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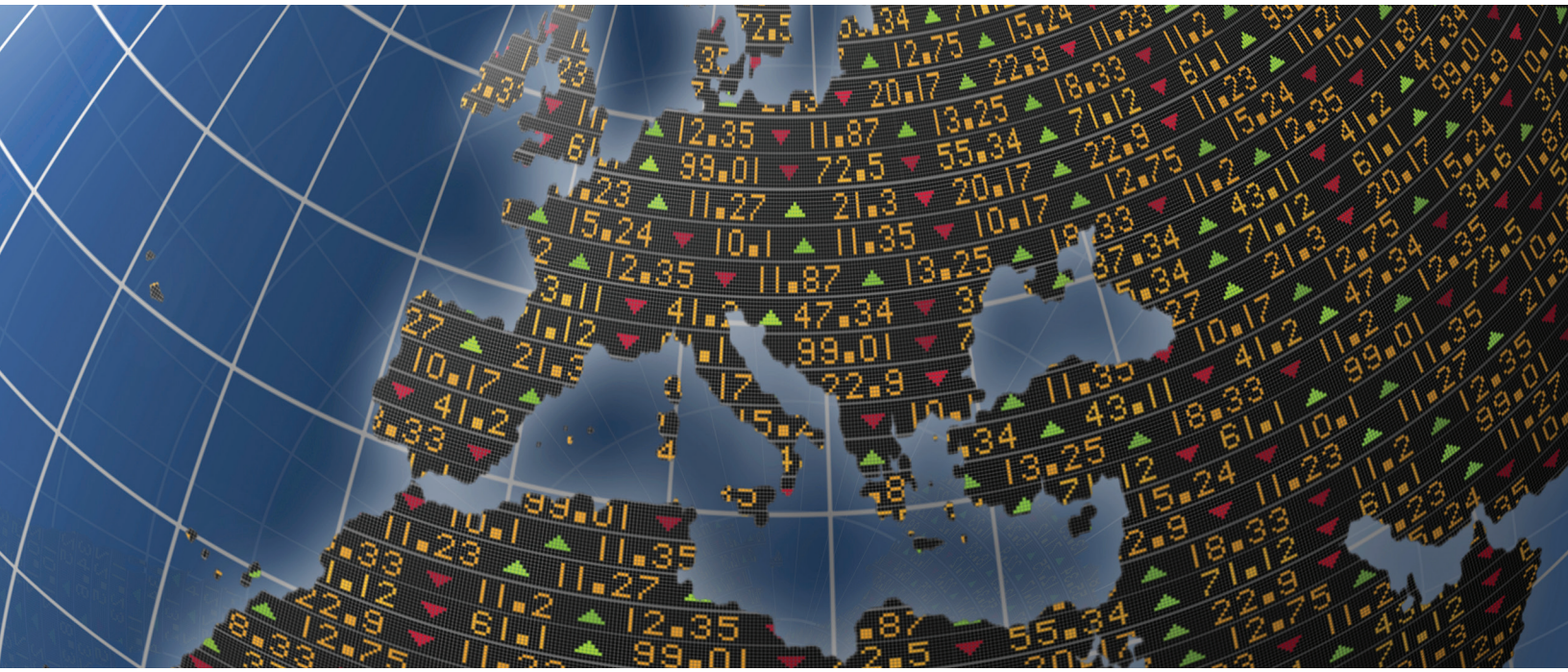

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SEC Brings its First Corporate Anti-Corruption Action of 2022

On February 17, 2022, the SEC brought a settled administrative proceeding under the FCPA against KT Corporation ("KT" or the "Company"), a South Korean telecom operator with American depository shares trading on the New York Stock Exchange.[1] In its Cease-and-Desist Order (the "Order"), the SEC found that KT engaged in multiple schemes to make improper payments in Korea and Vietnam, including through purported charitable donations and third-party payments. The SEC also found that KT paid executives inflated bonuses in order to generate slush funds to pay for gifts and illegal political contributions. As a result of the settlement, the Company agreed to pay $6.3 million in disgorgement and civil penalties, and to a two-year reporting obligation.[2] The settlement with the SEC

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1. *In re KT Corp.*, Securities Exchange Act of 1934 Rel. No. 94279, Admin. Proc. File No. 3-20780 (Feb. 17, 2022), https://www.sec.gov/news/press-release/2022-30.
2. *Id.* at 8.

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came several months after the Company and 14 executives were indicted in South Korea for the political contribution scheme.

Of particular note, the KT settlement is the SEC's most recent action involving charitable contributions, and it goes somewhat beyond earlier cases in that the Order does not find that the donations were made as part of any *quid pro quo*. It is also a cautionary tale demonstrating various ways that slush funds can be created.

Political and Charitable Donations in Korea

The SEC found that, between 2009 and 2017, KT employees engaged in a scheme to create slush funds that could be used to make illegal political contributions to Korean politicians. Beginning in 2009, two senior executives paid inflated bonuses to KT employees, who returned the cash to the executives in order to generate a slush fund of approximately $1 million. The cash was kept either in one of the senior executive's personal bank accounts or in a safe on company premises and was used to provide gifts and payments to government officials. According to the Order, KT failed to record the recipients of the gifts and improperly accounted for the funds as bonuses. This scheme was exposed in the South Korean press in 2013, leading to the resignation and indictment of the Company's then-CEO on charges of embezzlement.[3]

The SEC found that, after the bonus scheme was exposed by the press, KT executives shifted to generating slush funds using the purchase of gift cards. A KT employee bulk-purchased gift cards through KT's procurement system from a particular vendor. The vendor converted some of the gift cards into cash, which the SEC found was handed over to the KT employee in a paper bag at a parking lot next to KT's office building in Seoul. These funds were then passed to senior managers and used to make campaign contributions to Korean lawmakers on committees relevant to KT's business, in circumvention of Korean campaign finance laws.

Funds generated from this scheme were used to make a total of almost $400,000 in contributions to 99 lawmakers and candidates for political office. The individual contributions ranged from approximately $900 to approximately $12,500. Another approximately $910,000 from the scheme was allegedly used for "improper entertainment and gift expenses," all of which was generated by gift card expenses improperly recorded as "research and analysis" or "entertainment."[4]

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3. *Id.* ¶ 5.
4. *Id.* ¶¶ 5-9.

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In November 2021, three months before the Order, prosecutors in Seoul indicted fourteen senior KT executives, including its former CEO, for violations of campaign finance laws and embezzlement. The Company was also indicted.[5]

In addition to the political contributions, KT executives also funneled more than $1.6 million to various charitable foundations at the request of senior Korean officials, including former President Park Guen-hye.[6] The SEC faulted KT for not taking any steps to determine if the payments were legitimate charitable donations. According to the SEC, if KT had conducted due diligence, it would have learned that the requests were illegitimate, given that the charitable foundations did not even exist at the time of the requests.[7] Around the same time, KT hired two advertising executives at the urging of officials from the presidential office and altered its internal criteria for selecting advertising agencies in order to hire an agency connected to the charitable foundations. No due diligence was conducted on the individuals, who received a combined total of around $450,000 in salaries, or on the agency, which received $5.88 million in fees.[8]

"The SEC clearly intends to continue to scrutinize charitable donations and expects issuers to develop systems to conduct diligence on recipients of charitable donations, especially where red flags are present."

Payments in Vietnam

The SEC also found that KT engaged in two improper schemes in Vietnam. In the first scheme, in 2014, an employee of KT's Hanoi office allegedly agreed to pay approximately $95,000 to a senior provincial official in order to obtain the contract for a solar cell power system. The SEC found that KT Hanoi arranged for a construction company involved in the project to wire funds to an employee's personal bank account, which were then withdrawn in cash and delivered to the

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5. "KT CEO, company officials indicted on illegal political donations charges," Korea Herald (Nov. 4, 2021), http://www.koreaherald.com/view.php?ud=20211104000823; *see also* Securities and Exchange Commission, "Largest South Korean Telecommunications Provider Agrees to Pay the SEC to Settle FCPA Charges" (Feb. 17, 2022), https://www.sec.gov/news/press-release/2022-30.
6. KT Corporation, Form 20-F at 13-14 (filed April 28, 2017) https://www.sec.gov/Archives/edgar/data/0000892450/000119312517145082/d349157d20f.htm; *see also* Order at ¶¶ 10-11.
7. Order at ¶ 11.
8. *Id.* ¶ 12.

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official at a resort. Four years later, KT reimbursed the construction company, improperly booking the payment as "support/consulting for performance of the business (completed)."[9] The SEC also found that a KT employee used an office credit card to conduct cash-back transactions at a restaurant in Hanoi to generate approximately $3,000 in order to "give money to the public officials so that they can speed up the performance of their duties."[10]

In the second scheme, the SEC found that KT employees used a Vietnamese agent to funnel money to a government official in 2014 and 2015, in order to win a contract to provide technology services to vocational colleges. According to the Order, KT participated in a consortium to bid on the project. A high-level government official introduced KT to a Vietnamese agent. KT understood from its consortium partner that the agent would kick back 7% of its 10% fee to the government official. KT's consortium partner decided that it was not willing to pay the agent's fee, given the risk. KT Hanoi employees then brought on a second consortium partner to retain the agent, in part "in order to conceal the agent from KT's agent review process." KT reimbursed the second consortium partner two years later, reimbursing it for a "site survey for installation."[11]

The SEC ultimately found that KT violated the books and records and internal controls provisions of the FCPA by its actions in Korea and Vietnam. The Company did not receive self-reporting credit, but did receive credit for cooperating with the SEC's investigation by, among other things, providing translations of some relevant documents, providing "certain facts" developed in the Company's own internal investigation, and making some current and former employees available to SEC staff. The SEC's Order also noted the Company's remedial efforts, including terminating employees, enhancing its compliance organization, internal controls, and relevant polices, and increasing anti-bribery training. Despite the fact that the Company's remedial efforts were ongoing, the SEC did not require an independent compliance consultant (its version of a monitor), but instead required the Company to report on the status of its compliance implementation every six months for the next two years.

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9. *Id.* ¶¶ 14-16.
10. *Id.* ¶ 17.
11. *Id.* ¶¶ 18-24.

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Key Takeaways

- The Order is the latest example of the SEC policing charitable contributions. While prior SEC charitable donation settlements involved facts suggesting a clear *quid pro quo*, either in exchange for contracts or avoidance of an administrative penalty, here the link is not as clear.[12] The Order finds internal controls and books and records violations for the failure to diligence charities when donations were made at the "behest" of government officials, without a finding that KT received a specific benefit for the donation. The SEC clearly intends to continue to scrutinize charitable donations and expects issuers to develop systems to conduct due diligence on recipients of charitable donations, especially where red flags are present.
- The use of gift cards in Korea (and the cash-back transactions in Vietnam) highlight the risk that cash equivalents can easily be converted into slush funds. The conduct described in the Order demonstrates that, like payments to travel agencies,[13] anything that can be easily refunded or turned into cash can be misused.
- KT had disclosed some of the Korea-related allegations in its SEC filings beginning in 2014,[14] and included detailed disclosure about the charitable donations since 2017.[15] While there are significant questions around the merits of self-reporting in various circumstances, KT's lack of self-reporting credit serves as a reminder that formal self-reporting is advisable whenever an issuer is already disclosing elsewhere potential conduct that could be seen as violating the FCPA.

Postscript on the South Korean Anti-Corruption Law

The KT Corporation enforcement action is a hit parade of classic FCPA schemes: slush funds derived from bonuses, gift cards, charitable donations, speed money (along with conspicuous avoidance of the facilitation payment exception), and even cash in paper bags.

Given this array of familiar fact patterns, it is notable that the SEC chose not to include a "sons and daughters" allegation. According to press reports, in 2012, a former Korean lawmaker named Kim Sung-tae asked the former CEO of KT to

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12. *See* Colby Smith, Andrew M. Levine, Philip Rohlik, "Charitable Donations as FCPA Violations: SEC Settles with NuSkin over Donation by a Chinese Subsidiary," FCPA Update Vol. 8, No. 2, at 15 (Sept. 2016) (discussing prior charitable donation cases).
13. *See In re GlaxoSmithKline*, Securities Exchange Act Rel. No. 79005 (Sept. 30, 2016), https://www.sec.gov/litigation/admin/2016/34-79005.pdf.
14. KT Corp., Form 20-F at 13 (filed Apr. 28, 2014), https://www.sec.gov/Archives/edgar/data/0000892450/000119312514162033/d710660d20f.htm.
15. KT Corp., Form 20-F at 13-14 (filed Apr. 28, 2017), https://www.sec.gov/Archives/edgar/data/0000892450/000119312517145082/d349157d20f.htm.

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hire his daughter, who was already working part-time at KT, as a full-time employee. In exchange (according to press reports), the lawmaker protected the former CEO from being called as a witness for a parliamentary inquiry. Kim's daughter received the job, and Kim was later charged with receiving a bribe. The district court acquitted Kim in 2020 on the grounds that he did not receive the benefits (his daughter did) and therefore did not receive a bribe under South Korean law. The court of appeals reversed the district court, holding that, under social norms, hiring a daughter amounted to a benefit to Kim (and therefore a bribe). This interpretation of South Korean law was affirmed by the South Korean Supreme Court and reported in the press on February 17, 2022, the same day as the Order.[16]

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16. "Top court confirms suspended prison term for ex-lawmaker in daughter's hiring scandal," Korea Herald (Feb. 17, 2022), http://www.koreaherald.com/view.php?ud=20220217000575.

UK Economic Crime Act Strengthens Anti-Money Laundering and Sanctions Framework

On March 15, 2022, the United Kingdom's long-anticipated Economic Crime (Transparency and Enforcement) Act received royal assent.[1] It had been introduced on March 1 and fast-tracked through Parliament in response to recent events.

As outlined below, the Act is an important step in strengthening certain aspects of the UK's anti-money laundering and sanctions laws, especially by making it easier to identify and seize property obtained through illicit funds. However, effective enforcement of its provisions is likely to present a major challenge for UK authorities.

Unmasking Property Ownership

Previously, owners of real estate in the UK were able to conceal their identities by holding property through an overseas legal entity or a web of legal entities, leading to significant money laundering risk. It has been reported that there are over 95,000 UK properties, worth about £5 billion, owned by overseas companies. While UK companies are required to disclose their ultimate owners or controllers (with that information publicly available through Companies House), overseas companies were not subject to similar obligations.

The extensive and opaque ownership of UK property by individuals with criminal affiliations or close links to foreign governments has long been criticized, but it has not been a priority for concrete government action until now. The Act aims to uncover foreign property ownership, enabling UK authorities to target owners using measures such as unexplained wealth orders ("UWOs").

The key features of the Act are summarized below:

- Within six months, any overseas legal entity that owns UK property must register with Companies House if it took ownership of the property after January 1999. Failure to do so will be a criminal offence potentially rendering every officer of the entity liable to a two-year prison sentence.
  - For any property purchased by an overseas entity after the Act takes effect, the entity must be registered with Companies House.
  - For any property purchased by an overseas entity since January 1999, unless the entity is registered with Companies House, the property cannot be sold (except in very limited circumstances).

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1. Economic Crime (Transparency and Enforcement) Act 2022, https://www.legislation.gov.uk/ukpga/2022/10/contents/enacted.

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- Registration with Companies House involves providing specified information regarding the overseas entity and its beneficial owner(s)—including their name, date of birth, nationality and usual residential address. This information must be updated annually. Legal entities (including trusts) and government authorities may be beneficial owners, not just individuals; however, they also need to be registered, which should result in the individual who ultimately owns a property being identifiable.
  - A "beneficial owner" is a person or entity who (directly or indirectly) holds more than 25% of the shares or voting rights, has the right to appoint or remove the board of directors, or has the right to exercise significant influence or control over the entity.
- These obligations are reinforced by a requirement that the overseas entity must take "reasonable steps" to identify any beneficial owners and obtain the relevant information by giving them (and any others who might know the beneficial owner's identity) an information notice. Failure to comply with an information notice, or making a false statement, is a criminal offence punishable by up to two years' imprisonment.
  - Regulations supplementing the law will require the overseas entity to undertake a verification process regarding the information before registration.
- The new register will be publicly accessible, although a beneficial owner's date of birth and residential address will not be shown.

Bolstering the Unexplained Wealth Orders Regime

UWOs are a means of requiring individuals suspected of holding criminal property to explain how it was obtained; a failure to satisfy the terms of a UWO will lead to the presumption that the property is criminal property liable to recovery by UK authorities.[2] The Act sets out some changes to the UWO regime, including:

- Allowing UWOs to be issued to any responsible officer of a corporate entity, for property that is held through offshore or trust structures.
- Extending the period potentially available to the authorities to decide what further enforcement or investigatory proceedings they wish to take once the property is subject to an interim freezing order. Previously, the authorities had up to 60 days to make this decision from the date that the subject of the UWO provided the information requested. Now, with a court order, the authorities will now have up to 186 days.

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2. *See* Debevoise & Plimpton LLP, "UK Criminal Finances Act 2017" (May 9, 2017), https://www.debevoise.com/insights/publications/2017/05/uk-criminal-finances-act-2017; Debevoise & Plimpton LLP, "UK Unexplained Wealth Orders: English High Court Puts National Crime Agency to the Test" (April 16, 2020), https://www.debevoise.com/insights/publications/2020/04/uk-unexplained-wealth-orders-english-high-court.

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- Preventing a court from ordering the authorities to pay the legal costs incurred by the subject of the UWO, unless the authority had acted unreasonably, dishonestly, or improperly in conducting its unsuccessful case. This is intended to encourage the authorities to apply for UWOs more often and take on "difficult" cases, as they have been heavily criticized for the limited use of UWOs so far: only nine UWOs have been obtained since their introduction in 2017, and none since the end of 2019.

"[T]he Act is an important step in . . . making it easier to identify and seize property obtained through illicit funds. However, effective enforcement of its provisions is likely to present a major challenge for UK authorities."

Expanding Civil Liability for Sanctions Breaches

Another important feature of the Act is that it will make it significantly easier for the Office of Financial Sanctions Implementation ("OFSI") within HM Treasury to impose monetary penalties for breaching financial sanctions obligations. Previously, liability required the target of OFSI's investigation to know or have reasonable cause to suspect that it was in breach of sanctions laws. Now, OFSI will not need to demonstrate knowledge or suspicion of a sanctions breach. Civil sanctions breaches are now subject to strict liability.

This creates a disparity between how sanctions will be enforced by OFSI on a civil penalty basis compared to criminal penalties. It will also give OFSI an incentive to pursue civil penalties, as they will effectively have a "lower hurdle" of proof. It appears that this expansion of civil liability for sanctions breaches is modelled on the system in the United States, where the Office of Foreign Assets Control has a strict liability regime and a strong track record of enforcement action. It may be that OFSI was finding it difficult to show that targets of its investigations had reasonable cause to suspect that funds or economic resources were sanctioned: it remains to be seen whether the removal of this safeguard will result in a significant uptick in civil enforcement action from OFSI.

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Analysis

The Act has undoubtedly given UK authorities significant new intelligence tools and powers in combating money laundering and sanctions breaches; however, it raises equally significant questions.

The UK already has some of the world's most stringent financial crime laws. Historically, the difficulty has been a track record of enforcement that has ranged from patchy to poor. Considerable resources will be required to make use of the greater transparency regarding property ownership in terms of investigating the information, initiating UWOs and taking action for failures to comply with the disclosure requirements. The six-month transition period for registration, although an improvement on the 18-month period that was originally proposed, still allows ample opportunity for circumvention.

In addition, more resources and expertise will be needed at Companies House, which has gained an increasingly important role in the last few years. The UK government has announced plans to expand its responsibilities further, including requiring it to verify the identity of directors and beneficial owners of legal entities and enabling it to challenge the information it receives.

Notably, the Act does not include the long-delayed "failure to prevent economic crime" offence. It is expected that this is being accelerated and will be introduced in the coming months. The government has also indicated that further reforms to the UK's money laundering regime to build on the Act will be implemented in the near future.

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