as evidence suggests that putting things right for consumers directly affects company behaviour.**

5. **Other regulators should adopt the approach of Ofgem and Ofwat and reduce fines replacing them with compensation packages for customers. Where individual customers cannot be compensated measures which benefit groups of those affected could be used.**

6. **Naming and shaming can be an effective deterrent. Compensation packages should be clearly identified to customers as the result of enforcement action. Quarterly statistics of enforcement cases should be published by BIS on behalf of all economic regulators with enforcement powers.**