CORPORATE COMPLIANCE ALERT

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Broker Dealers Beware: SEC and DOJ Signal Possible New Era of FCPA Enforcement

On May 8, 2013, the Department of Justice (DOJ) announced the unsealing of a multi-count criminal complaint against members of Direct Access Partners' (DAP) Miami based Global Markets trading group and the Senior Vice President (SVP) of Banco de Desarollo Economico y Social De Venezuela (BANDES), a state owned and state controlled economic development of Venezuela.[1] The criminal complaint alleges that members of DAP and the SVP of BANDES conspired to violate the Foreign Corrupt Practices Act's (FCPA) anti-bribery provisions when members of BANDES paid kickbacks in the form of wire transfers from Swiss bank accounts to the SVP in exchange for maintaining BANDES' lucrative trading business.[2] The criminal complaint further alleges that SVP took advantage of her senior role at BANDES to ensure that BANDES' bonds trades were steered to DAP.[3] According to the criminal complaint, most of the trades executed by the DAP on behalf of BANDES involved fixed income investments for which the DAP charged BANDES a mark-up on purchases and a mark-down on sales causing DAP to generate millions of dollars.[4]

The Securities Exchange Commission (SEC) also filed a parallel civil complaint against members of DAP and the SVP of BANDES.[5] The civil complaint describes the bribery scheme in greater detail than the criminal complaint and includes an additional defendant, the spouse of a DAP member.[6] The complaint alleges that DAP executed fixed income trades for customers in foreign sovereign debt. DAP Global generated more than $66 million in revenue for DAP from transaction fees - in the form of markups and markdowns - on riskless principal trade executions in Venezuelan sovereign or state-sponsored bonds for BANDES.[7] The complaint also alleges that DAP then paid a portion of those revenues to Swiss accounts controlled by members of DAP's Global Markets group and the president of a Panama corporation, ETC Investment, S.A., and, in turn, ETC and the members illicitly wired those monies to Swiss accounts controlled by the SVP of BANDES and her "associate."[8]

After filing the complaint, Andrew M. Calamari, Director of SEC's New York Regional Office emphasized that "they thought they covered their tracks by using offshore accounts and a shadow accounting system to monitor their illicit profits and bribes, but they underestimated the SEC's tenacity in piecing the scheme together."[9]

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[1] *United States v. Tomas Clarke, et al*., No. 13-MAG-0683-RLE (S.D. N. Y. Mar. 12, 2013). The DOJ also alleges that defendants violated the Travel Act, 18 U.S.C. 1952, when they traveled in interstate and foreign commerce and used the mails and facilities in interstate commerce with the intent to promote, manage, establish, carry on, and facilitate the unlawful activity. *See United States v. Tomas Clarke, et al*., at pages 7-8.
[2] *United States v. Tomas Clarke, et al*., at pages 2-4.
[3] *United States v. Tomas Clarke, et al*., at pages 2-4.
[4] *United States v. Tomas Clarke, et al*., at pages 11-12.
[5] *SEC v. Tomas Clarke, et. al.,* No. 13-cv-3074 (S.D.N.Y. May 8, 2013)
[6] According to the SEC complaint, she received sham finders fees as part of a phony "foreign finder" agreement in violation of the applicable NASD and FINRA rules governing non-registered foreign entities residing outside of the U.S. *See SEC v. Tomas Clarke, et. al.,* at pages 11-14. Foreign finders are entitled to a "foreign finders fee, the percentage of the business that they direct to broker-dealers provided that they satisfy certain conditions. *See* NASD Rule 1060 and FINRA Incorporated NYSE Rule Interpretation 345(a)(i)/03.
[7] *SEC v. Tomas Clarke, et. al.*, at pages 7-11.
[8] *SEC v. Tomas Clarke, et. al.,* at pages 7-11.
[9] http://www.sec.gov/news/press/2013/2013-84.htm.

Possible New Era for Broker Dealers

The recent decision to prosecute DAP and the SVP of BANDES civilly and criminally should sound alarms for broker-dealers registered with a U.S. securities exchange or an American stock exchange, FINRA members,[10] and "domestic concerns."[11]

However, this is also not the first time that the twin enforcers of the FCPA have investigated or prosecuted financial firms.

In 2012, the SEC charged a former employee of Morgan Stanley with violations of the FCPA and aiding and abetting Morgan Stanley's wholly owned investment advisers in violation of the anti-fraud provisions of the Investment Advisers Act of 1940.[12] The former employee also pleaded guilty to a one-count criminal information charging him with conspiring to evade the internal accounting controls that Morgan Stanley was required to maintain under the FCPA.[13] Nonetheless, the DOJ and SEC declined to prosecute Morgan Stanley because of its strong internal controls and compliance procedures.[14]

In 2011, Goldman Sachs filed a 10-Q indicating that the company was subject to a number of investigations and reviews, "certain of which are industry wide," by various governmental, regulatory and self-regulatory bodies relating to a number of issues including compliance with the FCPA.[15]

Sovereign Wealth Funds (SWF)[16]

One of the issues that the SEC honed in on during their investigation of Goldman Sachs was the firm's continued relationship with a SWF in Libya under the Gaddafi regime.[17] In fact, in 2011, both Goldman Sachs, Blackstone and JP Morgan received target letters from the SEC relating to their investments in SWFs.[18] Accordingly, while the recent SEC and DOJ investigation and prosecution of DAP and BANDES did not involve SWFs and there has never been an FCPA prosecution against a financial firm based on the firms involvement with an SWF, they remain fertile ground for parallel investigations and prosecutions because of the DOJ's policy of treating employees of SWFs as "foreign officials" under the FCPA and because of the exorbitant amounts of revenues generated by the funds in recent years.

Potential Impact

Broker-dealers that transact any business with entities outside of the U.S. would be well-advised to note the DOJ and SEC's recent prosecution of DAP and to implement programs that effectively address and remediate any concerns related to foreign entities or funds, including SWFs, with which they regularly

[10] *See* FINRA Regulatory Notice 11-12 (March 2011) (reminding FINRA members of their obligations under the FCPA)
[11] *See* 15 U.S.C. 78dd-2(h)(1)(B) which defines "domestic concern" broadly to include companies having their principal places of business in the U.S. or which are organized under the laws of a state of the U.S. or the laws of a territory, possession, or commonwealth of the U.S.
[12] http://www.sec.gov/news/press/2012/2012-78.htm
[13] http://www.justice.gov/opa/pr/2012/April/12-crm-534.html
[14] *Ibid*, at supra at note 13.
[15] http://blogs.wsj.com/corruption-currents/2011/08/10/sec-probes-goldman-over-libya-deals/
[16] A sovereign wealth fund is a state-owned pool of money that is invested in various financial assets. The money typically comes from a nation's budgetary surplus. When a nation has excess money, it uses a sovereign wealth fund as a way to funnel it into investments rather than simply keeping it in the central bank or channeling it back into the economy. Some experts estimate that SWFs held more than a combined Five Trillion in assets in 2012. http://www.investopedia.com/articles/economics/08/sovereign-wealth-fund.asp
[17] http://blogs.wsj.com/corruption-currents/2011/07/11/new-rules-sovereign-fund-probe-awakens-financial-firms-to-corruption-risk/. As early as 2008, the DOJ announced that it would treat employees of SWFs as "foreign officials" for purposes of FCPA criminal liability. http://www.compliancebuilding.com/2008/11/04/are-sovereign-wealth-funds-state-owned-enterprises/
[18] http://www.bloomberg.com/news/2011-01-14/sec-probes-financial-firms-on-possible-bribes-to-sovereign-wealth-funds.html

conduct business. As demonstrated by the DAP prosecution, such concerns are also amplified when the broker dealer uses a "foreign finder" or when a foreign finder agreement exists.[19] Furthermore, as "domestic concerns," private equity funds and hedge funds should not simply assume that DAP is inapplicable. Both private equity funds and hedge funds may be liable as third-parties under a control or agency theory of liability because a company's actual or constructive knowledge of conduct committed by a third party is intimately connected to agency principles. For example, more often than not, liability will attach if the level of financial or managerial control a company wields over a subsidiary, a fund in its portfolio, or an investment consortium is substantial.[20] In sum, in light of the recent DAP prosecution, financial firms and their managers must remain vigilant in the context of business and trading partners located or having businesses outside of the U.S. and must implement whatever internal measures are necessary to avoid the potentially devastating consequences brought by a dual SEC and DOJ FCPA prosecution, including but not limited to imprisonment, crippling fines, civil monetary penalties, disgorgement of illicit profits, delisting from a stock exchange and disciplinary or administrative sanctions.

[19] *Ibid*, at *supra* at note 6.
[20] According to Congress, "control" depends on how closely a corporation's board of directors monitors management, how closely management supervises its employees, and finally, whether the corporation adheres to rigid accounting standards. See S. Rep. No. 95-114, at 11 (1977).

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