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Private Fund Managers Be Aware: FCPA Enforcement Is Coming Your Way

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The increased globalization of the private investment industry has given rise to an enhanced focus by U.S. prosecutors and regulators on rooting out corrupt business activities in private equity firms and hedge funds. As private investment firms expand both their efforts to attract financing from sovereign wealth funds and their investments in emerging foreign markets, it would behoove them to implement robust compliance controls targeted at minimizing their exposure to an anti-corruption investigation.

I. Foreign Corrupt Practices Act Enforcement

Federal investigators' anti-corruption efforts are rooted in the Foreign Corrupt Practices Act ("FCPA"), whose anti-bribery provision broadly prohibits anyone covered by the statute from corruptly giving anything of value to a foreign official for the purpose of obtaining or retaining business.[1] The FCPA also contains a set of accounting provisions, applicable to U.S. issuers only, that require them to maintain accurate books and records, and adequate internal accounting controls aimed at preventing and detecting FCPA violations. The DOJ and SEC have consistently maintained that the directors, officers, employees, and agents of state-owned or state-controlled entities, including sovereign investment funds, may qualify as foreign officials under the FCPA, because those entities are "instrumentalities" of a foreign government.[2]

During the recent economic crisis, many private investment funds sought capital from sovereign wealth funds that remained flush with cash and were seeking to expand outside of their home countries. Unsurprisingly, this shift sparked government interest in the industry, with the then-Chief of the DOJ's Fraud Section stating in 2008 that the "boom of sovereign wealth funds" is an area at the top of the DOJ's hit list. Then in 2011, the SEC sought information from ten hedge funds, private equity firms, and other financial institutions concerning their relationships with sovereign wealth funds. The message is clear: the private fund industry has joined the extractive and medical device industries as the most popular targets for FCPA enforcement investigations.

The lengths of time between publicly-known hints to the government's interest in the industry should not give private fund managers a false sense of comfort. Kara Brockmeyer, Chief of the SEC's FCPA Unit, explained at a recent conference in Washington, D.C. that FCPA investigations take a long time, in large part because of the amount of information that needs to be collected from foreign jurisdictions. Ms. Brockmeyer also acknowledged that the SEC will "look at an industry where there are risk factors [and] go out with a voluntary request to see whether there might be an issue." Such industry sweeps can have a domino effect as each successive investigation into a business may reveal damaging information about others.

II. Dangers to the Private Investment Fund Industry

Private investment funds face unique and significant anti-corruption risks through their dealings with sovereign wealth funds and other foreign government entities. Sovereign wealth funds worldwide have estimated assets topping $6 trillion, providing a tempting target for law enforcement and regulatory agencies.

Anti-corruption risks for private funds arise not only in securing funds from a foreign government-owned or -controlled entity, but also when investing funds in a foreign government-owned or -controlled asset. If a fund acquires a majority interest in a foreign company or exercises sufficient control over that company, it can be liable under traditional principles of agency for any FCPA violations committed by the company, including successor liability for any pre-acquisition FCPA violations. Even when a private fund may have only a minority ownership in such an investment, or perhaps just a single seat on the board of a foreign portfolio company, there are significant "headline risks" even if actual FCPA liability may not exist. Entering into a joint venture poses similar risks, as the DOJ and SEC will consider the joint venture's activities to be attributable to each of its members. All of this is compounded by the difficulties in determining whether an investment even involves a foreign government-owned or -controlled entity, as many sovereign wealth funds own or control entities through a chain of subsidiaries.

Many of the risks inherent in soliciting funds from or investing funds with a foreign government's entity arise from the use of third party agents to facilitate the process. Although the use of those agents may have significant benefits because of their familiarity with local markets and entities (and access to key decision-makers), agents have proven a fertile ground for FCPA investigations by the DOJ and SEC, and consistently present a key area of risk. If the agent, when soliciting an investment for the private fund, makes an unlawful payment to an individual working for a sovereign wealth fund or other government entity, the fund can be liable if there is evidence that it knew about the payment or about "red flags" indicating that the payment would be made.

III. Managing Anti-Corruption Risks

Private equity funds and hedge funds should give strong consideration to taking proactive steps to minimize their potential FCPA exposure to the greatest extent possible. The damages stemming from an FCPA investigation or conviction can be tremendous, resulting in massive fines, imprisonment for individuals, and collateral consequences that may include the appointment of an independent compliance monitor. Although every compliance program needs to be tailored to a company's particular needs and market space, a robust program should include some or all of the following components:

- A written FCPA compliance policy and procedures that prohibit bribery (with corresponding disciplinary consequences) and provide regular anti-corruption training for employees. The policy should also create a rigorous pre-approval procedure for any employee seeking to provide a gift or payment to a foreign official.
- A compliance officer or committee responsible for enforcing the anti-corruption policy and for engaging in periodic audits of the compliance policy and third party agents and investments for potential anti-corruption violations and compliance policy efficacy.
- For issuers, the maintenance of accurate books and records concerning all transactions that involve gifts or payments to foreign officials, and a corresponding system of internal controls designed to ensure that accuracy.

Due diligence procedures for potential investments, joint ventures, and acquisitions designed to determine whether the investment fund is dealing with a sovereign wealth fund or other foreign government entity.

- Due diligence procedures for vetting third party agents and joint venture partners to determine whether there are any red flags indicating that the intermediary might pay bribes to foreign officials, and to monitor the agent's activities and interactions with foreign officials.
- Written agreements with third party agents and joint venture partners concerning FCPA compliance and confirming that those parties do not have any financial relationship with a foreign official. The agreement should also provide for oversight and audit of the agents' or partners' activities, and termination of the relationship in the event a violation is discovered.
- Internal whistleblower procedures by which employees and agents can anonymously report potential FCPA violations without fear of retaliation.

Many of these measures can be incorporated into existing compliance programs (*e.g.*, preexisting AML procedures), to minimize the burden on the private investment fund of enacting or strengthening FCPA compliance measures.

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When a hedge fund or private equity fund identifies a potential FCPA violation, it should immediately consult with counsel. Simply hoping that the problem will go unnoticed poses far too great a risk in today's enforcement environment. A prompt, proactive investigation will allow managers, with counsel's assistance, to determine the best strategic course by which to minimize or eliminate FCPA liability.

[1] 15 U.S.C. §§ 78dd-1, *et seq*.

[2] Dep't of Justice & Sec. Exchange Comm'n, *A Resource Guide to the U.S. Foreign Corrupt Practices Act*, at 20 (2012).

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