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EXPERIENCE FOR TOMORROW

CRCA CONFERENCE

To Have and to Hold: The Compliance Regime – Where are We Today and Where are we Going?:
Preemption in the New Era of Transparency

John J. Carney and Patrick Hannon

Overview

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The Evolving Legal Environment

- Dynamically evolving systemic transparency
- Radical expansion of US jurisdiction
- Aggressive criminalization of noncompliant conduct
- Higher law enforcement governance demands
- Grand jury and “John Doe” access to global payment systems
- Intensifying public sector fiscal pressures
- Multilateral regulatory, investigatory & prosecution cooperation
- Private sector institutional & individual deputation
- OVDP amnesty disclosure incrimination
- Customer compliance no longer “NOT OUR JOB”

The Evolving Legal Environment: Areas of Concern for CCOs

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- ✓ Anti-Corruption
- ✓ Money Laundering
- ✓ Counter Terrorist Financing
- ✓ Cybersecurity
- ✓ Privacy and Data Protection
- ✓ Securities Fraud
- ✓ Sanctions
- ✓ Export Controls
- ✓ Antitrust and Competition

The Evolving Legal Environment: Yates Memo

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- September 9, 2015: Deputy Attorney General Sally Quillian Yates issues a memo "**Individual Accountability for Corporate Wrongdoing**."
- "The rules have just changed. Effective today, if a company wants any consideration for its cooperation, it **must give up the individuals, no matter where they sit within the company**."
- Applies to criminal and civil cases.

The Evolving Legal Environment: Pilot Program

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- One-year program announced on April 5, 2016: The goal of the program is to promote greater accountability for individuals and companies that engage in corporate crime by motivating companies to self-report.

- Program Requirements
  1. Voluntary Self- Disclosure
  2. Full Cooperation
  3. Timely and Appropriate Remediation

"In some way [the Pilot Program] implements the Yates memo, the individual culpability memo, to come up with an operational way to get at that information about individuals that we know is out there."
– Assistant Attorney General Leslie R. Caldwell

The Whistleblower Program: in the News

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Jury Awards $1.6M to Sarbanes-Oxley Whistleblower

U.S. SEC reviewing efforts by some companies to thwart whistleblower awards

Enforcement actions from whistleblower tips have resulted in more than $500 million in financial remedies

Federal Eye

$30 million award to tipster underscores banner year for SEC whistleblower program

IRS Awards Whistleblowers over $315 Million

This Is Not a Test: The CFTC Joins the SEC and IRS in Awarding Substantial Whistleblower Bounties

April 14, 2016

Justice Department Recovers Over $3.5 Billion From False Claims Act Cases in Fiscal Year 2015

Recoveries Exceed $3.5 Billion for Fourth Consecutive Year

The Whistleblower Program: Statistics

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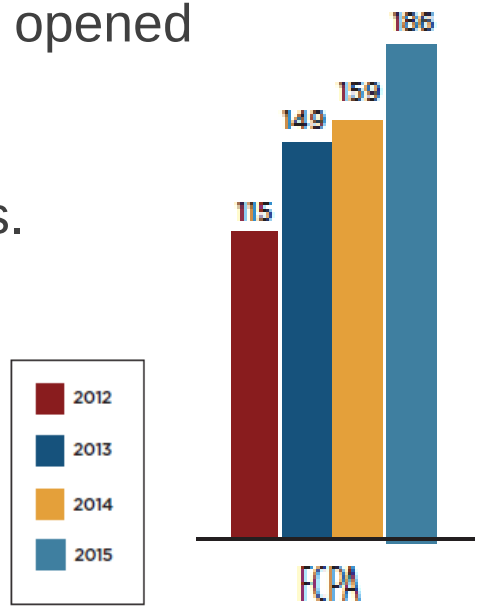
In 2015, the SEC:

- Received nearly **4,000** whistleblower tips, a **25% increase** from 2012.
- Had more than **700** matters in which a whistleblower's tip has caused a Matter Under Inquiry or investigation to be opened or which have been forwarded to Enforcement Staff.
- Paid almost **$38 million** in awards to whistleblowers.
- The majority of tips related to corporate disclosures and financials.

By August 2016, the SEC had awarded over $100 million to whistleblowers. In fiscal year 2016,the SEC awarded more money than all previous years combined.



Increasing whistleblower reports involving the FCPA.

The Whistleblower Program: Global Statistics

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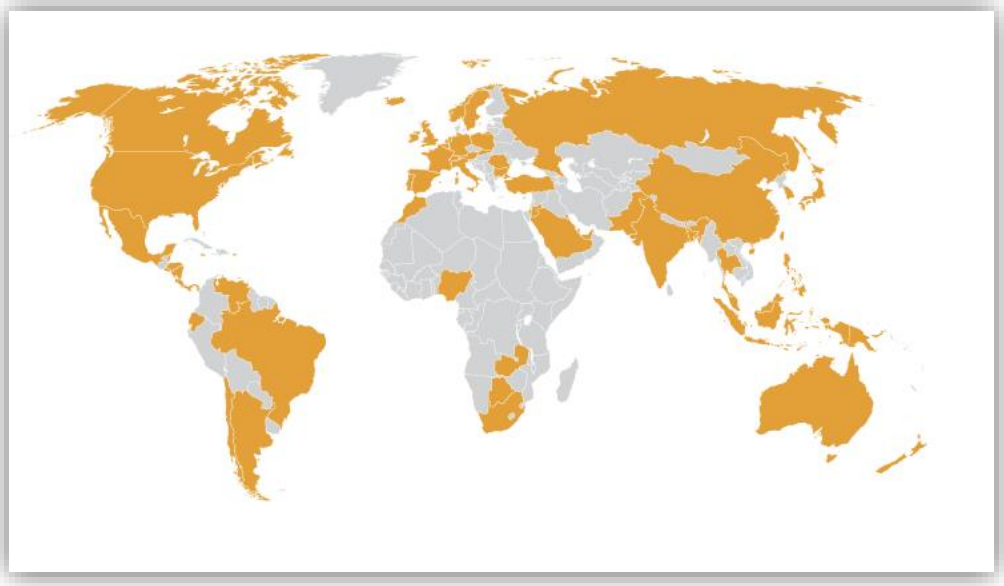
- The SEC has received **over 14,000** whistleblower tips from individuals in **95** countries



- The SEC is increasingly awarding whistleblowers in foreign countries – there have been 8 such awards, including the largest award to date, $30 million.

The Whistleblower Program: 'Top 10' Awards

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2016

- September 20: $4 million
- August 29: $22 million
- June 9: $17 million
- May 17: $5 million to $6 million
- May 13: $3.5 million
- March 8: $2 million

Whistle-Blowing Insiders: 'Game Changer' for the S.E.C.

White Collar Watch
By PETER J. HENNING SEPT. 6, 2016

2015

- July 17: $3 million
- April 22: $1.4 million to $1.6 million

2014

- September 22: $30 million to **a foreign whistleblower**

2013

- September 30: $14 million

The Whistleblower Program: Aheuser-Busch InBev (2016)

Belgium-based company settled allegations of violations of the FCPA and Whistleblower Protection Laws

- FCPA violations: wholly-owned Indian subsidiary's use of third-party promoters to make improper payments to government officials in India to induce the officials to increase sales of Anheuser-Busch InBev products and approve extended brewery hours.
  - Lack of internal accounting controls to detect and prevent improper payments, ***despite repeated complaints from employees***
  - Failure to ensure payments to promoters were properly recorded in the company's books and records
- Whistleblower Protection Law violations: after employee of the subsidiary complained of potential FCPA violations, the employee was terminated. After mediation, the company and employee entered into a Separation Agreement that impeded the employee's ability to communicate with the SEC about potential securities law violations.

Major Criminal Cases Involving Financial Institutions

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UBS

- Deferred prosecution agreement ("DPA") on charges of conspiring to defraud US by impeding IRS
- Agreed to provide US with identities of and account information for certain US customers of its cross-border business
- Agreed to exit business of providing banking services to US clients with undeclared accounts
- Agreed to pay $780 million in fines, penalties, interest and restitution
- Admissions:
  - In 2000, after it purchased US brokerage firm Paine Webber, UBS voluntarily entered into qualified intermediary agreement with IRS requiring UBS to report to IRS income and or identifying information for US clients holding US securities; agreement also required UBS to withhold income taxes from US clients who directed investment activities in foreign securities from US; in order to evade reporting requirements, UBS employees and managers with knowledge of UBS executives, helped US taxpayers open new accounts in nominee and/or sham entity names; assets of individual accounts were then transferred to newly created accounts, as to which US taxpayer would not be identified as beneficiary
  - UBS bankers routinely traveled to US to market Swiss bank secrecy to US clients interested in attempting to evade US income taxes; in 2004 alone, Swiss bankers traveled to US approximately 3,800 times to discuss clients' accounts; UBS managers and employees used encrypted laptops and counter-surveillance techniques to help prevent detection of marketing efforts and identities and offshore assets; US clients in turn filed false tax returns omitting income earned on Swiss accounts and failed to disclose existence of accounts to IRS

Major Criminal Cases Involving Financial Institutions

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Wegelin & Co.

- Guilty plea (not DPA) to conspiring with US taxpayers and others to hide more than $1.2 billion in secret Swiss bank accounts and income generated accounts from IRS
- Agreed to pay $20 million in restitution to IRS and pay $22 million fine
- Agreed to civil forfeiture of additional $15.8 million, representing fees earned on undeclared US taxpayer accounts
- Terminated all banking business and operations
- Admissions:
  - Although it had no branches outside Switzerland, it directly accessed US banking system through correspondent bank account with UBS in Stamford, Connecticut
  - In 2008 and 2009, opened and serviced dozens of new undeclared accounts for US taxpayers in effort to capture clients lost by UBS in wake of reports UBS was being investigated by US authorities for helping US taxpayers evade taxes and hide assets
  - Senior management decided to capture illegal business UBS had exited; employees told US taxpayer-clients that undeclared accounts would not be disclosed to US authorities because of bank's long tradition of secrecy; bank also emphasized that, unlike UBS, it had no offices outside of Switzerland and was therefore less vulnerable to US law enforcement pressure
  - Opened and serviced undeclared accounts for US taxpayer-clients in names of sham corporations and foundations in Liechtenstein, Panama, Hong Kong and other jurisdictions to conceal client identities from IRS
  - Accepted documents falsely declaring sham entities were beneficial owners of accounts, when in fact accounts were beneficially owned by US taxpayers, and made documents part of client files
  - Permitted US clients to open and maintain undeclared accounts using code names and numbers to minimize references to actual names of US clients on Swiss bank documents
  - Prevented account statements and mail for US clients from being mailed to US
  - Corresponded with US clients using personal email accounts to reduce risk of detection by law enforcement
  - Issued checks drawn on and executed wire transfers through US correspondent bank account for US clients with accounts at Wegelin and at least two other Swiss banks; separated transactions into batches of checks or wire transfers in amounts less than $10,000 to reduce risk that IRS would detect undeclared accounts

Major Criminal Cases Involving Financial Institutions

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Credit Suisse

- Pled guilty to conspiracy to aid and assist US taxpayers in filing false income tax returns and documents with IRS
- Agreed to pay $2.6 billion in penalties and fines
- Previously paid $196 million in disgorgement, interest and penalties to SEC for unlawfully providing cross-border brokerage and investment advisory services to US clients without registering as broker-dealer with SEC
- Admissions:
  - Assisted clients in using sham entities to hide undeclared accounts
  - Solicited IRS forms (W8-BEN) that falsely stated, under penalties of perjury, that sham entities were beneficial owners of assets in accounts
  - Failed to maintain US records related to accounts
  - Destroyed account records sent to US for client review
  - Used Credit Suisse managers and employees as unregistered investment advisors on undeclared accounts
  - Facilitated withdrawals of funds from undeclared accounts by providing hand-delivered cash in US or using Credit Suisse's US correspondent accounts
  - Structured fund transfers to evade currency transaction reporting requirements
  - Provided offshore credit and debit cards to repatriate funds in undeclared accounts

Major Criminal Cases Involving Financial Institutions

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Bank Leumi

- DPA for conspiracy to aid and assist US taxpayers in preparing and filing false tax returns by hiding income and assets in accounts in Israel, Switzerland and elsewhere
- Agreed to pay $270 million penalty
- Agreed that subsidiaries will cease providing banking and investment services to US taxpayers
- Admissions:
  - Sent private bankers from Israel and elsewhere to meet secretly with US clients at hotels, parks and coffee shops to discuss offshore account activity
  - Assisted US clients in using nominee corporate entities in Belize and other foreign jurisdictions to hide undeclared accounts
  - Used Bank Leumi le-Israel Trust Company as a nominee for US clients with accounts in Israel to conceal true beneficial ownership
  - Maintained US clients' undeclared offshore accounts under assumed names or numbered accounts to conceal true beneficial ownership
  - Provided hold-mail services so correspondence and account information would not reveal existence of undeclared offshore accounts
  - Extended loans to clients in US collateralized by assets in their offshore accounts, so clients could leverage offshore assets to obtain capital in US while keeping foreign account collateral undetected by US government
  - Opened and maintained accounts for US taxpayers who fled UBS and other Swiss banks to avoid detection by US government

Major Criminal Cases Involving Financial Institutions

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BNP Paribas

- Pled guilty to conspiring to violate International Emergency Economic Powers Act and Trading with Enemy Act, for processing billions of dollars of transactions through US financial system on behalf of Sudanese, Iranian and Cuban entities subject to US economic sanctions from 2004 through 2012
- Agreed to forfeit $8.8 billion, pay criminal fine of $140 million, cooperate with US authorities, and be subject to five-year term of probation, during which bank must enhance compliance policies and procedures pursuant to settlement agreements with Federal and NY State Department of Financial Services
- Admitted to knowingly and willfully moving more than $8.8 billion through US financial system in violation of US embargo from 2004 through 2012

DOJ's Heightened Expectations

- Too many firms "BEHIND THE CURVE"
- Not sufficient simply to address regulatory risk and potential legal violations in compliance programs
- Must be designed to protect reputation, customers, counterparties and "the public," as well as ensure compliance with law
- Examine all business lines, not just those subject to regulation
- Government skeptical of claims that "particular course of conduct took us by surprise"

DOJ's Heightened Expectations

- Hallmarks of effective compliance programs:
  - Proactive & preemptive, not reactive
  - Ensure senior leaders provide strong, explicit, visible support & enforcement of policies
  - DOJ looks beyond "paper" policies & examines all internal & external communications reflecting compliance culture
  - Senior executives must be responsible for implementation oversight, with authority, funding, resources & *independence*

DOJ's Heightened Expectations

- Active investigation of alleged violations of policies
- Confidential internal reporting system
- Robust mechanisms for incentivizing compliance internally & disciplining violations at every level of firm
- Active sensitizing of customers, counterparties, vendors & consultants regarding compliance expectations, including termination of relationships when appropriate
- Compliance with laws of all countries in which firm operates or with which it transacts

Corporate Criminal Liability: Basic Rules

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- Long-established common law agency principles
- Culpable knowledge & acts
- Willful blindness

Corporate Criminal Liability: Agency Principles

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- **US v. NY Central & Hudson RR Co** (US Supreme Court 1909)
  - "We see no valid objection in law, and every reason in public policy, why the corporation which profits by the transaction, and can only act through its agents and officers, shall be held punishable because of the knowledge and intent of its agents to whom it has entrusted authority to act in the subject matter, and whose knowledge and purposes may well be attributed to the corporation for which the agents act."
  - "And this is the rule when the act is done by the agent in the course of his employment, although done wantonly or recklessly or against the express order of the principal."

Corporate Criminal Liability: Culpable Knowledge & Acts

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- **US v. Bank of New England** (US Court of Appeals 1987)
  - "Corporations compartmentalize knowledge, subdividing the elements of specific duties and operations into smaller components. The aggregate of those components constitutes the corporation's knowledge of a particular operation. It is irrelevant whether employees administering one component of an operation know the specific activities of employees administering another aspect of the operation."
  - "A corporation cannot plead innocence by asserting that the information obtained by several employees was not acquired by any one individual who then would have comprehended its full import. Rather the corporation is considered to have acquired the collective knowledge of its employees and is held responsible for their failure to act accordingly."

Corporate Criminal Liability: Culpable Knowledge & Acts

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- US, UK and similar legal regimes charge financial institutions with knowledge of what agents actually know or have reason to know
- These doctrines play key roles in DOJ, IRS, SEC and other law enforcement investigations of and proceedings against financial institutions suspected of participating in, assisting or facilitating criminal or civil misconduct
- Financial institutions may also be charged with culpable knowledge under the doctrine of “conscious disregard” or “willful blindness”

Corporate Criminal Liability: Willful Blindness

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- Most criminal statutes require proof that defendants act intentionally, knowingly or willfully
- However, defendants cannot escape liability by denying awareness of criminal facts strongly suggested by the circumstances.
- **US v. Jinwright** (US Court of Appeals 2012)
  - "To allow the most clever, inventive, and sophisticated wrongdoers to hide behind a constant and conscious purpose of avoiding knowledge of criminal misconduct would be an injustice in its own right."

Corporate Criminal Liability: Selected Statutes & Regulations

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- **Internal Revenue Code, Title 26**
  - § 7201. Attempt to evade or defeat tax
  - § 7203. Willful failure to file return, supply information, or pay tax
  - § 7206. Fraud and false statements
  - § 7212. Attempts to interfere with administration of internal revenue laws

- **Crimes, Title 18**
  - § 2. Principals
  - § 4. Misprision of felony
  - § 371. Conspiracy to commit offense or to defraud United States
  - § 1001. Statements or entries generally
  - § 1341. Frauds and swindles
  - § 1343. Fraud by wire, radio, or television
  - § 1510. Obstruction of criminal investigations
  - § 1519. Destruction, alteration, or falsification of records in Federal investigations and bankruptcy
  - § 1962. (RICO) Prohibited activities
  - § 1956. Laundering of monetary instruments
  - § 1957. Engaging in monetary transactions in property derived from specified unlawful activity

- **Money & Finance, Title 31**
  - § 5314. Records and reports on foreign financial agency transactions
  - § 5322. Criminal penalties
  - 31 C.F.R. § 1010.350

- **Internal Revenue Code, Title 26, §1.1441-1(e)(5)**

Corporate Criminal Liability: Limiting the Risk

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- DOJ prosecutorial policies in US Attorneys Manual set forth factors considered when deciding whether to investigate and prosecute, or negotiate plea, non-prosecution or deferred prosecution agreements with business organizations

- Among the significant factors are:
  - Pervasiveness of wrongdoing, including complicity in wrongdoing by management
  - History of similar misconduct
  - Willingness to cooperate in investigation of agents
  - Effectiveness of pre-existing compliance program
  - Timely and voluntary disclosure of wrongdoing
  - Remedial actions, including
    - Efforts to implement effective compliance program or improve existing one
    - Replace responsible management
    - Discipline or terminate wrongdoers
    - Pay restitution
    - Cooperate with relevant government agencies
  - Adequacy of prosecution of individuals responsible for corporate malfeasance

- In criminal tax context, DOJ Tax Division has traditionally had strong preference for prosecuting responsible individuals

- DOJ has recently emphasized more generalized policy focusing on ensuring individual accountability for corporate criminal conduct and requiring corporations to cooperate in identifying responsible individuals as condition to obtaining any cooperation credit

DOJ Swiss Bank Program

- Established in 2013 to resolve potential criminal liability of Swiss banks for US customer tax offenses
- To be eligible for non-prosecution agreement with DOJ, bank must not be under investigation by DOJ and must agree to:
  - Make complete disclosure of cross-border activities, including name and function of all individuals who structured, operated or supervised US related accounts
  - Provide detailed account information, including US customers' transfers to and from Swiss accounts, and from and to other secret accounts
  - Cooperate with US requests for more information and retain relevant account records
  - Close recalcitrant US customer accounts
  - Pay penalties equal to 20%, 30% and 50% of account values for periods from and after 2008, subject to certain reductions and adjustments
  - Adopt procedures to prevent employees from helping recalcitrant US customers in further acts of concealment
  - Appoint independent examiner to verify information furnished to DOJ

DOJ & IRS' Access to Account Information

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- OVDI amnesty participants are prime information source for investigation and prosecution of banks, bankers, investment advisors, trustees, directors and accountants
- Grand Jury subpoenas to taxpayers, legitimate and sham entities set up by their banks and other advisors, and service providers are also key disclosure source
- "John Doe" summons for US correspondent bank account records and recipients of offshore funds transferred by offshore banks to taxpayers and their US and offshore service providers generate crucial data
- DOJ, IRS and other US law enforcement agencies' power to obtain correspondent bank records is not dependent on foreign bank physical presence in US:

  All that matters is existence of correspondent account in US
- US government may apply criminal law to, and US courts have jurisdiction of, foreign persons and entities acting abroad when aim of their criminal activity causes harm to US interests

“John Doe” Summons

- IRS increasingly serves “John Doe” summons on financial intermediaries and entities involved in facilitating money transfers for offshore accounts
- Bank of NY Mellon, Bank of America, Citibank, HSBC and JPMorgan Chase recently received demands for correspondent account bank records
- Wells Fargo received summons for similar records relating to CIBC, and UBS received one for Bank Wegelin

“John Doe” Summons

- IRS subpoenaed Federal Reserve Bank of New York, NY Clearing House, Western Union, Federal Express, United Parcel Service, DHL Express and HSBC for offshore bank records
- By demanding NY Clearing House records, IRS in effect demanded records of its Clearing House members, e.g., Banco Santander, Bank of America, Bank of Tokyo-Mitsubishi, BB&T, Capital One, Citibank, Comerica, Deutsche Bank, HSBC, JPMorgan Chase, Key Bank, PNC, RBS, UBS, US Bank, Wells Fargo (and their correspondents)
- By demanding records of Federal Reserve Bank of NY, through which all dollars in global payment system pass, IRS obtained access to immense amounts of information on potentially problematic money transfers

Deferred & Non-Prosecution Agreement Requirements

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- N/DPA is contract between corporation that has engaged in wrongdoing and government, imposing financial sanctions (fines and restitution) and often governance, reporting, operational and monitoring conditions for allotted time
- If corporation abides by conditions, government agrees not to prosecute (NPA) or dismiss filed charges (DPA)
- Preemptive remedial measures adopted by corporation often lead to governmental willingness to consider entering into N/DPA
- Such measures include:
  - Enhanced compliance efforts
  - Internal investigation
  - Cooperation
  - Internal monitoring
  - Reporting & disclosure
  - Training
  - Senior management changes
  - Board changes
  - Personnel creation
  - Employee termination

Protecting Privilege & Confidentiality

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- Attorney-Client Privilege:
  - Protects client seeking legal advice,
  - From professional legal advisor,
  - When communication is made in confidence for that purpose,
  - By client,
  - Without waiver of privilege

Protecting Privilege & Confidentiality

- Waiver of privilege occurs when sharing privileged information with third parties
- **Genentech, Inc. v. US ITC** (US Court of Appeals 1997)
  - Waiver is generally effective even when client may not have intended to waive privilege

Protecting Privilege & Confidentiality

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- **US v. Kovel** (US Court of Appeals 1961)
  - "'That as, by reason of the complexity and difficulty of our law, litigation can only be properly conducted by professional men, it is absolutely necessary that a man should have recourse to the assistance of professional lawyers, and it is equally necessary that he should be able to place unrestricted and unbounded confidence in the professional agent, and that the communications he so makes to him should be kept secret,' Jessel, M.R. in Anderson v. Bank, 2 Ch. D. 644, 649 (1876)."

Protecting Privilege & Confidentiality

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- **US v. Kovel** (US Court of Appeals 1961)
  - "If the lawyer has directed the client to tell his story in the first instance to an accountant engaged by the lawyer, who is then to interpret it so that the lawyer may better give legal advice, communications by the client reasonably related to that purpose ought fall within the privilege; there can be no more virtue in requiring the lawyer to sit by while the client pursues these possibly tedious preliminary conversations with the accountant than in insisting on the lawyer's physical presence while the client dictates a statement to the lawyer's secretary or in interviewed by a clerk not yet admitted to practice. What is vital to the privilege is that the communication be made in confidence for the purpose of obtaining legal advice from the lawyer."

Preemptive Governance & Compliance Strategies

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- To protect reputation and minimize legal risk, preemptive measures must be taken to protect organization, board, management and employees from potential US government investigations
- Key principles
  - Vigilance
  - Diligence
  - Commitment
  - Documentation
  - Preemption
  - Remediation
  - Transparency

Preemptive Governance & Compliance Strategies

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- Independently assess historical ("look back") & current business, compliance and marketing policies & practices
- Analyze historical & current customer risk profiles
- Protect & ensure service providers & consultants' confidentiality and privilege
- Anticipate self-interested customer disclosures
- Demonstrate and document commitment to governance & compliance "best practices"

Preemptive Governance & Compliance Strategies

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- Establish standards and procedures to prevent and detect internal or customer misconduct and achieve “zero tolerance” compliance through rigorous monitoring, training and testing
- Ensure board and senior management exercise robust oversight over internal and customer compliance
- Assign responsibility for internal, customer & third party compliance to empowered senior officers

Preemptive Governance & Compliance Strategies

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- Require that individuals with independent compliance responsibility regularly report to board of directors on effectiveness of compliance program and all significant compliance issues
- Develop and administer meaningful and ongoing testing & training programs
- Regularly disseminate compliance policies and related information to internal personnel and, as appropriate, customers, service providers, vendors and counterparties