Client Alert

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Recent FCPA Enforcement Actions Show Increased Scrutiny on Financial Services Sector

By Ruti Smithline and Jarod G. Taylor

Last week, the U.S. Department of Justice (DOJ) announced the indictment of a managing partner of U.S. broker-dealer Direct Access Partners (DAP) for violations of the Foreign Corrupt Practices Act (FCPA), the Travel Act, and money laundering statutes. This indictment follows on the heels of last month's indictment of two other DAP employees for the same alleged conduct, as well as the foreign official who received the bribes at issue.[1]

The investigation into DAP was prompted by information discovered during a routine, periodic examination by the U.S. Securities and Exchange Commission's (SEC's) New York office broker-dealer examination staff. The discovery of the alleged conduct without the involvement of any whistleblower, self-reporting, or regulator tasked directly with FCPA enforcement should serve as a wake-up call for the need for anticorruption compliance by regulated companies.

The criminal complaint alleges that the defendant, Ernesto Lujan, was the managing partner of DAP's Global Markets Group (GMG), which was established in 2008 to provide fixed income trading services to institutional clients.[2] One of these clients was Banco de Desarrollo Económico y Social de Venezuela (BANDES), Venezuela's state-owned economic development bank. According to the complaint, Lujan and others at DAP paid over $5 million in kickbacks to the Vice President of Finance at BANDES, María de los Ángeles González de Hernandez, who oversaw BANDES's overseas trading activity. A related SEC civil complaint alleges that the payments received or expected by González were closer to $9.1 million.[3]

The government claims that "the overwhelming majority of revenue generated by the GMG resulted from the execution of bond trades for BANDES."[4] According to the SEC complaint, revenues "soared" from $27 million in 2008 to $75 million in 2009 and $31 million in the first half of 2010.[5] The DOJ's criminal complaint alleges that $60 million in revenue was generated from BANDES from April 2009 through June 2010.[6]

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[1] *See* Client Alert, "DOJ Turns FCPA Spotlight on Financial Services Sector as Enforcement Efforts in Latin America Continue," dated May 15, 2013, *available at* http://www.mofo.com/files/Uploads/Images/130515-DOJ-Turns-FCPA-Spotlight.pdf.

[2] Complaint, *U.S. v. Lujan*, No. 13-MAG-1501 (S.D.N.Y. June 10, 2013), *available at* http://www.justice.gov/usao/nys/pressreleases/June13/LujanArrestPR/Lujan,%20Ernesto%20Complaint.pdf. *See also* DOJ Press Release, "Managing Partner of U.S. Broker-Dealer Charged in Manhattan Federal Court with Participating in Massive International Bribery Scheme," dated June 12, 2013, *available at* http://www.justice.gov/opa/pr/2013/June/13-crm-670.html.

[3] First Amended Complaint at ¶ 39, *SEC v. Clarke, et al.*, No. 13-CV-3074 (JMF) (S.D.N.Y. June 12, 2013), *available at* http://www.sec.gov/litigation/complaints/2013/comp-pr2013-109.pdf.

[4] *Supra* n. 2, at ¶ 25.

[5] *Supra* n. 3, at ¶ 22.

[6] *Supra* n. 2, at ¶ 25.

DISCOVERY OF CONDUCT DURING BROKER-DEALER EXAMINATION SHOWS THAT FCPA ISSUES CAN COME TO LIGHT DURING UNRELATED, ROUTINE GOVERNMENT INTERACTIONS

In 2011, the SEC sought information from numerous banks and private-equity firms regarding their dealings with sovereign wealth funds, prompting widespread fear of an imminent FCPA "sweep" of the financial services industry. Although enforcement actions from that sweep have yet to materialize, financial services firms have been under increasing regulatory scrutiny both with respect to anticorruption compliance and otherwise. Firms need to be prepared for the reality that being under the regulatory spotlight may cause FCPA issues to come to light when they may have previously remained undetected.

The SEC's press release in the Lujan matter notes, "An SEC examination of DAP that led to the investigation was conducted by members of the New York office's broker-dealer examination staff,"[7] and the DOJ complaint refers to the examination as a "periodic" examination.[8] There is no indication that the examination was conducted for the purpose of investigating FCPA issues.

As we noted in our May 15 client alert on the DAP matter, the Dodd-Frank Act recently expanded the SEC's examination authority to include investment advisors to certain private funds, security-based swap dealers, and others.[9] As regulatory scrutiny of the financial services industry has increased over the past few years, the likelihood that a potential corruption problem will come to the DOJ's and SEC's attention has increased as well. Increasingly, potential instances of corruption may not only be exposed by whistleblowers, acquisition partners, and other more conventional means of disclosure, but may also come to light through routine interactions with regulatory authorities.

Examinations by Self-Regulatory Organizations (SROs) like the Financial Industry Regulatory Authority (FINRA) are an example of a potential source of perhaps unexpected anticorruption-related scrutiny:

- In 2009, FINRA's Regulatory and Examination Priorities Letter listed FCPA compliance as an area of potential focus of examination.[10]
- In 2011, FINRA issued a regulatory notice "remind[ing] firms of their obligations under the Foreign Corrupt Practices Act."[11] That notice stated, "A member firm's failure to comply with its FCPA obligations will be considered conduct inconsistent with high standards of commercial honor and just and equitable principles of trade in violation of FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade)."
- In 2012, a panel including FINRA's New York Regional Director, Michael Solomon, reiterated FINRA's focus on the FCPA, noting that "hot button" issues included "procedures applicable to the investment banking/institutional side of the firm, and restrictions applicable to employee travel abroad and gifting."[12]

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[7] SEC Press Release 2013-109, "SEC Announces More Charges in Massive Kickback Scheme to Secure Business of Venezuelan Bank," dated June 12, 2013, *available at* http://www.sec.gov/news/press/2013/2013-109.htm.

[8] *Supra* n. 2, at ¶ 24.

[9] *Supra* n. 1.

[10] FINRA, 2009 Regulatory and Examination Priority Letter, dated Mar. 9, 2009, *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p118113.pdf.

[11] FINRA, Regulatory Notice 11-12 (Mar. 2011), *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p123357.pdf.

[12] Diana C. Campbell Miller and David G. Buffa, "FINRA Examinations: Regulatory Priorities and Firm Best Practices," American Bar Association Section of Litigation (Sept. 18, 2012), *available at*

USE OF TRAVEL ACT AND MONEY LAUNDERING STATUTES BROADENS DOJ'S REACH

In addition to violating the FCPA, Lujan was also charged with violating the Travel Act and federal money laundering statutes. Both the Travel Act and money laundering statutes broaden the DOJ's ability to bring corruption-related charges in instances where the FCPA may not otherwise reach the corrupt conduct.

The Travel Act criminalizes the use of interstate commerce for the purposes of carrying out specified unlawful activities. The unlawful activity does not need to be a violation of federal law to come within the scope of the Travel Act.[13] While the FCPA does not criminalize the receipt of a bribe or bribery of private individuals, as opposed to government officials, the Travel Act has been used to bring charges based on both of these activities. For example, the DOJ brought charges against González, the BANDES VP who received the bribes in the DAP case, under the Travel Act, based on the New York state law criminalizing receipt of commercial bribes.

Similarly, the DOJ brought money laundering charges against Lujan, as well as the other defendants in this matter. U.S. money laundering laws essentially make it a crime to engage in a financial transaction while knowing that the funds at issue represent the proceeds of a specified unlawful activity, including bribery.[14] Like the Travel Act, the money laundering statutes can be used against a foreign official for receiving a bribe, and they have also been used by regulators to reach defendants that may not otherwise have been subject to jurisdiction under the FCPA.

When a firm becomes aware of conduct that potentially violates the FCPA, it is not sufficient to consider only whether the technical elements of the FCPA are met, although that is an important analysis to undertake. A firm in that situation must also take into account the full panoply of criminal statutes available to prosecutors.

STRONG INTERNAL CONTROLS ARE ESSENTIAL FOR ISSUERS OF U.S. SECURITIES AND NON-ISSUERS ALIKE, BUT FINANCIAL SERVICES FIRMS ARE ONE STEP AHEAD

The FCPA requires issuers and companies that submit reports to the SEC as a result of capital raising activities to maintain internal accounting controls sufficient to detect and prevent bribery of foreign officials. While the statute itself does not require other companies (*e.g.*, non-publicly traded companies) to maintain such controls, it is vital that any company doing business outside the U.S. maintain reasonable compliance policies and procedures, given the many tools that U.S. enforcement authorities have for combatting corruption abroad. This is true for companies both large and small, as demonstrated by enforcement actions against companies like Siemens, which paid $800 million in FCPA-related penalties to U.S. regulators, as well as by the cases involving the low-revenue DAP, which has been forced to stop trading due to these allegations. Not only do effective compliance policies reduce the likelihood of corrupt conduct occurring, but enforcement authorities take such policies into account when deciding whether to bring an action against a company and when setting penalties.[15]

Fortunately for companies in the financial services industry, many of the policies that are likely to already be in

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http://apps.americanbar.org/litigation/committees/securities/email/summer2012/summer2012-0912-finra-examinations-regulatory-priorities-firm-best-practices.html.

[13] *See* 18 U.S.C. § 1952.

[14] *See* 18 U.S.C. § 1956.

[15] *See, e.g.*, U.S. Dep't of Justice and U.S. Sec. and Exchange Comm'n, "A Resource Guide to the U.S. Foreign Corrupt Practices Act" 53 (Nov. 14, 2012) (citing "existence and effectiveness of the corporation's pre-existing compliance program" as "factor[] considered in . . . determining whether to charge a corporation"), *available at* http://www.justice.gov/criminal/fraud/fcpa/guide.pdf.

place can be leveraged in the service of anticorruption compliance as well. For example, anti-money laundering policies and procedures are designed to look for many of the same red flags that are applicable in the anticorruption context, such as payments to third parties without any business justification. The lines of authority, testing procedures, and other facets of anti-money laundering policies and procedures can be similarly modified as needed and utilized in an anticorruption compliance program.

U.S. enforcement authorities are making creative use of the tools at their disposal in order to combat corruption worldwide, as evidenced by the use of broker-dealer examinations in the DAP case. Companies subject to the FCPA should similarly make use of their existing policies and procedures (amended and supplemented as necessary) to proactively combat corruption within their organizations.

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