Recent SEC Sweep Highlights the Need for U.S. Investment Advisers Seeking Business from Sovereign Wealth Funds to Develop Policies for FCPA Compliance

High-profile financial scandals in the past few years have focused the attention of the Securities and Exchange Commission ("SEC") on improper practices that have been used to influence the investment decisions of public pension plans in the United States. As a result of these scandals, the SEC has adopted new regulations designed to limit “pay to play” practices by investment advisers.¹ In addition, some states have placed significant new restrictions on the use of third-party finders or placement agents.²

Recently, the SEC’s Division of Enforcement circulated a widely publicized “sweep letter” to investment advisers requesting, among other things, information about their use of third parties to obtain investments from sovereign wealth funds, and their compliance with the Foreign Corrupt Practices Act ("FCPA").³ This


DechertOnPoint highlights provisions of the FCPA that may be applicable to investment advisers seeking investments from foreign governments.

Background

The FCPA initially was adopted by Congress in 1977 in response to scandals involving bribes by U.S. public companies to illegally influence decisions made by foreign governments. The law’s importance has increased in recent years as a result of high-profile actions by the U.S. Department of Justice (“DOJ”) and the SEC.⁴ Because of the FCPA’s origins, however, there is a common misconception—shared by many investment advisers—that the law only applies to public companies. In fact, the FCPA has a much broader scope and applies to both U.S.
investment advisers and their business partners seeking investments from government entities located outside the United States.

The FCPA’s Anti-Bribery Provisions

The FCPA’s anti-bribery provisions are implicated when, among other things, an investment adviser or its partners give money or “anything of value” to three categories of recipients—(1) a foreign official, (2) a “foreign political party or official thereof or any candidate for foreign political office,” or (3) any third party, while knowing that the third party, such as a placement agent or finder, will forward the money or thing of value to a recipient in category (1) or (2) above.5

Under the FCPA, the adviser cannot provide money or any thing of value to a recipient in one of the three categories listed above with the “purpose” of: (1) “influencing any act or decision” of a foreign official, foreign political party or official, or any candidate for foreign office; (2) “inducing [any of those individuals] to do or omit to do any act in violation of [a] lawful duty”; or (3) otherwise “securing any improper advantage,” or inducing [the individual] to use his influence with a foreign government or government instrumentality to effect any action.6

The FCPA applies to investment advisers whenever they seek a benefit, directly or indirectly, from a foreign official, as in the course of seeking investments from a sovereign wealth fund. In seeking such investments, there is the risk that, without adequate controls, an adviser’s employee, business partner, or third-party placement agent or finder might seek to encourage the investment through improper or illegal means. Thus, there is a potential that the adviser may be subject to prosecution for violating the FCPA, as well as other laws.

Policies and Procedures for Advisers

The policies and procedures that advisers employ to reduce the risk of FCPA actions should follow closely the guidance developed by the DOJ and the U.S. Sentencing Commission. Adhering to such guidance may persuade the DOJ or SEC not to bring action or to reduce the sanctions or penalties that they might otherwise seek.7 The guidance, which is set forth in DOJ Advisory Opinion 04-02 and Chapter 8 of the U.S. Sentencing Guidelines Manual, suggests that advisers should consider the following measures:

- Adopt clearly articulated FCPA compliance policies and procedures.
- Establish appropriate oversight by senior executives with responsibility for compliance policy implementation and review, and reporting responsibility to a board of directors or board committee.
- Require an annual certification and regular training (see below).
- Establish procedures for entering into third-party business relationships (see below).
- Create a reporting system (including an anonymous hotline) to ensure that violations can be promptly detected and remedied.8
- Implement and, in the event of violations of the policy, apply disciplinary procedures.
- Require contractual representations and warranties that permit the adviser to audit or terminate

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5 15 U.S.C. §§ 78dd-1(a)(1)-(3), 78dd-2(a)(1)-(3), and 78dd-3(a)(1)-(3). The FCPA also contains so-called “books and records” accounting provisions. The FCPA’s books and records provisions would require advisers that are part of public companies to “make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer,” and to “devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that” transactions are properly executed and recorded, and that asset access is limited. See 15 U.S.C. § 78m(b)(2)(A) and (B).


7 The SEC’s new cooperation initiative considers corporate compliance as one among several factors the SEC assesses in determining whether to bring civil charges. See SEC Enforcement Manual, § 6.1.2. Framework for Evaluating Cooperation by Companies (listing, as one of four factors for consideration, “[s]elf-policing prior to the discovery of the misconduct, including establishing effective compliance procedures and an appropriate tone at the top”), available at http://www.sec.gov/divisions/enforce/enforcementmanual.pdf#6.2.

8 This has taken increased significant in light of the Dodd-Frank whistleblower provisions.
an agreement in the event of a violation of its policy by a third-party partner.

- Establish accounting procedures and controls to ensure accurate accounting and books and records.
- Have independent audits conducted by experienced outside legal counsel or auditors.9

In addition to adopting policies and procedures, the adviser must assure that they are followed in practice. The DOJ has indicated, for example, that it frowns upon mere “paper” policies that are honored in the breach. Policies and training programs developed by advisers to comply with new Rule 206(4)-5 under the Investment Advisers Act of 1940 can be supplemented to create new FCPA policies and procedures that will govern non-U.S. activities.

Relationships with Third Parties

As noted above, foreign business partners and third-party consultants, or finders, can be a source of potential liability if they engage in improper business practices under provisions of the FCPA. Generally, the best safeguard against liability is evidence of a thorough due diligence review prior to entering into the relationship and, as noted above, clear contractual provisions governing the conduct of the parties.

According to the DOJ, “[t]o avoid being held liable for corrupt third-party payments, U.S. companies are encouraged to exercise due diligence, and to take all necessary precautions to ensure that they have formed a business relationship with reputable and qualified partners and representatives.” Through a series of public advisory opinions, and elsewhere, the DOJ has outlined the contours of appropriate due diligence reviews and ongoing monitoring.10 Advisers who are entering into a third-party relationship should undertake appropriate due diligence practices, including the following measures:

- Determine whether any person receiving payments is considered a foreign official or may be a foreign government entity;
- Provide detailed due diligence questionnaires to potential third-party firms and appropriate employees inquiring about current and former relationships with government entities or foreign officials, ownership structures, prior sanctions and violations of the law;
- Examine references and conduct background investigations using the internet, public and private databases, and information from U.S. embassies; and
- Review relevant compliance policies and resources of the third party.

Contracts with consultants and placement agents should contain a variety of provisions that may be designed to clarify the expectations of the adviser, and also to address FCPA concerns. Among those provisions that the contract may contain are: express prohibitions against kickbacks and bribery; limitations on gifts, gratuities or payments to any public officials or members of their families; and provisions addressing the following—developing and enforcing FCPA compliance policies, maintenance of accurate records of any expenses incurred or payments made (which will

for the position, whether they have personal or professional ties to the government, the number and reputation of their clientele, and their reputation with the U.S. Embassy or Consulate and with local bankers, clients, and other business associates. In addition, in negotiating a business relationship, the U.S. firm should be aware of so-called “red flags,” i.e., unusual payment patterns or financial arrangements, a history of corruption in the country, a refusal by the foreign joint venture partner or representative to provide a certification that it will not take any act that would cause the U.S. firm to be in violation of the FCPA, unusually high commissions, lack of transparency in expenses and accounting records, apparent lack of qualifications or resources on the part of the joint venture partner or representative to perform the services offered, and whether the joint venture partner or representative has been recommended by an official of the potential governmental customer.

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9 For additional recommendations on how financial institutions should respond to the ongoing FCPA focus, see May 2009 DechertOnPoint “How Financial Services Firms Should Respond to Recent FINRA Focus on FCPA Compliance” (http://www.dechert.com/library/White_Collar_SA_05-09_How_Financial_Services_Firms_Should_Respond.pdf).

10 See http://www.justice.gov/criminal/fraud/fcpa/docs/lay-persons-guide.pdf. The DOJ guidance also states:

Such due diligence may include investigating potential foreign representatives and joint venture partners to determine if they are in fact qualified

...
be provided to the adviser on request and may be audited), compliance with the law, prohibition on assignment of the agreement or sharing fees with third parties without written approval, and initial and periodic certifications of FCPA compliance.

Non-U.S. Anti-Bribery Laws

In addition to the FCPA, advisers seeking business opportunities outside the United States must be attuned to local licensing requirements as well as any restrictions on their activities under ethics laws. For example, last year, the United Kingdom enacted Bribery Act 2010, which broadly prohibits firms subject to the Bribery Act from bribing another with the intent to obtain or retain business for the firm or an advantage in conduct of business.11 Although implementation of the Bribery Act has been delayed pending the release of official guidance from the U.K. Ministry of Justice, investment advisers should continue to monitor developments in U.K. as well as laws in other countries designed to prohibit corruption.12

Conclusion

The recent SEC sweep letter is evidence of increased interest by the SEC of the potential for pay to play activities outside the United States. In light of these developments, investment advisers should develop new FCPA policies, or carefully review their existing policies. At a minimum, they should have procedures for vetting potential relationships with third parties, and develop training programs and policies to assure that their own employees are aware of the potential risks and fully compliant with the FCPA.

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