

Anti-Corruption Compliance for Investment Companies

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Investment Company Institute
April 12, 2011

Agenda

- Overview of the FCPA
 - Anti-Bribery Provisions
 - Record-Keeping and Accounting Provisions
- U.K. Bribery Act
 - Offenses
 - Jurisdiction
 - Comparison to the FCPA
- Engaging and Monitoring Third Party Agents, Consultants, Representatives, and Joint Ventures
- Hypothetical Scenarios

Increasing Anti-Corruption Enforcement: Recent Headlines

- **“Don't get hysterical – taking an extra biscuit won't get you arrested under the Bribery Act”** (*The Guardian* – April 3, 2011)
- **“Lawyer to Pay \$150 Million in Foreign Bribery Plea Deal”** (*New York Times* – March 11, 2011)
- **“Former Mabey & Johnson Execs Sentenced to Prison for Iraq Bribes”** (*Wall Street Journal* – February 23, 2011)
- **“Alcatel-Lucent pays \$137m to settle US Bribery Case”** (*BBC News* – December 28, 2010)
- **“Daimler to Pay \$185 Million to Settle Corruption Charges”** (*New York Times* – March 24, 2010)
- **“BAE Systems pays \$450 million to settle bribery scandal charges”** (*Wall Street Journal* – February 6, 2010)
- **“Siemens to pay €1bn as corruption inquiry closes”** (*London Times* - December 16, 2008)

Overview of the FCPA

- Anti-bribery Provisions
 - Prohibit individuals or organizations from bribing or attempting to bribe foreign officials in order to obtain or retain a business benefit or other improper advantage

- Record-Keeping and Accounting Provisions
 - Require companies whose stock is traded on a U.S. exchange to meet certain standards regarding their accounting practices, books and records, and internal controls

Who is covered?

■ Issuers

- Publicly-held companies subject to the registration or reporting requirements of the Securities Exchange Act of 1934
- Includes officers, directors, stockholders, employees, and agents of issuers

■ Domestic concerns

- Any citizen, resident, or national of the United States
- Any corporation, partnership, association, trust, unincorporated organization, etc., that is organized under the laws of the United States or that has its principal place of business in the United States
- Covers officers, directors, employees, agents and stockholders of domestic concerns

■ Any person who commits an act in furtherance of an improper payment while in the territory of the United States

Anti-Bribery: Elements of an Offense

- The anti-bribery provisions of the FCPA prohibit
 - Paying or offering to pay **anything of value**
 - To a **foreign official** or to any other person “while knowing” that all or part of the thing of value will be paid or offered to a foreign official
 - Corruptly for the purpose of influencing the official in some official act or to secure any improper advantage
 - In order to obtain or retain business.

Anti-Bribery: Anything of Value

- “Anything of Value” is defined very broadly
 - Cash or a cash equivalent
 - Vacation or tourist trips
 - Charitable donations
 - Gifts
 - Personal use of a corporate jet
 - Tickets, dinners, other entertainment
 - Jobs for relatives of officials
 - School tuition for children of officials
 - Free merchandise

Anti-Bribery: “Foreign Official”

- “Foreign Official” is also defined broadly to include:
 - Any officer or employee of a foreign government or any department, agency, or instrumentality thereof, including any employee of a state-owned or -controlled enterprise
 - Any political party, party official, or candidate for political office
 - Officials or employees of *public international organizations* - defined as organizations that have been designated as such by executive order of the President, such as the World Bank, IMF, and the United Nations
 - Any person acting in an official capacity for or on behalf of a foreign government or anyone who exercises official authority
- Employees of sovereign wealth funds (“SWF”) likely constitute “foreign officials” under the FCPA. The SEC has recently delivered letters of inquiry to at least 10 hedge funds, banks and private equity firms related to FCPA compliance.

Anti-Bribery: Exception

■ Facilitating payments

- The FCPA permits “grease payments” for **routine governmental action** if
 - The amount of the payment is small;
 - The payment is given to expedite performance of an action which the recipient of the payment is ordinarily and commonly obligated to perform; and
 - The payment is accurately recorded on the company’s books and records to show the amount, purpose, and person or class of person to whom the payment was made.
- A payment does not qualify as a facilitating payment if it is:
 - Made in order to obtain or retain the award of a contract; or
 - Made to facilitate a governmental act to which the payor is not legally entitled.

Anti-Bribery: Affirmative Defenses

- Payments relating to *bona fide* travel, lodging, or entertainment expenditures,
 - Are allowed by the FCPA if
 - The amount of the expense or reimbursement is **reasonable**; and
 - The expense is **directly related** to either (a) the promotion, demonstration, or explanation of products or services, or (b) the execution of a contract with a foreign government or governmental agency.
- Payments lawful under local law
 - A payment may be made to a foreign official if “lawful under the written laws of the foreign country.”
 - This defense is rarely invoked successfully as local laws almost never explicitly approve “corrupt” payments (i.e., payments that would meet all elements of an anti-bribery violation).

Record-Keeping & Accounting Provisions

- Record-keeping and accounting provisions require issuers to:
 - Keep books, records, and accounts in reasonably sufficient detail to accurately and fairly reflect transactions and dispositions of assets, and
 - Maintain internal accounting controls (such as management authorization of transactions).
 - *U.S. companies holding a minority interest in a foreign or domestic subsidiary or joint venture are still required to make “good faith efforts” to cause the subsidiary or joint venture to comply with the FCPA’s record-keeping and accounting provisions.*

Penalties for FCPA Violations

- Anti-Bribery Provisions
 - Individuals: Imprisonment of up to 5 years or criminal fines of up to \$250,000 or twice the gross gain or gross loss arising from the conduct
 - Companies: Criminal fines of up to \$2 million per violation or up to twice the gross gain or gross loss arising from the conduct
- Record-Keeping and Accounting Provisions
 - Same consequences as other violations of the 1934 Act.
 - Criminal penalties for individuals include imprisonment up to 20 years and fines up to \$5 million
 - Corporations may be fined up to \$25 million
- Individuals and companies are also subject to civil penalties.
- In addition, there are numerous potential collateral consequences.
 - Debarment from U.S. or E.U. government contracts or other programs (e.g., World Bank and the OPIC programs)
 - Debarment from receiving U.S. import/export licenses
 - Potential civil litigation

Polling Question

Which of the following best describes your efforts to ensure compliance with the FCPA?

- A) We currently have a program in place to ensure compliance with the FCPA
- B) We are current in the process of putting in place a program to ensure compliance with the FCPA
- C) We do not currently have a program but anticipate having to put a program in place in the future
- D) We are not that concerned with the FCPA because we do not conduct any foreign business and have no plans to

Bribery Act: Background

- In 1998, the United Kingdom signed the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Convention).
 - Since then, the OECD has repeatedly called for the modernization of the U.K.’s anti-corruption laws
 - Criticism became even more intense after the U.K. government dropped its investigation into improper payments made by BAE
- The U.K. Bribery Act was passed by Parliament and received Royal Assent in March 2010.
 - The U.K. government has twice delayed the Act’s implementation
 - On March 30, 2011, the Ministry of Justice (“MoJ”) published final guidance on the Act
- The Act will come into force on July 1, 2011.

Bribery Act: Overview

- As written, the Bribery Act is broader in scope than the FCPA.
- The Act includes four offenses: 2 general and 2 specific
 1. Offering or paying a bribe (general)
 2. Requesting or receiving a bribe (general)
 3. Bribing a foreign public official (specific)
 4. Failure by a commercial organization to prevent bribery (specific)
- The first two offenses prohibit both the giving and receiving of bribes within the U.K. and abroad and apply to both public corruption and commercial bribery.
- The third offense specifically addresses bribery of a foreign public official and is similar in most respects to the FCPA's anti-bribery provisions.
- The fourth offense is a strict liability offense that does not have a direct equivalent under U.S. law.

Bribery Act: Jurisdiction

- The general offenses and the offense of bribing a foreign official apply to:
 - Conduct where an act or omission which forms part of the offense takes place in the U.K.
 - The conduct of individuals who are U.K. citizens or ordinarily resident in the U.K.
 - The conduct of companies that are incorporated in the U.K.
- The fourth offense – “failure to prevent bribery” – applies to companies incorporated in the United Kingdom *and* to companies that “carr[y] on a business, or part of a business” in the United Kingdom
 - In its final guidance, the Ministry of Justice noted that in determining whether an organization is “carrying on” business in the UK requires a “common sense approach.”
 - It noted that “the Government would not expect, for example, the mere fact a company... [trades] on the London Stock Exchange, in itself, to qualify that company as carrying on a business or part of a business in the UK.”
 - However, it also warned that UK courts will be the final arbiter in determining jurisdiction. It is not yet clear how U.K. prosecutors and U.K. courts will interpret this language.

Bribery Act: General Bribery Offenses

- The first two offenses prohibit the offer or payment of a bribe or the request or receipt of a bribe, where the bribe is intended to induce or reward “improper performance” of a person’s relevant function or activity
 - These offenses apply to conduct occurring both domestically and overseas.
 - They cover bribery of public sector officials as well as private commercial bribery.
 - There is no requirement that the payment be made in order to obtain or retain business or a business benefit.

Bribery Act: Bribery of a Foreign Public Official

- This offense is similar in scope to the anti-bribery provisions of the FCPA.
- It prohibits offering, promising, or giving an advantage (financial or otherwise) intended:
 - to influence an official in his/her official capacity, and
 - to obtain or retain business or some other advantage in the conduct of business.
- There is no requirement that the offer, promise, or gift be made or given “corruptly” – it is enough to simply offer, promise or give an advantage to influence the official in his capacity to obtain or retain business.
 - This raises concerns regarding hospitality or promotional expenses, which seem to violate the plain language of the Act.

Bribery Act: Failure to Prevent Bribery

- An organization will be liable for the failure to prevent bribery offense if “a person associated with the organization” bribes another person intending to obtain or retain business or a business advantage for the organization.
 - No requirement that any part of the conduct occur in the U.K.
 - Associated persons include any person or legal entity that “performs services for or on behalf of the commercial organization.”
 - This broad definition includes employees, agents and subsidiaries, and could extend to joint venture partners.
 - The guidance suggests that in order for a company to count as an “associated person,” it needs to both (a) provide services on behalf of the commercial organization; and, (b) intend to directly benefit the organization.
 - However, the guidance is not binding on UK courts.
 - Because this is a strict liability offense, a prosecutor would not have to establish that the organization had knowledge of or approved the alleged bribe, only that the bribe was intended to benefit the organization.
- A commercial organization charged with this offense can only defend itself by establishing that it “had in place *adequate procedures* designed to prevent persons associated with [the commercial organization] from undertaking such conduct.”

Bribery Act: “Adequate Procedures”

- In March 2011, the U.K. government published final guidance on what constitutes “adequate procedures.”
- The guidance lists six principles that organizations should evaluate in determining whether they have “adequate procedures” in place:
 - 1) Proportionate Procedures (i.e., an organization’s procedures are proportionate to the bribery risks it faces and to the nature, scale and complexity of its activities)
 - 2) Top level commitment
 - 3) Risk Assessment (i.e., the commercial organization assesses the nature and extent of its exposure to potential bribery risks)
 - 4) Due diligence
 - 5) Communication (including training)
 - 6) Monitoring and review (of its anti-corruption program)
- These principals are similar to those described in the U.S. Sentencing Guidelines and the OECD’s “Good Practice Guidance.”

Bribery Act: Comparison to the FCPA

- The Bribery Act applies to both domestic and foreign bribery, while the FCPA applies only to bribes paid to foreign government officials.
- The Bribery Act covers both public and commercial bribery, while the FCPA only applies to bribery of foreign government officials.
 - Practically speaking, though, this is not a significant difference, as commercial bribery is covered by other relevant US laws.
- The Bribery Act’s strict liability offense of “failure to prevent bribery” has no counterpart under the FCPA.
 - However, the FCPA’s knowledge element is defined broadly to include willful blindness and conscious disregard. In other words, a company may be held liable for a third party’s actions where there is evidence that the company was aware of red flags regarding the third party, but chose not to investigate or act further.

Bribery Act: Comparison to the FCPA

- The specific offense under the Bribery Act of bribery of a foreign public official does not include a requirement that the payment be made “improperly” or “corruptly.”
- Under the Bribery Act, the fines are unlimited.
 - In addition, individuals face up to 10 years’ imprisonment.
- There is no ‘facilitating payments’ exception under the Bribery Act.
- The Bribery Act does not include an exception or affirmative defense for reasonable and *bona fide* business expenditures.
 - Unlike the FCPA, the plain language of the Act does not carve out payments for “reasonable and bona fide expenditure” in connection with promoting products and performing contracts.
 - However, in the final guidance, the MoJ stated that “[b]ona fide hospitality and promotional, or other business expenditure which seeks to improve the image of a commercial organisation, better to present products and services, or establish cordial relations, is recognised as an established and important part of doing business and it is not the intention of the Act to criminalise such behaviour.”

Engaging and Monitoring Third Party Agents, Consultants, Representatives & Joint Venture Partners

- Dealing with third party agents, consultants, representatives, and joint venture partners:
 - Under both the FCPA and the Bribery Act, if you can't do something directly, you can't do it indirectly either.
- Due diligence on third party agents, representatives, consultants and joint venture partners is very important.
 - Find out about the *ownership and business background* of entities which may act on the company's behalf. Confirm with reliable independent sources.
 - Use a *questionnaire* to obtain necessary information.
 - Analyze the third party's performance and *willingness to comply* or history of compliance with company business practices.
 - Bottom line: does the third party have a *reputation for integrity* and ethical behavior?
- Under the Bribery Act, due diligence efforts will need to be designed to prevent and detect both governmental and commercial bribery.
 - Companies may need to perform due diligence on a broader category of third parties, such as contractors and suppliers.

Third Party: Red Flags

- Some “red flags” that may indicate potential problems with third party representatives or business partners are:
 - The reputation for corruption and bribery of the country in which the activities take place
 - Preexisting relationships between the third party and government officials and/or customers
 - Refusal to promise in writing to abide by applicable anti-corruption laws, other laws, or company policies
 - Requests for payments that are unusual in size or method of delivery (e.g., payments to an unrelated individual or entity or into an account in a third country)
 - Requests for over-invoicing or cash payments
 - A desire to keep relationship secret

Third Party: Agreements

- Business dealings with third parties should always be documented by written agreement or contract
- Third party contracts and joint venture agreements should include:
 - Anti-corruption representations and warranties, including that the third party:
 - Is not a foreign official or customer or affiliated with/related to a foreign official or customer
 - Understands and will abide by the FCPA, OECD and local law
 - Has not previously engaged in questionable conduct and will not in the future
 - Anti-corruption procedural safeguards, such as:
 - Right to investigate
 - Payment restrictions
 - Good faith termination

Hypothetical: Entertainment

- FundInvest, an investment adviser, contacts a Sovereign Wealth Fund in China about possibly investing in a FundInvest mutual fund.
- The SWF manager expresses interest, but notes that it would be mutually beneficial if the parties could discuss terms in person. He suggests that they meet in New York, and asks FundInvest to cover his airfare.
- He notes that his wife will be accompanying him and, because he has a bad back, he needs to fly first class.
- Additionally, he asks to stay at The Waldorf Astoria Hotel for three nights, and that FundInvest provide a side trip to Miami for three days before he and his wife return to China.
- He also asks for \$200 *per diem* in cash to cover incidental expenses.

Hypothetical: Questions for Discussion

- Can FundInvest provide travel and hotel accommodations for the fund manager?
- Can FundInvest provide travel and hotel accommodations for the fund manager's wife?
- If the fund manager paid for his wife's travel expenses would it change your answer?
- If the fund manager asked you to schedule his return travel to China a few days after the conclusion of business and then paid for his own travel expenses to Miami, would that be permissible?

Hypothetical: Facilitating Payment

- FundInvest is organizing a mutual fund in Brazil which requires registration before the fund can begin offering its shares.
 - FundInvest has filed the registration paperwork, but the processing of the paperwork is delayed. A FundInvest representative pays the processing clerk \$50 cash to rush the registration paperwork.
 - After the initial processing is complete, the fund has 30 days in which to file any necessary supplementary documentation.
 - FundInvest missed the deadline, but for another \$50, the processing clerk is willing to accept the paperwork anyway.

Hypothetical: Questions for Discussion

- Does the payment to the processing clerk to rush the registration paperwork qualify as a facilitating payment under the FCPA exception?
- Does the payment to the processing clerk to process the paperwork received after the deadline qualify as a facilitating payment under the FCPA exception?
- Assuming the first payment was a proper facilitating payment, can it properly be recorded as “registration fees”?
- Would these payments be permissible under the U.K. Bribery Act?

Questions?

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