Ethics and the capital markets

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Anti-money laundering ("AML")
International Initiatives concerning Lawyers

Financial Action Task Force ("FATF")

FATF is an independent inter-government body that develops and promotes policies to protect global financial systems against money laundering, terrorist financing and the financing of the proliferation of weapons of mass destruction. The FATF recommendations “are recognized as the global anti-money laundering (AML) and counter terrorist financing (CFT) standard”

40 recommendations for fighting money laundering

FATF June 2013 report ‘Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals’ found that criminals seek out involvement of lawyers in ML/TF activities

The report identifies “unique features” of the legal sector including its ethical obligations, ability to hold client funds, its duty of confidentiality/privilege/secrecy
International Initiatives (continued)

It also identifies “vulnerabilities” through the use of client accounts, purchase of property, creation of trusts or companies and setting up of charities and purchase of real property

It discusses reports filed by legal professionals, the supervision of legal professionals, red flags, and money laundering typologies

The Solicitors Regulation Authority ("SRA") is now focusing on the forthcoming FATF engagement with UK Government to investigate and produce a report by May 2015. The SRA is highlighting FATF's list of high-risk countries “High Risk and non-co-operative jurisdictions” [http://www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions/](http://www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions/)

International Initiatives (continued)

European Union Moneylaundering (“ML”) Directives

**Fourth Money Laundering Directive (2015 implementation expected)**

- The Directive will include more risk-based approach elements, as well as the inclusion of tax crimes as a predicate offence for money laundering

- The rules on PEPs (‘Politically Exposed Persons’) will require enhanced due diligence on PEPs, to consider if a beneficial owner is a PEP. This may include enquiries into the PEPs Company’s funds. Enhanced measures will apply for 18 rather than 12 months after a PEP leaves office. Domestic PEPs, (ie., people with high level appointments in the UK) will be included.

- Other new provisions include written risk assessments and holding records of clients beneficial ownership for inspection by regulators.
UK Legislation, Regulations and Guidance for Lawyers

• Proceeds of Crime Act 2002 (POCA)
  (As amended by the Serious Organised Crime and Police Act 2005 and the Serious Crime Act 2007)

• Terrorism Act 2000
  (As amended by the Anti Terrorism Crime and Security Act 2001 and the Counter-Terrorism Act 2008)

• Money Laundering Regulations 2007
  (As amended by The Money Laundering (Amendment) Regulations 2012)

• Law Society Anti-Money Laundering Practice Note 2013

• Solicitors Regulation Authority (“SRA”) Warning Notices and Alerts

• UK Government:-
  • National Crime Agency Alerts
  • Home Office

New UK Government Initiatives

• 2014 National Crime Agency (“NCA”) Reports
  • “Submitting a Suspicious Activity Report (SAR) within the Regulated Sector” – May 2014
    • Guidance on submitting a SAR, including Reason for Suspicion, Subject Information, and Confidentiality
  • “Closure of Cases requesting consent” September 2014
    • Concerns about quality of consent SARs.
    • From October 2014 UK Financial Intelligence Unit, (“FIU”) will be returning consent SARs if quality is not adequate
New UK Government Initiatives

- New Participation offence, in the Serious Crimes Act, expected in Spring 2015. Test; Reasonably suspect or did suspect – 5 years imprisonment.

- “The new offence will help law enforcers to target the enablers, both professional and non-professional, who help criminals carry out their activities.” (Karen Bradley MP, UK Minister, Law Society Gazette December 1st 2014)

- She adds that solicitors should be aware of FATF red flags and in particular, be on the look out for:
  - Clients who come from a high-risk country or have known criminal connections
  - Clients who are overly secretive about the transaction or uncertain of relevant facts
  - Clients who require payments to third parties
  - Clients who have had a large number of legal advisors in a short space of time
  - Clients who choose legal advisers without specialist experience or at a geographical distance

UK Government

- Transactions that involve a disproportionate amount of private funding, bearer cheques or cash
- A lack of sensible commercial/financial/tax or legal reason for a transaction
- If the retainer relates to using the client account without the provision of legal services

- Government drive on “professional enablers,” part of the new Organised Crime Strategy, includes solicitors, accountants, doctors and others, being monitored by NCA “Professional Enablers Working Group.”

- Home Office ‘prevention and awareness programme’ targets the legal profession. In October 2014, the Home Office launched a campaign specifically aimed at solicitors to deter them and show how not to be unwittingly involved in ML
Regulatory initiatives of the SRA

• Reduction in reports from the legal profession
  
  2007 – 11000  
  2013 – 3600

• Concern about ‘conversion’ of reports

• SRA Working Group on AML

• SRA warning notices
  
  • 8 September 2014 – announcement of thematic review
  
  • 5 November 2014 – publishes AML paper as part of Autumn Risk Outlook (the SARs “assessment of significant trends in the legal services market”)
  
  • 8 December 2014 – two notices, on reporting to NCA and consent SARs, and on FATF warning signs

Regulatory initiatives SRA AML Paper

• AML Paper “Cleaning up – Law firms and the risk of money laundering” November 2014
  
  http://www.sra.org.uk/risk/resources/risk-money-laundering.page#start

  • SRA is working with NCA and Home Office to ensure robust systems in place to guard against law firms becoming involved in money laundering
  
  • List of “Good practices” includes;
    
    • Meeting clients in person to verify identify using original ID where possible
    
    • Taking extra steps to verify identify if you cannot meet the client in person
    
    • Only using the client account to hold client funds for a legal transaction, in accordance with rule 14.5 of the SRA Accounts Rules 2011
    
    • Investigating further when the source of client money is not clear or comes from a high-risk jurisdiction
    
    • Submitting Suspicious Activity Reports (SARs) that adhere to the best practice set out by the NCA, ensuring they are not vague or inaccurate
    
    • Making all relevant individuals aware there is a list of countries that are high risk for money laundering and where to find it. http://www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions/
Regulatory initiatives; SRA AML Paper

- Weak points
  - Failure to check ID
  - Failure to conduct due diligence on source of funds and ultimate beneficial owner

The UK Bribery Act 2010

- Covers active and passive bribery
- Corporate offence of failure to prevent bribery; sole statutory defence is “adequate procedures
- Unlike the US Foreign Corrupt Practices Act it encompasses private as well as FPO bribery
- Facilitation payments are unlawful
- Extra territorial effect and covers overseas companies which have link to the UK
The UK Bribery Act 2010 (continued)

SFO public guidance on a variety of issues, including:
• Impact of self-reporting by companies on any decision to prosecute under the Bribery Act
• The factors it considers when deciding whether or not to prosecute facilitation (“grease”) payments under the Bribery Act

UK Ministry of Justice guidance on the Bribery Act, including:
• How organisations should risk assess and manage their procedures for the “adequate procedures” statutory defence against the offence of failure to prevent bribery
• What constitutes acceptable (and non acceptable) gifts and entertainment
• What constitutes bribery of foreign public officials

UK Anti Bribery Enforcement - Current Themes

• Ongoing investigations into overseas bribery
  • Alstom (UK subsidiary of French company) – charged with 6 counts of corruption and conspiracy under Prevention of Corruption Act 1906 to win transport contracts in India, Poland and Tunisia
  • Rolls Royce – allegations of bribery in Indonesia, China and India to win contracts for their engines, two arrests made but no charges laid by SFO
  • GlaxoSmithKline plc – fined £297m in China for bribing health officials and hospitals to use their products, SFO and DoJ investigating potential breaches of Bribery Act and Foreign Corrupt Practices Act
• Increased number of prosecutions of individuals – substantial sentences of imprisonment
  • Sustainable AgroEnergy – Convictions under Bribery Act for bribery offences of ‘making and accepting a financial advantage’ in relation to £23m bio fuel fraud operation in Cambodia. Terms of imprisonment imposed
  • Financial Conduct Agency (“FCA”) recent themes – third parties, asset managers, retail sector

Others:
• UK private equity industry – increasing levels of counterparty due diligence being carried out by firms as a result of increased FCA oversight in this area
Self-reporting of violations in the UK; Deferred Prosecution Agreements (“DPAs”)

- DPA’s likely to encourage discretionary self-reporting
- DPAs likely to replace recent use of civil resolutions the main alternative to criminal prosecution
- New judicial role
- Multi-jurisdictional settlements

Frameworks designed to encourage self-reporting include:
- Serious Fraud Office (SFO) guidance in relation to Bribery Act
- Enforcement policies of other regulators, including the Financial Conduct Authority (FCA) in relation to the regulated financial services sector
- The UK money laundering regime; obligations and options to report

No single framework, and application of guidance and policies varies on a case-by-case basis
Europe - 2014 European Commission first EU Anti Corruption Report

- Analyses corruption in each EU Member State
- Discusses steps to prevent and fight corruption – follow up measures including mutual experience sharing programme
- Focusses on public procurement
- Defines corruption in broadest sense as “abuse of power for private gain”
- Identifies Members States strengths and weaknesses
- Seeks to promote high standards

(continued)

- Euro barometer and business focussed “flash” surveys – summarises some positive anti bribery perception but concludes that 76% of respondents at European level think that corruption is widespread in their own country, and 73% believe that the use of connections is the easiest way to obtain certain public services.
- Public procurement is particularly prone to corruption in Member States, owing to deficient control and risk management.
- Recommendations for control mechanisms and transparency, and liaison between relevant authorities.
The Bribery Act in the M&A Context

Bribery Act due diligence is critical to reduce risk

M&A transactions should include:

• Reps and warranties that the target has complied with the Bribery Act and other applicable anticorruption laws and regulations
• Termination provisions
• Language regarding the accurate recording of payments
• Antibribery Certification

For the buyer, post-closing compliance systems must be implemented effectively

• Ensure that anti-corruption policies, procedures and controls are implemented at the target
• Not a substitute for due diligence
• Bribery Act corporate offence provides “adequate procedures” as the only defence, with the burden of proof being upon the company.
• Discovering an issue mid transaction; self reporting and remedial action – reducing enforcement risk.

Due Diligence

Due Diligence should be performed before joint ventures, mergers and acquisitions

• Inquire about existing relationships with third parties
• Identify “red flags”
• Investigate the company’s anti-corruption policies and procedures
• Examine the company’s history – has it had prior corruption problems?
• For high risk business also interview senior management
Sanctions

Sanctions - Overview

- Foreign Policy Objectives (an alternative to armed conflict)
- Basic Approaches
  - Export Bans/Restrictions
  - Blocking/Asset Freezes (People/Entities), Specially Designated Nationals (SDNs) (US) or Designated Persons (DPs) (EU)
- Not Just US
  - Increasing coordination US-EU
  - Australia, Canada, Iceland, Norway, Switzerland and others
Sanctions - The Perfect Storm

- 2009 – 2012: Coordination and Amplification of Iran Sanctions
- 2009: Congress lifts fines from a maximum of $11,000 to $250,000 per violation or twice the value of transaction
- Enhanced Enforcement
  - Cooperation by Regulators across borders
  - Whistle blowers
  - Bank/Money Transfers
  - Self Reporting by counterparties
  - Bank due diligence/reporting
  - M&A Transactions

Sanctions (Russia) - Developments

United States
- Executive Order 13660 (March 6, 2014)
- Executive Order 13661 (March 16, 2014)
- Executive Order 13662 (March 20, 2014)
- Directives 1&2 (July 16, 2014)
- Directives 3&4 (September 12, 2014)
- Executive Order 13685 (December 19, 2014)

Europe
- EU Regulation 269/2014 (March 17, 2014)
- Council Regulation No. 833/2014 (July 31, 2014)
- Council Regulation No. 960/2014 (September 8, 2014)
- Council Regulation No. 1290/2014 (December 4, 2014)
- Council Regulation 1351/2014 (December 18, 2014) amending No. 692/2014
Sanctions (Russia) - Jurisdictional Reach

**US**
- US citizens (and green card holders)
- US corporate entities (but not subsidiaries)
- Branches of US entities
- Persons located in the US

**EU**
- EU territory
- Any business done in the EU
- EU corporate entities
- Any EU person or EU entity (or branch) wherever located

Sanctions (Russia) - Sectors Financing

**US**

**Finance Sector (Directive 1)**
- Banks (Sberbank, VEB, VTB, Gazprombank, Bank of Moscow, Russian Agricultural Bank)
- No new equity or debt over 30 days

**Energy Sector (Directive 2)**
- Energy Companies (Gazprom Neft, Novatek, Rosneft, Transneft)
- No debt over 90 days

**Defence Sector (Directive 3)**
- Defence Companies (Rostec)
- No new debt over 30 days

**EU**

**Finance Sector (Article 5)**
- Banks (the same, with Bank of Moscow now included as a subsidiary of VTB)
- No new equity or debt over 30 days

**Energy sector (Article 5)**
- Energy Companies (Gazprom Neft, Rosneft, Transneft)
- No debt over 30 days or new equity ("transferable securities")

**Defence Sector (Article 5)**
- Defence Companies (Oboronprom, United Aircraft, Uralvagonzavod)
- No debt new over 30 days or new equity ("transferable securities")
Sanctions (Russia) - The Impact on SSI Financing

US (OFAC FAQ 371)
• Debt: bonds, loans, extensions of credit, loan guarantees, letters of credit, drafts, bankers acceptance, discount notes or bills, or commercial paper
• Equity: stocks, share issuance, depository receipts, or any evidence of title ownership
• Any financing in support of prohibited new debt or new equity
• Note: “in support of”

Europe (EU Regulation 960/2014)
• Debt/Equity (Transferable Securities): For identified banks/companies, a prohibition, directly or indirectly, to purchase, sell, provide investment services for or assistance in the issue of, or otherwise deal with transferable securities and money market instruments with a maturity exceeding 30 days if issued after September 12, 2014
• Loans/Extensions of credit: For identified banks/companies, a prohibition on directly or indirectly making or being a part of any of any arrangement to make a new loan or credit with a maturity exceeding 30 days after September 12, 2014
• Note: “directly” and “indirectly” AND “investment services”

Sanctions - EU - US Differences

EU
• More than 50 % (or “dominant influence”)
• Energy Companies: new equity and debt exceeding 30 days
• Trade finance exemption but no exemption for Denizbank
• DPs more focused on government and military individuals
• Sunset provision
• Defence: did not know and did not have reasonable cause to suspect

US
• 50% or more
• Energy companies: only debt exceeding 90 days
• Licence for Denizbank but no trade exemption
• SDNs more focused on businesses and business people
• No sunset provision
• Generally, strict liability
Sanctions - Implications

• Many financial products impacted
  • Loans: (pre-existing loans cannot be amended, at least as to maturity, principle amount and interest rate) (OFAC FAQ 394 and EU Regulation 833/2014 5 December 2014). Waivers? Enforcement?
  • Derivatives: Lots of uncertainty, despite OFAC General Licence 1A and EU Guidance Note on EU Regulation 833/2014 5 December 2014
  • Enhanced due diligence: Language to ensure compliance of borrower/issuer and to ensure lender/underwriter not itself put in breach
  • Research on SSI’s?