U.S. SECURITIES AND EXCHANGE COMMISSION LAUNCHES PROBE OF FINANCIAL INSTITUTION DEALINGS WITH SOVEREIGN WEALTH FUNDS

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To Our Clients and Friends:

Last week, *The Wall St. Journal*, *The New York Times* and other news outlets reported that the U.S. Securities and Exchange Commission ("SEC") has launched an investigation into possible violations of the Foreign Corrupt Practices Act ("FCPA") by financial institutions, including banks, hedge funds, and private equity firms that have sought investments from or partnerships with sovereign wealth funds.

The reports describe the investigation as being in its infancy and suggest that some financial institutions have already received document preservation letters from the SEC. If accurate, the reports suggest that the SEC may be engaged in its latest industry-wide probe, on the heels of investigations of the oil and gas, freight forwarding, and pharmaceutical industries, among others.

We recommend that financial firms that have not already done so conduct a risk assessment to determine whether they have made or promised payments or conferred benefits, including travel or entertainment, in connection with efforts to transact business with sovereign wealth funds. Firms should also review their compliance policies and procedures to ensure that they are designed to prevent violations, by themselves or through indirect dealings via their agents, of the FCPA involving sovereign wealth funds or otherwise.

GENERAL SCOPE OF THE FCPA

The FCPA prohibits, among other things, payments by or on behalf of (1) issuers whose securities are registered on U.S. exchanges, (2) U.S. nationals, resident aliens, or entities that are organized under the laws of any of the states or territories of the United States or whose principal place of business lies within the United States ("domestic concerns"), or (3) any individuals or entities using the instrumentalities of U.S. interstate commerce, directly or indirectly, in each case, to "any foreign official for the purpose of inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality." 15 U.S.C. §§ 78dd-1(a)(1)(B), 78dd-2(a)(1)(B), and 78dd-3(a)(1)(B).

Although the FCPA has been on the books for nearly 35 years, in recent years we have witnessed an explosive growth in enforcement of its provisions, with fines, penalties, and disgorgement payments in 2010 totaling roughly $1.8 billion, as well as in prosecutions of individuals. The consequences are often only the tip of anti-bribery enforcement costs, which can include costs to address regulatory inquiries in other jurisdictions, litigation by shareholders, debarment proceedings, and additional collateral consequences.

The SEC's jurisdiction over "issuers" pursuant to 15 U.S.C. § 78dd-1 is considerably augmented by the agency's jurisdiction over the books, records, and internal controls of "issuers" under the Securities Exchange Act of 1934 ("1934 Act"). 15 U.S.C. § 78m(b). Issuers whose subsidiaries or affiliates are alleged to have paid bribes (regardless of whether those bribes can be prosecuted otherwise) are often charged with mischaracterizing in their books and records the nature of the underlying transactions related to the bribe payments and failing to implement appropriate internal controls, making corrupt conduct abroad a virtually strict-liability civil offense.

The SEC has independent books and records oversight authority over Registered Investment Advisers ("RIAs") pursuant to Section 204 of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-4, and this oversight authority could be used to generate information relevant to the enforcement of the FCPA.

If an RIA is not an "issuer" under the 1934 Act, it and its employees may still be subject to enforcement by the U.S. Department of Justice ("DOJ") of the FCPA's anti-bribery mandates that apply to domestic concerns and the transaction of business using the instruments of U.S. interstate commerce.

Entities planning to register as RIAs as required by the Dodd-Frank Act or otherwise may also find the SEC's recent actions relevant. Such new registrants may be called on to understand and report to the SEC on their dealings with sovereign wealth funds and could come under scrutiny by the SEC, the DOJ, or both, as a result. The SEC may share with the DOJ information it receives through the RIA registration or reporting process that is relevant to FCPA compliance.

So far, it does not appear from the published press reports that the DOJ has opened its own independent investigation into interactions with sovereign wealth funds, but the DOJ often acts in coordination with the SEC and could undertake such an independent review at any time.

ARE EMPLOYEES OF SOVEREIGN WEALTH FUNDS "FOREIGN OFFICIALS" UNDER THE FCPA?

According to the U.S. authorities, "Yes." The FCPA defines a "foreign official" as "any officer or employee of a foreign government or any department, agency or instrumentality thereof." 15 U.S.C. § 78dd-1(f)(1)(A). The SEC and the DOJ have long interpreted this definition – specifically, who is an employee of a government "instrumentality" – broadly to cover not just government officials, but also employees of state-owned entities, even if employees or entities do not perform what would commonly be perceived to be government functions. Thus, the SEC and DOJ have applied the FCPA to employees of a government-owned bank in Argentina, employees of state-owned oil and oil services companies in Nigeria and Angola, and, most recently, employees of a telecommunications company in Malaysia in which the government held a 43% ownership stake. Thus, employees of any enterprise, organization, or firm controlled by a non-U.S. government entity in fact are likely to be viewed as "foreign officials" under prevailing practice.

Whether the SEC's and DOJ's broad interpretation of "foreign official" under the FCPA – which has not as yet been tested in the courts – is correct and consistent with the FCPA's legislative history is debatable. Nevertheless, it is very likely that U.S. authorities will view sovereign wealth fund employees as "foreign officials" for FCPA purposes.

A sovereign wealth fund is, by definition, a *state-owned* investment fund. Whether the fund consists of assets held by a central bank or by the national government itself, employees of the sovereign wealth fund would fit squarely within the definition of "foreign officials" employed by U.S. authorities in a variety of prior cases.

THE LIKELY FOCUS OF THE SEC INQUIRY

The SEC appears to be investigating whether banks, hedge funds, or private equity firms, in seeking investments in their firms or in the funds they manage from, or partnerships with, sovereign wealth funds, made or promised to make payments – directly or indirectly – to sovereign wealth fund employees. Payments, as used here, include in-kind benefits, such as travel or entertainment. Indirect payments would include payments to placement agents, consultants or other third parties, while knowing or deliberately disregarding that the payee would pass monies on to a foreign official to secure access to or benefits, such as an investment or an asset purchase, from the sovereign wealth fund. Enabling a sovereign wealth fund employee or related party to co-invest alongside a sovereign wealth fund could also be considered a payment to that employee.

NEXT STEPS

To the extent that they have not already done so, firms should conduct an immediate risk assessment to determine whether they have made or promised to make payments or conferred benefits (in the form of travel or entertainment benefits, in particular) in connection with efforts to transact business with sovereign wealth funds. If placement agents or other third-parties were involved in the transactions, further inquiry is likely warranted.

If transactions with sovereign wealth funds are being contemplated but have not been consummated, it behooves firms to ensure that (1) they have conducted sufficient due diligence with respect to any third parties engaged to assist in the transaction and (2) any third-party contracts contain sufficient anti-corruption representations, covenants, and audit rights needed to provide comfort that monies or other benefits will not be improperly passed on to fund officials.

Finally, firms engaging in transactions with sovereign wealth funds (or other state-owned entities) must have robust compliance programs, including clearly-articulated policies, training, and testing, to reduce the risk of FCPA violations occurring and mitigate any penalties imposed in the event violations do occur.

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