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Private Equity News

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Client Alert: U.S. Targets Private Equity Funds For FCPA Scrutiny

The private equity industry is facing increased scrutiny by the U.S. Government for potential violations of the Foreign Corrupt Practices Act (FCPA). The Securities and Exchange Commission (SEC) has created a new private fund unit and publicly asserted that it is closely examining the operations of private equity funds and their portfolio companies. As with all SEC units, the private fund unit works in conjunction with the U.S. Department of Justice (DOJ) criminal and civil fraud divisions. This increased attention will likely lead to an increase in government investigations, and has enhanced the need for robust FCPA compliance by private equity funds.

Overview of the FCPA

The FCPA contains two main provisions: (1) those dealing with anti-bribery prohibitions and (2) those dealing with accounting requirements. The anti-bribery provisions prohibit corrupt payments of "anything of value" to "foreign officials" to obtain or retain business. "Corrupt" is defined generally as an intent or desire to wrongfully influence the recipient. "Anything of value" is a broad concept that includes tax benefits, information, promises of future employment, scholarships, discounts, entertainment, travel expenses, and insurance benefits. "Foreign official" is a similarly broad term that includes agents of foreign governments and State Owned Enterprises ("SOEs"). The anti-bribery provisions apply to U.S. companies, citizens, and residents wherever located, as well as foreign companies and persons that take any act in furtherance of corrupt payments in the U.S. This includes marginal conduct such as sending emails through U.S. servers and routing transactions through U.S. banks.

The accounting provisions apply to companies that are listed on U.S. stock exchanges and their agents. The accounting provisions require the maintenance of books and records that accurately reflect transactions and the disposition of company assets. These provisions also require companies to maintain internal controls that prevent and detect FCPA violations. Importantly, there is no requirement that false records or deficient controls be linked to corrupt payments. Therefore, even payments that do not run afoul of the FCPA's anti-bribery provisions can lead to prosecution under the accounting provisions if inaccurately recorded or attributed to a lack of internal controls. Significantly, there is no materiality threshold for a violation.

Penalties

Business entities are subject to fines of $2 million for each violation of the anti-bribery provisions while individuals are subject to fines of $100,000 and five years imprisonment. The accounting provisions carry fines of $25 million per violation for business entities while individuals are subject to fines of $5 million and 20 years imprisonment.

$5 Billion in Settlements Over Last Five Years With Emphasis on Financial Services

Table 1 depicts the aggregate fines assessed in public FCPA settlements over the last five years. The amounts do not include forfeitures or fines paid to foreign governments for violation of their anti-corruption laws, which often accompany FCPA fines.[1] Table 2 depicts the number of public FCPA investigations by industry in the last two years. The financial services industry ranks fourth.

TABLE 1

Year	Amount
2016 (Q1)	$498 Million
2015	$133 Million
2014	$1.5 Billion
2013	$731 Million
2012	$259 Million
2011	$509 Million

TABLE 2

Industry	FCPA Investigations
Manufacturing Services	23
Natural Resource Extraction	16
Technology	16
Financial Services	15
Communications	14

Areas of Concern for Private Equity

There are two principal areas of FCPA risk for private equity funds: (1) investments in portfolio companies and (2) interactions with sovereign wealth funds and foreign pension funds.

Private equity funds can be liable for FCPA violations at their portfolio companies. This compounds the risk for many private equity funds because portfolio companies, unlike the private equity funds themselves, may do business in regions and industries where corruption is endemic and many lack effective FCPA compliance programs. The SEC and DOJ also recently stated in advisory opinions that even partial stakeholders may have legal exposure for portfolio companies' FCPA violations if they did not undertake "good faith" efforts to try to prevent the violations. Good faith efforts include using influence to cause portfolio companies to devise internal controls and actively oppose deals that have not been properly vetted. For example, in 2011 the SEC investigated whether the private equity arm of a European-based financial services company, violated the FCPA's accounting provisions by failing to report certain payments made by a portfolio company in which it held a 60 percent interest.

In addition, the SEC and DOJ have made clear that they consider sovereign wealth funds and foreign pension funds to be SOEs and their officers and employees to be foreign officials under the FCPA. The SEC and DOJ have been investigating these funds' relationships with U.S.-based financial institutions since 2011 with an emphasis on the financial institutions' use of agents and consultants to solicit business. For example,

[1] For instance, in 2008, Siemens AG, the European-based engineering conglomerate, paid the SEC and DOJ $800 million to settle FCPA allegations. Siemens paid another $800 million to German authorities to settle allegations that it violated German anti-corruption laws, which brought the total settlement amount to $1.6 billion. Similarly, VimpelCom Amsterdam B.V., the European-based telecommunications company, paid the SEC and DOJ $398 million to resolve FCPA allegations in February 2016. VimpelCom paid an additional $397 million to Dutch authorities to settle allegations that it violated Dutch anti-corruption laws, bringing the total settlement amount to $795 million.

five employees of U.S.-based broker-dealer Direct Access Partners, including the CEO and managing director, pleaded guilty in 2014 and 2015 to FCPA violations in connection with the solicitation of bond-trading business from an economic development bank owned by the Venezuelan government. The employees hired "foreign finders" or "foreign associates" that in turn paid kickbacks to the bank's head of operations. The employees received fines ranging from $2.7 million to $18.5 million and prison sentences ranging from two to four years.[2]

Mitigating Risk

Private equity funds can combat this increased risk by implementing anti-corruption measures or re-evaluating the measures already in place:

- Conduct pre-deal anti-corruption due diligence on all acquisitions in elevated risk locations and require anti-corruption-related representations and warranties.
- Implement anti-corruption policies and procedures applicable not only to employees but also to third parties, and flow the policies and procedures down to portfolio companies. The policies and procedures should be distributed in the portfolio companies' local languages and tailored to their specific businesses and risks.
- Provide periodic training on the anti-corruption policies and procedures and conduct regular audits to ensure compliance.
- Implement mechanisms that allow for the anonymous reporting of potential anti-corruption violations.

Sheppard Mullin has extensive experience designing and implementing FCPA compliance programs. Any questions regarding this client alert or any other FCPA matter can be directed to Bethany Hengsbach. Any questions regarding any private equity, fund formation or compliance matters can be directed to our private equity team members listed below or any of our other private equity attorneys.

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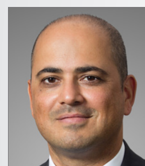

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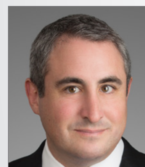

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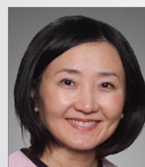

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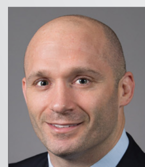

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[2] Soliciting business from SOE's would include soliciting SOE as investors in funds. In this way, FCPA concerns are similar to traditional "pay-to-play" rules in the private equity context.