



# 2016 Year-End Cross-Border Government Investigations and Regulatory Enforcement Review

**BakerHostetler**

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## Introduction

The increasing interconnectivity of global markets has become a significant driver of the regulatory and enforcement trends of U.S. and foreign nations. In 2016, U.S. authorities continued their aggressive approach to investigating and charging individuals and entities, both foreign and domestic, on the basis of alleged misconduct that occurred substantially outside of the U.S. But the U.S. did not pursue these cases on its own. Increasingly, individuals and entities caught in the cross-hairs of a cross-border investigation have become subjects of investigations and enforcement actions brought by multiple jurisdictions. As evident in 2016, the U.S. authorities often work together with their foreign counterparts in investigating and prosecuting alleged misconduct. In other instances, U.S. and foreign authorities maintain separate but parallel investigations and enforcement actions that concern the same cross-border conduct. Similarly, certain conduct has become the focus of overlapping legislation and regulation by the U.S. and foreign nations.

*BakerHostetler's 2016 Year-End Cross-Border Government Investigations and Regulatory Enforcement Review* delivers highlights and analysis of important legislative, regulatory, and enforcement activities that crossed national borders in the second half of 2016. Section I of this report focuses on the attempts of U.S. and foreign authorities to curtail alleged sophisticated manipulative securities trading tactics in the areas of “spoofing,” benchmark rates, and credit derivative swaps. Section I also reports on the increasingly cross-border nature of insider trading regulation and enforcement, including the interplay between insider trading and cyber-crime by overseas hackers. Section I further addresses cross-border regulations and enforcement in the areas of accounting fraud, anti-money laundering, trade sanctions and export controls, and international sports matters.

Section II of this report discusses the similar manner in which U.S. and foreign authorities seek to identify and combat alleged misconduct, including through the use of whistleblowers and deferred prosecution agreements and by increasing emphasis on executive prosecutions. Section II also discusses recent developments in case law and under the Federal Rules of Criminal Procedure concerning the DOJ's ability to obtain data stored overseas for use in its investigations and prosecutions and the advent of data sharing agreements between U.S. authorities and their overseas counterparts. This report examines all of these issues against the backdrop of the anticipated policies and priorities of the new Trump administration.

Finally, Section III of this report examines certain practical considerations concerning cross-border investigations and enforcement actions of which companies and their counsel should be aware as we enter 2017 and beyond. Companies and their counsel must know and comply with the data privacy rules of the jurisdictions in which they conduct internal investigations. These rules can be more stringent than data privacy rules in the U.S. and companies who mishandle private employee data can be subjected to significant penalties. Companies and their counsel also need to assess the attorney-client privilege rules of the countries in which they conduct internal investigations, as new developments in 2016 highlight the significant differences between the privilege laws of the U.S. and certain other countries.

We hope this report offers guidance to readers on how to navigate these issues and understand the various frameworks and their implications permeating a variety of industries in our transnational marketplace. We encourage you to read this report in conjunction with BakerHostetler's other year-end reviews that address cross-border regulatory and enforcement issues, including: [Foreign Corrupt Practices Act 2016 Year-End Update](#) and [2016 Year-End Securities Litigation and Enforcement Highlights](#). Please feel free to contact any member of the BakerHostetler White Collar Defense and Corporate Investigations team.



## Cross Border Regulatory and Enforcement Updates

# Securities Fraud

## Cross Border Regulatory and Enforcement Updates

### Market Manipulation

#### “Spoofing”

Regulators in the U.S. and abroad continue to curtail the manipulative trading technique known as “spoofing” by imposing rules and regulations and pursuing criminal and civil liability against alleged “spoofers.” Spoofing is a trading tactic in which traders place sham orders to artificially inflate or depress the price of a security, with the intent to cancel the order and profit off the manipulated price. U.S. regulators began prosecuting this manipulative practice after crediting it as the main cause of the May 6, 2010 “Flash Crash,” which resulted in the Dow Jones Industrial Average plummeting 1,000 points in minutes. Foreign regulators followed suit as this manipulative practice spread overseas and began impacting foreign securities markets.

Even with the recent surge in cross-border anti-spoofing regulation and enforcement, identifying this manipulative trading practice continues to be a significant challenge for regulators, given spoofers’ ability to layer their trades across multiple markets and firms to avoid detection. In the U.S., in July 2016, the Securities and Exchange Commission (SEC) approved a proposed rule that tightened the regulatory clock synchronization standard, forcing brokers to execute trade orders within 50 milliseconds, as opposed to the previous standard of one second.<sup>1</sup> The SEC promulgated this rule to attempt to root out the practice of delaying the execution of trades, which spoofers have used to manipulate stock prices.<sup>2</sup> While many anti-spoofing proponents see this rule as a step in the right direction, some fear that it does not go nearly far enough because some of the more advanced spoofing-related activity occurs at the sub-millisecond level.

On November 4, 2016, the Commodity Futures Trading Commission (CFTC) approved a supplemental proposal to amend the proposed Automated Trading Regulation.<sup>3</sup> The CFTC proposed the Automated Trading Regulation in November 2015 in an attempt to tighten regulations around the use of computer programs to engage in high-frequency trading in the futures markets.<sup>4</sup> After opening the rule to the industry for commentary, the CFTC received criticism that the rule appeared to give the government open access to the confidential source code underlying the computer programs companies utilize for high-frequency trading. The supplemental proposal addresses this concern and requires the CFTC to obtain a subpoena for this information.<sup>5</sup>

In November 2016, the Financial Regulatory Authority (FINRA) filed a proposed rule amendment with the SEC that expressly forbids spoofing or layering and allows for an administrative process

1 FINRA Regulatory Notice, “Clock Synchronization,” No. 16-23, (July 2016), available at [http://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Regulatory-Notice-16-23.pdf](http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-16-23.pdf).

2 Securities Exchange Act Release, “Order Approving a Proposed Rule Change to Reduce the Synchronization Tolerance for Computer Clocks that are Used to Record Events in NMS Securities and OTC Equity Securities,” Release No. 34-77565, (Apr. 8, 2016), available at <https://www.sec.gov/rules/sro/finra/2016/34-77565.pdf>.

3 U.S. Commodity Futures Trading Commission Release, “CFTC Approves Supplemental Proposal to Automated Trading Regulation,” Release No. pr7479-16, (Nov. 4, 2016), available at <http://www.cftc.gov/PressRoom/PressReleases/pr7479-16>.

4 U.S. Commodity Futures Trading Commission Release, “CFTC Unanimously Approves Proposed Rule on Automated Trading,” Release No. pr7283-15, (Nov. 24, 2015), available at <http://www.cftc.gov/PressRoom/PressReleases/pr7283-15>.

5 *Supra*, note 3.

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under which FINRA can seek a permanent injunction on an expedited basis.<sup>6</sup> This proposed provision would differ from section 4c(a)(5) of the Commodity Exchange Act (the CEA) – the rule that regulators commonly use to regulate spoofing – because it targets a “pattern” of spoofing-related activity, whereas section 4c(a)(5) of the CEA only targets a single act of spoofing.<sup>7</sup> FINRA’s proposed rule amendment would also enable it to enjoin spoofing-related activity on an expedited basis if an SEC hearing panel finds by a preponderance of the evidence that the alleged activity has occurred.<sup>8</sup> The SEC will collect comments on this proposed rule before it decides whether to adopt it.

On the enforcement front, on June 13, 2016, the SEC secured an order that sanctioned three Chicago-based traders – Behruz Afshar, Shahryar Afshar, and Richard F. Kenny – for their roles in alleged fraudulent schemes, included spoofing-related activity, that purportedly netted them more than \$225,000 in ill-gotten gains.<sup>9</sup> The SEC commenced an administrative action against these defendants in December 2015, alleging that, between 2011 and 2012, they posted and immediately canceled several options orders on the NASDAQ OMX PHLX exchange.<sup>10</sup> The SEC alleges that the defendants never intended to execute these trades and that they posted them solely to collect a liquidity rebate that the exchange offered, before canceling the trades. Although all three defendants consented to the entry of the June 2016 order, which asserts violations under Section 17(a) of the Securities Act of 1933 and Sections 9(a)(2) and 10(b) of the Securities Act of 1934, as well as SEC Rule 10b-5 thereunder, they did so without admitting or denying the SEC’s findings.

On November 9, 2016, U.S. regulators secured their second-ever spoofing conviction when Navinder Sarao – the British trader who the U.S. authorities alleged contributed to the Flash Crash of 2010 – pleaded guilty to spoofing and wire fraud in the Northern District of Illinois.<sup>11</sup> As part of his plea, Sarao admitted to using an automated trading program to manipulate the market for S&P 500 futures contracts. We previously reported in our *2016 Mid-Year Cross-Border Government Investigations and Regulatory Enforcement Review* on Sarao’s failed attempt to defeat extradition. Since his extradition, Sarao has cooperated with U.S. authorities but still faces up to 10 years in prison for the spoofing charge, and up to 20 years in prison for the wire fraud charge. In addition to facing a criminal sentence, Sarao was fined \$38 million by the CFTC and is barred from any further trading in the U.S. securities markets.<sup>12</sup> These civil penalties arise from a settlement agreement from the parallel civil enforcement action that the CFTC brought against Sarao, which the District Court ordered on November 17, 2016.

6 U.S. Commodity Futures Trading Commission Release, “Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Provide a Process for an Expedited Proceeding and Adopt a Rule to Prohibit Disruptive Quoting and Trading Activity,” Release No. 34-79361, (Nov. 21, 2016), available at <https://www.sec.gov/rules/sro/finra/2016/34-79361.pdf>.

7 Compare Id. to CFTC, “Q & A – Interpretive Guidance and Policy Statement on Disruptive Practices,” available at [http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/dtpinterpretiveorder\\_qa.pdf](http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/dtpinterpretiveorder_qa.pdf).

8 U.S. Securities & Exchange Commission, “Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Provide a Process for an Expedited Proceeding and Adopt a Rule to Prohibit Disruptive Quoting and Trading Activity,” Release No. 34-79361, (Nov. 21, 2016), available at <https://www.sec.gov/rules/sro/finra/2016/34-79570.pdf>.

9 *In the Matter of Afshar*, Admin. Pro. No. 3-16978 (June 13, 2016) (Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Section 9(b) of the Investment Company Act of 1940).

10 *In the Matter of Afshar*, Admin. Pro. No. 3-16978 (Dec. 3, 2015) (Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Section 9(b) of the Investment Company Act of 1940 and Notice of Hearing).

11 Press Release, U.S. Department of Justice, “Futures Trader Pleads Guilty to Illegally Manipulating the Futures Market in Connection With 2010 ‘Flash Crash,’” (Nov. 9, 2016), available at <https://www.justice.gov/opa/pr/futures-trader-pleads-guilty-illegally-manipulating-futures-market-connection-2010-flash>.

12 Press Release, U.S. Commodity Futures Trading Commission, “Federal Court in Chicago Orders U.K. Resident Navinder Singh Sarao to Pay More than \$38 Million in Monetary Sanctions for Price Manipulation and Spoofing,” No. 7486-16, (Nov. 17, 2016), available at <http://www.cftc.gov/PressRoom/PressReleases/pr7486-16>.

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On September 21, 2016, the CFTC filed an order charging and simultaneously settling spoofing-related allegations against Chicago-based clearing firm Advantage Futures LLC, its CEO Joseph Guinan, and its CRO William Steele.<sup>13</sup> The gravamen of these charges was that the defendants failed to supervise and manage commodity trading accounts under their control. The CFTC alleged that, for years, regulators had warned the defendants that spoofers were using these accounts to manipulate market prices in an unlawful manner. Their failure to follow up on these warnings and conduct their own independent investigation prompted the CFTC to commence this action and secure \$1.5 million in fines.

Finally, on December 20, 2016, the District Court for the Northern District of Illinois issued a consent order that permanently enjoined Igor B. Oystacher and his proprietary trading firm, 3Red Trading LLC, from engaging in securities fraud and fined them a total of \$2.5 million in civil penalties.<sup>14</sup> This order resulted from an enforcement action brought by the CFTC against the defendants that alleged spoofing-related activity over a two-year period.<sup>15</sup> This result is notable not only because of the large civil penalties but also because the CFTC defeated the defendants' legal argument that sections 6c(a)(5)(C) and 9(1) of the CEA, which regulate spoofing, are unconstitutionally vague. The defendants argued that the statute does not sufficiently differentiate between manipulative practices and instances in which a trader canceled an order simply because he changed his mind. The District Court sided with the CFTC's argument that the statute's scienter requirement – which requires that the trader lacked the intent to execute the trade order – gives sufficient notice as to what conduct violates the statute.<sup>16</sup> The CFTC's victory may be short-lived, however, as the Seventh Circuit Court of Appeals is currently considering this constitutional argument in Michael Coscia's appeal of his conviction for manipulative trading.<sup>17</sup> As we reported in our *2016 Mid-Year Update*, Coscia – the first-ever individual convicted for spoofing-related activity – unsuccessfully petitioned the federal district court in Chicago to overturn his conviction, arguing that the spoofing laws were unconstitutionally vague because they encompass innocuous conduct that commodities traders routinely undertake. Coscia then appealed his conviction to the Seventh Circuit, and a decision in that appeal is expected in the coming months.

European regulators have also made spoofing-related detection a top priority. As reported in our *2016 Mid-Year Update*, the European Union adopted new market abuse regulation that became effective on July 3, 2016. Under this regulation, investment companies trading in European securities markets are required to, among other things, record their own trading activity so that market abuse can be detected.<sup>18</sup> This requirement will likely be daunting for many investment companies that do not already have an in-house surveillance system in place, as building or purchasing one would likely be very expensive and/or time-consuming. Nevertheless, it is telling

13 Press Release, U.S. Commodity Futures Trading Commission, "CFTC Orders Chicago-based Advantage Futures LLC, its CEO Joseph Guinan, and Former Chief Risk Officer William Steele Jointly to Pay a \$1.5 Million Civil Monetary Penalty for Supervision, Risk Management Failures, and Making Inaccurate Statements in Required Filings with the CFTC," No. 7449-16, (Sept. 21, 2016), available at <http://www.cftc.gov/PressRoom/PressReleases/pr7449-16>.

14 *CFTC v. Oystacher*, No. 15-cv-09196 (N.D. Ill., Dec. 20, 2016) [ECF 236], available at [https://www.gpo.gov/fdsys/pkg/USCOURTS-ilnd-1\\_15-cv-09196/pdf/USCOURTS-ilnd-1\\_15-cv-09196-2.pdf](https://www.gpo.gov/fdsys/pkg/USCOURTS-ilnd-1_15-cv-09196/pdf/USCOURTS-ilnd-1_15-cv-09196-2.pdf).

15 Press Release, U.S. Commodity Futures Trading Commission, "U.S. Commodity Futures Trading Commission, Federal Court Orders Chicago Trader Igor B. Oystacher and 3Red Trading LLC to Pay \$2.5 Million Penalty for Spoofing and Employment of a Manipulative and Deceptive Device, while Trading Futures Contracts on Multiple Futures Exchanges," (Dec. 20, 2016), available at <http://www.cftc.gov/PressRoom/PressReleases/pr7504-16>.

16 *CFTC v. Oystacher*, No. 15-cv-09196 (N.D. Ill., Dec. 20, 2016) [ECF 236], available at [https://www.gpo.gov/fdsys/pkg/USCOURTS-ilnd-1\\_15-cv-09196/pdf/USCOURTS-ilnd-1\\_15-cv-09196-2.pdf](https://www.gpo.gov/fdsys/pkg/USCOURTS-ilnd-1_15-cv-09196/pdf/USCOURTS-ilnd-1_15-cv-09196-2.pdf).

17 *Coscia v. United States*, No. 16-3017 (7th Cir. 2016).

18 Press Release, European Commission, "European Commission seeks criminal sanctions for insider dealing and market manipulation to improve deterrence and market integrity," (Feb. 4, 2014), available at [http://europa.eu/rapid/press-release\\_IP-11-1218\\_en.htm](http://europa.eu/rapid/press-release_IP-11-1218_en.htm).



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that European legislators and regulators are willing to create significant barriers to entry into the securities markets in return for better surveillance over increasingly sophisticated trading, in order to combat spoofing and other forms of market manipulation.

In the meantime, European regulators continue to conduct investigations to root out spoofing-related conduct captured by this recent legislative initiative. For example, Great Britain's Office of Gas and Electricity Markets (Ofgem) announced in November 2016 that it is conducting an investigation into possible spoofing in Great Britain's power markets.<sup>19</sup> This probe is one of several that the Ofgem is bringing in the onset of Europe's market abuse regulation.

It remains to be seen whether U.S. regulators' aggressive attempts to curtail spoofing will continue in 2017. Shortly after the new year, the CFTC, which is at the forefront of U.S. regulation and enforcement against spoofing, entered into a \$25 million settlement with Citigroup Global Markets (Citigroup) for alleged spoofing activity in the U.S. Treasury futures markets.<sup>20</sup> The CFTC also found that Citigroup did not provide sufficient anti-spoofing training to its traders and that its U.S. Treasury and U.S. Swaps desks lacked adequate controls to detect spoofing.<sup>21</sup> In announcing the settlement, former CFTC Director of Enforcement Aitan Goelman stated, "Spoofing is a significant threat to market integrity that the CFTC will continue to vigorously investigate and prosecute."<sup>22</sup> However, the CFTC's continued aggressive regulation and enforcement in this area may depend on Goelman's successor, who has yet to be named.<sup>23</sup> In addition, Timothy Massad, the CFTC's former chairman who oversaw the Commission's recent aggressive spoofing regulation and enforcement, resigned on January 3, 2017, and it is unclear whether his successor, acting Chairman J. Christopher Giancarlo, or someone else the Trump administration nominates, will continue this trend.<sup>24</sup>

### Benchmark Rates

U.S. and European regulators continued to bring actions against banks and their traders for alleged manipulation of the London Interbank Offered Rate (LIBOR) and foreign exchange spot markets (the FX market) in the second half of 2016. LIBOR is the minimum interest rate, or benchmark interest rate, at which banks lend unsecured funds to each other.<sup>25</sup> Banks all over the world use LIBOR as a base rate for setting interest rates on consumer and corporate loans such as auto, student and home loans.<sup>26</sup> The FX market, which permits traders to buy, sell, exchange and speculate on currencies, is one of the world's largest and most actively traded financial markets,

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19 Aviv Handler, Ofgem investigate possible spoofing in GB market, Energy Trading Regulation, (Nov. 18, 2016), available at <https://energytradingregulation.com/2016/11/18/ofgem-investigate-possible-spoofing-in-gb-market/>.

20 Press Release, U.S. Commodity Futures Trading Commission, "CFTC Orders Citigroup Global Markets Inc. to Pay \$25 Million for Spoofing in U.S. Treasury Futures Markets and for Related Supervision Failures," Release No. pr7616-17, (Jan. 19, 2017), available at <http://www.cftc.gov/PressRoom/PressReleases/pr7516-17>.

21 *Id.*

22 *Id.*

23 *Id.*

24 Press Release, U.S. Commodity Futures Trading Commission, "CFTC Chairman Timothy Massad Announces Resignation as Chairman," Release No. pr7507-17, (Jan. 3, 2017), available at <http://www.cftc.gov/PressRoom/PressReleases/pr7507-17>.

25 James McBride, Understanding the Libor Scandal, Council on Foreign Relations, Council on Foreign Relations, (May 21, 2015), available at <http://www.cfr.org/united-kingdom/understanding-libor-scandal/p28729>.

26 *Id.*

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with trading volumes that have averaged close to \$5 trillion a day.<sup>27</sup> The alleged manipulations of LIBOR and the FX market purportedly had worldwide effects and, as we have discussed in our prior reports, have been the focus of several large-scale, cross-border enforcement actions.

In August 2016, Barclays agreed to pay \$100 million to 43 states plus the District of Columbia to settle claims that it manipulated LIBOR and other benchmark interest rates.<sup>28</sup> Under the settlement, Barclays agrees to pay \$93.35 million into a fund that will be used to pay restitution to government entities and not-for-profit organizations that were connected to LIBOR swaps and investment contracts with Barclays.<sup>29</sup> The settlement does not require that Barclays admit or deny allegations that it lowered its LIBOR submissions from 2005 until at least 2009.<sup>30</sup>

In November 2016, a Southern District of New York judge sentenced Paul Thompson, from Australia, a former interest-rate swaps trader at Rabobank, a Dutch financial services firm, to three months in prison for his role in a conspiracy to fix LIBOR rates.<sup>31</sup> According to evidence produced at trial, Thompson traded products linked to U.S. dollar and Japanese yen LIBOR rates and requested that Rabobank's LIBOR setters manipulate their submission to the British Banker's Association in order to achieve a more favorable outcome for him.<sup>32</sup> Thompson's alleged co-conspirators included Paul Robson, Takayuki Yagami, and Lee Stewart, who all pled guilty and are set for sentencing in June 2017, as well as Anthony Allen and Anthony Conti, who were convicted in November 2015.<sup>33</sup> U.S. District Judge Jed S. Rakoff sentenced Allen to two years in prison and Conti to one year plus one day.<sup>34</sup>

In the U.K., a recent London trial of five Barclays PLC members resulted in three convictions of former bankers Jay Merchant, Jonathan Mathew, and Alex Pabon for plotting to manipulate LIBOR.<sup>35</sup> The U.K. Serious Fraud Office (SFO) alleged that the bankers knew or believed Barclays was involved in trades that referenced dollar LIBOR, and either submitted false or misleading rates for the bank or persuaded others to do so.<sup>36</sup> Merchant was sentenced to six and a half years in prison, Mathew to four years, and Pabon to two years and nine months.<sup>37</sup> Each of them was refused leave to appeal by

27 Anirban Nag and Jamie McGeever, Foreign Exchange, the World's Biggest Market, is Shrinking, Reuters (Feb. 11, 2016), available at <http://www.reuters.com/article/us-global-fx-peaktrading-idUSKCN0VK1UD>; In the Matter of Citibank, N.A., CFTC Docket No. 15 – 03, Order Instituting Proceedings Pursuant to Sections 6(c)(4)(A) and 6(d) of the Commodity Exchange Act, Making Findings, and Imposing Remedial Sanctions, available at <http://www.cftc.gov/ucm/groups/public/@enforcementactions/documents/legalpleading/enfcitibankorder111114.pdf>.

28 Carmen Germaine, Barclays to Pay \$100M in Multistate Libor Settlement, Law360 (Aug. 8, 2016), available at <https://www.law360.com/articles/826018/barclays-to-pay-100m-in-multistate-libor-settlement>.

29 *Id.*

30 *Id.*

31 Y. Peter Kang, Ex-Rabobank Trader Gets 3 Months For Fixing Libor, Law360 (Nov. 9, 2016), available at <https://www.law360.com/articles/861470>.

32 *Id.*

33 *Id.*

34 Carmen Germaine, Ex-Rabobank Boss Gets 2 Yrs, Trader 1 Yr For Libor Scheme, Law360 (March 10, 2016), available at <https://www.law360.com/articles/770147/ex-rabobank-boss-gets-2-yrs-trader-1-yr-for-libor-scheme>.

35 Melissa Lipman, "London Jury Convicts 3 Ex-Barclays Libor Traders," Law360 (July 4, 2016), available at <http://www.law360.com/articles/796701>.

36 *Id.*

37 William Shaw, "3 Ex-Barclays Traders Appealing Libor Convictions," Law360 (Aug. 16, 2016), available at <http://www.law360.com/articles/828878/3-ex-barclays-traders-appealing-libor-convictions>.

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the London Court of Appeal.<sup>38</sup> Meanwhile, swaps traders Ryan Reich and Stylianos Contogoulas are set to face a retrial in early 2017 after the jury's failure to reach a verdict after an 11-week trial.<sup>39</sup>

It appears that LIBOR and FX market manipulation enforcement activity will continue in 2017. For one, the DOJ seems intent on continuing its long-running investigations and prosecutions concerning LIBOR and the FX markets. On January 12, 2017, Christopher Cummins, a former foreign currency trader at Citigroup, pled guilty to manipulating currency prices on electronic trading platforms by creating bogus trades, coordinating bids, and offering agreed-upon prices for specific customers.<sup>40</sup> That same week, the DOJ charged three other former foreign currency traders at Citigroup, Barclays, and two other large banks as part of a probe into foreign currency market manipulation.<sup>41</sup>

In February, the SFO will have a second chance to obtain convictions against Stylianos Contogoulas and Ryan Reich.<sup>42</sup> The SFO is also scheduled to try the "Euribor Six" – six former Deutsche Bank and Barclays traders accused of rigging the Euribor benchmark – in September.<sup>43</sup>

Another development to watch in 2017 concerns the use of testimony that defendants were compelled to provide overseas in U.S. LIBOR and FX markets criminal actions. For example, as previously mentioned, in November 2016, two Rabobank traders, Anthony Allen and Anthony Conti, were sentenced for their roles in a conspiracy to fix LIBOR rates.<sup>44</sup> Allen and Conti created a system that allowed bank derivative traders to communicate directly with bank employees, who would in turn submit estimates to the British Banker's Association that were beneficial for both the traders and the bank.<sup>45</sup> The defendants appealed the ruling to the Second Circuit Court of Appeals.<sup>46</sup> During oral argument, the court expressed skepticism about the veracity of the government's main cooperating witness, who had changed his account of events after reviewing testimony from the defendants that was compelled by British banking authorities.<sup>47</sup> The Fifth Amendment prevents the use of a criminal defendant's statements made under compulsion against him. The Second Circuit has yet to render a decision, but its line of questioning seems to shed something of a spotlight on the role that compelled testimony abroad can play in U.S. criminal proceedings.

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38 Kirstin Ridley, "Three former Barclays traders denied Libor appeal request," (Nov. 25, 2016), available at <http://www.reuters.com/article/us-libor-barclays-appeal-idUSKBN13L00S>.

39 *Suzi Ring*, "Ex-Barclays Traders Contogoulas, Reich Face Second Libor Trial," Bloomberg.com (Jul. 6, 2016), available at <https://www.bloomberg.com/news/articles/2016-07-06/ex-barclays-traders-contogoulas-reich-face-second-libor-trial>.

40 Stewart Bishop, "Ex-Citigroup Currency Trader Cops to Forex Manipulation," Law360 (Jan. 12, 2017), available at <https://www.law360.com/articles/880488/ex-citigroup-currency-trader-cops-to-forex-manipulation>.

41 Jody Godoy, "3 More Ex-Currency Traders Charged With Forex Rate Rigging," Law360 (January 10, 2017), available at <https://www.law360.com/articles/879265/3-more-ex-currency-traders-charged-with-forex-rate-rigging>.

42 Alex Davis, "5 Big UK Financial Services Cases to Watch," Law360 (September 19, 2016), available at <https://www.law360.com/articles/825408/5-big-uk-financial-services-cases-to-watch>.

43 *Id.*

44 *Supra*, note 35.

45 *Id.*

46 William Gorta, "2nd Circ. Drills DOJ On Use Of Compelled Libor Testimony," Law360 (January 26, 2017), available at <https://www.law360.com/articles/885485/2nd-circ-drills-doj-on-use-of-compelled-libor-testimony>.

47 *Id.*

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### Insider Trading

The second half of 2016 also saw significant activity in cross-border insider trading regulation and enforcement. On December 27, 2016, in an intersection between alleged cybercrime and violations of U.S. insider trading laws, the DOJ and SEC brought parallel criminal and civil actions against a trio of Chinese nationals who allegedly hacked U.S. law firms to obtain nonpublic information about upcoming mergers and acquisitions, and traded on this information for profit.<sup>48</sup> The alleged unlawful trading activity was carried out with the use of both U.S. and offshore accounts. The documents filed with the parallel actions do not reveal the names of the law firms, but suggest they are based in New York and counseled U.S. companies involved in several large mergers and acquisitions between March and September 2015.<sup>49</sup> During that time, the three defendants, lat Hong, Bo Zheng, and Chin Hung, allegedly hacked the credentials of a lawyer from one of those law firms and installed malware that allowed them to obtain critical information regarding those deals, including the deal price and the identities of the target companies. The defendants then purchased the shares of the target companies and sold them after the deals were announced and the trading prices had increased, gaining more than \$4 million in profits.

The DOJ charged the three foreign defendants with insider trading, conspiracy to commit insider trading, wire fraud, conspiracy to commit wire fraud, computer intrusion, and conspiracy to commit computer intrusion.<sup>50</sup> The SEC charged the defendants with violating the anti-fraud provisions of the Securities and Exchange Act of 1934, namely §§ 10(b), 14(e), and 20(b), as well as the SEC rules promulgated thereunder.<sup>51</sup> Indicative of the cross-border nature of this action, the DOJ and SEC worked with the Hong Kong Securities and Futures Commission and the Hong Kong criminal authorities that arrested defendant Hong on Christmas Day in Hong Kong, China. The other two defendants remain at large.

This case is rare because, traditionally, regulators do not charge hackers with securities fraud. But this may be an increasing trend in securities regulation and enforcement. In our *2016 Mid-Year Update*, we reported that in May 2016 Vadym Iermolovych, a Ukrainian hacker, pleaded guilty in a New Jersey federal court to hacking a social networking website to obtain nonpublic information that others used to trade for profit. We also reported that in June 2016 the SEC announced that it obtained an emergency court order freezing the assets of a U.K. resident charged with hacking online brokerage accounts of U.S. investors and making unauthorized stock trades that netted a hefty profit. Now it seems that law firms may be the new target for international hackers looking to trade on nonpublic information. In March 2016, the FBI issued an alert that targeted law firms and recommended that they educate their personnel about the threat of cyberattacks and update their systems to mitigate against this threat.<sup>52</sup> And in December 2016, Preet Bharara, the former

48 Press Release, U.S. Department of Justice, "Manhattan U.S. Attorney Announces Arrest Of Macau Resident And Unsealing Of Charges Against Three Individuals For Insider Trading Based On Information Hacked From Prominent U.S. Law Firms," (Dec. 27, 2016), available at <https://www.justice.gov/usao-sdny/pr/manhattan-us-attorney-announces-arrest-macau-resident-and-unsealing-charges-against>; Press Release, "Securities and Exchange Commission, Chinese Traders Charged with Trading On Hacked Nonpublic Information Stolen from Two New York-Based Law Firms," (Dec. 27, 2016), available at <https://www.sec.gov/litigation/litreleases/2016/lr23711.htm>.

49 *United States v. Hong, et al.*, No. 16-cr-360 (S.D.N.Y. Dec. 27, 2016) (Indictment), available at <https://www.justice.gov/usao-sdny/press-release/file/921006/download>; SEC v. Hong, et al., No. 16 Civ. \_\_\_ (S.D.N.Y. Dec. 27, 2016) (Complaint), available at <https://www.sec.gov/litigation/complaints/2016/comp-pr2016-280.pdf>.

50 *United States v. Hong, et al.*, No. 16-cr-360 (S.D.N.Y. Dec. 27, 2016) (Indictment), available at <https://www.justice.gov/usao-sdny/press-release/file/921006/download>.

51 *SEC v. Hong, et al.*, No. 16 Civ. \_\_\_ (S.D.N.Y. Dec. 27, 2016) (Complaint), available at <https://www.sec.gov/litigation/complaints/2016/comp-pr2016-280.pdf>.

52 Federal Bureau of Investigations Alert, "Criminal-Seeking-Hacker Requests Network Breach for Insider Trading Operation," (Mar. 4, 2016), available at <https://info.publicintelligence.net/FBI-InsiderTradingHacking.pdf>.

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U.S. Attorney for the Southern District of New York, issued a statement following the DOJ's release on its insider trading charges against the Chinese hackers, saying that "[t]his case of cyber meets securities fraud should serve as a wake-up call for law firms around the world" because they "have information valuable to would-be criminals."<sup>53</sup> Time will tell if law firms continue to be targeted by hackers as part of insider trading schemes, or if this was just an isolated incident. However, it is likely that cybercrimes will increasingly overlap with insider trading, and possibly other types of securities fraud, going forward.

In a separate cross-border insider trading enforcement action, the SEC recently obtained judgments in a case involving trades and communications of confidential information which took place overseas. In November 2016, a California jury found Dr. Sasan Sabrdaran, a former director at California-based biotechnology company InterMune, and his friend, Farhang Afsarpour, liable for insider trading.<sup>54</sup> Sabrdaran is a resident of San Francisco, California, and Afsarpour is a resident of Manchester, England.<sup>55</sup> The SEC accused Sabrdaran of giving Afsarpour confidential information about the European drug approval for InterMune's Esbriet, a lung disease medication, which Afsarpour then used to earn \$1 million in the stock market. The SEC provided evidence showing that the timing of Afsarpour's bets coincided with calls, texts, and in-person meetings between Afsarpour and Sabrdaran, many of which took place in London. The SEC also alleged that Afsarpour purchased spread bets from the United Kingdom firm IG Index, which in turned hedged his bets by purchasing InterMune stocks and options in the United States. While all public information and market analysis indicated that the approval would not come down until the first quarter of 2011 based on the standard 210-day time line for these applications, Afsarpour bet on the Esbriet drug's approval in December 2010 which, the SEC alleged, resulted in his \$1 million profit.<sup>56</sup>

In the EU, a new Market Abuse Regulation (the MAR) was implemented that addresses insider trading, disclosure of inside information, and market manipulation.<sup>57</sup> The new rules repeal and replace the EU Market Abuse Directive (the MAD).<sup>58</sup> Unlike the MAD, which set minimum standards through national law, the MAR will directly enforce its new regulations throughout the EU. While most of the MAR mirrors the MAD, some changes will have an important impact on European issuers, investment firms, and their employees. One of the most notable changes is that the MAR has an expanded scope. While the MAD only applied to financial instrument trading on regulated markets and derivatives based on such instruments, the MAR will also apply to financial instruments trading on multilateral and organized trading facilities, as well as related derivatives.

The MAR will also require covered issuers to create and maintain records showing compliance with rules for delaying disclosure of inside information, and disclosure of inside information as part of a market sounding, as well as more expansive regulation for the creation of lists of individuals

53 Press Release, U.S. Department of Justice, "Department of Justice, Manhattan U.S. Attorney Announces Arrest Of Macau Resident And Unsealing Of Charges Against Three Individuals For Insider Trading Based On Information Hacked From Prominent U.S. Law Firms," (Dec. 27, 2016), available at <https://www.justice.gov/usao-sdny/pr/manhattan-attorney-announces-arrest-macau-resident-and-unsealing-charges-against>.

54 Cara Bayles, "SEC Wins Insider Trading Trial of Ex-InterMune Director," Law360 (Nov. 14, 2016), available at [http://www.law360.com/securities/articles/862273?nl\\_pk=40be814d-d483-4682-834e-5ca3db600dde&utm\\_source=newsletter&utm\\_medium=email&utm\\_campaign=securities](http://www.law360.com/securities/articles/862273?nl_pk=40be814d-d483-4682-834e-5ca3db600dde&utm_source=newsletter&utm_medium=email&utm_campaign=securities).

55 *Id.*

56 *Id.*

57 John F. Savarese, Wayne M. Carlin, Jonathan Siegel, "The New European Union Market Abuse Regulation," Oxford University Law Blog (May 03, 2016), available at <https://www.law.ox.ac.uk/business-law-blog/blog/2016/05/new-european-union-market-abuse-regulation>.

58 *Id.*

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possessing inside information.<sup>59</sup> In addition, the MAR makes several changes that attempt to aid the enforcement of market abuse rules. The MAR requires that professionals arranging and executing transactions report any suspicious transactions or orders and maintain effective systems to detect suspicious transactions and orders.<sup>60</sup>

To reduce the burden of proof for market manipulation, the MAR also adds an offense for attempted market manipulation, which eliminates the requirement of proof of actual impact on the market.<sup>61</sup> To increase deterrence, the MAR creates minimum remedies and maximum penalties that every EU member state must implement. The civil remedies work jointly with the EU Directive of Criminal Sanctions for Market Abuse, and require member states, with the exception of the U.K. and Denmark, to criminalize market abuse violations.<sup>62</sup>

It appears that regulators will continue to aggressively pursue insider trading in 2017. For one, in December 2016, the U.S. Supreme Court, in *United States v. Salman*, ratified U.S. regulators' approach to charging downstream tippers who trade on confidential information, even if there is no evidence of a quid pro quo between the tipper and tinee.<sup>63</sup> In *Salman*, the first Supreme Court decision to address the scope of liability in insider trading cases in almost 20 years, the Court unanimously held that traders who pass along inside information to friends or relatives can be criminally liable for insider trading – even if the disclosing party did not receive a financial benefit in exchange for the inside information. The decision appears to abrogate the Second Circuit's landmark decision in *United States v. Newman*, which held that receipt of a potentially pecuniary benefit was a required element to proving insider trading.<sup>64</sup> *Salman* is certainly a boon for prosecutors, who now face one less obstacle to obtaining insider trading convictions where friends and family relationships are at play.

However, whether prosecutors in the U.S. continue to aggressively enforce insider trading laws may depend on the priorities set by the Trump administration's nominee to replace Bharara as the U.S. Attorney for the Southern District of New York. Bharara was clearly focused on prosecuting insider trading and the Southern District under his leadership obtained dozens of insider trading prosecutions over the past several years. Bharara had also released a statement praising the *Salman* decision shortly after the case was decided.<sup>65</sup>

**Market Transparency – Credit Default Swaps**

During the second half of 2016, U.S. and European regulators have continued to attempt to increase regulatory visibility into the derivatives and swaps markets. As we reported previously in the *2016 Mid-Year Update*, the CFTC in August 2015 proposed regulations that, among other things, aim to decrease investor risk in credit default swap transactions. In that vein, the CFTC in September 2016 unanimously voted to adopt a rule that expanded currencies of interest

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59 *Id.*

60 *Id.*

61 *Id.*

62 *Id.*

63 *Salman v. United States*, 137 S. Ct. 420, 196 L. Ed. 2d 351 (2016).

64 *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014).

65 Colby Hamilton, "Bahara Praises Supreme Court Decision on Insider Trading," Politico, (Dec. 6, 2016), available at <http://www.politico.com/states/new-york/albany/story/2016/12/scotus-insider-trading-decision-hailed-as-a-victory-by-bharara-107844>.

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rate swaps subject to mandatory clearing under the CEA.<sup>66</sup> This rule aims to shore up investor confidence by veering swaps from over-the-counter markets to centralized execution facilities.

Also in the last half of 2016, the CFTC proposed a new rule that addresses whether it can regulate swaps that take place overseas. Back in 2013, the CFTC sparked some controversy when it interpreted certain of its swaps rules as having extraterritorial application.<sup>67</sup> Some members of the swap industry sued the CFTC on the basis that such an interpretation would unduly burden tax traders in foreign markets with adhering to two sets of laws that may in some instances conflict. The federal court overseeing that litigation ordered the CFTC to conduct a two-year review as to whether its rules should apply extraterritorially, take comments from members of the swaps industry, and report whether it still supports an extraterritorial application of its laws. In August 2016, the CFTC completed its court-mandated review and concluded that an extraterritorial application of certain of its rules was proper.<sup>68</sup> Then, on October 11, 2016, the CFTC proposed a new rule that makes clear that the CFTC rules pertaining to registration thresholds and external business conduct standards for swap dealers and major swap participants have extraterritorial application.<sup>69</sup> The comments period on this proposed rule ended on December 19, 2016.

As market transparency and oversight of credit default swaps has increased, the EU has been pursuing landmark legislation called the European Market Infrastructure Regulation (EMIR), which will require derivatives contracts to be traded on exchanges or electronic trading platforms and will implement other measures designed to reduce risk in the credit derivatives markets.<sup>70</sup> Although the EU had previously announced that EMIR would have a September 2016 start date, the European Commission (EC) announced on June 10, 2016, that this body of legislation will take effect sometime before mid-2017.<sup>71</sup>

In the meantime, preparatory steps are being taken to support the industry as it moves to mandatory clearing of over-the-counter credit default swaps. First, clearinghouses are obtaining EMIR authorization to ensure that EMIR's central clearing mandates are implemented. For example, in September 2016, the Bank of England authorized ICE Clear Europe to help oversee this process.<sup>72</sup> Second, credit default swaps that have already been entered must be cleared before EMIR takes effect.<sup>73</sup> The clearing of these trades, known under EMIR as "frontloading," commenced in October 2016 and remains ongoing.

66 Press Release, U.S. Commodity Futures Trading Commission, "U.S. Commodity Futures Trading Commission, Clearing Requirement Determination under Section 2(h) of the Commodity Exchange Act for Interest Rate Swaps," (Oct. 3, 2016), available at <http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/federalregister092816.pdf>.

67 U.S. Commodity Futures Trading Commission, "Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations", 78 Fed. Reg. 45292 (July 26, 2013), available at <http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/federalregister071213b.pdf>.

68 Press Release, U.S. Commodity Futures Trading Commission, "CFTC Announces Two Cross-Border Related Actions," (Aug. 4, 2016), available at <http://www.cftc.gov/PressRoom/PressReleases/pr7418-16>.

69 Proposed Rule, U.S. Commodity Futures Trading Commission, "Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants; Proposed Rule, Interpretations," 81 Fed. Reg. 71946 (Oct. 18, 2016), available at <http://www.cftc.gov/idc/groups/public/@lfederalregister/documents/file/2016-24905a.pdf>.

70 Sia Partners, "EMIR II: Requirements, improvements, development", (Aug. 11, 2015), available at <http://en.finance.sia-partners.com/emir-ii-requirements-improvements-developments>.

71 European Commission, Press Release, "Daily News 10/06/2016," (June 10, 2016), available at [http://europa.eu/rapid/press-release\\_MEX-16-2171\\_en.htm](http://europa.eu/rapid/press-release_MEX-16-2171_en.htm).

72 Jeff Patterson, Bank of England Authorizes ICE Clear Europe as Central Counterparty, (Sep. 20, 2016), available at <http://www.financemagnates.com/institutional-forex/execution/bank-of-england-authorizes-ice-clear-europe-as-central-counterparty/>.

73 European Securities and Markets Authority, OTC Derivatives and Clearing Obligation, available at <https://www.esma.europa.eu/regulation/post-trading/otc-derivatives-and-clearing-obligation>.

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Questions remain as to whether the U.K. will adopt EMIR after “Brexit” occurs. As we reported in our *2016 Mid-Year Update*, it is possible that the U.K. will refuse to recognize EMIR or adopt similar legislation, adding confusion and uncertainty to the European markets. But the more likely outcome is that the U.K. will adopt legislation similar to EMIR, especially considering that EMIR was created from international standards that the U.K. has previously agreed to adopt.

It is also unclear how much additional progress the CFTC will make on regulating credit default swaps in 2017, or even whether the existing rules will be maintained. As noted above, on January 20, 2016, former CFTC Chairman Massad resigned. One of Massad’s priorities was implementing the mandates of the Dodd-Frank Act which requires the promulgation of rules for greater transparency of the swaps markets.<sup>74</sup> The CFTC’s accomplishments in credit derivative swaps regulation under Massad’s leadership included adopting margin requirements for uncleared swaps transactions and strengthening clearinghouses, which must now be used for certain classes of credit default and interest rate swaps under the rules the CFTC had previously issued under Dodd-Frank. These rules were designed to add transparency to a traditionally opaque market that contributed to the 2008 financial crisis.<sup>75</sup>

However, it appears that acting CFTC Chairman Giancarlo, if nominated and confirmed to permanently replace Massad, may take a different approach. On January 18, 2017, Giancarlo outlined his plan for swaps regulations going forward.<sup>76</sup> He characterized the current swaps regime as having “caused numerous harms.”<sup>77</sup> He also noted that “[m]aking market reform work for America means allowing market participants to choose the manner of trade execution best suited to their swaps trading and liquidity needs and not have it chosen for them by the federal government.”<sup>78</sup>

In addition, President Trump has openly criticized the Dodd-Frank Act, vowing several times on the campaign trail to roll back its provisions, and, as recently as January 30, noting that the act “is a disaster.”<sup>79</sup> As president, Trump recently issued two executive orders that appear to relate to his promises on the campaign trail. On January 30, President Trump signed an executive order requiring two regulations to be repealed for every new one promulgated.<sup>80</sup> Then, on February 3, President Trump signed another executive order directing U.S. regulators to review financial regulations to ensure they fit with “six core principles.”<sup>81</sup> While these executive orders do not mention Dodd-Frank by name, they may be used to significantly undercut the legislation and the rules promulgated under it.

74 Press Release, “U.S. Commodity Futures Trading Commission, CFTC Chairman Timothy Massad Announces Resignation as Chairman,” (Jan. 3, 2017), available at <http://www.cftc.gov/PressRoom/PressReleases/pr7507-17>.

75 *Id.* See also Clearing Requirement Determination Under Section 2(h) of the CEA; Final Rule, 77 FR 74284 (Dec. 13, 2012) available at <http://www.cftc.gov/idc/groups/public/@lfederalregister/documents/file/2012-29211a.pdf>; Clearing Requirement Determination Under Section 2(h) of the Commodity Exchange Act for Interest Rate Swaps; Final Rule, 81 FR 71202 (Oct. 14, 2016) available at <http://www.cftc.gov/idc/groups/public/@lfederalregister/documents/file/2016-23983a.pdf>.

76 “Keynote Address of CFTC Commissioner J. Christopher Giancarlo Before SEFCON VII,” Speech, (Jan. 18, 2017), available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-19>.

77 *Id.*

78 *Id.*

79 Glenn Thrush, Trump Vow to Dismantle Dodd-Frank ‘Disaster,’ New York Times, (Jan. 30, 2017), available at [https://www.nytimes.com/2017/01/30/us/politics/trump-dodd-frank-regulations.html?\\_r=0](https://www.nytimes.com/2017/01/30/us/politics/trump-dodd-frank-regulations.html?_r=0).

80 Press Release, The White House, *Presidential Executive Order on Reducing Regulation and Controlling Regulatory Costs*, (Jan. 30, 2017), available at <https://www.whitehouse.gov/the-press-office/2017/01/30/presidential-executive-order-reducing-regulation-and-controlling>.

81 See Press Release, The White House, *Presidential Executive Order on Core Principles for Regulating the United States Financial System*, (Feb. 3, 2017), available at <https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-executive-order-core-principles-regulating-united-states>.



## Accounting Fraud

### Cross Border Regulatory and Enforcement Updates

In the latest sign that the DOJ will pursue foreign individuals for engaging in alleged accounting fraud that purportedly affects U.S. interests, in November 2016 a federal grand jury indicted U.K. citizen Sushovan Hussain, the former chief financial officer of Autonomy Corporation plc (Autonomy), on felony wire fraud charges stemming from Hewlett-Packard Co.'s (HP) botched takeover of Autonomy that ended in HP writing off \$8.8 billion.<sup>82</sup> According to the indictment, Hussain engaged in a scheme to mislead HP about the true performance of Autonomy's business in an effort to overinflate the price of Autonomy's shares and entice HP into the deal.<sup>83</sup> The DOJ alleged, among other things, that Hussain backdated agreements to record revenue in prior periods and made false statements to HP regarding Autonomy's financial condition and performance during acquisition negotiations.<sup>84</sup>

Hussain argued that the case has no business in a United States court because he is a U.K. citizen and resident and Autonomy is incorporated in the United Kingdom, with dual headquarters in San Francisco and Cambridge. However, the DOJ asserted that Autonomy derives substantial revenue from business in the United States: as of 2010, about 68 percent of Autonomy's reported revenues came from the United States and other countries in the Americas.<sup>85</sup> Despite his jurisdictional arguments, it does not appear that Hussain will surmount a legal challenge to the indictment on these grounds: at a hearing in December 2016, Hussain's attorney told the judge that his client is eager to go to trial and has agreed to travel from England for an arraignment that was set for January 12, 2017, in San Francisco.<sup>86</sup> The government's charges against Hussain carry a combined maximum prison sentence of 20 years.<sup>87</sup> In addition to jail time, the government is seeking to recoup at least \$7.7 million in alleged ill-gotten gains through the purported scheme.<sup>88</sup>

The DOJ's action targeting accounting fraud parallels the increased attention the SEC has shown in this area. In 2013, the SEC created a Financial Reporting and Audit Task Force to address accounting failures and pursued several accounting fraud cases throughout 2016.<sup>89</sup> On the international front, former SEC Chairman Mary Jo White issued a statement on January 5, 2017, urging her replacement to continue to pursue global standards for financial reporting.<sup>90</sup> It remains to be seen, however, whether accounting fraud cases and the pursuit of a global accounting standard will remain a priority under the new administration.

82 David Goldman, *HP takes \$8.8 billion writedown on Autonomy* (Nov. 20, 2012), available at <http://money.cnn.com/2012/11/20/technology/enterprise/hp-earnings/>.

83 Press Release, U.S. Department of Justice, "Former Autonomy CFO Charged With Wire Fraud," (Nov. 14, 2016), available at <https://www.justice.gov/opa/pr/former-autonomy-cfo-charged-wire-fraud>.

84 *Id.*

85 *Id.*

86 Bloomberg L.P., "Ex-Autonomy Trader Headed to U.S. to Face Trial Over HP Deal" (Dec. 6, 2016), available at <https://www.bloomberg.com/news/articles/2016-12-06/ex-autonomy-cfo-headed-to-u-s-to-face-fraud-trial-on-hp-takeover>.

87 *Supra*, note 83.

88 *Id.*

89 Press Release, U.S. Securities and Exchange Commission, "SEC Announces Enforcement Initiatives to Combat Financial Reporting and Microcap Fraud and Enhance Risk Analysis," (Jul. 2, 2013), available at <https://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171624975>.

90 Mary Jo White, "A U.S. Imperative: High-Quality, Globally Accepted Accounting Standards," (Jan. 5, 2017) available at <https://www.sec.gov/news/statement/white-2016-01-05.html>.

## Anti-Money Laundering and The Panama Papers

### Cross Border Regulatory and Enforcement Updates

The fallout from the so-called Panama Papers, a cache of more than 11.5 million financial and legal documents relating to more than 200,000 offshore entities, continued in the latter half of 2016. After the leak of these documents from the Panamanian law firm Mossack Fonesca, anti-money laundering regulations and enforcement in the United States, the European Union and around the world has become a high priority. Firms across the globe should expect increased legislation, regulations and scrutiny regarding suspected money laundering and tax evasion.

In the United States, the Financial Crimes Enforcement Network (FinCen) – a bureau of the U.S. Department of the Treasury – had previously announced a final rule on customer due diligence in May 2016. This new rule became effective on July 11, 2016, and covered financial institutions have until May 11, 2018 to comply.<sup>91</sup> As discussed more fully in our *2016 Mid-Year Update*, this rule requires covered financial institutions to now monitor the beneficial owners of the legal entity account holders, not just the account holders themselves.

Additionally, U.S. lawmakers are still seeking information about U.S. companies listed in the leaked Panama Papers. In October 2016, Oregon Senator Ron Wyden, the Ranking Member of the Senate Finance Committee, sent a letter to the U.S. Treasury and the IRS asking for information about the “Treasury Department’s efforts to combat tax abuse by anonymous shell companies.”<sup>92</sup> In his letter, Senator Wyden also asked for detailed information about the specific companies found in the Panama Papers, including whether the companies had obtained Federal Employer Identification Numbers or had any U.S. tax liability.<sup>93</sup>

On the enforcement side, using information revealed in the Panama Papers, the New York State Department of Financial Services (DFS) ordered Taiwan’s Mega International Commercial Bank (Mega) to pay a \$180 million penalty and install an independent monitor as part of a consent order under New York’s anti-money laundering laws.<sup>94</sup> The DFS found that Mega had poor internal controls, leading to a number of suspicious transactions between Mega’s New York and Panama branches. Further, the DFS found that a “substantial number” of Mega’s entity customers in Panama were formed with help from Mossack Fonseca.<sup>95</sup> The DFS’s investigation into Mega reverberated around the world, leading to Taiwanese authorities undertaking a criminal investigation into the bank and its ties to overseas bank accounts. On December 2, 2016, the Taiwanese investigation culminated in indictments against the former head of the bank and his two aides for accepting improper gains, money laundering, releasing false documents and insider trading.<sup>96</sup>

91 Federal Register, Customer Due Diligence Requirements for Financial Institutions, (May 11, 2016), available at <https://www.federalregister.gov/documents/2016/05/11/2016-10567/customer-due-diligence-requirements-for-financial-institutions>.

92 Sen. Ron Wyden, Letter to Jacob Lew and John Koskinen, (Oct. 19, 2016), available at [https://www.scribd.com/document/328173783/Wyden-IRS-Treasury-Panama-Papers-Letter#from\\_embed](https://www.scribd.com/document/328173783/Wyden-IRS-Treasury-Panama-Papers-Letter#from_embed).

93 *Id.*

94 See *In the Matter of Mega Int’l Comm. Bank Co., Ltd., et al.*, New York State Department of Financial Services Consent Order Under New York Banking Law §§ 39 and 44 (Aug. 19, 2016), available at <http://www.dfs.ny.gov/about/ea/ea160819.pdf>.

95 Jeremy Maltby and Grant Damon-Feng, “The Panama Papers: The Story So Far, And What Comes Next,” Law360, (Dec. 16, 2016), available at <https://www.law360.com/articles/874074/the-panama-papers-the-story-so-far-and-what-comes-next>.

96 “Taiwan Indicts Ex-Head of Bank Linked to Panama Papers”, The Straits Times, (Dec. 2, 2016), available at <http://www.straitstimes.com/asia/east-asia/taiwan-indicts-ex-head-of-bank-linked-to-panama-papers>.

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In the European Union, the European Commission announced a new anti-money laundering proposal in July 2016, directly citing the revelations contained in the Panama Papers as an impetus behind the new regulations.<sup>97</sup> At its core, the proposal allows for the automatic sharing of information between member states' tax authorities, subjecting certain companies and trusts (which were previously exempt) to EU due diligence controls, and increasing transparency of the beneficial ownership registers in member states.<sup>98</sup> These new regulations will require the publication of beneficial owners who have a 10 percent ownership in "certain companies that present a risk of being used for money laundering and tax evasion."<sup>99</sup>

But the European Commission's proposal is still subject to approval from the European Parliament, with debate and negotiations having begun in late November 2016 and likely to continue through the first quarter of 2017. Currently, the member states have expressed disagreement about the transparency amendments – at issue is the balance between more transparency and data privacy concerns.<sup>100</sup> Firms should expect final regulations to be voted on, and possibly come into effect by, March 2017.

Finally, the United Kingdom's Panama Papers Taskforce, created in April 2016, is still actively working through the information found in the Panama Papers, and recently reported that 22 people face civil and criminal investigations into suspected tax evasion as a result of the revelations.<sup>101</sup> Philip Hammond, Chancellor of the Exchequer, explained in written comments to the House of Commons in November 2016 that in addition to the 22 individuals, the Taskforce has identified 43 "wealthy individuals" and 26 offshore companies as "potentially suspicious." Investigations by the Taskforce and by the Financial Conduct Authority and the National Crime Agency are ongoing.<sup>102</sup>

## Corruption Investigations in International Sports

### FIFA

The DOJ and Office of the Attorney General of Switzerland (the OAG) continue to investigate high-ranking officials of the Fédération Internationale de Football Association (FIFA) in connection with a wide-ranging conspiracy that allegedly involved the receipt of more than \$200 million in bribes and kickbacks relating to the bidding process for the 2018 and 2022 World Cup tournaments and the sale of broadcasting rights for past and future FIFA tournaments.

Rafael Esquivel, former president of the Venezuelan soccer federation, pled guilty in the District Court for the Eastern District of New York in November 2016 for his involvement in a bribery conspiracy, and must forfeit over \$16 million, in addition to potentially facing a 20-year prison

97 Press Release, European Commission, "Commission strengthens transparency rules to tackle terrorism financing, tax avoidance and money laundering," (Jul. 5, 2016), available at [http://europa.eu/rapid/press-release\\_IP-16-2380\\_en.htm](http://europa.eu/rapid/press-release_IP-16-2380_en.htm).

98 *Id.*

99 *Id.*

100 Chuck Stanley, "EU Anti-Tax Evasion Move Targets Company Ownership Info," (Dec.7, 2016), Law360, available at <https://www.law360.com/articles/870249/eu-anti-tax-evasion-move-targets-company-ownership-info>.

101 HM Revenue and Customs, Government of the U.K., "Taskforce launches criminal and civil investigations into Panama Papers," (Nov. 8, 2016), available at <https://www.gov.uk/government/news/taskforce-launches-criminal-and-civil-investigations-into-panama-papers>.

102 Holly Watt and David Pegg, "Panama Papers: 22 people face tax evasion investigations in UK," The Guardian, (Nov. 8, 2016), available at <https://www.theguardian.com/world/2016/nov/08/panama-papers-22-people-face-tax-evasion-investigations-in-uk>.

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sentence.<sup>103</sup> Esquivel is now one of the 18 named individuals who have pled guilty in response to U.S. federal prosecutors' probe into FIFA's allegedly expansive network of corruption.<sup>104</sup>

Sepp Blatter, former FIFA president, continues to remain the subject of ongoing and separate investigations initiated by FIFA, the DOJ, and Swiss prosecutors, but continues to deny any wrongdoing.<sup>105</sup> However, in early December 2016, Blatter was unsuccessful in his appeal to challenge FIFA's imposition that he be banned from soccer for six years.<sup>106</sup> The Court of Arbitration for Sport rendered the verdict, which also requires Blatter to pay a fine of approximately \$49,500 to FIFA.

Finally, on December 13, 2016, an Argentine sports marketing company entered into a deferred prosecution agreement with the DOJ related to the FIFA scandal. Torneos y Competencias SA (Torneos) admitted to its involvement in a bribery scheme, paying millions of dollars in bribes and kickbacks to a FIFA executive through shell companies and phony contracts in order to gain broadcast rights for the next four editions of the World Cup.<sup>107</sup> Federal prosecutors in the Eastern District of New York have agreed to a deal in which the company will pay \$112.8 million, comprised of an \$89 million forfeiture plus a \$23.8 million penalty.<sup>108</sup> In exchange, the government will dismiss its charge of wire fraud conspiracy if Torneos complies with the agreement for four years, including correcting and improving internal controls and appointing new management heads.<sup>109</sup>

## Russian Doping Investigation

As reported in the *2016 Mid-Year Update*, the DOJ initiated an investigation into state-sponsored doping of Russian professional athletes. Since then, the International Olympic Committee (the IOC) has imposed sanctions on Russia,<sup>110</sup> particularly as the long-awaited McLaren Report, commissioned by the World Anti-Doping Agency, revealed significant evidence that Russian officials implemented a doping program at the Olympics and other professional sports competitions.<sup>111</sup> The report even recommends that the IOC reconsider any medals won by Russia from the 2014 Sochi Winter Olympics and impose penalties before the 2018 Winter Games.<sup>112</sup> Following the release of the report, the head of the IOC stated that any athlete who was involved in the doping program should be denied participation

103 Joyce Hanson, "Ex-Venezuelan Soccer Head Pleads Guilty to Racketeering," Law360, (Nov. 10, 2016), available at <http://www.law360.com/articles/861554/ex-venezuelan-soccer-head-pleads-guilty-to-racketeering>.

104 Nate Raymond, "Ex-Venezuela soccer official to plead guilty in U.S. bribe case," Reuters, (Nov. 8, 2016), available at <http://uk.reuters.com/article/uk-soccer-fifa-court-idUKKBN1332PR>.

105 "Sepp Blatter loses appeal against 6-year FIFA ban," Chicago Tribune, (Dec. 5, 2016), available at <http://www.chicagotribune.com/sports/soccer/ct-sepp-blatter-loses-appeal-fifa-ban-20161205-story.html>.

106 *Id.*

107 Erica Orden, "Argentine Firm to Pay \$112.8 Million to Settle FIFA Case," (Dec. 13, 2016), available at <http://www.wsj.com/articles/argentine-firm-to-pay-122-8-million-penalty-to-settle-fifa-case-1481666967>.

108 Nate Raymond and Mica Rosenberg, "Argentine firm reaches \$112.8 million deal with U.S. in FIFA probe," Reuters, (Dec. 13, 2016), available at <http://www.reuters.com/article/us-soccer-fifa-court-idUSKBN14229V>.

109 Pete Brush, "Breaking: Argentine Marketing Co. Pays DOJ \$113M in FIFA Bribery Deal," Law360, (Dec. 13, 2016), available at [http://www.law360.com/whitecollar/articles/872243/breaking-argentina-co-pays-doj-113m-in-fifa-bribery-deal?nl\\_pk=7d552c11-ea47-4657-8ff6-0e0f9a23d050&utm\\_source=newsletter&utm\\_medium=email&utm\\_campaign=whitecollar](http://www.law360.com/whitecollar/articles/872243/breaking-argentina-co-pays-doj-113m-in-fifa-bribery-deal?nl_pk=7d552c11-ea47-4657-8ff6-0e0f9a23d050&utm_source=newsletter&utm_medium=email&utm_campaign=whitecollar).

110 "IOC extends doping sanctions on Russia as Richard McLaren's report looms," The Guardian, (Dec. 7, 2016), available at <https://www.theguardian.com/sport/2016/dec/07/ioc-extends-doping-sanctions-on-russia>.

111 Rebecca R. Ruiz, "Report Shows Vast Reach of Russian Doping: 1,000 Athletes," 30 Sports, (Dec. 9, 2016), available at <http://www.nytimes.com/2016/12/09/sports/russia-doping-mclaren-report.html>.

112 *Id.*

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in future Olympic events in any capacity.<sup>113</sup> Additionally, the IOC has named two commissions in response to the report, and a team will further examine doping samples for banned substances and any tampering.<sup>114</sup> The Russian sports ministry denies such a state-sponsored program existed and promised to cooperate with authorities.

## Trade Sanctions and Export Controls

### Trade Sanctions

During his last days in office, President Obama lifted most U.S. economic sanctions imposed on Sudan, and now trade between the two countries is authorized.<sup>115</sup> This move came in response to the Sudanese government's progress in providing humanitarian organizations access to the country, and its commitment to cease support of South Sudanese rebels, including cooperating with U.S. intelligence agents.<sup>116</sup> However, if within six months the Sudanese government defaults on its promises, the U.S. may reinstate the sanctions. Because these sanctions were lifted through an executive order, there is a possibility that the new administration will rescind the lifting. Therefore, U.S. entities should still exercise caution if engaging in any dealings within Sudan.

### OFAC Developments

In the second half of 2016, the United States Office of Foreign Assets Control (OFAC) continued to levy significant fines against foreign banks and other corporations for violating U.S. sanctions programs. OFAC issued three Findings of Violation in the latter half of 2016:

- Finding of Violation to Compass Bank, which operates under the name BBVA Compass (Compass), for violations of the Foreign Narcotics Kingpin Sanctions Regulations.<sup>117</sup> From June 12, 2013, to June 3, 2014, Compass maintained accounts on behalf of two individuals on OFAC's List of Specially Designated Nationals and Blocked Persons – two members of the Sanchez Garza drug family, operating out of Guadalajara, Mexico.
- Finding of Violation to AXA Equitable Life Insurance Company (AXA) for violations of the Foreign Narcotics Kingpin Sanctions Regulations.<sup>118</sup> From December 3, 2009, to approximately May 11, 2011, AXA processed payments and maintained health insurance policies for three individuals on the List of Specially Designated Nationals and Blocked Persons.
- A related but separate Finding of Violation to Humana Inc., the parent company of Kanawha Insurance Company (Kanawha), for violations of the Foreign Narcotics Kingpin Sanctions

113 International Olympic Committee, Statement of the IOC Regarding the "Independent Person" Report, (Dec. 9, 2016), available at <https://www.olympic.org/news/statement-of-the-ioc-regarding-the-independent-person-report>.

114 Lawrence Ostlere, "McLaren report: more than 1,000 Russian athletes involved in doping conspiracy," The Guardian, (Dec. 9, 2016), available at <https://www.theguardian.com/sport/live/2016/dec/09/mclaren-report-into-doping-in-sport-part-two-live>.

115 Melissa Miller Proctor, "With Less Than a Week Left in Office, President Obama Lifts U.S. Economic Sanctions on Sudan," The National Law Review, (Jan. 17, 2017), available at <http://www.natlawreview.com/article/less-week-left-office-president-obama-lifts-us-economic-sanctions-sudan>.

116 Jeffrey Gettleman, "United States to Lift Sudan Sanctions," The New York Times, (Jan. 13, 2017), available at [https://www.nytimes.com/2017/01/13/world/africa/sudan-sanctions.html?\\_r=0](https://www.nytimes.com/2017/01/13/world/africa/sudan-sanctions.html?_r=0).

117 Enforcement Action for July 27, 2016, OFAC, available at [https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20160727\\_bbva.pdf](https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20160727_bbva.pdf).

118 Enforcement Action for August 2, 2016, OFAC, available at [https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20160802\\_axa\\_fov.pdf](https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20160802_axa_fov.pdf).

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Regulations.<sup>119</sup> From December 3, 2009, to approximately May 11, 2011, Kanawha facilitated and processed payments for health insurance policies for the same individuals discussed above.

In addition to these Findings of Violation, there were important changes in the latter half of 2016 to OFAC's embargos and sanctions regimes, including changes to the Cuba sanctions regulations and the Burma sanctions program.

**Cuba Sanctions Regulations**

On October 14, 2014, OFAC announced new amendments to the Cuban Assets Control Regulations and Export Administration Regulations designed to provide additional easing to the Cuban embargo in five major areas: (i) health-related transactions, (ii) humanitarian-related transactions, (iii) civil aviation, (iv) travel-related transactions, and (v) trade and commerce.<sup>120</sup> The changes to health-related transactions, titled "Expanding Opportunities for Scientific Collaboration and Access to Medical Innovations," allow for joint medical research, authorizing joint medical research projects with Cuban nationals for both commercial and noncommercial purposes.<sup>121</sup> Further, OFAC issued a new authorization to allow FDA approval of Cuban-origin pharmaceuticals, and will allow the importation of FDA-approved Cuban-origin pharmaceuticals for marketing, sale, or other distribution in the United States.<sup>122</sup> To affect these two newly authorized health-related activities, persons and companies engaged in these activities will be permitted to open Cuban bank accounts to conduct the authorized business.<sup>123</sup>

To further ongoing humanitarian work in Cuba, OFAC is authorizing a program titled "Providing Additional Grant Opportunities and Strengthening Cuban Infrastructure." This new program expands the current authorization for grants, scholarships, and awards given from U.S. institutions to Cuba, Cuban nationals, and Cuban organizations for scientific research or religious activities.<sup>124</sup> OFAC is also adding a new authorization that will allow individuals or firms to provide services to Cuba or Cuban nationals for the purposes of "developing, repairing, maintaining, and enhancing certain Cuban infrastructure in order to directly benefit the Cuban people."<sup>125</sup>

The changes to the civil aviation regulations focus on "Supporting International Aviation and Passenger Safety." OFAC is implementing a new authorization that will allow individuals or firms to provide "civil aviation safety-related services" to Cuba and Cuban nationals. The purpose, which fits with newly expanded commercial airline service to Cuba from the United States, is to ensure the safe operation of commercial aircraft within Cuban airspace.<sup>126</sup>

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119 Enforcement Action for August 2, 2016, OFAC, available at [https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20160802\\_humana\\_fov.pdf](https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20160802_humana_fov.pdf).

120 Amendments to Cuba Sanctions Regulations, October 14, 2016, available at [https://www.treasury.gov/resource-center/sanctions/Programs/Documents/cuba\\_fact\\_sheet\\_10142016.pdf](https://www.treasury.gov/resource-center/sanctions/Programs/Documents/cuba_fact_sheet_10142016.pdf).

121 *Id.*

122 *Id.*

123 *Id.*

124 *Id.*

125 *Id.*

126 Amendments to Cuba Sanctions Regulations, October 14, 2016, available at [https://www.treasury.gov/resource-center/sanctions/Programs/Documents/cuba\\_fact\\_sheet\\_10142016.pdf](https://www.treasury.gov/resource-center/sanctions/Programs/Documents/cuba_fact_sheet_10142016.pdf).

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To complement easier travel access to Cuba for United States nationals, OFAC announced authorizations to support “People-to-People Contact by Facilitating Authorized Travel and Commerce.” The new authorization removes the monetary value limitations on what authorized travelers may import from Cuba into the United States as baggage, including the value limitations on alcohol and tobacco products.<sup>127</sup> United States nationals will also be authorized to make remittances to third-country nationals for travel by those third-country nationals to, from, or within Cuba.<sup>128</sup>

Finally, OFAC’s largest change to the Cuba sanctions regulations is to the trade and commerce restrictions, titled “Bolstering Trade and Commercial Opportunities and the Growth of Cuba’s Private Sector.” The new authorizations remove barriers to trade, including permitting air cargo transit to Cuba, permitting contingent contracts with Cuban nationals and entities, and permitting the sale of consumer goods directly to Cuban nationals.<sup>129</sup>

As noted above with respect to the lifting of Sudan sanctions, it is unclear whether these new policies on the Cuban sanctions regime will survive in the new administration. A few weeks after he was elected, President Trump threatened to reimpose sanctions on Cuba if “Cuba is unwilling to make a better deal for the Cuban people.”<sup>130</sup> Companies and individuals who do business with and travel to Cuba should thus monitor the state of Cuban sanctions in 2017.

#### Burma Sanctions Program

On October 7, 2016, President Obama signed an executive order terminating the national emergency with respect to Burma, revoking the Burma Sanctions Executive Orders and waiving other statutory blocking and financial sanctions on Burma.<sup>131</sup> As a result, all OFAC economic and financial sanctions against Burma, also known as Myanmar, are no longer in effect. The executive order was signed in order to support the changes that the Southeast Asian country has undergone in recent years, including political reform and democratic elections. The Department of the Treasury will also help the government of Burma implement new anti-money laundering programs to help ensure the stability and integrity of the nation’s financial system.<sup>132</sup>

#### DOJ Guidance on Export Control

On October 2, 2016, the DOJ’s National Security Division issued new guidance regarding voluntary self-disclosures, cooperation, and remediation in export control and sanctions investigations into companies.<sup>133</sup> The guidance is intended to encourage firms to self-disclose, cooperate with investigations, and remediate criminal violations of the export control laws, by providing

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<sup>127</sup> *Id.*

<sup>128</sup> *Id.*

<sup>129</sup> *See id.*

<sup>130</sup> Dawn Brancati and Javier Corrales, “Trump has threatened to rip up the “deal” with Cuba. Would that work?”, *The Washington Post*, (Nov. 29, 2016), available at [https://www.washingtonpost.com/news/monkey-cage/wp/2016/03/30/the-u-s-embargo-didnt-push-cuba-toward-democracy-neither-will-its-end-so-whats-the-point/?utm\\_term=.e143d6369fd5](https://www.washingtonpost.com/news/monkey-cage/wp/2016/03/30/the-u-s-embargo-didnt-push-cuba-toward-democracy-neither-will-its-end-so-whats-the-point/?utm_term=.e143d6369fd5).

<sup>131</sup> Burma Fact Sheet, Oct. 7, 2016, U.S. Treasury Department Office of Public Affairs, available at [https://www.treasury.gov/resource-center/sanctions/Programs/Documents/burma\\_fact\\_sheet\\_20161007.pdf](https://www.treasury.gov/resource-center/sanctions/Programs/Documents/burma_fact_sheet_20161007.pdf).

<sup>132</sup> *Id.*

<sup>133</sup> U.S. Department of Justice, “Guidance Regarding Voluntary Self-disclosures, Cooperation, and Remediation in Export Control and Sanctions Investigations Involving Business Organizations”, (Oct. 2, 2016), available at <https://www.justice.gov/nsd/file/902491/download>.

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cooperation credit for doing so. This new guidance coincides with the DOJ's broader policy on corporate cooperation articulated in the September 9, 2015 memorandum issued by then-Deputy Attorney General Sally Yates (the Yates memo), which, in an effort to hold more individuals responsible for corporate wrongdoing, requires companies to provide all facts relevant to employee misconduct in order to receive cooperation credit.<sup>134</sup>

At its core, the new guidance provides greater transparency to companies about what is required if they seek cooperation credit, including disclosure of all relevant facts within a reasonable time after becoming aware of the offense "prior to an imminent threat of disclosure or government investigation." If companies do so, they may be eligible for significantly reduced penalties, including nonprosecution agreements, reduced fines and forfeiture, a reduced period of supervised compliance, and no requirements for a monitor.<sup>135</sup>

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134 Sally Quillian Yates, U.S. Dep't of Justice, Individual Accountability for Corporate Wrongdoing (2015).

135 U.S. Department of Justice, "Guidance Regarding Voluntary Self-disclosures, Cooperation, and Remediation in Export Control and Sanctions Investigations Involving Business Organizations", (Oct. 2, 2016), available at <https://www.justice.gov/hsd/file/902491/download>.





## International Parallels In Law Enforcement Methods and Priorities

# Whistleblower Programs

## International Parallels In Law Enforcement Methods and Priorities

## Update on Annual Statistics

The SEC whistleblower program, instituted in 2010 under Dodd-Frank, had its busiest year ever in 2016, with awards totaling over \$57 million – more than all award amounts issued in previous years combined. The SEC issued six of the 10 highest awards in the program’s history in 2016, proving that the incentives for corporate insiders and market participants to report to the SEC have never been higher.

In total, the SEC Office of the Whistleblower received over 4,200 tips in 2016. These tips led to 34 whistleblower awards. The SEC reported that enforcement actions based on these tips resulted in over \$584 million in financial sanctions, including more than \$346 million in disgorgement.<sup>136</sup>

Also of note this year was the SEC’s first stand-alone whistleblower retaliation case, brought in September 2016 against International Game Technology (IGT), a casino-gambling company.<sup>137</sup> The employee at issue reported to senior management at the company and the SEC that the company’s financial statements may have been distorted or inaccurate.<sup>138</sup> The employee was then fired, despite several years of positive performance reviews. IGT later agreed to pay a half-million dollar penalty for the alleged retaliation.<sup>139</sup>

## Foreign Whistleblowers Under the SEC Whistleblower Program

Similar to last year, the SEC continues to see an uptick in the number of tips coming from outside the U.S.: during the 2016 fiscal year, approximately 11 percent of the tips received by the SEC originated from individuals in foreign countries, including Canada (68), the United Kingdom (63), Australia (53), Mexico (29), and China (35). Overall, the SEC received whistleblower tips from individuals in 67 foreign countries in 2016.<sup>140</sup>

Although the SEC did not publicly announce any whistleblower awards to foreign nationals in 2016, outgoing Director of the Division of Enforcement Andrew Ceresney reiterated the importance of foreign whistleblowers in a September 2016 speech.<sup>141</sup> In his speech, titled “The SEC’s Whistleblower Program: The Successful Early Years,” Ceresney noted:

[I]nternational whistleblowers can add great value to our investigations. Recognizing the value of international whistleblowers, we have made eight awards to whistleblowers living in foreign countries. In fact, our largest whistleblower award

136 See 2016 Annual Report to Congress on The Dodd-Frank Whistleblower Program, available at <https://www.sec.gov/whistleblower/reportspubs/annual-reports/owb-annual-report-2016.pdf>.

137 Press Release 2016-204, SEC: Casino-Gaming Company Retaliated Against Whistleblower, available at <https://www.sec.gov/news/pressrelease/2016-204.html>.

138 *Id.*

139 *Id.*

140 See 2016 Annual Report to Congress on The Dodd-Frank Whistleblower Program, available at <https://www.sec.gov/whistleblower/reportspubs/annual-reports/owb-annual-report-2016.pdf>.

141 Andrew Ceresney, “The SEC’s Whistleblower Program: The Successful Early Years,” Speech, Sept. 14, 2016, available at <https://www.sec.gov/news/speech/ceresney-sec-whistleblower-program.html>.

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to date – \$30 million – went to a foreign whistleblower who provided us with key original information about an ongoing fraud that would have been very difficult to detect. In making this award, the Commission staked out a clear position that the fact that a whistleblower is a foreign resident does not prevent an award when the whistleblower’s information led to a successful Commission enforcement action brought in the United States concerning violations of the U.S. securities laws.<sup>142</sup>

Both the number of tips originated from foreign whistleblowers and statements of support from the SEC should serve as a reminder to firms that internal controls and compliance programs must take on a worldwide focus, rather than simply focusing on domestic employees.

### Whistleblower Programs in Other Jurisdictions

The continued success of the SEC’s Whistleblower Program has inspired other countries to increase the scope and scale of their own whistleblower programs. Of note in 2016, the U.K.’s FCA and Prudential Regulation Authority (the PRA) now require, as of March 2016, each regulated firm to appoint a “whistleblowers’ champion.”<sup>143</sup> This position must be held by a nonexecutive director whose responsibilities are separate from a firm’s day-to-day operations.<sup>144</sup> The whistleblowers’ champion has two main responsibilities:

- Ensuring and overseeing the integrity, independence and effectiveness of the company’s whistleblowing policies and procedures.
- Preparing an annual report on whistleblowing, including, among other things, a list of any employment claims involving whistleblowing which the company has lost in the previous year.<sup>145</sup>

In addition to the required whistleblowers’ champion, the new regulations require firms, as of September 2016, to, among other things:

- Establish an “internal whistleblowing channel” in order to effectively address concerns and communicate this channel to employees.
- Inform all U.K.-based employees that they can blow the whistle directly to the FCA and PRA without having to go through any internal whistleblowing channel first.
- Protect whistleblowers’ confidentiality and allow anonymous disclosures.
- Ensure the firm’s internal whistleblowing policies offer protection for whistleblowers, even if the disclosure does not qualify as a protected disclosure under the FCA or PRA regulations.<sup>146</sup>

These extensive new regulations have already required U.K.-based and U.K.-operated firms to take a fresh look at their internal reporting and compliance programs, in order to properly follow the new FCA

142 *Id.*

143 Policy Statement, Bank of England, “Whistleblowing in Deposit-Takers, PRA-Designated Investment Firms and Insurers”, Oct. 2015, available at <http://www.bankofengland.co.uk/prd/Documents/publications/ps/2015/ps2415.pdf>.

144 *Id.*

145 *Id.*

146 *Id.*

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and PRA guidance. Both the detail and breadth of these requirements are likely effects of different incentives for U.K. whistleblowers – there are no monetary rewards for whistleblowers in the U.K.

In Canada, the Ontario Securities Commission (the OSC) launched a new whistleblower program in July 2016. Administered under the newly created Office of the Whistleblower, this program is the first paid whistleblower program run by a securities regulator in Canada.<sup>147</sup>

The OSC whistleblower program allows for compensation of up to \$5 million CAD for individuals who provide tips to the OSC that lead to enforcement actions.<sup>148</sup> Qualifying tips include “possible violations of Ontario securities law, including illegal insider trading, market manipulation, and accounting and disclosure violations.”<sup>149</sup> As in the U.S.’s SEC program, whistleblowers can report anonymously, and there are new anti-retaliation provisions that have been added to the Ontario Securities Act.<sup>150</sup> These anti-retaliation provisions allow the OSC to take enforcement action against firms who retaliate against or try to silence whistleblowers.

In Germany, the country’s Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, known as “BaFin”) established a new platform for whistleblowers to report tips.<sup>151</sup> This new platform, launched in July 2016, creates a “central contact point” for whistleblowers to provide tips to BaFin.<sup>152</sup> The platform does not change any underlying law, so Germany still does not permit whistleblower incentives. But the platform increases the protection of anonymous whistleblowers through new procedures and will help BaFin better manage the inflow of whistleblower tips.

In November 2016, the *Sapin II* legislation became law in France, making several major changes to French anti-corruption law, including the addition of new investigative and enforcement mechanisms and protections for whistleblowers.<sup>153</sup> The law, which was modeled after the U.S. Foreign Corrupt Practices Act and the U.K. Bribery Act 2010, modernizes France’s anti-corruption regime by creating the Agence Française Anticorruption (AFA), which will be responsible for enforcing *Sapin II*.<sup>154</sup> The law will apply to all French companies that employ more than 500 employees and have revenues of more than €100 million. These companies will be required to create and implement anti-corruption compliance programs under Article 17 of the law.<sup>155</sup>

Regarding whistleblowers, *Sapin II* does not add financial incentives for providing tips, and the law requires whistleblowers to first use the internal whistleblowing channels established at

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147 Press Release, Ontario Securities Commission, “OSC launches Office of the Whistleblower,” (Jul. 14, 2016), available at [http://www.osc.gov.on.ca/en/NewsEvents\\_nr\\_20160714\\_osc-launches-whistleblower.htm](http://www.osc.gov.on.ca/en/NewsEvents_nr_20160714_osc-launches-whistleblower.htm).

148 *Id.*

149 *Id.*

150 *Id.*

151 Federal Financial Supervisory Authority (Germany), “BaFin Establishes a Reporting Platform for Whistleblowers,” (Jul. 5, 2016), available at [https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Pressemitteilung/2016/pm\\_160701\\_hinweisgeberstelle\\_en.html](https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Pressemitteilung/2016/pm_160701_hinweisgeberstelle_en.html).

152 *Id.*

153 See “The Sapin II Bill is Adopted: The Main Measures,” *Le Point*, (Nov. 8, 2016) (translated from French), available at [http://www.lepoint.fr/politique/les-mesures-principales-de-la-loi-sapin-ii-08-11-2016-2081688\\_20.php](http://www.lepoint.fr/politique/les-mesures-principales-de-la-loi-sapin-ii-08-11-2016-2081688_20.php).

154 LOI n° 2016-1691 du 9 Décembre 2016 relative à la transparence, à la lutte contre la corruption et à la modernisation de la vie économique (Law Number 2016-1691 of December 9 2016 on Transparency, the Fight Against Corruption, and the Modernization of Economic Life), available at <https://www.legifrance.gouv.fr/>.

155 *Id.*

their companies before they blow the whistle to the AFA.<sup>156</sup> But whistleblowers – with very few exceptions – receive immunity from criminal prosecution for offenses relating to their tips.<sup>157</sup>

## Deferred Prosecution Agreements

### International Parallels In Law Enforcement Methods and Priorities

Deferred prosecution agreements (DPAs) have long been used by the DOJ and the SEC as federal pretrial tools, where the government and the defendant agree that if specific conditions are met by the defendant, the government will not proceed with prosecuting a filed criminal case.<sup>158</sup> The U.K. has begun to implement U.S.-style DPAs in relation to prosecutions against companies, when prosecutors will suspend criminal charges in return for a company's compliance with the terms of the agreement. In July 2016, the SFO's request for its second DPA was approved in connection with a bribery case in which a U.K. company allegedly engaged in a conspiracy to corrupt and bribe and allegedly failed to prevent bribery through its contracts in foreign jurisdictions.<sup>159</sup> The SFO's director, David Green, noted an increasing demand for DPAs by companies, which would prefer to defer trials and reduce penalties.<sup>160</sup> Meanwhile, other countries are still considering whether to use DPAs after the intergovernmental Organisation for Economic Co-operation and Development, whose mission is to promote economic and social policies to improve the social well-being of people around the world, suggested incorporating them to tackle corporate bribery cases, creating a common approach in enforcement.<sup>161</sup> This second DPA in the U.K. suggests that U.K. prosecutors will continue to implement such agreements as necessary when a company facing charges of corporate crime agrees to cooperate with authorities in exchange for a lesser penalty.

However, recent developments in the U.S. may bear on the continued frequency of use of DPAs, and the types of requirements DPAs impose on companies when used. One issue is the possibility of the public disclosure of reports generated under a DPA. After the DOJ brought charges against HSBC in 2012 for failure to prevent various alleged money laundering schemes, the bank and the government entered into a DPA in which HSBC would pay a \$1.92 billion fine and allow an independent corporate compliance monitor to inspect its enhanced procedures for five years.<sup>162</sup> In 2015, the independent monitor filed a report detailing HSBC's compliance with the DPA with the Eastern District of New York Court overseeing the monitorship under seal. An individual suing HSBC on mortgage loan modifications petitioned the court for disclosure of the monitor's report<sup>163</sup> The government and the bank opposed disclosure, arguing, among other things, that public disclosure of the monitor's findings would reveal any vulnerabilities of HSBC's money laundering

<sup>156</sup> *See id.*

<sup>157</sup> *Id.*

<sup>158</sup> Emma Radmore and Stephen L. Hill, Jr., "Deferred Prosecution Agreements: the US Experience and the UK Potential," Lexology, (Jul. 14, 2014), available at <http://www.lexology.com/library/detail.aspx?g=4f0cc529-bfdb-49c3-ac8d-e989e87fc84a>.

<sup>159</sup> Samuel Rubinfeld, "U.K. Secures Second Deferred-Prosecution Agreement," The Wall Street Journal, (Jul. 8, 2016), available at <http://blogs.wsj.com/riskandcompliance/2016/07/08/u-k-secures-second-deferred-prosecution-agreement/>.

<sup>160</sup> *Id.*

<sup>161</sup> Stephen Dockery, "France and Australia Consider DPAs as Global Enforcement Discussion Brews," The Wall Street Journal, (May 9, 2016), available at <http://blogs.wsj.com/riskandcompliance/2016/05/09/france-and-australia-consider-dpas-as-global-enforcement-discussion-brews/>.

<sup>162</sup> Peter J. Henning, "HSBC Case Tests Transparency of Deferred Prosecution Agreements," The New York Times, (Feb. 8, 2016), available at [https://www.nytimes.com/2016/02/09/business/dealbook/hsbc-case-tests-transparency-of-deferred-prosecution-agreements.html?\\_r=0](https://www.nytimes.com/2016/02/09/business/dealbook/hsbc-case-tests-transparency-of-deferred-prosecution-agreements.html?_r=0).

<sup>163</sup> *Id.*

### International Parallels In Law Enforcement Methods and Priorities

efforts to criminals and that disclosure would have a chilling effect on those who cooperated with the monitor with the expectation that their cooperation would be confidential.<sup>164</sup> Ultimately, the court ordered that a redacted version of the report could be released,<sup>165</sup> and the government has since filed an appeal in the Second Circuit. If the reports of independent monitors are discoverable, corporations may be reluctant to agree to DPAs that require independent monitorships.

The use of DPAs may take an additional hit under the new administration. Attorney General Jeff Sessions has previously indicated his preference for “traditional prosecutions” over DPAs.<sup>166</sup> Though nominated by the Trump administration for his overall pro-business stance, Sessions, a former Alabama senator, has articulated his position to push corporate indictments rather than settlements, being one of 25 senators who voted against the economic bailout resulting from the 2008 financial crisis.<sup>167</sup> Also a former prosecutor, Sessions had stated his belief that “harsh sentencing does deter,”<sup>168</sup> and we might see a push for more indictments rather than DPAs under his tenure.

## Executive Accountability

During his confirmation hearing, Attorney General Sessions expressed his commitment to pursue individuals entangled in corporate crimes, continuing the guidance under the Yates memo. When asked about fraudulent sales practices, Sessions said that “corporate officers who caused the problem should be subjected to more severe punishment than the stockholders...who didn’t know anything [about the wrongdoing].”<sup>169</sup> Indeed, while he was on the Senate Judiciary Committee, Sessions demonstrated his opinion that the most effective deterrent in corporate crime cases is prison, and he fiercely pursued bankers while he was a federal prosecutor.<sup>170</sup> This hardline approach seems to clash with the overall pro-business stance of the Trump administration, so it remains to be seen whether Attorney General Sessions will aggressively charge corporate executives as he indicated during his confirmation hearing and his tenure on the judiciary committee.

The push to hold corporate executives accountable continues in Europe as well. In the U.K., fines against corporate executives by the FCA may be on the rise in light of new rules that pursue individuals for misconduct,<sup>171</sup> which the FCA has indicated make it difficult to issue fines against financial institutions. The rules, which became effective as of March 2016, require financial

164 *Id.*

165 *United States v. HSBC Bank USA, N.A.*, No. 12-CR-763 (JG), 2016 WL 347670 (E.D.N.Y. Jan. 28, 2016), *motion to certify appeal denied*, No. 12-CR-00763, 2016 WL 2593925 (E.D.N.Y. May 4, 2016).

166 Jody Godoy, “Trump DOJ Expected to Cut Down on Deferred Prosecution,” Law360, (Jan. 20, 2017), available at [https://www.law360.com/whitecollar/articles/882690/trump-doj-expected-to-cut-down-on-deferred-prosecution?nl\\_pk=82503858-21e4-4460-8f7f-81f7947f2c5b&utm\\_source=newsletter&utm\\_medium=email&utm\\_campaign=whitecollar](https://www.law360.com/whitecollar/articles/882690/trump-doj-expected-to-cut-down-on-deferred-prosecution?nl_pk=82503858-21e4-4460-8f7f-81f7947f2c5b&utm_source=newsletter&utm_medium=email&utm_campaign=whitecollar).

167 Julie Ragatz, “What Jeff Sessions as U.S. Attorney General Would Mean for Corporate Crime,” The Financial Times, (Jan. 23, 2017), available at <http://fortune.com/2017/01/23/jeff-sessions-u-s-attorney-general-corporate-crime>.

168 *Id.*

169 Jody Godoy, “Sessions Hints Yates Memo, Fraud to Stay on DOJ Radar,” Law360, (Jan. 11, 2017), available at <https://www.law360.com/articles/879816/sessions-hints-yates-memo-fraud-to-stay-on-doj-radar>.

170 David J. Lynch, “Jeff Sessions set to show his steel on white-collar crime,” The Financial Times, (Nov. 24, 2016), available at <https://www.ft.com/content/c870f24c-b1c5-11e6-a37c-f4a01f1b0fa1>.

171 Richard Crump, “UK Bank Watchdog Braces for Spike In Legal Battles,” Law360, (Jan. 20, 2017), available at <https://www.law360.com/articles/883060/uk-bank-watchdog-braces-for-spike-in-legal-battles>.

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institutions to submit organizational structures to demonstrate lines of responsibility, along with specified duties for each individual.<sup>172</sup> Unless corporate executives can prove they took sufficient steps to prevent any misconduct, they may face fines for the corporate wrongdoing at issue. The FCA is also proposing a new dispute resolution mechanism which would allow defendants who do not dispute the facts to challenge the proposed penalty before the Regulatory Decisions Committee, which is independent of the FCA.<sup>173</sup> The head of the SFO is also pushing for a revision to the U.K. criminal corporate liability rules to allow for prosecutions against companies for failing to prevent economic crime, which would make it easier for the SFO to prosecute corporations.<sup>174</sup> Under the current corporate criminal liability rules, the SFO must prove that a very senior executive in the company was complicit in the economic crime to hold the corporation responsible.<sup>175</sup>

In France, the new *Sapin II* legislation described above also introduced new anti-corruption offenses and penalties and new regulations on companies and their senior management to prevent corruption. Similar to the FCA rules addressing executive accountability, the new legislation imposes a duty on senior management to prevent corruption in their firms.

## U.S. Government's Authority to Seize Data Stored Overseas

### The Microsoft-Ireland Case

In January 2017, the Second Circuit Court of Appeals denied the DOJ's petition for a rehearing<sup>176</sup> in the so-called *Microsoft-Ireland* case, after the court had previously overturned the district court's decision enforcing a search warrant targeting data stored overseas.<sup>177</sup> The Second Circuit on July 14, 2016 held that warrants for user data that an internet provider stores outside of U.S. borders are unenforceable because the federal statute authorizing data-centered search warrants – the Stored Communications Act<sup>178</sup> – only has territorial effect.<sup>179</sup> The court held that the act does not authorize courts to issue and enforce against U.S.-based service providers warrants for the seizure of customer email content that is stored exclusively on foreign servers.

The Second Circuit's decision was the culmination of a years-long battle over the enforceability of search warrants targeting data stored on foreign servers. In December 2013, the DOJ convinced a federal magistrate judge in New York to issue a warrant under the Stored Communications Act directing Microsoft to disclose all emails and other private information associated with a certain email account in Microsoft's possession, custody, or control. When Microsoft determined that the target account was hosted in Dublin, Ireland, and that the data content was stored there, it filed a motion to quash the warrant, arguing the information was beyond the U.S. government's reach.

172 *Id.*

173 *Id.*

174 Melissa Lipman, "EXCLUSIVE: SFO Chief Calm About Future Amid Breakup Rumors," Law360, (Oct. 31, 2016), available at [https://www.law360.com/whitecollar/articles/857463/exclusive-sfo-chief-calm-about-future-amid-breakup-rumors?nl\\_pk=7d552c11-aa47-4657-8ff6-0e0f9a23d050&utm\\_source=newsletter&utm\\_medium=email&utm\\_campaign=whitecollar](https://www.law360.com/whitecollar/articles/857463/exclusive-sfo-chief-calm-about-future-amid-breakup-rumors?nl_pk=7d552c11-aa47-4657-8ff6-0e0f9a23d050&utm_source=newsletter&utm_medium=email&utm_campaign=whitecollar).

175 *Id.*

176 *Microsoft Corporation v. United States of America*, Petition for Rehearing and Rehearing En Banc filed, Docket No. 14-2985 (Oct. 13, 2016), available at [https://www.justsecurity.org/wp-content/uploads/2016/10/Microsoft\\_14-2985-United-States-Appellee-Petition.pdf](https://www.justsecurity.org/wp-content/uploads/2016/10/Microsoft_14-2985-United-States-Appellee-Petition.pdf).

177 *In re: Warrant to Search a Certain E-Mail Account Controlled and Maintained by Microsoft Corp.*, 13-MJ-2814 (S.D.N.Y. July 31, 2014) (ECF 84).

178 18 U.S.C. §§ 2701–2712.

179 *Matter of Warrant to Search a Certain E-Mail Account Controlled & Maintained by Microsoft Corp.*, 829 F.3d 197 (2d Cir. 2016).

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The magistrate judge denied Microsoft's motion to quash the subpoena in April 2014, and U.S. District Court Judge Preska adopted the magistrate's ruling in August 2014. But Microsoft appealed to the Second Circuit and won, convincing the court that the Stored Communications Act does not authorize courts to compel internet service providers like Microsoft to produce emails or other private communications stored in a foreign nation.<sup>180</sup>

In its rehearing petition, the DOJ argued that the Second Circuit's decision departed from two decades of enforcement and compliance with the Stored Communication Act and will impede the government's ability to use search warrants to investigate and prosecute serious crimes like terrorism and narcotics trafficking. The DOJ said the issue is about disclosure of data – not the location of the physical servers – and that the Stored Communications Act authorizes the seizure of data so long as the “conduct relevant to the statute's focus occurred in the United States.” The Second Circuit denied the DOJ's rehearing petition and for now it appears that data located outside the U.S. will enjoy greater levels of protection against U.S. government investigation and enforcement activity.

### Cross-Border Data Sharing Agreements

On the heels of the Second Circuit's decision in *Microsoft-Ireland*, the DOJ submitted to Congress proposed legislation that would allow the U.S. to enter into reciprocal agreements with other countries to facilitate the DOJ's ability to obtain electronic data stored abroad.<sup>181</sup> The Obama administration got to work quickly thereafter, moving to negotiate such deals with select countries. On July 15, 2016, just a day after the Second Circuit's *Microsoft-Ireland* decision, senior DOJ official Brad Wiegmann announced at a public forum in Washington, D.C., that the Obama administration was working on a series of reciprocal agreements with foreign governments that would allow those governments to serve U.S. technology companies with foreign warrants for email searches and wiretaps.<sup>182</sup> Such deals would also give U.S. investigators reciprocal authority to search data in those countries.

The first such deal under consideration is a bilateral agreement between the U.S. and the U.K. that would permit U.S. companies to provide electronic data in response to U.K. orders targeting non-U.S. persons located outside the United States, while affording the United States reciprocal rights regarding electronic data of companies storing data in the United Kingdom. If Congress enacts the proposed legislation enabling the agreement with the U.K., British law enforcement would be able to serve a search warrant on a U.S. company to obtain a suspect's emails or intercept them in real time, as long as the surveillance did not involve U.S. citizens or residents.<sup>183</sup> The U.S. would be able to do likewise for data of U.S. citizens located in the U.K., although it remains to be seen how the *Microsoft-Ireland* decision may impede that effort.

180 *Matter of Warrant to Search a Certain E-Mail Account Controlled & Maintained by Microsoft Corp.*, 829 F.3d 197 (2d Cir. 2016).

181 Peter J. Kaszik, Letter to Vice President of the United States Joseph R. Biden, (Jul. 15, 2016), available at <https://www.documentcloud.org/documents/2994379-2016-7-15-US-UK-Biden-With-Enclosures.html#document/p1>.

182 Devline Barret, *U.S. to Allow Foreigners to Serve Warrants on U.S. Internet Firms*, (July 15, 2016), available at <https://www.wsj.com/articles/obama-administration-negotiating-international-data-sharing-agreements-1468619305>.

183 Nakashima & Peterson, *The British want to come to America – with wiretap orders and search warrants*, (Feb. 4, 2016), available at [https://www.washingtonpost.com/world/national-security/the-british-want-to-come-to-america--with-wiretap-orders-and-search-warrants/2016/02/04/b351ce9e-ca86-11e5-a7b2-5a2f824b02c9\\_story.html?utm\\_term=.42618423863b](https://www.washingtonpost.com/world/national-security/the-british-want-to-come-to-america--with-wiretap-orders-and-search-warrants/2016/02/04/b351ce9e-ca86-11e5-a7b2-5a2f824b02c9_story.html?utm_term=.42618423863b).



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It also is unclear whether cross-border data sharing will continue to be a top priority for the DOJ under the Trump administration. Nevertheless, the complex policy issues surrounding the *Microsoft-Ireland* decision will likely continue to play out in the courts, Congress, and the international arena in 2017 and beyond.

### Amendments to Federal Rule of Criminal Procedure 41

On December 1, 2016, an amendment to Rule 41 of the Federal Rules of Criminal Procedure (Rule 41) took effect, granting U.S. law enforcement the ability to execute remote search warrants of data without knowing the physical location of the server.

With the amendment, Rule 41 now allows the government to execute search warrants via remote access when the physical location of the place to be searched is unknown, which could include data stored abroad.<sup>184</sup> The rule change facilitates the government's ability to obtain a remote search warrant in situations where alleged wrongdoers use sophisticated anonymizing technologies to obscure a user's IP address or use multiple computers in many districts simultaneously as part of complex criminal schemes.<sup>185</sup> The amendment authorizes a court in a district where "activities related to a crime" have occurred to issue a warrant to use remote access to search electronic storage media, and to seize or copy electronically stored information located within or outside that district, (A) "[where] the district where the media or information is located has been concealed through technological means," or (B) "in an investigation of a violation of 18 U.S.C. § 1030(a)(5) [concerning computer fraud and related activity], the media are protected computers that have been damaged without authorization and are located in five or more districts."<sup>186</sup>

The rule change faced strong resistance from lawmakers as well as technology companies and advocacy groups, who raised concerns that the rule gives law enforcement the ability to hack innocent users and collect massive amounts of data outside a court's jurisdiction. In May, U.S. Senators Ron Wyden (D-Ore.) and Rand Paul (R-Ky.) introduced the Stopping Mass Hacking Act to prevent the amendment from taking effect.<sup>187</sup> Then, in November, a bipartisan coalition of lawmakers introduced the Review the Rule Act to delay implementation of the rule change pending further discussion on its implications for law enforcement and privacy rights.<sup>188</sup> And on November 21, 2016, a coalition of 26 organizations, including the American Civil Liberties Union and Google, sent Congress a letter requesting that lawmakers take action to delay implementation of the new rule. The letter asked Senate Majority Leader Mitch McConnell (R-Ky.) and Minority Leader Harry Reid (D-Nev.), plus House Speaker Paul Ryan (R-Wis.) and House Minority Leader Nancy Pelosi (D-Calif.), to further review the proposed changes to Rule 41 and delay its implementation until July 1, 2017.<sup>189</sup> These efforts ultimately proved unsuccessful.

184 Stuart Lauchlan, *US Rule 41 makes data sovereignty even more complicated for cloud buyers*, (Dec. 5, 2016), available at <http://diginomica.com/2016/12/05/us-rule-41-makes-data-sovereignty-even-complicated-cloud-buyers/>.

185 Mythili Raman, Letter to Judge Reena Raggi, (Sept. 18, 2013), available at <https://www.justsecurity.org/wp-content/uploads/2014/09/Raman-letter-to-committee-.pdf>.

186 Committee on Rules of Prac. & Proc. of the Judicial Conference of the United States, Preliminary Draft of Proposed Amendments to the Federal Rules of Criminal Procedure, Fed. R. Crim. P. 41(b)(6), 10-11, available at <https://www.justsecurity.org/wp-content/uploads/2014/09/preliminary-draft-proposed-amendments.pdf>.

187 H.R.5321 - Stopping Mass Hacking Act, 114th Congress (2015-2016), available at <https://www.congress.gov/bill/114th-congress/house-bill/5321/text>.

188 S.3475 - A bill to delay the amendments to rule 41 of the Federal Rules of Criminal Procedure,

114th Congress (2015-16), available at <https://www.coons.senate.gov/imo/media/doc/2016-11-17%20Review%20the%20Rule%20Act%20of%202016.pdf>.

189 Letter from Access now to U.S. Sens. McConnell, Reid, Ryan and Pelosi (Nov. 21, 2016), available at [https://na-production.s3.amazonaws.com/documents/Rule41Delay\\_CoalitionLetter.pdf](https://na-production.s3.amazonaws.com/documents/Rule41Delay_CoalitionLetter.pdf).



## Practical Considerations In Defending Against Cross-Border Regulatory Investigations

## Data Privacy

### Practical Considerations In Defending Against Cross-Border Regulatory Investigations

Companies, their compliance professionals, and their defense counsel are facing new challenges where the globalization of laws focusing on financial fraud, money laundering, and corruption intersect with the growth and development of foreign data privacy laws. Both at regional and national levels, “data protection” or “data privacy” laws function to restrict companies’ ability to collect, process, review, or transfer data containing various kinds of personal information. Data privacy and the rights of the employees must be taken into consideration during an internal investigation. This is particularly relevant in cases of multinational organizations where the data gathered from the investigation may be transferred abroad. In this case, the data privacy rules regulating the transfer of the data to third countries must be followed. Provided that adequate EU standard data transfer agreements – binding corporate rules or standard contractual clauses – are in place between the parties to the flow of data, cross-border data transfers are permitted inside the EU and to a few countries with perceived “adequate” levels of data protection.<sup>190</sup> A U.S. organization is also deemed to have an “adequate” level of protection if it has self-certified to the EU-U.S. Privacy Shield (the EU Privacy Shield).

The EU Privacy Shield is the trans-Atlantic agreement that permits the lawful transfer of personal data from the European Union to the United States.<sup>191</sup> It was formally adopted on July 12, 2016, by the European Commission (the EC).<sup>192</sup> The EU Privacy Shield replaces the EU-U.S. Safe Harbor framework (the Safe Harbor), which was invalidated by the European Court of Justice in the *Schrems* decision in October 2015.<sup>193</sup> Following the Safe Harbor invalidation, organizations were left scrambling to implement legal transfer mechanisms – standard contractual clauses or binding corporate rules – to be able to transfer personal data from EU to the United States; organizations that conducted unlawful transfers were subject to fines.<sup>194</sup> Vis-à-vis its predecessor, the EU Privacy Shield, *inter alia*, imposes stronger obligations on companies handling EU personal data, clear limitations and safeguards with respect to U.S. government access of EU personal data, effective protection of EU data subjects’ rights, and an annual joint review mechanism.<sup>195</sup> U.S. organizations were able to self-certify as members of the EU Privacy Shield beginning August 1, 2016.<sup>196</sup> Regarding the EU Privacy Shield, the EC released an Adequacy Decision concluding that “the United States ensures an adequate level of protection for personal data transferred under the EU-

190 Jenna N. Felz, Melinda L. McLellan, and Alexandra Beierlein, “German Data Protection Authority Issues Fines for Unlawful Cross-Atlantic Data Transfers”, (Jun. 9, 2016), available at <https://www.dataprivacymonitor.com/enforcement/german-data-protection-authority-issues-fines-for-unlawful-cross-atlantic-data-transfers/>.

191 Melinda L. McLellan and Jenna N. Felz, Privacy Shield to Open for Business August 1, July 20, 2016, available at <https://www.dataprivacymonitor.com/international-privacy-law/privacy-shield-to-open-for-business-august-1/>.

192 *Id.*

193 Melinda L. McLellan and James A. Sherer, “EU High Court Invalidates Safe Harbor Framework for Cross-Border Data Transfers”, (Oct. 7, 2015), available at <https://www.dataprivacymonitor.com/enforcement/eu-high-court-invalidates-safe-harbor-framework-for-cross-border-data-transfers/>.

194 The Hamburg Data Protection Authority reviewed the data transfers of 35 multinational organizations to verify compliance and fined three companies (€8,000, €9,000 and €11,000, respectively). See Jenna N. Felz, Melinda L. McLellan, and Alexandra Beierlein, “German Data Protection Authority Issues Fines for Unlawful Cross-Atlantic Data Transfers”, (Jun. 9, 2016), available at <https://www.dataprivacymonitor.com/enforcement/german-data-protection-authority-issues-fines-for-unlawful-cross-atlantic-data-transfers/>.

195 Melinda L. McLellan and Jenna N. Felz, “Privacy Shield to Open for Business August 1,” (Jul. 20, 2016), available at <https://www.dataprivacymonitor.com/international-privacy-law/privacy-shield-to-open-for-business-august-1/>.

196 *Id.*

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U.S. Privacy Shield from the Union to self-certified organizations in the United States.”<sup>197</sup> Although the EU Privacy Shield has been subject to one legal challenge thus far,<sup>198</sup> as of the time of this writing it remains a valid transfer mechanism for personal data from EU to the United States.

Closely mirroring the EU Privacy Shield is the Swiss-U.S. Privacy Shield (the Swiss Privacy Shield), which was announced on January 11, 2017.<sup>199</sup> The Swiss Privacy Shield, which applies the same standards to the transfer of personal data to the U.S. as are applied under the EU Privacy Shield, replaces the U.S.-Swiss Safe Harbor framework.<sup>200</sup> The U.S. Department of Commerce will start accepting self-certification applications for the Swiss Privacy Shield on April 12, 2017.<sup>201</sup>

Government investigations and regulatory enforcement of foreign or multinational organizations implicate these privacy rules. For example, every Foreign Corrupt Practices Act investigation of a multinational company will necessarily include a cross-border component requiring collection and review of data from employees in countries alleged to be involved.<sup>202</sup> Companies and their counsel need to be aware of the data privacy rules of the countries in which they are gathering data and take the necessary precautions if transferring that data outside the country of origin. Particular data privacy issues can arise when companies seek to make voluntary submissions to authorities in an attempt to obtain cooperation credit. There is often an expectation among U.S. regulators that companies will conduct internal investigations and provide the results to the SEC and DOJ in order to earn “cooperation” credit.<sup>203</sup> In light of the Yates memo, this cooperation credit depends on whether the company provides the relevant authorities with all facts concerning individual misconduct. Often, this cannot be achieved without the disclosure of data protected by data privacy laws.<sup>204</sup> In principle, there is no barrier against transfer of personal data from the EU to authorities in the U.S. as part of a voluntary cooperation in the context of a defense in public investigations.<sup>205</sup> That changes if the data is transferred as part of a voluntary submission in an attempt to benefit from cooperation with authorities.<sup>206</sup> To assure an adequate data protection level in those situations, the following understandings should be reached with the recipient authorities beforehand: “[T]here will be no data sweeps; the data transfer will occur in context (only) with a specific investigative interest in a specific public proceeding against the data controller or its parent; there shall be no proliferation of data; names of employees will be redacted;” and Freedom of Information Act requests will be denied by the recipient authority.<sup>207</sup>

197 Commission Implementing Decision, European Commission, Brussels, 12.7.2016, available at [http://ec.europa.eu/justice/data-protection/files/privacy-shield-adequacy-decision\\_en.pdf](http://ec.europa.eu/justice/data-protection/files/privacy-shield-adequacy-decision_en.pdf).

198 Melinda L. McLellan and Emily Fedeles, “Privacy Rights Group Files First Legal Challenge to EU-U.S. Privacy Shield,” (Oct. 31, 2016), available at [https://www.dataprivacymonitor.com/international-privacy-law/privacy-rights-group-files-first-legal-challenge-to-eu-u-s-privacy-shield/?utm\\_source=feedburner&utm\\_medium=feed&utm\\_campaign=Feed%3A+DataPrivacyMonitor+%28Data+Privacy+Monitor%29](https://www.dataprivacymonitor.com/international-privacy-law/privacy-rights-group-files-first-legal-challenge-to-eu-u-s-privacy-shield/?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+DataPrivacyMonitor+%28Data+Privacy+Monitor%29).

199 Melinda L. McLellan and Emily Fedeles, “Swiss-U.S. Privacy Shield Framework to Launch April 12,” (Jan. 14, 2017), available at [https://www.dataprivacymonitor.com/international-privacy-law/swiss-u-s-privacy-shield-framework-to-launch-april-12/?utm\\_source=feedburner&utm\\_medium=feed&utm\\_campaign=Feed%3A+DataPrivacyMonitor+%28Data+Privacy+Monitor%29](https://www.dataprivacymonitor.com/international-privacy-law/swiss-u-s-privacy-shield-framework-to-launch-april-12/?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+DataPrivacyMonitor+%28Data+Privacy+Monitor%29).

200 *Id.*

201 *Id.*

202 U.S. Securities and Exchange Commission, Foreign Corrupt Practices Act, available at <https://www.sec.gov/spotlight/foreign-corrupt-practices-act.shtml>.

203 See U.S. Department of Justice, Criminal Division and U.S. Securities and Exchange Commission, A Resource Guide to the U.S. Foreign Corrupt Practices Act, 54 (Nov. 14, 2012).

204 *Id.*

205 Philipp von Holst, Germany, The European, Middle Eastern and African Investigations Review 2016, Global Investigations Review, pg. 23, available at <http://globalinvestigationsreview.com/edition/1000144/the-european-middle-eastern-and-african-investigations-review-2016>.

206 *Id.*

207 *Id.*

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In addition, certain countries' data protection laws can include expansive protections, such as the State Secrets Law in China, which has, in the past, been used in an attempt to block the SEC from obtaining documents in a securities fraud investigation of the Chinese affiliates of the "Big Four" accounting firms.<sup>208</sup> Thus, although not their intended purpose, these data privacy laws may serve to shield malfeasant employees by posing obstacles to internal compliance procedures that rely heavily on documentary information to identify and investigate areas of potential misconduct and to monitor compliance efforts.

2017 is expected to bring continued strengthening of data privacy laws around the globe, including the implementation of laws in jurisdictions where they were traditionally absent, such as Latin America. With the ongoing development and strengthening of these protections worldwide, companies defending against cross-border regulatory investigations should ensure that any data collection and transfer in the context of responding to the investigation are in compliance with the local jurisdiction's data privacy laws.

## Attorney-Client Privilege

Cross-border investigations can be fraught with complications with respect to attorney-client privilege. Because attorney-client privilege protections do not apply in the same manner across the globe as they do in the United States, an organization must consider privilege protections not only in the jurisdiction in which it is currently engaged, but also in any jurisdictions where proceedings may subsequently be commenced.

For instance, the professional secrecy doctrine – the Italian equivalent of the attorney-client privilege – is limited in scope; rather than protecting certain documents based on their origin or creation, the doctrine is bound by specific procedures and precautions to be adopted for gathering and using the documentation exchanged between a law firm and its clients.<sup>209</sup> Further, the doctrine only protects communications between counsel and the investigated person; if the defendant is an organization, the doctrine only applies to communications with the person who has the power to represent the organization.<sup>210</sup> Finally, the doctrine only applies to lawyers who are members of the Italian bar and does not apply to foreign lawyers or in-house counsel.<sup>211</sup>

208 In 2011 and 2012, the SEC sought documents and audit papers from the Chinese affiliates of the "Big Four" accounting firms – Ernst & Young, KPMG, Deloitte Touche Tohmatsu, and PricewaterhouseCoopers – to investigate suspected securities fraud by certain China-based issuers. Citing China's State Secrets Law and express directions from the China Securities Regulatory Commission (SCRC), the accounting firms refused to produce the requested documents. After negotiations reached an impasse, the SEC commenced administrative proceedings against the accounting firms, alleging violations of Section 106 of Sarbanes-Oxley Act. In January 2014, an administrative law judge issued a 112-page decision, concluding that the accounting firms had violated § 106 by willfully refusing to comply with the SEC's demands. As a sanction, the judge banned the firms from practicing before the SEC for six months. See Michael Rapoport, "SEC, Big Four Accounting Firms in China Settle Dispute: Deal Over Refusal to Turn Over Audit Documents Lifts Threat of Suspension," *The Wall Street Journal*, (Feb. 6, 2015), available at <http://www.wsj.com/articles/sec-big-four-accounting-firms-in-china-settle-dispute-1423237083>. Under the settlement with the SEC, the SCRC will act as a conduit, enabling the SEC to gain access to Chinese firms' audit documents. *Id.* This case underscores the challenges facing companies doing business in China, which often find themselves caught between competing legal regimes.

209 Bruno Cova and Francesca Petronio, Italy, *The European, Middle Eastern and African Investigations Review 2016*, *Global Investigations Review*, page 27, available at <http://globalinvestigationsreview.com/edition/1000144/the-european-middle-eastern-and-african-investigations-review-2016>.

210 *Id.*

211 *Id.* As another example, the attorney-client privilege under German law is more restricted than the privilege under U.S. law. The German attorney-client privilege only protects: (i) "attorneys and auditors from having to testify against or relating to their own client, and (ii) documents obtained or created by, or communication with, external lawyers or auditors that are stored in the external lawyer's or auditor's offices from seizure or attachment by the public authorities." See Philipp von Holst, Germany, *The European, Middle Eastern and African Investigations Review 2016*, *Global Investigations Review*, page 23, available at <http://globalinvestigationsreview.com/edition/1000144/the-european-middle-eastern-and-african-investigations-review-2016>. It generally does not protect communication or documents in possession of the client or documents created by and communication with in-house counsel.

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On this point, other EU jurisprudence limits the attorney-client privilege to communications with external counsel.<sup>212</sup>

In addition to these general limitations on the applicability of the attorney-client privilege in certain European countries, the applicability of the privilege in the context of internal investigations was significantly restricted by two European court decisions in the second half of 2016. On September 20, 2016, the Swiss Federal Supreme Court (the SFSC) held that professional privilege<sup>213</sup> did not prevent prosecutors from accessing documents and information obtained and analyzed by attorneys retained by a Swiss bank conducting an internal investigation.<sup>214</sup> The bank launched the internal investigation after the Office of the Attorney General of Switzerland sent the bank disclosure requests regarding a former bank employee who was suspected of involvement in money laundering and document forgery.<sup>215</sup> The bank retained two law firms to perform the internal investigation to evaluate potential penal and regulatory risks. Citing professional privilege, the bank subsequently refused demands from the federal prosecutor to turn over documents relating to the investigation, including notes of interviews of the bank's employees, a memorandum summarizing the law firms' analysis and investigation, and internal minutes of a meeting between the bank's employees and the attorneys regarding the results of the investigation.

Although the SFSC acknowledged that the reports and notes possibly qualified as attorney work product, it found that professional privilege did not shield them from access by the prosecuting authorities,<sup>216</sup> reasoning that the privilege no longer applies where the bank "in effect delegates to external counsel its compliance related obligations under the Anti-Money Laundering Act and its relevant ordinances."<sup>217</sup> According to the SFSC, "compliance (including the monitoring/controlling and documenting thereof) is a general obligation of the bank and cannot be brought under the protection of attorney-client privilege if outsourced to external counsel, as this is not part of typical legal counsel work."

This decision has the practical effect of allowing Swiss prosecutors to have broad access to information and work product created by or with the assistance of outside legal counsel. In addition, it provides Swiss prosecutors with an incentive to delay prosecution until the completion of an internal investigation, at which time it will be easier for them to argue that the investigation was not conducted to defend against pending criminal proceedings.<sup>218</sup>

Similarly, on December 8, 2016, the English High Court rejected assertion of privilege over

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212 Case C-550/07 P Akzo Nobel Chemicals Ltd v European Commission [2010] ECR I-8301 (limiting the attorney-client privilege to communications with external counsel in the context of European Commission investigations). Similarly, in Switzerland, professional privilege does not apply to attorneys working as in-house counsel. Rory Hishon, Anneka Randhawa, and Vanessa Alarcon Duvanel, "Significant Swiss ruling handed down on privilege in anti-money laundering investigations," Nov. 21, 2016, available at <http://www.lexology.com/library/detail.aspx?g=eca60470-5768-482c-bcde-62487861fb9c>.

213 "Attorney-client privilege" is known as "legal privilege" or "professional privilege" in Switzerland.

214 CMS von Erlach Poncet AG, Federal Tribunal on professional privilege in context of internal investigations, Dec. 5, 2016, available at <http://www.lexology.com/library/detail.aspx?g=4f894d8c-7bd5-4355-9f3e-2356f24598b4>.

215 *Id.*

216 CMS von Erlach Poncet AG, Federal Tribunal on professional privilege in context of internal investigations, Dec. 5, 2016, available at <http://www.lexology.com/library/detail.aspx?g=4f894d8c-7bd5-4355-9f3e-2356f24598b4>.

217 Dr. Andreas D. Lanzlinger, Andrew Michael Garbarski, and Dr. Pascal Hachem, "Attorney Client Privilege Arising out of Internal Investigations: Milestone Decision of the Swiss Federal Supreme Court," Lexology, (Oct. 5, 2016), available at <http://www.lexology.com/library/detail.aspx?g=d94e6a6d-1f57-4749-8df1-3763616e9e63>.

218 *Id.*

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interview notes<sup>219</sup> taken by a bank and its external lawyers during the course of two internal investigations.<sup>220</sup> The bank argued that the legal advice privilege<sup>221</sup> prevented the disclosure of transcripts, notes or other records of interviews with employees and former employees during the course of investigations regarding Financial Services and Markets Act 2000 claims.<sup>222</sup> While the court acknowledged that the interview notes were direct communications with lawyers, it held that they were subject to disclosure because the employees and former employees do not fall within the definition of “client” under English law<sup>223</sup> An employee of a party is not a “client” under English law, thus any information obtained from an employee of a party is not privileged, even if obtained to enable a party to seek legal advice.<sup>224</sup> Notably, the court also confirmed that English privilege rules should be applied in cases before the English court, meaning that, even though the interview notes would likely be considered privileged as a matter of U.S. law, they were not privileged as a matter of English law<sup>225</sup>

Both of these decisions have far-reaching consequences for internal investigations. Counsel should take care to familiarize themselves with the attorney-client privilege laws of the jurisdiction in which they are conducting an internal investigation, because, as described above, the privilege laws of certain jurisdictions vary greatly from the privilege laws of the U.S.

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219 The U.K. SFO has repeatedly and publicly criticized the tendency for companies to claim privilege over the accounts of witnesses, making clear in relation to DPAs that it views the “free supply of relevant information,” including “the account of any witnesses spoken to by those conducting the enquiry” to be “the hallmark of cooperation.” Speech given by Alun Milford, General Counsel to the SFO, titled The Use of Information to Discern and Control Risk to the Cambridge Symposium on Economic Crime, September 2014, available at <https://www.sfo.gov.uk/2014/09/02/alun-milford-use-information-discern-control-risk/>.

220 Maria Petzsch and Parham Kouchikali, “Another Meander Through Three Rivers (No 5): the Scope of Legal Advice Privilege,” (Dec. 22, 2016), Lexology, available at <http://www.lexology.com/library/detail.aspx?g=3e0f64da-0d99-484c-88f6-bd15c4e55b04>.

221 *See id.* The “legal advice privilege” covers communications between a client and its lawyer for the purpose of giving or receiving legal advice. The legal advice privilege does not apply to communications with third parties, so an organization should exercise caution when considering involving external parties, such as forensic accountants.

222 *Id.*

223 Andrew Howell and Georgina Jones, “Privilege: Interview Notes Revisited,” (Jan. 11, 2017), Lexology, available at <http://www.lexology.com/library/detail.aspx?g=12b0f09e-a4c0-43a3-847b-b0d5e5f81ea4>.

224 *Id.*

225 Maria Petzsch and Parham Kouchikali, “Another Meander Through Three Rivers (No 5): the Scope of Legal Advice Privilege,” (Dec. 22, 2016), Lexology, available at <http://www.lexology.com/library/detail.aspx?g=3e0f64da-0d99-484c-88f6-bd15c4e55b04>.

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