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FSA FINES PRUDENTIAL AND PUBLICLY CENSURES ITS CEO

On 27 March 2013, in one of its last acts before being abolished, the Financial Services Authority ("FSA") announced the outcome of enforcement action against Prudential and its Chief Executive Officer, Tidjane Thiam. The proceedings arose from Prudential's attempt in 2010 to acquire AIA Group Limited ("AIA"), a subsidiary of American International Group Inc ("AIG"). In three final notices, the FSA announced:

- a financial penalty of £14 million on Prudential plc ("Prudential"), the FTSE 100 listed company, for breach of Listing Principle 6 ("A listed company must deal with the FSA in an open and co-operative manner");

- a financial penalty of £16 million on The Prudential Assurance Company Limited ("PAC"), a UK regulated insurance company, for breach of Principle 11 of the FSA's Principles for Businesses ("A firm must deal with its regulators in an open and co-operative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice"); and

- a public censure of Mr Thiam for being knowingly concerned in PAC's breach of Principle 11.

Background

In 2009, AIG began preparations to dispose of AIA by way of an initial public offering or third party sale. Following an approach to Mr Thiam from the CEO of AIG, in early 2010, Prudential commenced due diligence and entered into a confidentiality agreement. At a board meeting on 31 January 2010, the directors of Prudential were briefed on the proposed transaction. It was considered that a key risk to the proposed transaction was a leak and the FSA was one of a number of parties which might be the cause of a leak. Shortly thereafter, Prudential decided that if there was a leak, it would abandon the deal and issue a "no discussions" announcement in order to protect its share price and avoid any chance of a protracted suspension.

Although at this stage there was considerable doubt that the transaction would proceed, the negotiations continued and it was noted at a board meeting on 3 February 2010 that the "AIA IPO was running into difficulties, which gave Prudential a strong negotiating hand".

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On 5 February 2010, Mr Thiam and the Prudential chairman met with the CEO of AIG and gave him an "indicative non-binding proposal" which included a preliminary price range of $30-35 billion, a proposed debt and equity financing structure and a timetable. Further discussions between the parties ensued and on 11 February 2010 Mr Thiam reported to the Prudential board on the outcome of a meeting which the Prudential chairman and he had attended with the US Treasury and AIG.

By 12 February 2010 the negotiations had progressed sufficiently for Prudential to submit a revised indicative non-binding proposal to AIG. This revised proposal included a specific price of $35.5 billion. Also on 12 February 2010, Mr Thiam and another director of Prudential and PAC met with the supervision team at the FSA. This meeting was one of a series of regular meetings in the supervisory process. The FSA asked detailed questions about Prudential's strategy for growth in Asia and its intentions to raise equity and debt capital, but Prudential did not disclose the proposed acquisition of AIA.

The negotiations between Prudential and AIA continued to make progress such that on 17 February 2010, the Prudential board agreed that the transaction was sufficiently advanced that if there was a leak, a "discussions happening" announcement would be made confirming that the parties were in talks about the transaction. Although it had previously been decided that the FSA would be notified when the negotiations reached this stage, no approach to the FSA was made. In the ensuing 10 days, Credit Suisse, the lead sponsor, raised the need to inform the FSA on three occasions, but Prudential decided that no approach should be made.

On Friday, 26 February 2010, it became apparent that a leak of the deal was likely and, on the following morning, a report of a rumour about the transaction was published in the media. Prudential informed the FSA of the transaction in the afternoon of 27 February 2010. Since the relevant agreements had not been signed, a holding announcement was required to be made at the start of trading on 1 March 2010. Ultimately, the transaction did not proceed.

Breaches

Prudential: The FSA found that between 17 and 27 February 2010, Prudential was in breach of Listing Principle 6.

The FSA found that Prudential had recognised that it would be necessary to approach the UKLA once the negotiations had reached the stage at which it was prepared to issue a "discussions happening" announcement and this stage had been reached at the board meeting on 17 February 2010. The FSA found that Prudential had failed to inform the UKLA until after news of the transaction was leaked to the media "despite repeatedly receiving advice that an approach should be made well in advance of the transaction, and in circumstances where that transaction was transformative and raised significant and complex market confidence issues for consideration by the UKLA".

PAC: The FSA found that between 11 (at the latest) and 27 February 2010, PAC was in breach of Principle 11 in two respects:

- by 11 February 2010, the transaction was significantly advanced and PAC should have informed the FSA of the transaction at that time at the latest; and
- PAC had failed to mention the transaction at the meeting with the FSA on 12 February 2010 when the FSA had asked detailed questions about Prudential's strategy in Asia and its plans for raising equity and debt.

Mr Thiam: The FSA found that Mr Thiam was knowingly concerned in PAC's breach of Principle 11. His concerns about the leak risk "materially influenced his judgment as to what the appropriate time to inform the FSA was".

Comments

The financial penalties

Previous cases involving a breach of Principle 11 have tended to involve small retail brokers or advisers who have submitted incorrect reports to the FSA. On the face of it, the most relevant case appears to be the Final Notice issued to BDO LLP[1] which was publicly censured for its role as sponsor on a merger transaction and, in particular, agreeing to delay any contact with the UKLA until after the transaction had been announced. However, the factual background was very different to the present case and the Final Notices expressly state that there were no previous comparable cases for a breach of either Listing Principle 6 or Principle 11.

The size of the financial penalties imposed in this case were clearly influenced by the FSA's concern that the late notification had given it little time in which to make some "far-reaching decisions regarding complex issues" and had resulted in a significant risk that the wrong regulatory decision would be made.

In relation to Prudential, the FSA accepted that Prudential had not acted deliberately or recklessly, but it considered that a significant penalty was justified "to send a clear message to issuers as to the fundamental importance of behaving openly and cooperatively towards the UKLA".

In relation to PAC, the FSA noted that if the transaction had proceeded, it would have led to a change in the corporate controller of PAC. As the FSA had supervisory responsibilities for Prudential's UK regulated subsidiaries, including PAC, the FSA should have been notified of the proposed change of control. The FSA rejected PAC's arguments that the requirements of Principle 11 in relation to a change of control were encapsulated in SUP 11.4.8G[2] and SUP 15.3.9G[3] which set minimum standards for notification in such a situation holding that these provisions are "merely illustrative" of PAC's obligation to disclose information to the FSA under Principle 11.

Personal culpability

The FSA has stated that it will only take action against an approved person for being knowingly concerned in a firm's breach where there is evidence of personal culpability. According to DEPP 6.2.4G: "Personal culpability arises where the behaviour was deliberate or where the approved person's standard of behaviour was below that which would be reasonable in all the circumstances at the time of the conduct concerned".

In practice, it is not always clear how this approach is applied and why the FSA takes action against some individuals (a recent example is the financial penalty imposed on Peter Cummings, the former director of HBoS[4]) and not others. In its report into the failure of The Royal Bank of Scotland ("RBS") the FSA sought to explain why it had not brought enforcement proceedings against any of the former directors of RBS: "…Enforcement… needs to have clear evidence of personal culpability. Nor can it take action just because a decision is made which subsequently proves to be a wrong decision. In order to succeed in enforcement action, it needs to prove that the

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1 26 May 2011

2 "Principle 11 requires firms to be open and co-operative with the FSA. A firm should discuss with the [FSA], at the earliest opportunity, any prospective changes of which it is aware, in a controller's or proposed controller's shareholdings or voting power (if the change is material). These discussions may take place before the formal notification requirement in SUP 11.4.2R or SUP 11.4.4R arises….As a minimum, the [FSA] considers that such discussions should take place before a person:

(1) enters into any formal agreement in respect of the purchase of shares or a proposed acquisition or merger which would result in a change of control (whether or not the agreement is conditional upon any matter, including the [FSA]'s approval); or

(2) purchases any share options, warrants or other financial instruments, the exercise of which would result in the person acquiring control or any other change in control."

3 "The period of notice given to the [FSA] will depend on the event, although the [FSA] expects a firm to discuss relevant matters with it at an early stage, before making any internal or external commitments."

4 Final Notice dated 12 September 2012

individual's action or decision, when viewed without the benefit of hindsight, was below reasonable standards at the time it was taken"[5].

Mr Thiam argued that the action against him was contrary to these statements of FSA policy. Amongst other things, he argued that action should only be taken when the individual has engaged in conduct which differentiates him from others. The FSA rejected these arguments and, in particular, did not accept there was a need to differentiate Mr Thiam's conduct from that of others. The FSA appears to have singled out Mr Thiam on the basis that he was primarily responsible for determining the timing of any notification to the FSA. However, it is clear that, at all times, Mr Thiam acted with the full knowledge and authority of the Prudential board and he was not the only director who attended the meeting with the FSA on 12 February 2010. As a result, the Final Notice provides no clarification as to when an approved person might be exposed to enforcement action. It also provides little comfort to significant influence function holders who may be held responsible for regulatory breaches even when the relevant conduct has been agreed by the board of directors.

Publication of Decision Notices

The three Final Notices were published after the parties had agreed to withdraw their references to the Upper Tribunal.

Since 2010, the FSA has had the power to publish Decision Notices unless publication would be unfair to the subject of the decision or would be prejudicial to consumers. The Enforcement Guide states that the decision will be taken on a case by case basis but the FSA "expects normally" to publish a decision notice if the matter is referred to the Upper Tribunal[6]. It is understood that, in the present case, a settlement was reached before the question of publication of the Decision Notices arose.

Standard of proof

The Prudential made representations about the applicable standard of proof. It argued that the penal nature of the matter and the very significant financial, reputational and personal consequences of a finding of a breach meant that the criminal standard of proof should apply. In support, Prudential relied on the House of Lords decisions in *In re B (Children) (Care Proceedings: Standard of Proof)*[7] and *In re D*[8]. In these cases, the House of Lords rejected earlier cases which had referred to a "sliding scale" (i.e. the more serious the allegation, the stronger the evidence that was required to prove it) and held that there is only one civil standard of proof: the facts in issue must be shown to be more probable than not. The FSA rejected Prudential's argument but the Final Notices fail to give adequate reasons, simply asserting that the Tribunal, in regulatory cases, applies the civil standard of proof.

The Tribunal has not had cause to consider in detail the appropriate standard of proof in regulatory cases since the two House of Lords decisions. It remains to be seen what approach the Tribunal will adopt in the light of these decisions particularly in a market abuse case (which the Tribunal has previously determined is a "criminal charge" for the purposes of Article 6 of the European Convention on Human Rights).

5 "The failure of the Royal Bank of Scotland", Part 3, paragraph 22
6 Paragraph 6.8
7 [2009] 1 AC 11 (HL)
8 [2008] 1 WLR 1499 (HL)

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