

Drug and alcohol misuse: a risk factor ignored by the regulator?

Jul 29 2011 [Jonathan Goodliffe](#)

Alcohol and drug misuse is a taboo issue within the financial services sector. There is no evidence that the Financial Services Authority itself has considered this risk factor at any point since it acquired its statutory powers in 2001.

The Perkins case

In 2010, the FSA made a prohibition order (PDF) against Steven Perkins, whose trading in Brent crude futures "secured the price of Brent at an abnormal and artificial level". The trading records showed that Perkins' trading had had the direct effect of increasing the price of Brent. Perkins lied to his employer in placing the trades on June 29 and then initially attempted to cover up his unauthorised trading on June 30.

The final notice recorded: "Perkins' explanation for his trading on June 29 and 30 is that he was drunk. He says he drank heavily throughout the weekend and continued drinking from around midday on Monday June 29. He claims to have limited recollection of events on Monday and claims to have been in an alcohol-induced blackout at the time he traded in the early hours of June 30. Perkins' explanation for his behaviour is supported by medical evidence."

There is no indication that the FSA considered whether this may have raised questions as to the adequacy of governance arrangements at Perkins' firm. People do not develop alcoholism (which Perkins admitted was his problem) overnight. There are some very obvious signs.

Bank of England's discarded guidance

The Bank of England, on the other hand, seems to have been alive to this problem. It issued the London Code of Conduct for principals and broking firms in the wholesale markets in 1995. The Code said:

"Management should take all reasonable steps to educate themselves and their staff about possible signs and effects of the use of drugs and other abused substances. The judgement of any member of staff using such substances is likely to be impaired; dependence upon drugs, etc, makes them more likely to be vulnerable to outside inducement to conduct business not necessarily in the best interests of the firm or the market generally and could seriously diminish their ability to function satisfactorily."

This guidance was abandoned by the FSA when the Financial Services and Markets Act 2000 came into force in 2001.

A disease of denial?

Addiction has been described as a disease of denial. The addict blames his problems

on everything but his drug of choice. Sometimes this denial is encouraged by family and colleagues, hence the need for appropriate systems to identify the problem. Some professions, including doctors, dentists, airline pilots, lawyers and judges, go much further in efforts to identify and address the risks arising from addiction. The author did ask Andrew Sheen, the FSA's head of operational risk, for an interview to discuss the subject. He was initially willing to meet but was overruled by the FSA press office.

Other misconduct cases linked to alcohol

It may well have been the case that other people targeted by FSA enforcement action have had underlying health or addiction problems. In December 2010, the FSA disqualified a non-executive director, Barry Williams, who had turned a blind eye to fraudulent activities in his firm. The decision (PDF) of the Tribunal on appeal indicated that one of the relevant factors was that he and his colleagues spent much of their time in the pub rather than attending to their business. That factor was, however, edited out of the FSA's publicity relating to the case.

Cases where the link to alcohol and drugs could not be concealed include trader David Redmond, who was also banned by the FSA. He had a wet lunch and his trading while drunk "represented more than 30 per cent of the total lots of WTI Futures traded on ICE on February 6, 2008. His short position reached 8,900 lots at 18.36. By 19.37, Redmond had a substantial net short position of 5,395 lots". Again, governance questions do not seem to have arisen.

Sometimes the link with alcohol or drugs does not emerge until some considerable time after the fall of the firm and/or individual concerned. The memoirs of Nick Leeson, "Rogue Trader", reveal regular drinking binges over the period of his trading activities. This may have been a factor (although not necessarily the most significant one) leading to him developing cancer of the colon as well as bringing down Barings Bank in 1995.

Financial misconduct among lawyers often leads to disciplinary proceedings. Common issues include money laundering, practising while uninsured and stealing or failing to account for client money. The solicitors' disciplinary process often flushes out the addicts, since if the lawyer can establish that he has taken steps towards recovery it may make the difference between striking off and suspension. Misconduct by investment advisers may also be influenced by substance misuse.

Industry attitudes

It is equally difficult to get comment on alcohol and drug misuse from the industry itself. The stigma and denial associated with addiction results in firms being reluctant to admit that there may be a problem, or share knowledge about how it may be addressed. Informative comment, if made at all, is generally "off the record", often because of stringent confidentiality constraints applied to occupational health staff.

Insurance group RSA was, however, featured as an example of best practice in applying workplace policies in the Labour government's first alcohol strategy for England in 2004. The author was unable to get an update from RSA on how, if at all, its policy had developed over the last seven years. Other financial groups outsource health issues to employment assistance programmes and have no alcohol/drug policies

of their own, or else refuse to comment in any way.

The most helpful company which the author contacted was Aviva Occupational Health, where Dr Padraic Ryan is the recently appointed UK medical director of Aviva's occupational health business. His views are of particular interest as he has a long track record within the financial sector, whereas other occupational health physicians often only have incidental contact with the sector through outsourcing arrangements.

Although Dr Ryan would not comment on specific cases, he was happy to offer some best practice advice: "Companies need to start to remove the stigmas and fears associated with ill-health by aligning their drug and alcohol policy with their occupational health function. Managers need to be trained to identify issues early. Confidential support services should be put in place to help the individual address the issue before it escalates." It may be that this happens already in some UK regulated firms, particularly those in US-based financial groups.

Research

The human and health elements within risk management (described as "people risk") are recognised in enterprise risk management processes and in the FSA's own Handbook (SYSC 13.6.2G). The health perspective (and within it the problem of substance misuse) is ill-developed, however, so there is little relevant data to fit into this segment of ERM. Peer-reviewed research into workplace substance misuse problems tends to be focused on safety critical working environments and the public sector.

It is perhaps surprising that insurance companies covering liability risks have not shown significant interest in this area of research. There is peer-reviewed evidence that alcohol misuse is linked to inappropriate risk taking in, for instance, sexual activity and motoring. This issue perhaps deserves the same consideration in relation to, for instance, insurance underwriting, mis-selling payment protection insurance and lending on sub-prime mortgages.

The role of the regulator

The various risks encompassed within ERM compete with each other for resources in the regulator and the regulated firms. If substance misuse is ignored as a risk factor by a regulator applying "intrusive supervision", it will probably be ignored by many firms struggling to meet the regulator's expectations in other aspects of risk management. The fact that substance misuse may be a less significant risk factor than, say, climate change is not a justification for ignoring it completely and stifling discussion on the subject.

Author Biography:

Jonathan Goodliffe is a solicitor who specialises in insurance regulation; the views expressed are his own.