

# FINANCIAL FRAUD LAW REPORT

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# Fraud Law Developments

MARTIN J. WEINSTEIN, ROBERT J. MEYER, AND JEFFREY D. CLARK

*The authors describe recent enforcement actions, a major settlement in a foreign bribery investigation, and proposed legislation designed to combat fraudulent financial activities in the U.S. and the U.K.*

## **Recent Enforcement Actions by the U.K. Serious Fraud Office and the Introduction of a New U.K. Bribery Bill in Parliament Demonstrate Increased Focus on Corruption**

In 2009, the Serious Fraud Office (the “SFO”) initiated the United Kingdom’s first overseas bribery cases, one against a company and another against an individual business executive. Further, in 2009 a new comprehensive bribery bill intended to simplify and clarify U.K. antibribery law was introduced before Parliament. These developments indicate an increased focus by the U.K. government and enforcement authorities on identifying, investigating and prosecuting acts of overseas bribery involving U.K. companies and/or individuals.

Most recently, on December 1, 2009, the SFO charged Robert John Dougall, former Vice President of Market Development for DePuy International Limited (“DPI”), a U.K.-based subsidiary of Johnson & Johnson,

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with conspiracy to corrupt, in violation of the Criminal Law Act 1977. Following the filing of the charges, Dougall appeared before the City of Westminster Magistrates' Court and was released on bail. He is expected to appear before the Southwark Crown Court in February 2010. Dougall's case was referred to the SFO by the U.S. Department of Justice (the "DOJ") in March 2008 and is believed to be the first case in which the SFO has charged an individual business executive based on allegations of overseas bribery.

The SFO case against Dougall is based on allegations that, from February 2002 to December 2005, Dougall conspired to make corrupt payments or to give other inducements to medical professionals in the Greek public healthcare system in connection with the supply of orthopedic products. These allegations appear to arise out of an ongoing investigation by the U.S. Securities and Exchange Commission (the "SEC") and the DOJ into potential violations of the U.S. Foreign Corrupt Practices Act (the "FCPA") by leading manufacturers of orthopedic products, including Johnson & Johnson and its affiliates, such as DPI. On February 12, 2007, Johnson & Johnson voluntarily disclosed that "subsidiaries outside the United States are believed to have made improper payments in connection with the sale of medical devices in two small-market countries." Johnson & Johnson went on to state that the payments may fall within the jurisdiction of the FCPA and that it would cooperate with the DOJ and SEC reviews of these matters.

In July 2009, a U.K. manufacturer of steel bridge equipment, Mabey & Johnson Ltd., pled guilty to corruption charges based on allegations that the company had sought improperly to influence decision makers on public contracts in Jamaica and Ghana, as well as to charges that the company had breached United Nations sanctions in connection with the Iraq "Oil-for-Food" program. In September 2009, the company was sentenced to pay £6.6 million (\$10.7 million) in fines, confiscations, and reparations and to submit its internal compliance program for review by an SFO approved independent monitor. This resolution was the result of the company's voluntary disclosure to the SFO in February 2008 and was the first prosecution brought by the SFO against a company for overseas corruption. Further, prosecutors in the Mabey & Johnson case indicated that "[a]

number of individuals are the subjects of investigation with regard to the corrupt business practices.”

The SFO has taken steps in order to encourage voluntary disclosures like the one made by Mabey & Johnson. In July 2009, the SFO issued guidance summarizing its approach to self reporting. The guidance was intended to demystify the process of self reporting, which, although increasingly common in the U.S., is unfamiliar in the U.K. The guidance lists various factors that the SFO will consider when it decides how to resolve matters that have been voluntarily reported, including the commitment by a company’s board of directors to “resolving the issue and moving to a better corporate culture” and the preparedness of the company to work with the SFO regarding the scope and handling of any additional investigation. Further, the SFO guidance states that the timing of the disclosure will be a consideration in determining how the matter is to be resolved and specifically notes that, in cases potentially within both U.S. and U.K. jurisdiction, it would expect to be notified at the same time as the DOJ. The SFO guidance also describes the potential benefits of self reporting, such as its preference that self reported cases be resolved civilly rather than criminally, and states that failure to self report might be considered as a negative factor if the SFO discovers a potential violation through other means.

In an open letter addressing questions raised since the July 2009 guidance, the Director of the SFO has provided further clarification on certain issues related to the SFO’s new enforcement approach, most notably concerning the use of compliance monitors and the waiver of the attorney-client privilege and work product protections. The Director confirmed that the SFO will seek to impose compliance monitors in certain cases but stated that the SFO will seek to reach agreement with companies as to an appropriate monitor and the scope of monitoring. With regard to the attorney-client privilege and work product protections, the SFO expects self reporting corporations to produce notes of interviews and factual reports, even if such production may waive otherwise applicable legal privileges. In this respect, the SFO appears to be taking a harder line approach than that associated with current DOJ policy.

The SFO’s recent enforcement efforts appear to be, at least in part, a

reaction to the criticism the SFO and the U.K. government received as a result of their 2006 decision to close a high profile inquiry into allegedly improper payments made by BAE Systems plc (“BAE”) to secure arms contracts in Saudi Arabia. In 2008, the Organisation for Economic Co-operation and Development (the “OECD”) publicly expressed “serious concerns” as to whether the decision to close the BAE inquiry was consistent with the U.K.’s obligations under the OECD Convention on Combating Bribery of Foreign Public Officials (the “OECD Convention”). The OECD Working Group on Bribery stated that it was “extremely disappointed and gravely concerned by the continuing lack of implementation of previous Working Group recommendations...that the UK enact [modern] foreign bribery legislation at the ‘earliest possible date.’” Further, it raised concerns about the SFO’s ability to investigate and prosecute cases effectively.

Perhaps prompted in part by this criticism, the U.K. government has recently taken steps to enact comprehensive antibribery legislation. On March 25, 2009, the U.K. Ministry of Justice published a new draft bribery bill for prelegislative scrutiny. The draft bill was aimed at replacing the existing antibribery legal regime, which has been criticized by Transparency International U.K. as “ineffective and out-of-date.” Since its publication in March, the bill has been revised by the U.K. government in response to recommendations made by a Joint Committee of Parliament and was introduced in the House of Lords on November 19 as the Bribery Bill (the “Bill”).

In addition to clarifying and consolidating U.K. antibribery law, the Bill includes several distinct features that will fundamentally change anti-bribery enforcement in the U.K.:

- The Bill creates a separate offense of bribery of a foreign public official. This is in contrast to the current antibribery laws, which originally were enacted as domestic bribery statutes nearly a century ago and were then amended in 2001 to apply to bribe recipients outside the U.K. Because of their antiquated origins and *ad hoc* development, these laws are often difficult to interpret and apply in the context of overseas bribery cases. The elements of the new offense, however, are

modeled on those outlined in the OECD Convention and more clearly apply to overseas bribery.

- The Bill creates a new corporate offense: “failure of commercial organisations to prevent bribery.” Under this provision of the Bill, a company will be strictly liable for a bribe paid by an employee or agent of the company in order to obtain or retain business or a business advantage for the company, regardless of whether company management knew about or authorized the bribe. However, under the Bill, a company charged with failure to prevent bribery may assert a valid defense if it can prove that it had in place adequate procedures designed to prevent such conduct. The U.K. government has acknowledged that companies will require guidance on key aspects of the Bill, including the “adequate procedures” defense, and has announced that it intends to publish nonstatutory guidance on this and other points before the Bill comes into force.
- Both the Joint Committee and the U.K. government agree that local custom or practice should not be considered when evaluating conduct under the Bill. However, the Bill does create an exception for conduct that is permitted or required under the written law applicable to a foreign public official.
- The Bill increases penalties for bribery, authorizing unlimited fines for companies and a maximum 10 year prison sentence for individuals.
- Finally, it should be noted that, unlike the U.S. Foreign Corrupt Practices Act, neither current U.K. law nor the Bill permits facilitation or “grease” payments. However, both the Joint Committee and the U.K. government stated that in cases where payments are identified that are unlawful but small, they would expect prosecutors to adhere to the “concept of proportionality” in enforcement decisions.

Recent developments in the U.K. indicate an increased focus on the investigation and prosecution of overseas bribery. In addition, they suggest a marked shift toward enforcement procedures and methods typically used by U.S. enforcement authorities in FCPA cases. Specifically, the SFO has expressed a clear preference for self reporting, internal investiga-

tions, and negotiated settlements through its guidance and enforcement decisions. In light of these developments, companies with significant ties to the U.K. should expect to be held to anticorruption and antibribery standards similar to those applied to their U.S. counterparts. They should make certain that they have antibribery compliance programs in place that will adequately detect and prevent overseas corruption and bribery. Moreover, where evidence of improper payments is uncovered, companies with a significant U.K. presence will need to consider whether self reporting in the U.K. is warranted.

### **BAE Reaches Global Settlement with U.S. and U.K. Authorities, Agreeing to Pay \$447 Million in Fines and Ending Five Years of Bribery Investigations**

On February 5, 2010, BAE Systems plc (“BAE”) agreed to plead guilty to charges stemming from foreign bribery allegations investigated by the U.S. Department of Justice (the “DOJ”) and the U.K. Serious Fraud Office (the “SFO”). The BAE settlement represents the first global settlement between the two agencies. In settling charges arising from conduct in Saudi Arabia, the British Virgin Islands, Hungary, the Czech Republic, and Tanzania, the U.K. defense contractor agreed to pay a \$400 million fine to U.S. authorities for conspiring to make false statements and £30 million (approximately \$47 million) to U.K. authorities for failing to keep reasonably accurate accounting records. BAE also agreed to appoint a DOJ approved “ethics monitor” to serve on its marketing advisor panel. The global settlement brings to an end more than five years of investigations by U.K. and U.S. enforcement authorities into allegations of overseas bribery and corruption at BAE.

### **THE INVESTIGATIONS**

The investigations into BAE began after allegations arose in the press in 2003 regarding the use of “slush funds” by BAE to bribe Saudi officials

with gifts, holidays, and cash payments in connection with the “Al Yamamah” deal (Arabic for “*The Dove*”), BAE’s largest weapons contract. In November 2004, the SFO, the U.K. agency charged with prosecuting allegations of foreign bribery, began investigating BAE’s conduct relating to the Al Yamamah deal. The SFO soon expanded its investigation into BAE’s business activities in the Czech Republic, Romania, South Africa, Tanzania, Chile, and Qatar. Further, the SFO’s investigation of the Saudi conduct uncovered evidence of large payments made by BAE into bank accounts controlled by Saudi Prince Bandar bin Sultan, former ambassador to the U.S. In 2006, however, the SFO halted its investigation into the Al Yamamah contracts following warnings from Prime Minister Tony Blair and the U.K.’s ambassador to Saudi Arabia that the inquiry risked causing “serious damage” to national security and antiterrorism cooperation with the Saudi government. The SFO continued to investigate BAE’s business activities in Africa and Eastern Europe.

The SFO’s decision to discontinue its investigation into the Saudi payments was widely criticized. In 2008, the Organisation for Economic Co-operation and Development (the “OECD”) publicly expressed “serious concerns” as to whether the decision to close the BAE inquiry was consistent with the U.K.’s obligations under the OECD Convention on Combating Bribery of Foreign Public Officials. Further, it raised concerns about the SFO’s ability to investigate and prosecute cases effectively. In response to the SFO’s action and public disclosures about certain BAE payments to Prince Bandar and others that were made in the U.S., the DOJ opened its own investigation into BAE in June 2007. In response to a “severe lack of cooperation by BAE,” U.S. officials detained BAE’s then CEO, Mike Turner, and other top BAE executives at U.S. airports for questioning in May 2008.

## THE GLOBAL SETTLEMENT

As part of the global settlement, BAE has agreed to plead guilty in the U.K. to an offense under Section 221 of the Companies Act of 1985 for failing to keep reasonably accurate accounting records in connection with its activities in Tanzania. According to press accounts, the charges

stem from allegations that BAE made corrupt payments to a marketing advisor in Tanzania in connection with a 1999 contract for a military air traffic control system valued at £28 million. The payments to the marketing advisor were made into a Swiss bank account and totaled approximately a third of the value of the contract. In a press release regarding the settlement, BAE Chairman Dick Olver stated that BAE had failed to record accurately the payments to the marketing advisor, failed to scrutinize its records adequately to ensure that they were reasonably accurate, and permitted those records to remain inaccurate. As a result of having reached this settlement, the SFO announced that it would bring no further prosecutions against BAE in relation to the matters that have been under investigation to date.

In the U.S., BAE has agreed to plead guilty to one count of conspiracy to make false statements to the U.S. Department of Defense and the U.S. Department of State in violation of the Arms Export Control Act (the "AECA") and the International Traffic in Arms Regulations (the "ITAR") and to pay a fine of \$400 million. According to a criminal information filed against BAE in federal court in Washington, D.C. (the "Information"), BAE made false, inaccurate, and incomplete statements to the U.S. Department of Defense in a November 18, 2000 letter addressed to then Secretary of Defense William Cohen regarding the adequacy of BAE's anticorruption compliance measures. In the November 18 letter, BAE CEO John Weston committed to "use best efforts to adopt within six months, and in any event within twelve months, compliance programs to ensure that [non U.S.] BAE Affiliates" comply with the antibribery provisions of the U.S. Foreign Corrupt Practices Act (the "FCPA"), as if those provisions applied to them. The DOJ also cites a follow up letter from BAE to the Under Secretary of Defense, dated May 28, 2002, in which BAE stated that it had complied with the spirit and the letter of the November 18, 2000 letter. Finally, the DOJ alleged that BAE had failed to disclose commissions paid to third parties in the applications made to the U.S. Department of State for export licenses in violation of the AECA and the ITAR.

The DOJ's charges against BAE stem from alleged improper payments in Saudi Arabia, the British Virgin Islands, Hungary, and the Czech Republic. According to the Information, BAE served as the prime con-

tractor to the U.K. government in connection with the Al Yamamah deal with Saudi Arabia. In connection with that transaction, BAE provided substantial benefits, including travel accommodations, security services, real estate, automobiles, and personal items, to an unnamed Saudi “public official” who “was in a position of influence regarding the [Saudi] Fighter Deals.” BAE also provided benefits to the Saudi public official’s “associates.” These benefits were allegedly provided through various payment mechanisms in the U.S. and elsewhere, including through travel agents retained by an unnamed BAE employee, who was a “trusted confidant” of the Saudi public official.

In the Information, the DOJ alleges that BAE failed to review and scrutinize the payments and benefits provided to the Saudi public official and his associates according to the standards outlined in the November 2000 and May 2002 letters to the Department of Defense. In particular, from May 2001 to early 2002, BAE (1) failed to review adequately over \$5 million in invoices submitted by the unnamed BAE employee; (2) improperly used intermediaries and shell entities to conceal payments to advisors who were helping BAE secure sales to Saudi Arabia; and (3) agreed to transfer over \$25 million to a bank account in Switzerland controlled by an intermediary, despite knowing of the “high probability” that the “intermediary would transfer part of these payments” to the Saudi public official. The DOJ further alleged that even after the six and 12 month periods following the November 2000 letter from BAE to the Department of Defense had expired, BAE continued to engage and make payments to “marketing advisors” without conducting an appropriate anticorruption review of those payments. According to the DOJ, in many instances, BAE possessed no adequate evidence that its advisors were performing legitimate services or activities that justified their fees, but it nonetheless continued to work with them. Moreover, according to the DOJ, BAE took steps to conceal its relationships with certain marketing advisors by paying them through offshore shell entities, including an entity in the British Virgin Islands (the “Offshore Entity”), even though, in certain situations, BAE was aware of a high probability that part of the payments would be used in order to ensure that BAE was favored in foreign government decisions regarding the purchase of BAE products. According to the DOJ, BAE paid over \$230 million to marketing advisors

through the Offshore Entity, during the relevant time period. In addition to the allegations relating to Saudi Arabia and to BAE's marketing advisors, the Information alleges that BAE made improper payments totaling more than \$30 million in connection with leases of Gripen fighter jets to the Czech Republic and Hungary.

As part of the settlement with the DOJ, BAE has agreed to appoint an "ethics monitor" to sit on its marketing advisor compliance panel. Since 2007, BAE's marketing advisor compliance panel has helped examine in detail every proposal to hire marketing or sales agents. Although the monitor will be a British national (likely a lawyer), his or her appointment will have to be approved by the DOJ — an unprecedented concession for one of Britain's largest companies.

## **SIGNIFICANCE OF THE GLOBAL SETTLEMENT**

As noted above, this global settlement is the product of the SFO's highly publicized five year investigation into the conduct of BAE. In the context of U.K. anticorruption enforcement efforts, the BAE investigation and settlement illustrate both the deficiencies of past enforcement efforts and the trend toward more vigorous investigation and prosecution of acts of overseas corruption by U.K. companies. Although the U.K. portion of the global settlement is relatively small, it represents the largest fine paid to U.K. authorities to date in connection with allegations of overseas bribery.

Moreover, the global settlement highlights several important trends in anticorruption enforcement. First, the settlement is one of an increasing number of multijurisdictional anticorruption enforcement actions. Second, the \$447 million settlement illustrates the extent to which anticorruption penalties have increased in recent years. In particular, companies that are perceived not to have cooperated fully with U.S. regulators may face elevated penalties in settlements with the DOJ. Third, the case illustrates the DOJ's ability to craft charges that may be used to assert jurisdiction over foreign companies — in this case, by prosecuting alleged overseas bribery through allegations of criminal false statements under the AECA and other statutes and regulations. Finally, the global settlement demonstrates the willingness of U.S. and foreign enforcement authorities to

structure a settlement in a way that will serve as a deterrent for future improper conduct, but does not threaten the corporate defendant's core business. In this case, the fact that the DOJ and the SFO alleged criminal false statement and accounting charges, respectively, rather than criminal bribery charges, allowed BAE to avoid a conviction that could have led to debarment from future government contracts in Europe or the U.S.

On March 1, 2010, BAE entered its guilty plea in U.S. District Court in the District of Columbia. BAE was sentenced the same day to pay the agreed upon fine of \$400 million, one of the largest criminal fines in the history of DOJ's prosecution of overseas corruption in international business. Following the guilty plea, Acting Deputy Attorney General Gary G. Grindler stated: "Today, BAE Systems pleaded guilty to knowingly and willfully making false statements to U.S. government agencies. The actions of BAE Systems impeded U.S. efforts to ensure international trade is free of corruption and to maintain control over sensitive U.S. technology. BAE Systems will pay a \$400 million fine for its criminal conduct — one of the largest criminal fines ever levied in the United States against a company for business related violations.... The Department of Justice will continue to hold accountable companies that impair the operations of the U.S. government by lying about their conduct and operations." Also, in a surprising development in the U.K., BAE's settlement with the SFO has been temporarily enjoined. Two charities — Corner House and Campaign Against Arms Trade — obtained an injunction against finalizing the settlement with the SFO, alleging the SFO failed to follow proper prosecution guidance on plea bargains and reached an agreement that fails to reflect the seriousness and extent of BAE's alleged corruption and bribery offenses. A decision on the matter is expected March 20.

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## **U.S. Senate Hearing on Foreign Corruption May Result in New Antimoney Laundering Rules for Some U.S. Businesses**

A two year investigation by the Senate Permanent Subcommittee on Investigations (“PSI”) has revealed that current loopholes and weaknesses in U.S. antimoney laundering (“AML”) laws and regulations enabled certain government leaders from four African countries, or their families or associates, to launder significant amounts of money — allegedly the product of foreign corruption — through U.S. financial institutions and other businesses or entities. PSI’s 330 page report, released at a February 4, 2010 subcommittee hearing, also included a set of recommendations for strengthening U.S. AML laws and extending such laws to some businesses that are not currently subject to AML regulations. The subcommittee supports enacting its legislative recommendations through the proposed financial regulatory reform legislation currently pending in Congress.

The subcommittee’s recommendations include:

- Disclosure of the beneficial owners of newly formed U.S. corporations;
- Additional controls over bank accounts opened by or for foreign government officials and related persons;
- New regulations requiring real estate and escrow agents, sellers of vehicles, and escrow agents for aircraft sales to implement formal AML programs; and
- Certifications to financial institutions by law firms that attorney-client or other office accounts will not be used to circumvent AML laws or to conceal financial activity by foreign government officials.

Some of these recommendations are quite controversial and will raise significant political opposition. Whether or not they all become law, the PSI report is indicative of heightened scrutiny by U.S. authorities. U.S. businesses and other entities should assess their risk of exposure to transactions involving foreign officials and their families — either directly or

through intermediaries, such as nominee investors — and evaluate their internal policies and procedures to make sure that adequate controls are in place to identify and prevent transactions through which the entity might unintentionally be used to funnel illicit funds into the United States.

## **PSI'S FINDINGS**

The subcommittee reported on four case studies involving Equatorial Guinea, Gabon, Nigeria, and Angola where government officials, members of their families, or other close associates — referred to as “Politically Exposed Persons” (“PEPs”) — either attempted to channel or succeeded in channeling over \$150 million in “suspect funds” into the United States by exploiting weaknesses in AML laws. Although in some cases the transactions were declined or eventually detected by U.S. banks through existing AML procedures, some transactions were effected through persons or entities that are not currently subject to AML regulations and therefore have no due diligence obligation to scrutinize such transactions. The PEPs moved funds into the United States using a variety of conduits, including banks, offshore corporations, U.S. shell corporations, real estate agents, escrow agents, lawyers, a lobbyist, and an educational institution.

## **CURRENT U.S. LAW**

U.S. criminal law in general prohibits U.S. persons from knowingly dealing in the proceeds of “specified unlawful activity,” including the proceeds of foreign corruption. Under the AML regulations issued as a result of the 2001 USA PATRIOT Act, U.S. depository institutions, securities broker-dealers, futures commission merchants, and mutual funds that offer “private banking accounts” within the meaning of the regulations must maintain policies, procedures, and controls that are reasonably designed to enable the institution to detect and report money laundering or other suspicious activity conducted through the account. If a nominal or beneficial owner of such an account is a “Senior Foreign Political Figure” (an “SFPP”), the institution is required to engage in “enhanced scrutiny” of the account to detect or report transactions that may involve the proceeds

of foreign corruption.<sup>1</sup> Apart from these financial institutions, no other U.S. business or entity has an affirmative obligation to scrutinize transactions with SFPFs.

## PSI'S RECOMMENDATIONS

The subcommittee report made eight recommendations based on its findings. They include proposals that the U.S. government work with the World Bank and the International Financial Action Task Force on Money Laundering to strengthen global anticorruption and PEP controls. In addition, PSI recommended the enactment of U.S. legislation that would:

- Require persons forming U.S. corporations to disclose the names of the corporation's beneficial owners;
- Repeal the provision of U.S. AML law that exempts real estate agents, escrow agents, and sellers of vehicles — including escrow agents for aircraft sales — from having to maintain formal AML policies and procedures;
- Require U.S. financial institutions to obtain certifications from attorneys maintaining accounts for clients and for their own law offices stating that such accounts will not be used to circumvent AML regulations, including PEP controls, or to “accept suspect funds involving PEPs, conceal PEP activity, or provide banking services for PEPs previously excluded from the bank”;
- Direct the Treasury Department to issue new regulations requiring enhanced monitoring by financial institutions of accounts involving PEPs; and
- Amend immigration laws to make it easier to prevent PEPs involved in foreign corruption from entering the United States.

The PSI report also urges professional associations, such as those representing attorneys, real estate agents, and lobbyists, to issue guidance discouraging member involvement in financial accounts or transactions involving PEPs engaged in suspect activity.

The PSI report also urges Congress to consider its legislative recommendations as part of Congress's ongoing drafting of financial regulation reform. The Senate Banking Committee is currently considering such reform legislation, and the House of Representatives has already passed its version of the bill without any provisions related to PSI's recommendations.

The financial reform bill faces a number of significant political challenges and it is unclear as to when — or whether — such legislation will be enacted. Moreover, the PSI recommendations will almost certainly be opposed by businesses and professions that would be brought under new compliance and enforcement regimes. The findings of the PSI investigation and the recommendations, in and of themselves, indicate that U.S. enforcement agencies are already under pressure to more carefully scrutinize the U.S. dealings of foreign officials and their families. In the meantime, the PSI report highlights the extent to which foreign officials may attempt to channel suspect funds into the United States. All U.S. entities having international business or other dealings should review their policies and procedures to safeguard their operations against such attempts.

## NOTE

<sup>1</sup> “Senior foreign political figure” is the term in U.S. law corresponding to “Politically Exposed Person,” a term used primarily in international agreements and foreign law.