

MAYER • BROWN

# Global Investigations and Enforcement Update

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# Enforcement Priorities Around the World

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UNITED STATES

## U.S. Department of Justice – Slow Transition or Policy Shift?

- Apparent decline in white collar criminal enforcement
  - 22 corporate Deferred Prosecution Agreements (“DPAs”) and Non-Prosecution Agreements (“NPAs”) in 2017
  - Monetary sanctions seem more modest
- Policy statements of AG Sessions and DAG Rosenstein
  - April 2017: AG Sessions comments that companies should not be forced to pay substantial sums due to the misconduct of a single employee or division chief
  - October 2017: DAG Rosenstein comments that DOJ sees good corporate citizens as effective partners to law enforcement

# U.S. Department of Justice – Slow Transition or Policy Shift?

- Policy Announcements
  - Extension of FCPA “Pilot Program”
  - Application of “Pilot Program” to Other Areas
  - Use of Informal Agency Guidance
- Transition Difficulties

# U.S. Securities & Exchange Commission

- Focus on Main Street, not Wall Street
  - Disclosures, Fees
  - Execution of Customer Orders in Fixed Income
- Concerns About Cybersecurity & Critical Infrastructure
  - OCIE Priorities: clearing agencies, exchanges, transfer agents
- FINRA and MSRB
- Cryptocurrencies and Initial Coin Offerings
- AML

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UNITED KINGDOM

## Serious Farce Office – to Effective Prosecutor in 6 years

- April marks the end of David Green's tenure as director of the SFO
- Position very different six years ago – Serious Farce Office
- At a pivotal moment continuing upward trajectory/politics/successor
- Bribery Act 2010 – Section 7 but corporate criminal liability?
- DPAs/Prosecutions/Convictions – the SFO has recovered its mojo



# Deferred Prosecution Agreements 2014

- Only offered if “extraordinary level of trust”
- Judge agrees “in interests of justice” and “fair, reasonable and proportionate”
- Rolls-Royce fined \$900m - £500m UK, US\$170m DoJ, \$25m Brazil
- Is 50% reduction sufficient to encourage self report?
- What about Directors? Can DPAs be seen as a success without successful prosecution of individuals?
- Three guilty pleas by ex Rolls-Royce employees in US – SFO considering charges in UK – new Director’s first big issue?

# Prosecutions

- SFO LIBOR investigation, 6 years - 4 convictions, 1 guilty plea, 6 acquittals
- LIBOR trial 2015 – Tom Hayes 11 years
- EURIBOR trial April 2018 – 11 charged, 4 German and 2 French Traders refuse to attend trial
- Christian Bittar – star trader recent guilty plea to conspiracy to defraud
- Barclays Plc and 4 senior executives charged – Qatar \$3bn defraud/financial assistance

## 2017 – A Busy Year

- SFO launches increased number of high profile criminal investigations:
  - ABB – February
  - KBR – April
  - Petrofac – May
  - AMEC Foster Wheeler – July
  - Rio Tinto – July
  - British American Tobacco – August
- Unaoil – 4 individuals charged
- FH Bertling and 6 executives plead guilty \$20m Angola fraud

# Developments in 2018

- Unexplained Wealth Orders introduced – January
- Criminal Finances Act 2017 introduced failure to prevent tax evasion offence – January
- R v Skansen Interiors Ltd – first contested s7 Bribery Act “failure to prevent bribery” case on Adequate Procedures – January
- SFO charges Barclays Bank plc with financial assistance re Qatar \$3bn loan – February
- Tesco – SFO seeks retrial – March
- New SFO approach to interviews with individuals – record/handover notes/flexibility/discuss – March
- Ex trader Bittar pleads guilty re EURIBOR manipulation – April
- EURIBOR trial starts April 2018 – attendance?

## The Future?

- SFO Director term ends April 2018. New director, new approach?
- Privilege issues – ENRC – Court of Appeal June 2018
- Creation of NECC
- Government's desire to merge SFO into National Crime Agency
- More strict liability offenses (i.e. failure to prevent economic crime)
- Increased use of DPAs
- Onwards? Upwards?

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FRANCE

# France's "Sapin II Law"

- France recently enacted *Law No. 2016-1691 of 9 December 2016 on transparency, anti-corruption and economic modernization* (known as the "Sapin II Law"), a new anticorruption law applying from June 1, 2017. Among key changes, the Sapin II Law:
  - requires compliance programs for companies with at least 500 employees and €100 million annual turnover (including French subsidiaries of foreign companies)
    - The Sapin II Law is one of the only anticorruption laws to codify sanctions for the failure to implement or improve compliance program measures
  - imposes the implementation of 8 measures and procedures aiming at preventing and detecting acts of corruption;
  - establishes a new French anticorruption agency – *Agence Française Anticorruption* (AFA) – to monitor compliance programs and impose sanctions

# France's Anticorruption Agency: AFA

- Sapin II establishes the *Agence Française Anticorruption* (AFA), a new anticorruption agency headed by former judge Charles Duchaine with approximately 50 agents. The AFA has two primary roles:
  1. Advisory – providing advice to companies on matters within its jurisdiction
  2. Oversight – overseeing companies with respect to compliance with obligations
- In December 2017, the AFA published its *“Guidelines to help private and public sector entities prevent and detect corruption, influence peddling, extortion by public officials, unlawful taking of interest, misappropriation of public funds and favouritism”*
- Other authorities:
  - Autorité des Marchés Financiers (AMF) – Financial Market Authority
  - Autorité de Contrôle Prudentiel et de Régulation (ACPR) - Prudential Control and Regulation Authority
  - Autorité de la concurrence - Anti-trust and competition Authority
  - ESMA



# Compliance Measures under the Sapin II Law

Sapin II Law Measure	Summary of Obligations
1. Code of Conduct	<ul style="list-style-type: none"><li>Defines and illustrates the different types of unacceptable behaviors likely to qualify as acts of corruption or influence peddling</li></ul>
2. Whistleblowing system	<ul style="list-style-type: none"><li>Internal whistleblowing procedure to collect and report breaches of the Code of Conduct and other applicable laws and regulations</li></ul>
3. Risk assessment/mapping	<ul style="list-style-type: none"><li>Regularly updated documentation aimed at identifying, analyzing and prioritizing risks of corruption</li></ul>
4. Third-party due diligence	<ul style="list-style-type: none"><li>Due diligences concerning clients, suppliers and intermediaries</li></ul>
5. Accounting control procedures	<ul style="list-style-type: none"><li>Procedures (internal or external) aimed at ensuring that the company's accounts are not used to hide acts of corruption</li></ul>
6. Training	<ul style="list-style-type: none"><li>Training for executives and personnel exposed to the risks of corruption</li></ul>
7. Disciplinary regime/incentives	<ul style="list-style-type: none"><li>Effective sanctions for breaches of the Code of Conduct (acts of corruption and conduct contrary to the company's ethics)</li></ul>
8. Control and evaluation system	<ul style="list-style-type: none"><li>System to monitor and evaluate the measures implemented within the company</li></ul>

# France's Judicial Agreement in the Public Interest

- Sapin II creates the French equivalent of a deferred prosecution agreement, known as a Judicial Agreement in the Public Interest (*Convention Judiciaire d'Intérêt Public* or "CJIP")
  - CJIPs are similar to DPAs in the US and UK; offenses that can lead to a CJIP include active or passive corruption and illicit influence peddling
- A CJIP may impose on entities: (i) a "public interest fine" not to exceed 30% of the average turnover of the last three years; and/or (ii) implementation of a compliance program; and/or (iii) compensation of victims
- Three CJIPs entered into in France so far:
  1. HSBC paid a public interest fine of €300 million and paid €142,024,578 in compensation to the victim (November 2017)
  2. Kaeffer Wanner paid a public interest fine of €2.7 million (March 2018)
  3. SET Environnement paid a public interest fine of €800,000 (March 2018)

# Sapin II Law Sanctions and Recent Enforcement Actions

- Administrative: AFA administrative sanctions for lack of a satisfactory compliance program may include (i) warnings; (ii) injunctions; and (iii) financial penalties of up to €200,000 for natural persons and €1 million for legal entities
- Criminal: AFA may refer cases for criminal prosecution, through which legal representatives may face up to two years in prison and a €50,000 fine for failing to implement a compliance program
- French companies recently sanctioned by French and foreign authorities include:

Company	Date	Competent Authority	Sanction
BNP Paribas	November 2017	Autorité des Marchés Financiers	€ 200,000 and commitment to update procedures
Société Générale	July 2017	Autorité de contrôle prudentiel et de résolution	€ 5 million and a warning
Alstom	December 2014	U.S. Department of Justice	\$ 772 million
Total SA	May 2013	U.S. Securities and Exchange Commission	\$ 400 million

# Other Developments in France and the EU

## 1. Duty of Care Law:

- Act No. 2017-399 of 27 March 2017 on the duty of care of parent and contracting companies

## 2. Anti-Money Laundering and Countering the Financing of Terrorism:

- Directive 2015/849/EU (known as the 4th EU Money Laundering Directive)
- French Decree No. 2016-1635 of December 1st 2016

## 3. Data Privacy:

- Regulation (EU) 2016/679 (known as the “General Data Protection Regulation or “GDPR”)

## 4. MiFID/MiFIR/AIFMD:

- Directive 2014/65/EU (known as the Markets in Financial Instruments Directive or “MiFID II”)
- Regulation (EU) No 600/2014 (known as the Markets in Financial Instruments Regulation or “MiFIR”)
- Directive 2011/61/EU (known as the Alternative Investment Fund Managers Directive or “AIFMD”)

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HONG KONG

# Enforcement priorities of the Securities and Futures Commission (SFC), Hong Kong

- Corporate fraud
  - False or misleading financial statements
  - Initial public offering fraud (and ICO fraud)
  - Transactional fraud and conflicts of interest
- IPO sponsor failures
  - 15 sponsors under investigation
  - 8 sponsors and 4 sponsor principals facing disciplinary sanctions

# Enforcement priorities of the Securities and Futures Commission (SFC), Hong Kong

- Insider dealing and market manipulation
  - Targeting sophisticated syndicates
  - But where are the criminal prosecutions?
- Money Laundering internal control failures
  - Action in 2017 against several brokers for KYC deficiencies
- Mis-selling of financial products
  - Cross-divisional approach by SFC to the review of investor offerings and selling practices

# Enforcement priorities of the Securities and Futures Commission (SFC), Hong Kong

- Senior management and individual accountability
  - The impact of the Manager-In-Charge regime
- Closer co-operation with the China Securities Regulatory Commission under Mainland-Hong Kong Stock Connect
  - The Tang Hangbo case



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BRAZIL

# The Brazilian Anti-Corruption Legal System



# Brazil's Clean Companies Act

- **Strict Liability** of legal entities
  - Liability for actions perpetrated by **employees or third parties** acting on behalf or for the benefit of the company, exclusive or not.
- The company's liability does not preclude its **executives' liability**
- **Offenses:**
  - Committed against the **domestic** or **foreign** Public Administration;
  - Includes **not only corruption**, but other illicit conduct (e.g., bid rigging);
  - **Broad definition of corruption** (e.g., concept of public agent, undue advantage).
- **Sucessor liability** in amendments to the articles of incorporation, transformation, merger, acquisition or spin-off
- Possibility of entering into **leniency agreements** as a mitigating factor
- Credit for having an **effective Compliance Program** (16 Evaluation Parameters)
- **Joint liability** of parent, controlled and affiliated companies, and, within the scope of contract, consortium members
  - Decree No. 8,420/2015 – guidelines for integrity programs.

# Anticorruption in Brazil: Major Special Police Operations

- “Carne Fraca” (Weak Flesh) (2017)
- “Bulish” (2017)
- “Greenfield” (2016)
- “Boca Livre” (Free Lunch) (2016)
- “Unfair Play” (2016)
- “Zelotes” (Zealots) (2015)
- “Acrônimo” (Acronym) (2015)
- Fifa-related cases (2015)
- “Lava Jato” (Car Wash) (2014-2018)\*
  - **1.765** proceedings initiated;
  - **174** cooperation agreements (163 plea bargains and 11 leniency agreements);
  - **227** arrests;
  - **953** search warrants;
  - Charges brought against **305** individuals, with 40 convictions so far;
  - **395** international cooperation requests.



\* Updated as of April 4, 2018 (<http://www.mpf.mp.br/para-o-cidadao/caso-lava-jato/atuacao-na-1a-instancia/parana/resultado>)

# Enforcement in Brazil: Challenges

- Conflicts (and even competition) arises between multiple agencies with similar enforcement powers;
- Dissenting interpretations of the law;
- Lack of harmony among the authorities;
- Dispute for the spotlight;
- Questionable validity of investigative methods (detention for questioning, plea bargaining).
- The enforcement and governmental agencies are working more and more together: leniency agreement signed by AGU, MPF and CGU with **MullenLowe and FCB Brasil**

# Plea Bargaining and Leniency Agreements

- Plea Bargaining
  - Encompasses criminal liability;
  - Applicable to individuals (generally, there is no corporate criminal liability under Brazilian Law).
- Leniency Agreements
  - Encompasses civil and administrative liabilities;
  - Applicable to legal entities (does not preclude its executives' liability).

# International Dynamics


- Highest penalties in international anti-corruption enforcement were a result of joint action:
  - In view of the worldwide impact of corrupt practices throughout the globe, international authorities have developed a network of cooperation to bring the pieces together in increasingly sophisticated investigations

Company	Amount	Countries
Odebrecht/Braskem	\$ 4.3 billion	Brazil, US & Switzerland
Siemens	\$ 1.6 billion	Germany & US
Telia	\$ 965 million	Sweden, the Netherlands & US
Alstom	\$ 814 million	UK, US & Brazil
Rolls Royce	\$ 809 million	UK, US & Brazil
Vimpelcom	\$ 795 million	US & the Netherlands
Halliburton	\$ 604 million	US & Nigeria
Teva Pharmaceutical	\$ 519 million	US
GSK	\$ 498 million	China
Och-Ziff	\$ 412 million	US

Sources:  
SEC, DOJ, OECD

# What's Happening?

- Clean Companies Act (No. 12,846/2013) and Regulatory Decree (No. 8,420/2015) **came to stay**;
- Companies are speeding the process of **approaching the authorities** in order to get credits.
- **Companies are more cautious** with governmental interaction and adopting more effective internal regulation;
- **Greater interaction** among authorities;
- The Supreme Court constitutional **veto for companies financing political parties**.



**COMPANIES  
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## What's New?

- **Raquel Dodge** took office as the Prosecutor-General in September 18th.
  - Responsible for supervision and coordination of the Federal Prosecutor's Office and in charge of anti-corruption enforcement and criminal litigation before the Supreme Court;
  - Less tolerant with leaks in the criminal investigation and political influence. Possible adjustments to plea bargaining procedure and leniency agreements as consequence of the **Congress Investigation Committee** of JBS plea bargain
- For the first time Brazil President was indicted (twice) by the Prosecutor General Office.
- The former President Luiz Inacio Lula da Silva is taken to prison

# What's Next?

- The political scenario has been affected by the criminal procedures and trigger new operations
  - Joaquim Barbosa (former Justice), Jair Bolsonaro (right wing representative) Marina Silva (left wing candidate) appear as strong possibilities. The only traditional candidate, Geraldo Alckmin, still less of 10% in the presidential race polls
  - Prison of former President Luis Inacio Lula da Silva, yet still has political power to reckon with
- The Brazil Supreme Court (STF) will review the possibility of prison after the first appeal trial?
- New plea bargains?
  - **Eduardo Cunha** (former Speaker of the House of Representatives)
  - **Antonio Palocci** (former Minister of Finance)
  - **Geddel Vieira Lima** (former Minister of National Integration and former Vice-President of Caixa Econômica Federal – public bank).

**Focus the investigation in political agents**  
**The Judicial institutions are under strong political pressure**  
**Political turmoil but not a democratic crisis**

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# Everything Is Global

- The global enforcement landscape is an active arena for myriad agencies in multiple jurisdictions.
  - Bribery/Anti-corruption
    - VimpelCom (Feb. '16): U.S., Netherlands
    - Odebrecht/Braskem (Dec. '16): U.S., Brazil, Switzerland
    - Telia (Sept. '17): U.S., Netherlands, Sweden
    - Keppel Offshore (Dec. '17): U.S., Brazil, Singapore
  - Financial Crimes
    - Libor/FX: U.S., UK, Netherlands, EC
  - Corporate Malfeasance
    - Volkswagen: U.S., Germany

# Keys for Coordinating Across Borders

- Data Preservation/Collection/Transfer
  - Data Privacy
  - Blocking Statutes
  - State Secrets
- Interviews
  - Labor and Employment Laws
- Reporting/Disclosure Obligations
  - Thresholds

# Keys for Coordinating Across Borders

- Communicating with the regulators/enforcement authorities
  - Confidentiality agreements
- Cooperation
  - How is it measured?
  - Benefits
- Settlements
  - One and done
  - Collateral consequences

## Cross-Jurisdictional Issues

- Great significance and outputs of the international cooperation agreements signed between countries engaged in anti-corruption practices.
- Internal investigations conducted on a multijurisdictional scenario must take into consideration and comply with the culture and certain procedures expected by the authorities, as well as the applicable law.
  - More than one law firm working on the case
  - Experience and attorney-client privilege
  - The creation of an independent investigation board to report the findings obtained during the investigation, supplemented by the hiring of law firms and forensics assure the independence of the investigation



# Corporate Monitors

- Corporate settlements increasingly require the use of monitors to keep corporations accountable.
- Features to consider:
  - Length of time
  - Cost of monitor
  - Implementing reforms
  - Staffing
  - Degree of access to corporation's files (further exposure)
  - Monitor's reports (further exposure)

# Corporate Monitors: Best Practices in Negotiation

- Explore whether one is necessary
  - Culpability / Complexity
  - Remedial efforts already undertaken
  - Voluntary cooperation and reporting
- Negotiate limits
  - Duration / Hybrid
  - Scope of responsibility
  - Authority
  - Access to corporate files
  - Report Confidentiality

# Corporate Monitors: Moving Forward

- Selecting a monitor
- Creating a work plan
- Reviewing documents and interviewing witnesses
- Issuing recommendations and reports
  - *United States v. HSBC Bank USA, NA*, 863 F.3d 125 (2d Cir. 2017)
- Cost considerations
  - *United States v. Apple, Inc.*, 787 F.3d 131 (2d Cir. 2015)
- Repeat monitors / hybrid monitor arrangements
  - *Rolls Royce*

# Navigating Data Privacy Laws

- Access to data abroad is governed by data privacy laws that vary from country to country and can impact:
  - Collection/Processing
    - Notice and consent
    - Deletion rights
  - Cross-border transfer
    - Does recipient jurisdiction provide adequate privacy protections
- U.S. authorities will carefully analyze any claim a company makes that foreign data privacy laws prevented it from sharing information related to an investigation.

# Navigating Data Privacy Laws

- Practical considerations for overseas data collection in an internal investigation:
  - Determine in which jurisdiction(s) the relevant data is stored
  - Determine existence of the local jurisdiction's data privacy laws and how they impact collection, storage, and transfer
  - Establish parameters of “personal information”
  - Can you obtain consent
  - How will collection efforts impact confidentiality of investigation
  - Repercussions for failure to comply with the relevant data privacy laws

# Navigating Data Privacy Laws

- May 2018: From the E.U. Data Protection Directive (DPD) to the General Data Protection Regulation (GDPR)
  - The DPD sets minimum standards for “processing of personal data and on the free movement of such data” to guide member states on the implementation of national legislation.
  - DPD restricts transfer of employee data to a country with insufficient protections.
    - *E.g.*, U.S. – but Privacy Shield adopted in '16 for transatlantic transfer of personal data
  - Under GDPR, similar general restrictions on cross-border data transfer.
    - Privacy Shield certification still a valid mechanism for transferring data from the EU to the U.S.

# Navigating Data Privacy Laws

- Asia
  - South Korea and Hong Kong require affirmative opt-in consent for some uses of data.
  - Some countries restrict cross-border data transfers to countries without adequate protections.
  - China's new Cybersecurity Law (June 2017) requires data collected or generated in China during business operations to be stored in China unless the entity subjects itself to a security assessment and shows that cross-border transfer of data is necessary for its business.
- Latin America
  - Countries with privacy laws include choice requirements.
  - Consent for cross-border transfers of data.
- Africa / Middle East
  - Almost all countries that have data privacy laws provide for cross-border transfer limitations.

# Witnesses

- Before the interviews:
  - Consult relevant authorities regarding potential restrictions
    - Finland and France labour laws
  - Employee cooperation considerations
  - Identifying witnesses
    - Current versus former employees or other third parties
  - Sequence of interviews
    - May want whistleblowers to go first
    - Ascending order of involvement or authority



# Whistleblowers

- UK
  - Policies and processes should be put in place pursuant to several laws/regulators:
    - Public Interest Disclosure Act/ Bribery Act/Criminal Finances Act/SFO Confidential
    - Employment Rights Act
    - FCA/PRA Individual Conduct Rules/Rules and Guidance on Whistleblowing
  - Financial Services sector: FCA/PRA goes above and beyond general employment law, require process for “reportable concerns”
  - Use care trying to determine identity
  - Individual still has exposure for wrongdoing, and should consider whether to disclose externally

# Whistleblowers

- US
  - Strong policies and processes should be put in place pursuant to several laws:
    - Dodd-Frank Act (CFTC, SEC, SOX, Consumer Financial Protection Act)
    - False Claims Act, Department of Defense, FDA (Food Safety Modernization Act)
    - State law protections
  - Use caution with confidentiality agreements
    - SEC Rule 21F-17: cannot impede a whistleblower from communicating with the SEC; SEC has been focused on pursuing violations of this rule
  - Investigating whistleblower concerns: overcoming anonymity, existing knowledge from another source, prevent retaliation, identify legitimacy, wider dissemination of complaint, potential disclosure of identity, managing up

# Interview Tips and Techniques

- Careful planning and preparation of interview
  - Relevant documents, prior statements (recall data privacy issues)
- Weigh the benefits/risks of Company reps at the interview
- Note-taking and interview memos (recall privilege issues, *Upjohn*)
- Preserving privilege
- Anticipating witness questions
  - Procedural rights/review of interview notes
- Adjust interview techniques to type of witness
  - Behavioral or verbal indicators

# Witness Interviewing Scenario

- A bombing occurred at a bank in Cameroon that is being termed a terrorist event. In-House Counsel for the bank, which has its corporate headquarters in the United States but keeps its data in the EU, has decided to retain Outside Counsel from the United States to do an internal investigation of the attack and the bank's security measures.
- In-House Counsel and Outside Counsel have set up 14 witness interviews with all the bank's employees who were present at the bank at the time of attack, all of whom speak French. This includes the branch's manager and the security guard on duty at the time. Other employees have said that both individuals were out when the attack happened, which may violate company policy.
- What are some interview considerations for In-House and Outside Counsel?

# Self-Disclosure

- Assessment of the necessity of disclosure of the findings gathered during an internal investigation.
  - Duty to report?
- Assessment of the benefits resultant from the self-disclosure, as well as the requirements provided by the law in order to be entitled to credits.
  - Leniency agreements (e.g., in Brazil, reduction up to 2/3 of the applicable penalty)
  - Compliance programs
  - Control of the information, confidentiality and protection of the company's image

# Self-Disclosure

- Review of the jurisdictions involved and impacted by the unlawful act and authorities and regulators with enforcement powers.
  - The company may have to self-disclose to more than one authority in more than one jurisdiction
  - Time-frame and strategy
  - International cooperation

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# Developments in FinTech Compliance and Enforcement from a Global Perspective

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# What is a Coin or Token?

- Tokens broadly characterized as:
  - Currency Tokens – serve (or are intended to serve) as a medium of exchange that a community of users will accept as payment, even though it does not provide any enforceable redemption rights.
    - Bitcoin is an example.
    - Some people would classify tokens in this category as a subset of “Utility Tokens.” We split them out here because they are distinguishable for a variety of regulatory purposes.
  - Utility Tokens – serve as currency or coupon that can be used for the purchase of goods or services on a decentralized, distributed network.
    - Key factor that distinguishes a “Utility Token” (as defined here) from a “Currency Token” (as defined above) is that holding Utility Token provides some sort of contractual or otherwise enforceable right to receive a good or service.
  - Securities Tokens – offer a share of profits, revenue, dividends or similar gains or serve as a substitute for traditional corporate stock, limited partnership interest, etc.

# Hybrid Tokens

- Increasingly, we are seeing tokens that have characteristics of more than one of the categories listed in the previous slide.
- It is possible that a token will be subject to more than one regulatory regime.
  - E.g., a token might be a Security Token (e.g., it represents the present rights to a share of profits) and also be intended (at some point) to serve as a medium of exchange among a community of users.
  - Bottom Line: Categories are not mutually exclusive.
- In most instances, we expect that a token that fits into more than one category will need to comply with regulatory requirements applicable to each category into which it falls.
  - E.g., a Security/Currency Token hybrid might be subject to securities regulations and the regulations applicable to Currency Tokens (discussed later).
  - But . . . It's complicated, and there are too many scenarios and variations to articulate a general rule.

## What Is the Position of the SEC on ICOs and What Does This Mean for the Future of Token Sales?

- Determination of whether an instrument is a security depends on the facts and circumstances
- Analyze using the traditional tests for determining whether an instrument is a security
- SEC has used the four-factor Howey test
  - Investment of money
  - In a common enterprise
  - With the expectation of profit
  - “Solely” from the efforts of others

# Consequences of Not Complying with Securities Laws in the Sales of Securities

- Violation of Section 5 of the Securities Act of 1933
  - Criminal penalties (DOJ)
  - Civil penalties (SEC)
- Section 10(b) of the Exchange Act and Rule 10b-5
  - Material misstatements or omissions
- Investors have rescission rights
- Issuer/sponsors that are “bad actors” affect ability to rely on certain registration exemptions
- Common law fraud actions under state law

# Consequences of Not Complying with Securities Laws in the Sales of Securities

- SEC enforcement actions and Public Statements
  - On July 25, 2017, the SEC issues “Investor Bulletin: Initial Coin Offerings”
  - On July 25, 2017, the SEC issues “Statement by the Divisions of Corporation Finance and Enforcement on the Report of Investigation on The DAO”
  - On July 29, 2017, the SEC issues its Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO
  - Temporary trading suspensions:
    - CIAO Group, Inc. (Aug. 10, 2017), First Bitcoin Capital Corp. (Aug. 23, 2017) and American Security Resources Corp (Aug. 28, 2017)

# Consequences of Not Complying with Securities Laws in the Sales of Securities

- SEC enforcement actions and Public Statements (con't)
  - Creation of a Cyber Unit announced by the SEC on September 25, 2017 lists as one of its enforcement priorities “violations involving distributed ledger technology [blockchain] and initial coin offerings
  - September 29, 2017, SEC v. RECoin Group Foundation, LLC, DRC World Inc. a/k/a Diamond Reserve Club, and Maksim Zaslavskiy
  - On November 2, 2017, the SEC issues “Statement on Potentially Unlawful Promotion of Initial Coin Offerings and Other Investments by Celebrities and Others”
  - November 7, 2017, SEC Chair Jay Clayton says that he has yet to see a digital coin that does not have some securities attribute

# BitLicense and Money Service Business Laws

- Money Service Business laws
  - The original cryptocurrency laws
  - Have existed for over a century, regulating various non-bank financial service providers like check sellers, money transmitters, and open-loop stored value issuers.
- Virtual Currency-Specific Laws
  - In the US, only one: the New York BitLicense regulations
  - Conference of State Bank Supervisors and the Uniform Laws Commission have issued dueling proposals for uniform laws that other states can adopt.

# Money Service Business Laws

- MSBs are regulated at both the federal and state level in the US; are regulated at the national level in most developed countries.
- These laws serve two principle purposes:
  - Combatting Financial Crimes: Prevent MSBs from facilitating money laundering, terrorist financing, and other financial crimes.
    - In the US, this is primary focus of federal regulations for MSBS.
  - Customer Protection: Ensuring that MSBs will honor their financial obligations to customers.
    - Accomplished through licensing requirements (so regulators can keep ne'er-do-ells out of the industry) and safety-and-soundness rules.
    - In the US, this is the primary focus of state MSB laws.



# Federal MSB Regulations

- In March 2013, FinCEN issued guidance on the application of MSB regulations to various parties involved with cryptocurrencies.
- Concluded that most exchanges providing services related to “convertible virtual currencies” and most administrators of systems involving such currencies were MSBs (specifically, “money transmitters”).
  - *Convertible virtual currency* refers to virtual currency that “either has an equivalent value in real currency, or acts as a substitute for real currency.”
  - *Money transmission services* defined in FinCEN rules as “the acceptance of currency, funds, or other value that substitutes for currency from one person and the transmission of currency, funds, or other value that substitutes for currency to another location or person by any means.”
- This required them to register with FinCEN and adopt AML programs.

# New York BitLicense Regulations

- Applies to *virtual currency business activities*, defined as:
  - Transmitting virtual currency
  - Storing, holding, or maintaining custody or control of virtual currency on behalf of others;
  - Buying and selling virtual currency as a customer business;
  - Performing exchange services as a customer business; or
  - Controlling, administering, or issuing a Virtual Currency
- Virtual currency defined as “any type of digital unit that is used as a medium of exchange or a form of digitally stored value.”
  - Various exclusions

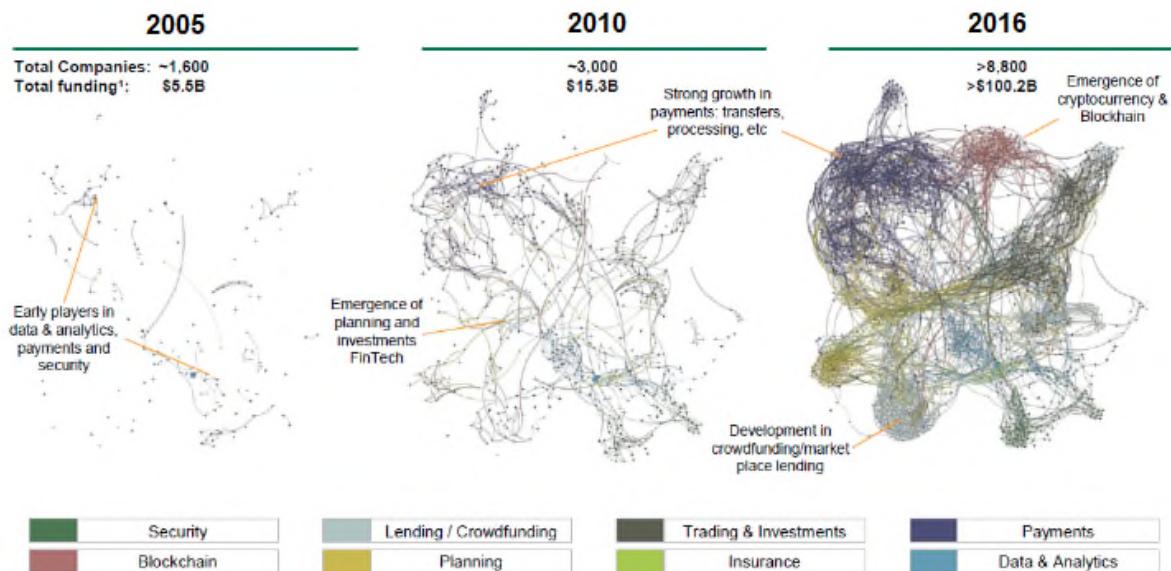
# Are ICOs Subject to Virtual Currency Laws Like the Foregoing?

- It depends . . . Do the tokens being issued qualify as “virtual currency” or equivalent term?
  - Answer can vary from law to law, since they all define *virtual currency* slightly differently.
- General rule is that it depends on whether the token can be used as a medium of exchange within a community.
  - Not clear whether it matters whether the sponsor of the token designed the token with this in mind or actively promotes its use as a medium of exchange.
  - Also not clear exactly when these laws apply—when the token with the potential for use as a medium of exchange is first issued, or only after a community actually starts using it for this purpose.
- Can SAFTs trigger these laws?

## Other Laws Applicable to Utility Tokens or SAFTs

- Utility Tokens can become subject to a wide range of laws, depending on what they represent ownership of.
- E.g.:
  - Does the issuance of a sale of a token that represents ownership in real estate constitute acting as a real estate broker?
  - Are tokens that represent ownership of precious metals or jewels subject to laws applicable to dealers in those types of commodities?
  - Is a SAFT a swap subject to regulation by the CFTC?
- Bottom line: Given the nearly limitless range of intangible rights that can be embodied in a token, there are a broad range of laws that potentially can be implicated.

# Fintech Products Expanding Rapidly



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Visualization based on ~1,600 FinTechs receiving the highest amount of private funding. Dataset mapped with Quid and allowed to cluster based on similar products, technologies, customers etc.  
1) Data based on over 8,800 companies which were discovered across over 4 data sources. Total funding based on date of funding. Total companies based on founding year. Data as of November 2016.  
Source: Quid, BCG/Expand/BCG Digital Venture/B Capital analysis

Adapted from IOSCO Research Report on Financial Technologies (Fintech), February 2017

## Potential Benefits

**Efficiency**

**Decision Making**

**Convenience**

**Savings**

**Security**

**Transparency**

# E-Gold: Not All That Seems to Glitter is Gold

E-Gold: “the only electronic currency that has achieved critical mass on the web”

-Financial Times, 1999



# Selected Regulators and Enforcement Agencies





# Don't Facilitate Money Laundering



# Don't Breach Individuals' Privacy



# Don't Facilitate Fraud or Consumer Scams



**FOR  
SALE  
BY OWNER**  
1-800-TRU-STME

# Be Aware of Potential Impacts on Government Investigations

**Going Dark**

# Don't Jeopardize Cybersecurity

# YOUR IMPORTANT DATA HAS BEEN ENCRYPTED

[illegible]

Your Documents, Photos, Videos, and other important files  
has been encrypted.

```
The only way to restore your data is you must pay 3 BTC to my wallet address.
To complete your payment please contact me at geekhaxid[at]gmail.com,
and get your private key to decrypt your files
```

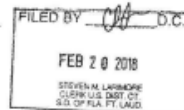
Your data will be safe until 24 hours. If in 24 hours I'm not receive the payment  
Your data will be encrypted forever.

Big Thanks,



Case 0:18-cv-60379-KMM \*SEALED\* Document 1 Entered on FLSD Docket 02/20/2018 Page 1  
of 15

IN THE UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF FLORIDA  
No. 18-cv-60379 Moore



FEDERAL TRADE COMMISSION,

Plaintiff,

v.

THOMAS DLUCA, individually and also d/b/a  
Bitcoin Funding Team and My7Network,

LOUIS GATTO, individually and also d/b/a  
Bitcoin Funding Team and My7Network,

ERIC PINKSTON, individually and also d/b/a  
Bitcoin Funding Team and My7Network, and

SCOTT CHANDLER, individually and also  
d/b/a Bitcoin Funding Team and Jetcoin,

Defendants.

(FILED UNDER SEAL)

COMPLAINT FOR PERMANENT INJUNCTION  
AND OTHER EQUITABLE RELIEF

UNITED STATES DISTRICT COURT  
DISTRICT OF NEW JERSEY

FEDERAL TRADE COMMISSION, and  
JOHN J. HOFFMAN, Acting Attorney  
General of the State of New Jersey, and  
STEVE C. LEE, Acting Director of the New  
Jersey Division of Consumer Affairs,

Plaintiff,

v.

EQUILIV INVESTMENTS, a Limited  
Liability Company and RYAN  
RAMMINGER, an individual,

Defendants.

Case No. \_\_\_\_\_

STIPULATED ORDER FOR  
PERMANENT INJUNCTION AND  
MONETARY JUDGMENT

# FINCEN



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For more information, please contact FinCEN's Office of Public Affairs at (703) 905-3770

**FOR IMMEDIATE RELEASE**  
May 5, 2015

**CONTACT:** Steve Hudak  
703-905-3770

## **FinCEN Fines Ripple Labs Inc. in First Civil Enforcement Action Against a Virtual Currency Exchanger**

**RELEASE Number: 7380-16**

June 2, 2016

**CFTC Orders Bitcoin Exchange Bitfinex to Pay \$75,000 for Offering Illegal Off-Exchange Financed Retail Commodity Transactions and Failing to Register as a Futures Commission Merchant**

**Washington, DC** — The U.S. Commodity Futures Trading Commission (CFTC) today issued an Order filing and simultaneously settling charges

**RELEASE Number: 7614-17**

September 21, 2017

**CFTC Charges Nicholas Gelfman and Gelfman Blueprint, Inc. with Fraudulent Solicitation, Misappropriation, and Issuing False Account Statements in Bitcoin Ponzi Scheme**

CFTC Files Its First Anti-Fraud Enforcement Action Involving Bitcoin



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12 IN THE UNITED STATES DISTRICT COURT  
13 EASTERN DISTRICT OF CALIFORNIA

14 UNITED STATES OF AMERICA,

15 Plaintiff,

16 v.

17 ALEXANDRE CAZES,  
18 aka "ALPHA02,"  
19 aka "ADMIN,"

20 Defendant.

SEALED

FILED

JUN 01 2017

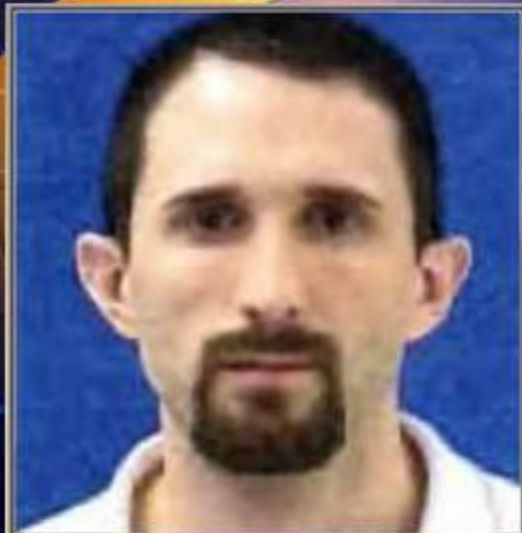
CLERK, U.S. DISTRICT COURT  
EASTERN DISTRICT OF CALIFORNIA  
BY                     

CASE NO. 17 CR - 00144 LJO SKO

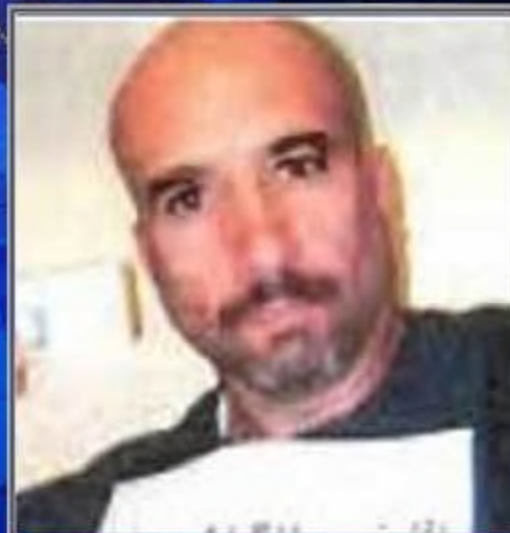
VIOLATIONS:

18 U.S.C. § 1962(d) – Conspiracy to Engage in a  
Racketeer Influenced Corrupt Organization;  
21 U.S.C. §§ 846 and 841(a)(1), (b)(1)(A), (b)(1)(C),  
841(h), and 843(b) – Narcotics Conspiracy; 21 U.S.C.  
§§ 841(a)(1), (b)(1)(C), & 846, and 18 U.S.C. § 2 –  
Distribution of a Controlled Substance, Attempt, and  
Aiding and Abetting (5 Counts); 21 U.S.C.  
§§ 841(a)(1), (b)(1)(A), & 846, and 18 U.S.C. § 2 –  
Distribution of a Controlled Substance, Attempt, and  
Aiding and Abetting; 18 U.S.C. § 1028(f) –

DOJ



**SHAUN BRIDGES**



**CARL FORCE**

## The Bottom Line



I want you to play dirty . . . but don't get caught!

## Unintended Consequences

“There are downsides to everything; there are unintended consequences to everything. The most corrosive piece of technology that I've ever seen is called television - but then, again, television, at its best, is magnificent.”

-- Steve Jobs

## Not Cobras and Smog . . .



# AI Use Cases

- Customer service
- Portfolio Management
- Algorithmic Trading
- Fraud detection
- AML/BSA compliance
- Loan and Insurance Underwriting



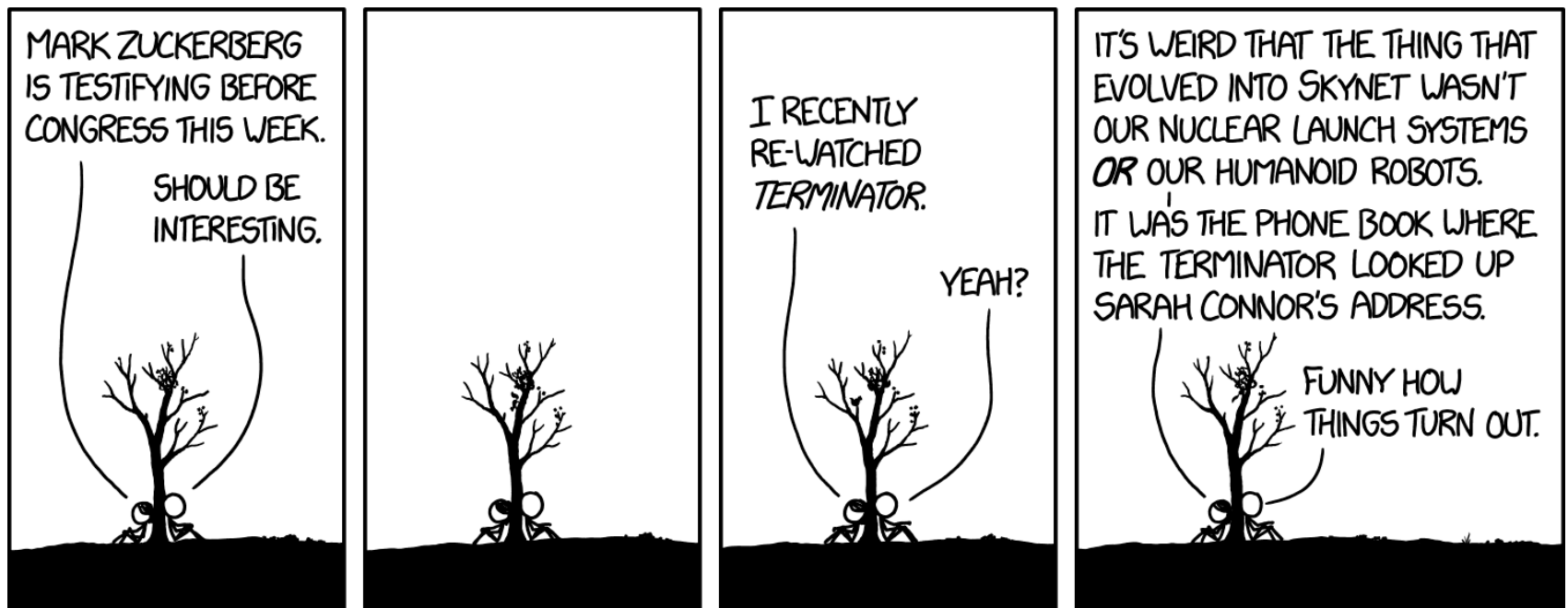


# The Wrong Concerns

- *DAVE: Open the pod bay doors, Hal.*
- *HAL: I'm sorry, Dave. I'm afraid I can't do that.*
- *DAVE: What's the problem?*
- *HAL: I think you know what the problem is just as well as I do.*
- *DAVE: What are you talking about, Hal?*
- *HAL: This mission is too important for me to allow you to jeopardize it.*
- *DAVE: I don't know what you're talking about, Hal.*
- *HAL: I know that you and Frank were planning to disconnect me, and I'm afraid that's something I can't allow to happen.*



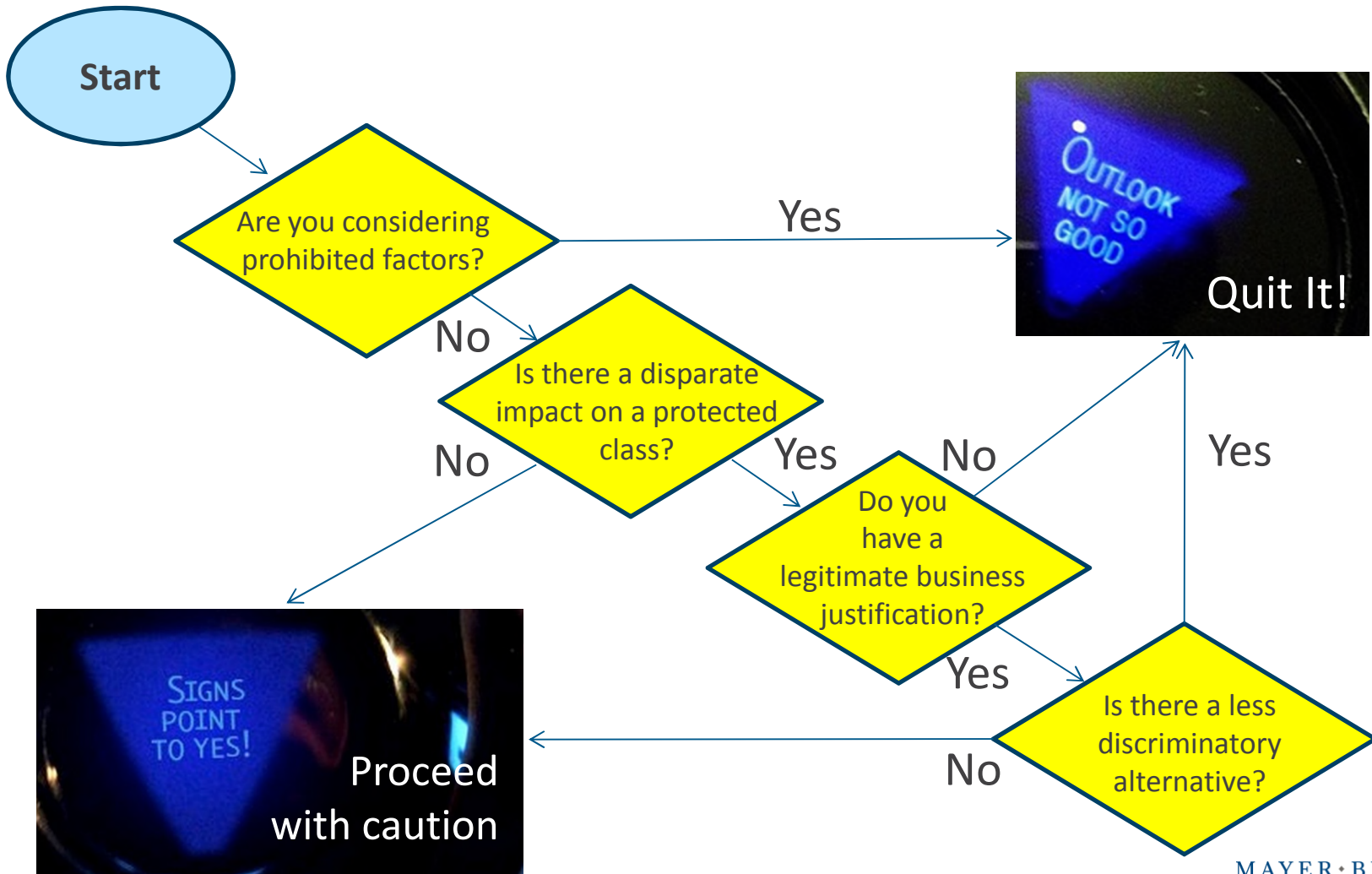
# The Right Concerns







- Equal Credit Opportunity Act
- Fair Housing Act



# Attorney-Client Privilege

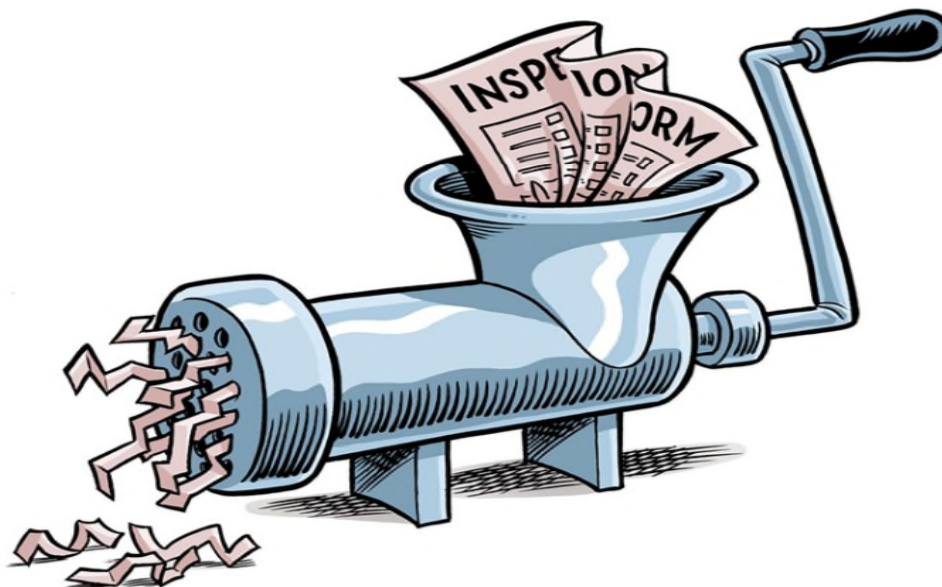


# Are We Safe from Humans?



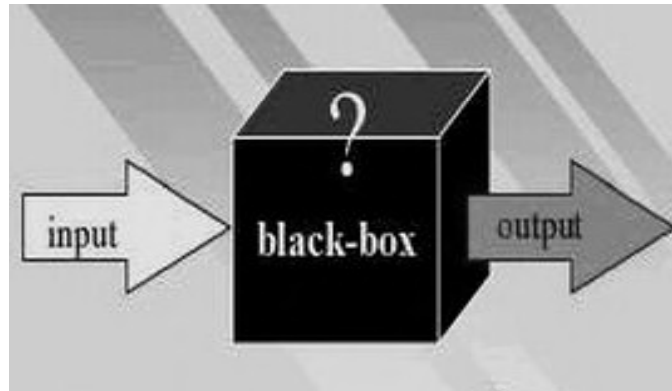
## Three Things to Think About, No. 1

- What are your features (attributes) is your AI platform considering?



## Three Things to Think About, No. 2

- Can you explain, in English, what's happening inside of the “black box”?



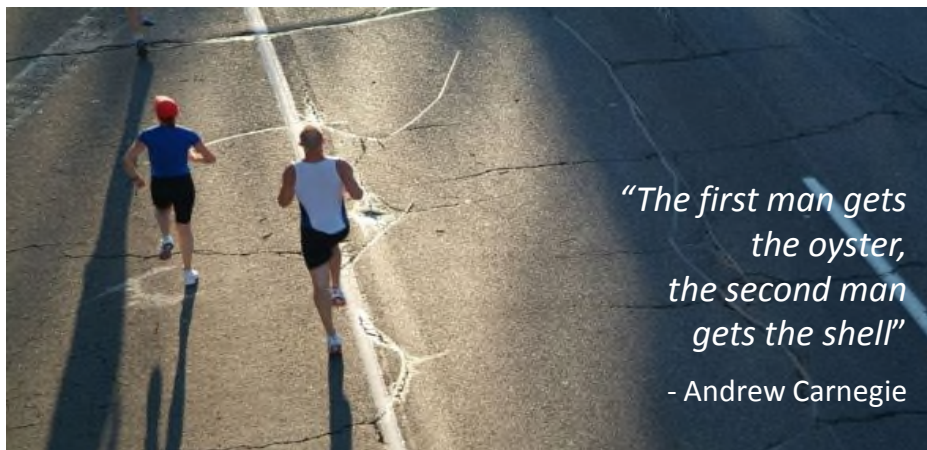
## Three Things to Think About, No. 3

- What are the demographics of the customers being served?



# Don't Stand on the Sidelines

- 44 million credit invisibles and thin file customers without traditional FICO scores
  - 10-15 million who are prime
  - Multi-billion dollar market



*"The first man gets  
the oyster,  
the second man  
gets the shell"*

- Andrew Carnegie



# Conclusion

- Consider the three key points:
  1. Inputs
  2. Processing
  3. Outputs
- Feel free to call me to discuss informally

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