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Anti-corruption enforcement – the new global reality

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The spectre of anti-corruption enforcement, which has cast its shadow over many industries in recent years, may now have settled on the financial services sector. In early 2011, it was widely reported that the United States Securities and Exchange Commission (SEC) sent letters of inquiry to several banks and private equity firms, requesting that they retain documents related to their dealings with sovereign wealth funds. While neither the SEC nor the United States Department of Justice (DOJ) have confirmed whether this is an industry-wide probe, financial services companies' dealings with sovereign wealth funds are certainly a logical place to begin a sweeping inquiry.

Sovereign wealth funds are by definition government owned and funded. Therefore, their employees would be considered 'foreign government officials' under the US Foreign Corrupt Practices Act (FCPA). The same would hold true for employees of any other government owned or controlled financial institutions, or, for that matter, any government owned or controlled business. As such, all financial industry participants should be cognizant of the FCPA, which has a shockingly broad reach, as well as other anti-corruption initiatives being launched in nations around the globe.

The FCPA

Broadly speaking, the FCPA prohibits offering or paying anything of value to a foreign government official or political party official to obtain or retain business, or to secure any improper advantage. It further requires companies that trade on US exchanges, including through ADRs, to keep accurate books and records of all payments and to maintain reasonable internal accounting controls for preventing and detecting FCPA violations.

Since 2005, there has been an explosion in FCPA enforcement, with DOJ bringing more than 80 corporate actions and criminal charges against more than 70 individuals. This is more than the total number of prosecutions brought between 1977, the year of the statute's enactment, and 2005. And the SEC has been equally busy on the civil enforcement side, opening 26 new civil enforcement actions in 2010 alone. Corporate fines not uncommonly reach into the tens and even hundreds of millions, and individuals have been sentenced to up to 87 months imprisonment.

US jurisdiction under the FCPA is broad. It applies to all US companies and their non-US subsidiaries, US subsidiaries of non-US companies and, as alluded to above, non-US companies that trade on a US exchange. It also applies when any act in furtherance of a violation occurs within the United States. This can be as simple as a single email or telephone call received or sent while in the United States, or a dollar-denominated transaction cleared through a US correspondent account, causing a blip at the Federal Reserve in New York. Nor can a company outsource its potential FCPA liability, as companies are generally liable for the acts of their agents and other business partners.

Recently, in what may be an attempt to answer US critics that the FCPA puts US companies at a competitive disadvantage, the number of enforcement actions against non-US companies has burgeoned. Eleven out of the 20 corporate actions brought by DOJ in 2010 involved non-US companies. Additionally, of the nearly $1.8bn in penalties collected in 2010, approximately $1.6bn were paid by non-US companies.

To make compliance more challenging, there are new players on the anti-corruption field. Chief among them is the United Kingdom, whose new Bribery Act takes effect 1 July 2011. This statute is even broader than the FCPA in many respects and possesses even more sweeping jurisdictional provisions. Additionally, many other countries are beginning to enforce their anti-corruption laws, and international cooperation in such matters has become the norm.

Challenges for the financial services sector

The FCPA and other anti-corruption regimes provide particular challenges to the financial services industry, and not only with respect to its dealings with sovereign wealth funds. What many consider typical client entertainment in the industry – tickets to sporting events, payment of client travel to industry conferences, significant gifts, lavish closing dinners and the like – could be considered 'something of value' under the FCPA and may run afoul of the statute if the client is a foreign government official or political party official. Similarly, allowing friends and family participation in IPOs, or offering favourable loan terms or other, similar benefits for those deemed foreign government officials would likely also be a violation.

Additionally, successor liability issues are particularly acute for the financial services industry, as a company can literally buy another company's FCPA problem – an issue of great concern for private equity and venture capital firms. The dangers of successor liability are amply demonstrated by GE's $23.4m settlement with the SEC last summer, where 14 of the 18 unlawful payments for which GE was held liable were made

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by subsidiaries GE purchased after the subsidiaries made the unlawful payments. Even minority stakes in companies can lead to FCPA liability if the investor is aware of FCPA issues or warning signs, yet takes no action. Furthermore, financial services companies frequently operate and invest in high corruption risk areas, such as India, China, the Middle East, and other emerging markets and will continue to do so at increasing levels in the years to come. Given these and other potential pitfalls for financial services companies, it is no surprise that DOJ and the SEC have turned their attention to the industry, and it is conceivable that non-US regulators could follow suit.

How financial services companies can protect themselves from anti-corruption exposure

Anti-corruption compliance policy. A comprehensive and rigorous anti-corruption compliance policy that includes the FCPA and any other applicable anti-corruption laws is essential to preventing and detecting unlawful conduct.

Global implementation. Corporate anti-corruption compliance programs must apply not only to the US entity and its employees, but also to its non-US subsidiaries and agents, sales representatives, distributors, joint venture partners, or other business affiliates in any country in which the company is doing business.

Due diligence guidelines. Devise specific FCPA and anti-corruption due diligence guidelines for acquisitions and investments, concentrating on sales to foreign governments, foreign operations (focusing on such things as how licences, permits and other government approvals were obtained, how the company handles customs and immigration clearances and other such issues) and the use of agents in high risk areas. Insist on FCPA/anti-corruption reps and warranties in the transactional documents.

Finding an FCPA or other anti-corruption red flag or violation during the course of transactional due diligence, however, need not scuttle the deal. Among other measures, an acquiring company can: (i) insist that the target corporation hire independent counsel to conduct a pre-acquisition internal investigation at its expense to determine the severity and breadth of the problem; (ii) require that any control weaknesses be remedied pre-acquisition; (iii) require that the target corporation voluntarily disclose pre-acquisition to DOJ, the SEC and/or an applicable non-US regulator; (iv) insist that the target corporation create a reserve to pay any potential fines or disgorgement; and (v) drive down the price of the transaction.

Training and oversight. Both the compliance and due diligence programs must include robust and effective training components, together with objective reviews and audits by those knowledgeable in FCPA and anti-corruption compliance.

While the dual tasks of implementing a robust anti-corruption compliance program and conducting effective transactional due diligence to limit or mitigate FCPA and other anti-corruption liability may seem daunting, the cost of compliance is substantially less than that of defending against a government investigation, and perhaps ultimately paying heavy civil or criminal penalties.

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