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FCPA Broker-Dealer Case Highlights Compliance Risks for Financial Institutions

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Last week saw a significant Foreign Corrupt Practices Act (FCPA) enforcement action against employees of a US broker-dealer, who are alleged to have bribed a Venezuelan government official to direct brokerage to the firm. The case is one of only a handful of financial services industry FCPA enforcements and is a reminder of the government's interest in extending the law's reach to all economic sectors. This client publication summarizes recent events and provides suggestions on how the banking and finance sector can manage its FCPA risks.

Background

On May 7, 2013, the DOJ and SEC announced charges against two Miami-based brokers—Tomas Alberto Clarke Bethancourt and Jose Alejandro Hurtado—at the New York financial services firm Direct Access Partners LLC (DAP). The government's investigation appears to have originated in a 2010-2011 SEC examination of DAP that ultimately resulted in Clarke and Hurtado being accused of paying bribes worth at least $5 million to Maria de los Angeles Gonzalez de Hernandez, a senior official at the Venezuelan state economic development bank, Banco Desarrollo Económico y Social de Venezuela (BANDES), in exchange for diverting valuable financial trading business to DAP. As part of the scheme, Hurtado and Clarke received millions of dollars in salary, bonuses and finder's fees, a portion of which were funneled to Gonzalez either by way of Hurtado's spouse or through a Panamanian entity controlled by Clarke. The charging documents suggest that officials were initially suspicious of Hurtado because he was among the highest earning employees at the firm, receiving approximately $4.4 million in compensation in 2010 after being employed by DAP for only one full year.

Gonzalez, the public official, was arrested in Miami at the same time as Clarke and Hurtado. In addition to the pending criminal charges, the DOJ filed a civil forfeiture action against the three defendants, targeting real estate around the Miami area and several bank accounts located in Panama and Switzerland. The SEC's parallel complaint named Haydee Leticia Pabon—Hurtado's spouse—and Iuri Rodolfo Bethancourt—president of the Panamanian entity that allegedly funneled bribes on behalf of Clarke. The government has not charged

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DAP itself, although the firm allegedly generated nearly $66 million from Hurtado's and Clarke's scheme. To date, none of the individuals charged have entered pleas, and thus the complaints are no more than the government's allegations and remain to be proven.

Prosecution of Financial Institutions

Clarke and Hurtado are not the first financial services professionals to be prosecuted. Nor, if DAP is charged, would it be the first financial services firm to be the subject of an FCPA enforcement action.

In a group of prosecutions referred to as the *Kozeny* cases, the government charged David Pinkerton,[1] head of AIG Global Investment Corp., and Clayton Lewis, principal of Pharos Capital Management, L.P., and Omega Advisors, Inc., alleging that they knew bribes were paid to Azerbaijani officials in an attempt to influence the privatization and ultimately gain control of a state-owned oil company. Omega ultimately entered into a non-prosecution agreement with the DOJ for its role in the scheme. More recently, the 2012 *Garth Peterson* case charged an executive of a Morgan Stanley real estate funds business with bribing a Chinese official to obtain valuable real estate properties and permits.

The DOJ press release, however, makes clear that the government sees the financial industry context as an important element to its Clarke and Hurtado case, calling the prosecution a "wake-up call to anyone in the financial services industry who thinks bribery is the way to get ahead." The charges also mark the first time the DOJ and SEC have pursued individuals for bribes directly related to the sale of a financial service (here, brokerage and trading)—as distinct from bribes relating to the underlying investment activity of a financial business, which were the offenses at issue in *Kozeny* and *Garth Peterson*.

For SEC-regulated firms, that this latest case was generated in an SEC examination is also meaningful. It suggests that SEC-regulated firms should be aware that their FCPA compliance efforts—or weaknesses—are being tested in the course of the agency's normal reviews. The charges therefore may prompt a fresh round of internal FCPA assessments and compliance build-out, the goals of which will be to identify the FCPA risks faced by a business and then to develop appropriate checks and balances.

Types of FCPA Risks

Given the multi-million dollar settlements and various criminal convictions witnessed in other industries, this most recent enforcement activity demonstrates that financial sector leaders will be well advised to pay close attention to their overseas activities—whether those activities involve sourcing assets for investment (a la *Kozeny* and *Garth Peterson*) or sourcing clients of the firm (a la Clarke and Hurtado). Liability under these cases may take the form of charges under the FCPA's anti-bribery provisions, which require the affirmative involvement of the company or one of its agents, or, if the financial institution is an issuer, under the FCPA's books and records or internal controls provisions, which

[1] Charges against Pinkerton for conspiring to violate the FCPA were eventually dropped.

impose upon issuers the requirement to have accurate books and records and effective internal financial controls.

While the Clarke and Hurtado allegations illustrate the prototypical example of an employee paying bribes to a foreign official in exchange for a business advantage, financial institutions could find themselves under the threat of an enforcement action in a number of alternate scenarios, including through efforts to obtain investment opportunities or to secure underwriting and advisory business from government instrumentalities (such as national development banks like BANDES or sovereign wealth funds). With the emphasis the DOJ and SEC place on third-party liability, it also would be entirely possible for an institution, such as a private equity fund, to be subject to an FCPA enforcement action after an agent or consultant paid a bribe to secure an overseas investment or land an overseas investor. Alternatively, an investment fund which exerts practical control over a board of directors or is the controlling shareholder of a portfolio company may be similarly liable for the FCPA violations of the underlying corporation.

Finally, it bears noting that a bribe need not take the form of a bag of currency or a suspicious wire transfer. Gifts and hospitality such as elaborate vacations and entertainment, practices sometimes utilized by the finance industry to garner business, also draw scrutiny.

Mitigating FCPA Risks

While there is no such thing as a one-size-fits-all compliance program, over the past few years the US and UK governments have published guides suggesting the elements they would consider in evaluating a company's anti-bribery compliance policies and controls. These include:

- Commitment from Senior Management and a Clearly Articulated Policy Against Corruption;
- Code of Conduct and Compliance Policies and Procedures—particularly concerning the use of third parties; gifts, travel and entertainment expenses; charitable and political donations; and expediting payments;
- Oversight, Autonomy and Resources;
- Risk Assessment;
- Training and Continuing Advice;
- Incentives and Disciplinary Measures;
- Third-Party Due Diligence;
- Confidential Reporting and Internal Investigation; and
- Continuous Improvement: Periodic Testing and Review.

Furthermore, while all effective compliance programs must require risk-based due diligence on third parties, due diligence for nearly all overseas business transactions deserves special attention from financial institutions. In the context of a third-party partner, firms must carefully vet potential agents, consultants and business partners. Close connections with foreign officials, unusually high commissions or vague service agreements are all red flags that should heighten the sensitivity of managers or other leaders and lead to appropriate scrutiny and monitoring of a third party's activities.

The same logic applies to the acquisition context where a firm is interested in acquiring another entity whether by way of a straight acquisition, merger or hostile takeover. An acquiring entity should pay careful attention of the target's former activities such as where the target operated, the methods it used to secure business and the extent to which FCPA compliance was already a priority. The failure to do so could prove a costly error in the event of an FCPA investigation.

Put plainly, how a company elects to address FCPA compliance will vary, but a general response to limiting FCPA risk should include the development of an effective FCPA compliance program and adequate due diligence into potential third-party partners and target companies. For more specific guidance, see Urofsky, Dollinger and Torres-Fowler, *Cracking the Code: Here's how to build effective compliance programmes under the FCPA and UK Bribery Act Guidance*, International Financial Law Review (March 2013) at 55 (*available at* *https://reaction.shearman.com/reaction/pdf/2013-03-01_21Corp_B_C1.pdf*).

Conclusion

Although the banking and finance sector has yet to experience the extent of FCPA enforcement that other industries have seen, last week's announcement makes clear that the industry is very much on the radar of the DOJ and SEC. Recent industry experience also shows the potential protection in careful and comprehensive FCPA risk identification and risk management efforts. Morgan Stanley's favorable treatment in the *Garth Peterson* prosecution—while certainly not a guaranteed outcome—stands as an object lesson in that regard, with the government going out of its way to paint Mr. Peterson as a rogue employee and crediting Morgan Stanley for its significant investments in compliance.

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