Mr Gowdy
0238A
1/7/88

CONFIDENTIAL

DEPARTMENT OF FINANCE & PERSONNEL

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DEPARTMENT OF ECONOMIC DEVELOPMENT
30 JUN 1988
RECEIVED
BRANCH

1. Mr O'Hara
2. Mr Hardy - I think it would be prudent to bring this to the attention of Mr Alan Magee, only on a need to know basis, but it should not be a child of an Under Secs. 18/7/88

Your Reference

Our Reference A296/88

Date 29th June 1988

Dear Permanent Secretary

30/6

Mr McKenna

To note + PA pl 22/7/88

19.7.88

CONTRACTORS, CRIMINAL ACTIVITY AND FINANCIAL INSTITUTIONS

1. I am enclosing a copy of a recent HMT guidance paper on Contractors, Criminal Activity and Financial Institutions.

   The legislation referred to in the HMT paper (the Financial Services Act 1986, the Building Societies Act 1986, and the Banking Act 1987) extends to NI, and HMT's guidance is broadly relevant to NI Departments except that their contact point for all advice is DFP (Government Accounts Branch, Rosepark House) rather than HMT, Bank of England, etc.

2. The guidance paper should be read in the context of DAO(DFP) 3/87 and DAO(DFP) 3/87 (1st Amendment) on Departmental Banking and Money Transmission Arrangements.

3. In the Northern Ireland context special regard should be given to ensuring that public funds do not leak to paramilitary organisations. Central Secretariat should be consulted in any case where there are reasonable grounds to suspect a paramilitary involvement or linkage.

4. Departments may find it useful to include in their Internal Audit programme an initial examination of the operation of contracts by Departments and their agencies.

5. This is a sensitive area and these papers should be circulated within Departments on a strict "need-to-know" basis. Where necessary, relevant parts of the guidance may be drawn to the attention of NDPBs, but the existence of a list of contractors regarded as ineligible to tender would not normally be disclosed to bodies outside Government.

Mr Magee (ALAJ) 3/7

Mr. Hardy. Noted thanks. A.J. Magee 21.7.

Mr O'Hara has asked that you have sight of this. Please return to me but do not copy.

D.S Hardy
20.7.88

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6. Any further guidance issued on this subject will be copied to the recipients of this letter.

Yours sincerely

R J JORDAN
Rating, Accountability and
European Division

cc. Sir Kenneth Bloomfield
Mr Cole
Mr Court
Mr Semple
Mr R Wilson
Mr F Smyth
Mr S Quinn
Mr Walker
Mrs Collins, Companies Registry
DED

LGr-8.22a (New)
MM/IS

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CONTRACTORS, CRIMINAL ACTIVITY AND FINANCIAL INSTITUTIONS

Note by HM Treasury

The existing guidance on "Criminal activity by contractors" (PPC(80)12) lays down broad guidelines for departments needing to take decisions about dealings with individuals or firms who are in some way involved in criminal investigations or prosecutions. While the guidance is cast in general terms, its main practical application has been in the field of procurement other than services. Following the recent spate of allegations and investigations involving financial institutions, the question has arisen whether similar guidelines are appropriate for banks, merchant banks, and other providers of financial services, such as stockbrokers and financial advisers, who are likely to be subject to statutory supervision.

2. Also relevant is the passage of new legislation (Financial Services Act 1986, Building Societies Act 1986, Banking Act 1987) defining the scope of statutory supervision and the legal constraints on the use of supervisory information. When the Financial Services Act is fully implemented, in April 1988, it will be a criminal offence to carry on investment business, without authorisation. (It is already a criminal offence to accept deposits in the course of carrying on a deposit - taking business without authorisation or exemption from the Bank of England, or to deal in securities without authorisation or exemption). This note therefore provides additional guidance relating to financial institutions. It is intended to supplement existing guidance on choosing banks for privatisation work and major export credit business.

3. In this paper the terms 'financial institutions' and 'deposit taking institutions' include building societies. Where cases involving building societies arise, references in these guidelines

to banks, the Banking Act 1987 and the Bank of England should be taken to apply to building societies, the Building Societies Act and the Building Societies Commission.

Existing Arrangements

4. PPC(80)12 formalised arrangements that had been standard practice for dealing with criminal activity by contractors since the early 1960's. It envisaged that departments would maintain a list of contractors regarded as ineligible to tender. Although the existence of such lists has been admitted publicly, it is not something to which attention is drawn if this can be avoided. The information about firms recorded in such lists is commercially very sensitive, but there are arrangements, operated by PSA, for the interdepartmental exchange of this information, on a strictly "need to know" basis. While firms are not told that they have been placed on an ineligible list, they are informed that they have been removed from a department's approved list.

5. The purpose of ineligible lists is to assist departments in discharging their responsibilities for the proper use of public funds. The general approach is summarised as follows:-

> "The accountability of departments for the proper use of public funds and the need to exercise prudence in commercial relationships make it necessary that, so far as possible, they should only deal with contractors in whose integrity they can place full confidence."

Accordingly, where a department finds out that a company is being investigated by the police or is likely to be prosecuted for a serious offence, it should "consider whether there is a risk in continuing to deal with that company until the matter has been resolved, and also whether a confidential warning should be sent to other departments". Similar questions arise where directors or senior managers of companies are charged with or convicted of serious criminal offences.

6. It is recognised that a department's response necessarily depends on the circumstances. In the case of investigations or prosecutions, action is normally limited to imposing a temporary ban or removing a company's name from an approved list. A conviction might lead to a firm being put on the ineligible list, which implies that it would not be invited to tender for new business for a period of years. Existing contracts are normally allowed to run their course, particularly if unilateral termination could lead to a claim for damages.

7. To ensure that lists are kept up to date and uniform, PSA arranges for annual circulation of a consolidated list to named individuals in the departments principally concerned. The responsibility for placing firms on lists lies with departments: and names can only be removed from the central list after consultation with the originating department.

Dealings with Financial Institutions

8. The general principles underlying these arrangements are clearly applicable to financial institutions. In particular:-

- departments must have full confidence in the integrity of all those with whom they have commercial relations;
- it is part of Accounting Officers' duty to satisfy themselves on this score;
- information that leads one department to question a firm's integrity should be shared with others, to ensure that Government's dealings are consistent and evenhanded.

9. The implementation of these principles should however take account of certain features of the financial sector, and the Government's dealings with it:-

- deposit taking institutions, and (to a lesser extent) other financial institutions, are subject to strict statutory supervision to ensure their financial soundness

and the "fitness and properness" of all those with a significant influence in the running of their affairs.

- statutory confidentiality constraints impose very strict limits on disclosure to, or within, Government of information about the affairs of an individual financial institution which has been obtained for supervisory purposes.

- commercial dealings between Government departments and financial institutions vary very widely - from routine banking transactions to highly prestigious appointments as HMG's agent or confidential adviser in privatisations and foreign currency issues;

- for the most sensitive and high profile appointments in the privatisation and export credit field, arrangements already exist for pooling departmental experience.

10. The fact that financial institutions are subject to strict supervision should mean that only in the most exceptional circumstances will a department's dealings need to be curtailed because of a risk of loss to public funds. As a general rule, where an institution or its managers or directors are involved in a serious criminal case, the Bank of England (or other statutory supervisor) will take whatever steps are needed to safeguard the interests of depositors (or investors). Continued authorisation by the Bank of England, or relevant financial services regulators is therefore prima facie evidence of financial probity.

11. More frequently, departments may be less concerned about the risk of actual financial loss than with the need to avoid the appearance of impropriety or partiality. The risk of such embarrassment will depend on the circumstances. It will normally be negligible in the case of routine banking transactions. But where commercial dealings with Government confer considerable cachet, Departments should consider whether it might be inappropriate to give new business to private firms where their

activities, or those of their directors or senior managers are under investigation by the police, Serious Fraud Office, DTI, Bank of England or Securities and Investments Board.

12. Civil as well as criminal cases may be relevant. There may be a need to protect Government's position in current litigation: for example, if the fact that a firm has been re-appointed could prejudice the Government's position in an outstanding suit for damages in respect of a previous appointment, particularly in the US courts.

Procedures: Routine Cases

13. There is no centrally held list of "approved" financial institutions: nor is it intended that such a list should be compiled. Departments should however check that a financial institution with whom they propose to do business holds a current authorisation under the Banking Act (a list is published by the Bank of England), or in the case of securities and investment business, the appropriate authorisation from the Secretary of State, the Securities and Investment Board (SIB) or associated Self-regulating Organisation (SRO). (The SIB keeps a register of all businesses authorised under the Financial Services Act). This should be done, as a routine matter, by asking firms for the name of their regulators (there may be more than one), and cross-checking with the regulatory bodies concerned.

14. Where, exceptionally, a firm is not authorised under the Financial Services or Banking Acts, departments should satisfy themselves that the business in question is properly exempted from the scope of the legislation, and that there are no other relevant supervisory arrangements. For example, foreign exchange and wholesale money market activities are exempt from the Financial Services Act, but supervised, on a non-statutory basis, by the Bank of England, who maintain a list of approved institutions. Treasury (FIM Group) or DTI (Financial Services Division) can advise on such cases.

Procedures: Sensitive Contracts

15. More thorough checks should be made in the small minority of cases where departments are proposing to employ financial institutions in a very sensitive fiduciary or advisory capacity. Virtually all such cases are likely to arise in connection with privatisation, export credit or foreign currency borrowing programmes, where existing guidance already alerts departments to the need to make enquiries about management expertise and track record, and to consult the Treasury and the Bank before issuing invitations to tender.

16. In these cases departments should take steps to ensure that they are aware of any police or Companies Act enquiries or investigations, or equivalent enquiries under the Financial Services, or Banking Acts, as well as pending criminal cases, or civil cases to which Government is also a party. The Treasury and Bank of England can advise on those cases where knowledge of on-going investigations is in the public domain. But the majority of Companies Act and Financial Services Act enquiries are not, and Banking Act enquiries are only rarely publicly announced. Statutory confidentiality provisions mean that Departments need to approach firms directly for their permission before attempting to obtain information from the Bank of England or other supervisors.

17. Before drawing up short lists for particularly sensitive contracts, Departments should therefore ask each candidate for details of:

(i) an institution's financial supervisor(s);

(ii) any current or recently completed investigations into the affairs of the institution, its directors or key managers, under the Companies, Financial Services, or Banking Acts; any police or Serious Fraud Office enquiries into possible fraud; or any involvement in investigations and enquiries into the affairs of others which might result in public critcism or action against the institution.

(iii) whether it is content for the Department to confirm the information supplied at (ii) with the relevant supervisor.

In the event of unsatisfactory replies to any of these questions, Departments should direct their queries in the first instance to the firm concerned, before pursuing the matter further with the supervisors. If, in these circumstances, a firm refuses permission for an approach to be made to its financial supervisor, departments should normally regard this as grounds for not employing it on a sensitive contract.

18. Where a financial institution is involved in an investigation by the police, Serious Fraud Office, DTI, Bank of England or SIB; or is facing criminal charges, or engaged in litigation to which Government is a party, departments should assess the nature and extent of the risks involved in engaging it, bearing in mind the need to act fairly towards the firm and:-

- the nature of the appointment or contract under consideration;

- the seriousness of the alleged or actual misdemeanours and whether the damage done to a firm by treating it as ineligible would be disproportionate;

- whether they raise issues of general propriety or financial probity;

- whether the relevant statutory Supervisor (eg Bank of England) is in possession of the facts;

- whether shortcomings in the organisation have been put right, for example by the introduction of new systems or the departure of particular individuals;

- whether the appointment would in any way compromise the Government's reputation and standing.

19. It would be helpful if Departments could inform the Treasury (through their expenditure division) of any case where a firm has refused permission for an approach to its supervisor or given any other grounds for serious reservation, so that the Treasury can alert other departments to the need for thorough checking before employing the firm concerned. If information subsequently comes to light which suggests that these reservations were misplaced or no longer valid, the Treasury should again be notified.

20. These guidelines do not apply to the appointment of professional advisers other than investment advisers authorised under the Financial Services Act. Queries on the appointment of such advisers (lawyers, accountants etc) should be addressed to the relevant Head of Profession within Government.