FCPA AND UK BRIBERY ACT RISKS FACING FINANCIAL INSTITUTIONS

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This article contains information regarding the following topics: STRATEGY + LEADERSHIP + RISK MANAGEMENT

INTRODUCTION

The financial crisis increased regulatory scrutiny both from an investigative and a legislative perspective. The Securities and Exchange Commission (SEC) and the Department of Justice (DOJ) are investigating financial institutions for violations of securities laws, the Foreign Corrupt Practices Act (FCPA), anti-money laundering rules, and similar regulations. Although financial institutions historically have not been targets of FCPA enforcement, lending practices and management of certain financial instruments can lead to liability, especially in this heightened regulatory and enforcement environment. Accordingly, financial institutions must institute anti-bribery compliance programs, consistent with the recommended government standards and building off of their current anti-money laundering procedures, to avoid falling prey to this complex regulatory framework.

Indeed, in mid-January 2011, several financial institutions received letters from the SEC directing them to retain documents and to provide information related to their transactions with sovereign wealth funds. The SEC's inquiry, albeit in the preliminary stages, seeks to identify whether U.S. financial institutions violated the FCPA in their dealings with sovereign wealth funds. Sovereign wealth funds are investment funds owned and managed by foreign governments. These funds have invested in large U.S. financial institutions, particularly at the height of the financial crisis when these entities required large capital infusions, and have partnered with private equity firms on significant ventures. Among the issues potentially under review by the SEC, as is typical in any FCPA investigation, is whether any improper payments were made by the financial institutions or private equity firms to officials affiliated with a sovereign wealth fund in order to win business or a competitive advantage. Such payments may involve entertainment, travel, or gifts. Given the FCPA's expansive definition of "government official," employees or representatives working on sovereign wealth funds would be considered foreign government officials and thus covered by the FCPA.

As discussed below, and as the SEC's recently disclosed probe of the banking industry reveals, banks, private equity firms, and other financial institutions face several avenues of potential liability under a myriad of domestic and international statutes. To navigate this regulatory framework properly requires an effective compliance program, and any responses to regulatory requests demand a carefully structured internal investigation.

MULTIPLE SOURCES OF LIABILITY AND INCREASED ENFORCEMENT

Financial institutions face anti-money laundering regulations in multiple jurisdictions, requiring identification of customers and sources of funds, monitoring of account activity, inquiries into transactions, and reporting of suspicious transactions to government entities. The potency of these laws increased when combined with the expanded enforcement of anti-corruption laws.

Many financial institutions recognized their enhanced obligations and undertook responsive initiatives, as evidenced by, for example, the Wolfsberg Principles, adopted by eleven of the world's largest private banks to develop anti-money laundering principles and policies. The Principles state that the banks will "endeavor to accept only those clients whose source of wealth and funds can be reasonably established to be legitimate." Under the Wolfsberg Principles, as in several statutes, certain individuals such as government officials and politicians "require

THE POTENTIALLY VAST LIABILITY FOR "WILLFUL BLINDNESS" HIGHLIGHTS THE NEED FOR PROPER DUE DILIGENCE. FINANCIAL INSTITUTIONS ALREADY PERFORM SOME DILIGENCE BEFORE PROVIDING FUNDING, BUT INADEQUATE DUE DILIGENCE MAY RESULT IN CRIMINAL LIABILITY.

heightened scrutiny," as do transactions with high-risk countries, all of which coincide with best practice principles under the FCPA, the U.K. Bribery Act, and other anti-corruption legislation.

Despite such efforts to address the legitimacy of funds and financial transactions, a recent increase in anti-corruption enforcement has begun to affect financial institutions as visibly as enforcement in other industries. Even before the SEC's probe began in mid-January 2011, Congress was examining the role of U.S. banks in facilitating foreign corruption. For example, a February 2010 U.S. Senate report found that Bank of America and five other U.S. banks helped the son of Equatorial Guinea President Teodoro Obiang bring over $110 million in suspect funds into the U.S. between 2004 and 2008. In addition, financial institutions face the same risks of liability for paying bribes as other industries, as the recent case involving Mercator Corporation illustrates. Mercator, a merchant bank with offices in New York, pleaded guilty in August 2010 to making an unlawful payment to a senior government official in Kazakhstan in connection with its services on oil and gas deals (the oil and gas industry was the subject of a recent DOJ and SEC probe which netted more than $235 million in fines in November, 2010).

Over the last few months, enforcement agencies have publicly declared their intent to increase scrutiny. For example, in July 2010, Attorney General Eric Holder announced the Kleptocracy Asset Recovery Initiative, "aimed at combating large-scale foreign official corruption and recovering public funds for their intended – and proper – use: for the people of our nations."

LIABILITY WITHOUT ACTUAL KNOWLEDGE

In one recent high-profile case, entrepreneur Frederic Bourke Jr. invested in an energy-related company. The government alleged that Bourke recognized, or must have constructively known, that the company was carrying out its business by bribing foreign (Azerbaijani) officials. After trial, a jury convicted Bourke of conspiracy to violate the FCPA despite any allegation that Bourke actually bribed an official or designated specific funds for a bribe. As one juror explained after trial, "[H]e definitely should have known . . . He's an investor. It's his job to know." The jury found that Bourke was willfully blind, i.e., he was aware of circumstances in which illegal payments were highly probable but consciously avoided looking further.

The potentially vast liability for "willful blindness" highlights the need for proper due diligence. Financial institutions already perform some diligence before providing funding, but inadequate due diligence may result in criminal liability if a financial institution ignores indications of potential violations, or fails to conduct a review consistent with the risks. As the Bourke case illustrated, greater due diligence is required in a corruption-prone region than in a country known for stringent anti-corruption legislation and market practices.

In another example, the SEC settled allegations against Nature's Sunshine and two of its executives, the Chief Financial Officer and the Chief Operating Officer, related to improper payments to Brazilian customs authorities. The SEC alleged that the company failed to keep reasonably accurate books and records and to maintain a system of internal accounting controls to permit preparation of adequate financial statements. The SEC did not claim that the executives had actual knowledge of the improper payments, but rather that they were liable as control persons -- another way in which a company and its senior officers may be held responsible for improper payments without participation or actual knowledge.

U.K. BRIBERY ACT EXPANDS LIABILITY

The recently enacted U.K. Bribery Act, which will be implemented in April 2011, demonstrates the continually expanding reach of anti-corruption regulations and their more stringent application and enforcement. The U.K. Serious Fraud Office has adopted DOJ-like enforcement strategies, and the Bribery Act is generally viewed as being broader in scope than the FCPA. The Act defines four criminal offenses: offering or paying a bribe, requesting or receiving a bribe, bribing a foreign public official, and a corporate offense of failing to prevent bribery. Liability will extend to bribes paid within either the public or private sectors.

The Bribery Act will apply not only to all companies, partnerships, and individuals in the U.K., but also to foreign companies and individuals doing business in the U.K., and may affect acts or omissions occurring anywhere in the world. The Bribery Act carries a rebuttable presumption that an employee has acted on behalf of his or her employer in paying a bribe. Moreover, the Act covers bribes by agents and other intermediaries including, in certain circumstances, joint ventures and other comparable business combinations in which a commercial organization is participating and in which financial institutions may be involved as partners.

The Act provides a company with a safe harbor defense to bribes paid "on its behalf" if the company can show that it developed and implemented "adequate procedures" to prevent bribery. Such "adequate procedures" are likely to mirror the best practices of the U.S. Federal Sentencing Guidelines and the OECD's

UNDER THE FCPA, THE AMOUNT OF INVESTMENT NECESSARY TO TRIGGER THE "FOREIGN OFFICIAL" RELATIONSHIP IS UNCLEAR.

Good Practice Guidance on Internal Controls, Ethics, and Compliance, but a finding of adequacy depends on the practices that may give rise to liability.

COMMON SOURCES OF LIABILITY FOR FINANCIAL INSTITUTIONS

Financial institutions face potential liability not simply through traditional transactions and joint venture arrangements, but also through complex structures with international components, such as sovereign wealth funds or investment of required offset funds.

Sovereign wealth funds are state-owned investment vehicles pooled from a foreign nation's economic reserves. Sovereign wealth funds are composed of financial assets such as stocks, bonds, property, precious metals or other financial instruments, and these funds invest globally. Financial institutions may receive sovereign wealth fund investments or may transact with other companies receiving such funding. Transactions with a sovereign wealth fund that lead to new business opportunities may generate anti-bribery scrutiny if improper payments were made or inadequate diligence conducted. Liability also may arise from interactions with other companies receiving such funding. Entities receiving monies from soverign wealth funds may be treated as agents of the foreign country for purposes of FCPA or other anti-bribery law enforcement.

Businesses dealing with sovereign wealth funds thus may be exposed to anti-corruption liability without any portion of the transaction occurring in a foreign nation. To protect themselves from this danger, companies must perform sufficient due diligence to determine the relationships of their business partners or source of funding and incorporate certain representations and warranties into the deal documents.

Required offset funds pose a similar risk. Many foreign government deals with contractors include offset requirements, whereby some percentage of the contract funds is invested back into the foreign country, sometimes as a direct investment, or a requirement to use particular foreign components in a deal. Hedge funds or private equity firms manage those funds and may not know all of the partners in the venture, thereby creating the potential for anti-corruption liability. To avoid claims of willful blindness, the funds involved must perform enough due diligence to know the source of the money and its intended use, as well as ensure that all dealings with any government officials satisfy the requirements of applicable anti-corruption laws.

Under the FCPA, the definition of "foreign official" includes employees of businesses receiving foreign funding, but the amount of investment necessary to trigger the "foreign official" relationship is unclear. State-owned or state-controlled enterprises ("SOEs") are common in many countries, particularly in China and emerging markets. The DOJ and SEC view employees of these SOEs – regardless of rank, title, or position – as "foreign officials" under the FCPA, rendering transactions with these individuals susceptible to FCPA scrutiny as well. As a result, many common business practices may expose financial institutions to liability. Beginning with a more obvious example, most companies actively market services through activities such as "wining and dining" customers or prospective customers to maintain "good will" and increase sales. While such activities with purely private customers in foreign countries may be no more than effective marketing – provided they comply with the parameters set by the Bribery Act – this conduct with SOE customers or "foreign officials" invites FCPA and Bribery Act review. Given the gift-giving, and hospitality culture in certain countries, this is no trivial matter.

The blurry line between private and public is a dangerous chasm, and financial institutions may face liability whether through common activities, such as setting up a transaction in a foreign country or serving as a broker for companies listing ADRs on a U.S. exchange, or through complex arrangements involving sovereign wealth funds, SOEs, or joint ventures with government entities. These multiple layers of potential liability render it critical that financial institutions -- whether serving as intermediate correspondent banks on foreign deals, investors in foreign transactions, or partners with foreign companies -- perform risk-appropriate due diligence, incorporate appropriate anti-corruption representations and warranties in deal documents, and implement stringent compliance programs, building off of existing anti-money laundering programs, to include internal controls, independent testing of the compliance procedures, and training consistent with the guidance of U.S. and foreign regulators.

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