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Hot Topics Affecting the Financial Services Industry

Alistair Graham
Partner
+ 44 20 3130 3800
alistair.graham@mayerbrown.com

Richard Rosenfeld
Partner
+1 212 506 2178
rrosenfeld@mayerbrown.com

Laurence Urgenson
Partner
+1 202 263 3280
luregenson@mayerbrown.com

John M. Hickin
Partner
+ 852 2843 2576
john.hickin@mayerbrown.com

Matthew Rossi
Partner
+1 202 263 3374
mrossi@mayerbrown.com

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Hot Topics Affecting the Financial Services Industry

Recent FCPA and Anti-Bribery Focus in the United States, the United Kingdom and Asia

The Enforcement Environment: The Financial Services Industry

- Historic: The financial services sector ranks #7 in the number of enforcement actions
- Prospective: Senior U.S. & U.K. enforcement officials have expressed increased interest in the financial services industry.
- Increased global resources and interest in anti-corruption Enforcement
- Age of the Empowered Whistleblower Changes Detection Risks

Foreign Corrupt Practices Act: The Statute
The Essentials: Knowledge & Participation

- Substantive (*Section 30*) anti-corruption risk derives from two things:
  - Knowledge
  - Participation
- Belief of payment is enough
- An offer of payment is enough
- The knowledge and diligence standards
  - Includes conscious disregard and deliberate ignorance
- Note: Competitive intelligence

The Essentials: Knowledge & Participation
The FCPA's Knowledge and Diligence Standards

A Case Study: US v. Kozeny

- In July 2009, Frederic Bourke, Jr., co-founder of accessory brand Dooney & Bourke, was convicted by a federal jury in the Southern District of New York of conspiracy to violate the FCPA and the Travel Act (18 USC § 371), in addition to making false statements to federal agents (18 USC § 1001).
- Bourke was convicted based on his investment in an unsuccessful attempt to gain control of the State Oil Company of the Azerbaijan Republic in 1998, along with Czech-born promoter Viktor Kozeny, in which bribes were alleged to have been paid to Azeri government officials.
- Rather than attempt to prove Bourke's actual knowledge of bribery, the Government proceeded on a "conscious avoidance" theory, in order to impute the requisite "knowledge" to Bourke.

Customizing an FCPA Compliance Program: Setting the Foundation

- Compliance program scope should:
  - Match how company goes to business
  - Target FCPA risk: Government touch points
- *Examples include*:
  - Private banking: PEP clients and custody services for government-owned Entities
  - Asset management: Sovereign wealth funds
  - Product distribution to government-owned entities

When Prevention Turns to Detection: S.P.E.A.R.

- Advice in situations of a potential suspect or improper payment:
  - Stabilize
  - Preserve
  - Evaluate/Investigate
  - Analyze
  - Remediate

New Approach of Serious Fraud Office to Role of External Advisers

- Director of Serious Fraud Office (SFO), David Green says SFO has recovered its “mojo”
- First conviction after trial of Corporate Foreign Bribery – December 2014
- First conviction of individuals under Bribery Act 2010 – December 2014

BUT

- Celtic Energy – “doomed to fail” – November 2014
- No use section 7 – Failure to Prevent Bribery
- Deferred Prosecution Agreements (DPA) – “no cosy deals”

New Approach of Serious Fraud Office to Role of External Advisers

- May 2015 – New SFO approach
- If detect problem, self-report early, fully and honestly
- SFO will be "unimpressed" if they find out from someone else – "good chance we will"
- Will prosecute people who didn't tell or are "less than frank"
- Now new opportunity - DPA

New Approach of Serious Fraud Office to Role of External Advisers

- No longer why DPA but how DPA – But US experience?
- Corporates want them – first invitations issued May 2015
- Don't "trample over the crime scene"
- "Some sort of game to be resisted" versus genuine cooperation

FCPA and Anti-Bribery Issues for Banks in Asia

- Challenges arising from entering new markets in Asia
- Issues with disclosure obligations and data privacy
- The princeling problem

Challenges Arising from Entering New Markets in Asia

- Many Asia jurisdictions have protectionist legislation for the benefit of local banks
- Examples of foreign ownership restrictions can be found in China, Malaysia, India, Indonesia, Thailand and Vietnam all of which limit total foreign ownership of local banks and cap ownership of single foreign investors (from 10% to 30%)
- The approval process for making such investments can also be multi-tiered (e.g. in China 13^{+} levels of agency must be navigated)
- As a consequence foreign banks looking to access Asian markets face heightened risks in relation to FCPA and other anti-corruption laws

Challenges Arising from Entering New Markets in Asia

- Potential risks of violation of anti-corruption legislation are further heightened given:

Need to enter Joint Venture or other collaborative arrangements

Role played by agents, affiliates and third-parties

Involvement of State-owned enterprises (SOE) and politically-exposed persons (PEP)

Poor compliance programs and past conduct

Challenges Arising from Entering New Markets in Asia

- Given these risk factors it is crucially important to conduct a thorough and tailored risk based FCPA and anti-corruption due diligence process
- Also try to secure representations and compliance commitments in transaction documents
- Compliance steps post investment include
  - Adoption of appropriate policies/codes
  - Training of officers/employees/partners
  - Conducting a FCPA specific audit
- Appropriately deal with any corrupt payments discovered and consider benefit of making voluntary disclosure

Challenges Arising from Entering New Markets in Asia

- Also, differences between international and local anti-corruption legislation in various Asian countries present compliance challenges
- For example, exceptions for gifts:

China	•Gifts worth less than RMB 200 (US$32) is acceptable
Malaysia	•Gifts worth less than MYR 100 (US$27) is acceptable
India	•No prescribed exception and has different monetary thresholds under different rules of conduct issued by government
Indonesia	•Officials should obtain approval from the Corruption Eradication Commission (KPK) to accept gifts •Gifts given at weddings may be kept without approval if value is less than IDR 1 million (US$110)
Thailand	•Gifts or benefits from persons other than relatives are permissible if the amount is under THB 3,000 (US$89)
Vietnam	•Gifts provided under special circumstances (e.g. New Year, weddings) and value is under VND 500,000 (US$25)

Issues with Disclosure Obligations and Local Data Privacy Laws

- SEC and DoJ investigations often require disclosure of documents /information from overseas
- This often gives rise to conflicts with foreign blocking statutes and data protection laws
- Ambiguity in China's very broadly drafted State Secrets Law prevents disclosure of documents without authorization from government
- Covers
  - *"…matters which have a vital bearing on state security" but also includes*
  - *"other matters that are classified as state secrets by the National Administration …"*

Issues with Disclosure Obligations and Local Data Privacy Laws

- The prohibition on disclosure extends to auditor's working papers and financial documents are especially susceptible to disclosure
- Severe sanctions for violations including imprisonment
- Also need to consider these issues in the context of internal investigation as well as in response to overseas regulator requests

Issues with Disclosure Obligations and Local Data Privacy Laws

- In 2013, China announced new procedure for disclosure of sensitive documents to foreign regulators:

1. Screen documents and redact/remove all state secrets/sensitive information
2. Retain independent local law firms to certify screening was done properly
3. Submit all documents for government approval, and documents will be sent by the government to foreign regulators directly

Issues with Disclosure Obligations and Local Data Privacy Laws

- Notwithstanding the China procedures and various Mutual Legal Assistance Treaties (MLAT's) the USA has entered with Asia countries this area is still complex
- Need to consider in country review and limit transfer of electronic material if any doubt
- Country specific advice on these issues is crucial in order to avoid potentially very harsh sanctions both in the USA and the Asian jurisdiction involved

The Princeling Problem

- Growing area of enforcement against financial institutions offering employment/internships to unqualified princelings
- Particularly acute where princelings do not possess satisfactory qualifications and/or work experience
- Institutions should be conscious of their exposure to and associations with PEPs and their children/relatives
- There is every reason to believe that the PRC regulators will now target princelings (every other level of the state hierarchy has been targeted)

The Princeling Problem

- Top global investment bank accused of improperly hiring the son of a Chinese commerce minister
- Senior Chinese insurance regulator successfully asked CEO of a top global investment bank to offer an internship in the U.S. office to his daughter
- Investment bank hired daughter of Chairman of a Chinese corporation in Hong Kong office while the corporation pursued an IPO in Hong Kong worth HK$1 billion.

SEC Enforcement Priorities and Tactics Aimed at Investment Advisers

SEC Enforcement Priorities: Investment Advisers

- The SEC's increasing focus on private equity
- Prospective: SEC enforcement officials have expressed a marked increase in interest in investment advisers to private equity funds
  - Andrew Bowden, "Spreading Sunshine in Private Equity" (May 6, 2014)
  - Marc Wyatt speech, "Private Equity: A Look Back and a Glimpse Ahead" (May 13, 2015)
- Greater detection risk for investment advisers
  - More sophisticated SEC examinations & use of analytics
  - SEC whistleblower program

Frequent Charges Against Private Equity Fund Advisers

- The SEC has recently brought enforcement actions against private equity fund advisers arising from:
  - Misrepresentations
  - Undisclosed conflicts of interest
  - Compliance failures
- These actions are typically based on violations of the Investment Advisers Act of 1940
  - Section 206
  - Rule 206(4)-7

OCIE and Enforcement

- New coordination between the Office of Compliance Inspections & Examinations and Division of Enforcement
  - The “eyes and ears of the SEC”
  - 2015 Exam Priorities
    - Protect retail investors
    - Assess market-wide risks
      - Fees and Expenses: "Given the high rate of deficiencies that we have observed among advisers to private equity funds in connection with fees and expenses, we will continue to conduct examinations in this area."
  - Creation of OCIE Private Funds Unit
    - Led by former enforcement official
  - Use of data analytics to target examinations and detect illegal activity

Recent Enforcement Actions

- *In re Kohlberg Kravis Roberts & Co., L.P.* (June 29, 2015)
  - SEC "scrutinizing the private equity industry to make sure that fund managers aren't misallocating or unfairly charging fees and expenses to investors." Broken deal expenses
  - Failure to adequately implement a written compliance policy governing fund expense allocation practices
- *In re Clean Energy Capital, LLC et al.* (Oct. 17, 2014)
  - Nondisclosure of payment arrangements and expense payments in fund offering documents
- *In re Lincolnshire Management, Inc.*, (Sept. 22, 2014)
  - Undisclosed and unequal expense sharing
- *In re Brian Williamson* (Aug. 20, 2013) and *In re Oppenheimer Asset Management Inc.* (Mar. 11, 2013)
  - Valuation methodology and other failures to disclose

Compliance/Recidivism Initiative

- Public Awareness:
  - Announcement: AMU Co-Chief Julie Riewe, speech "Conflicts, Conflicts Everywhere" (Feb 26, 2015)
  - Cases
    - *In re Trust & Investment Advisors, Inc*. (May 18, 2015)
      - Failure to correct deficiencies from previous OCIE exams & misleading statements
    - *In re Transamerica Financial Advisors, Inc*. (April 3, 2014)
      - Failure to correctly apply advisory fee discounts and to correct deficiencies previously identified by OCIE

SEC Whistleblower Program

- The Dodd-Frank Act authorized the SEC to create its whistleblower program
  - The SEC now provides monetary awards to eligible individuals who provide the SEC with original information that leads to an enforcement action in which over $1 million in sanctions is recovered
  - Awards range between 10% and 30% of the monetary sanctions collected
  - 14 separate awards including one award of $30 million by the end of FY 2014
  - Creates pressure to self-report

Whistleblower Protection

- SEC rules protect whistleblowers
  - *In re Paradigm Capital Management, Inc.* (June 16, 2014)
    - Whistleblower retaliation prohibited
    - Exchange Act, Section 21F(h)
  - *In re KBR, Inc*. (April 1, 2015)
    - SEC determined that a broad confidentiality statement required from employees violated SEC Rule 21F-17(a)
    - KBR's confidentiality statement: *"I understand that in order to protect the integrity of this review, I am prohibited from discussing any particulars regarding this interview and the subject matter discussed during the interview, without the prior authorization of the Law Department. I understand that the unauthorized disclosure of information may be grounds for disciplinary action up to and including termination."*

Whistleblower Protection (Con't)

- As part of its settlement with the SEC, KBR agreed to amend its confidentiality statement by including the following limitation:
  - New KBR agreement with SEC approved language: *"Nothing in this Confidentiality Statement prohibits me from reporting possible violations of federal law or regulation to any governmental agency or entity, including but not limited to the Department of Justice, the Securities and Exchange Commission, the Congress, and any agency Inspector General, or making other disclosures that are protected under the whistleblower provisions of federal law or regulation. I do not need the prior authorization of the Law Department to make any such reports or disclosures and I am not required to notify the company that I have made such reports or disclosures."*
- Consider scope of confidentiality provisions in all agreements

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Questions?

Please email Erica Weber at eweber@mayerbrown.com

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Alistair Graham
Partner
+ 44 20 3130 3800
alistair.graham@mayerbrown.com

Richard Rosenfeld
Partner
+1 212 506 2178
rrosenfeld@mayerbrown.com

Laurence Urgenson
Partner
+1 202 263 3280
luregenson@mayerbrown.com

John M. Hickin
Partner
+ 852 2843 2576
john.hickin@mayerbrown.com

Matthew Rossi
Partner
+1 202 263 3374
mrossi@mayerbrown.com

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