Money Laundering bulletin

The monthly briefing service for anti-laundering specialists

The back of the brown envelope

Bribery and corruption are rapidly establishing themselves as a permanent part of the financial crime portfolio as the UK and US begin to lock-step both legal practice and enforcement. ***Keith Korenchuk*** *and* ***Oliver Kerridge*** *of Arnold & Porter LLP talk to MLB editor Timon Molloy about the transatlantic lessons and risks.*

MLROs might grumble that responsibility for anti-bribery and corruption compliance is inexorably heading their way but one can see why, says Keith Korenchuk, when we meet in Arnold and Porter's London office. "There is prior translatable experience," he says, looking out across a sweeping panorama of the City from this, the 30th floor. Oliver Kerridge, his UK colleague agrees: "MLROs have similar knowledge and experience of due diligence, which will be expected for associated persons and their roles [as well as employees] under the [UK] Bribery Act." Adequate procedures to defend the business against a charge of failing to prevent bribery will mean applying a risk based approach to identify the areas that need specific attention and tailoring appropriate controls. "It's a transition from know your customer – KYC – to KY3, ie, know your third party and what he or she is doing for you," says Korenchuk. Financial institutions are concentrating heavily on their third party relationships, Kerridge confirms: "Some are finding that they know them better than they do their own customers, which can cause some internal astonishment." If so, there is pressure to revisit and improve the KYC process.

The *US Foreign Corrupt Practices Act* (FCPA) has been around since 1977 but Korenchuk applauds the UK *Bribery Act* for its sensitivity to the needs of business in allowing organisations to establish their own exposures and procedures. "In the US, the guidance is focused on steps; you must have this, this and this in place." Having worked all over the world, setting up anti-bribery programmes, he says that establishing broad principles and letting firms come up with their own defensible, risk based approach (RBA) is the only effective model. "Do you have rules? Have you trained your people and made them aware of the risks? Have you given them an opportunity to ask questions? Do you monitor compliance and audit the controls? What are the consequences if they break the rules?" This "natural continuum" is not a British or US invention, it's a control process that applies internationally. The adequate procedures have to inform business behaviour on the ground, he adds; they cannot simply exist on paper. Kerridge concurs but notes that "the key is to document and ensure you can trace any decision as to where your risks lie and how to address those risks in case you need to justify that decision later."

Organisations that understand their risks are those which appreciate the RBA, he adds, while others, "not just the smaller players", believing they don't have an issue, prefer a more prescriptive regime and fuller guidance. Once anti-bribery and corruption (ABC) systems and controls are instituted, it's not a matter of job done, rather one of continual implementation, revision, gap detection and correction. "When a breach occurs, the temptation is to act against the perceived rogue employee rather than address the root cause."

Firms always have the option to abide by the letter rather than the spirit of new law and regulations but such firms are unlikely to be able to make full use of the new "adequate procedures" defence if a problem does occur. "We're at the stage where a lot of historical business practices will need to be looked at," says Korenchuk. One CFO told him that hitherto his firm had not paid much attention to corruption risk but now 'we will have to readjust our thinking to match the new expectations.' It won't be an overnight conversion: "I don't think many companies will be able fully to effect the change by April 2011 [when the new *Bribery Act* takes effect]." A 2-3 year horizon is more realistic for full implementation in Korenchuk's view. Firms must be hoping that the authorities will be lenient as they work out their own definition of "adequate procedures" to prevent bribery under the Act and attempt to implement them. "The easy part is writing a set of procedures but the word 'adequate' isn't helpful," say Korenchuk, "It lends a false sense of security. The challenge is to implement them effectively and to help the business make them real."

A multinational that operates profitably in jurisdictions with a high propensity to corruption is unlikely, surely, to give up valuable revenue streams by immediately invoking a zero tolerance to bribing local public officials. "Well, there may be legal ways to create Chinese walls between compliant and non-compliant parts of the business, by moving some elements offshore," Kerridge acknowledges, "But no major company can seriously contemplate carrying out business in a significantly non-compliant way." Special pleading that it simply isn't possible to do business in jurisdictions like China without getting one's hands dirty will not wash in London or Washington, says Korenchuk. Even if the board were keen to hide corrupt payments in an obscure corporate vehicle, the personal liability is now a real deterrent: "One only has to look at the *Siemens* case [1]. The directors on both the managing and supervisory boards were subject to internal investigation for failing to provide compliance oversight. They had to repay the company – the minimum figure was €2m. Many Siemens executives were also investigated by the German criminal authorities."

Facilitation payments are a particular headache for UK businesses that operate in some African countries, for example, where it is reputedly nigh on impossible to avoid their use. "The difficulty is that you cannot put in anti-bribery and corruption procedures but then create an exclusion for facilitation payments in certain jurisdictions," says Kerridge. Not only would such an approach undermine the purpose, let alone the letter, of the new, and indeed existing, English law on bribery, it also may give rise to reporting obligations under the *Proceeds of Crime Act 2002* (POCA). Where, then, does this leave the company?

Nothing daunted, Korenchuk deploys a real life case of a foreign company that wanted to open a new plant in India. The country manager requested connection to the electricity supply as soon as possible: he was told by a local government official that it would be easy to link to a point across the road on payment of a UK£1,000 facilitation fee. The alternative was to wait to be hooked up to a supply two kilometres away at the official cost of UK£25,000. "So be it," said the manager. "He ultimately earned the respect of the official for taking the right course," said Korenchuk. "I recognise that we're just at the start of a recalibration of standards. It's about being in a leadership position. That may cost you in the short run but you will gain in the longer term by changing the expectations of government officials."

Korenchuk points to the Republic of Ireland as an example of a major cultural shift: "Business used to talk about going to a politician and giving them the 'brown envelope' [stuffed full of cash]." The populace became tired of the corruption and expectations were reset. "It is a fascinating period of transition as both corporate and governments begin to address deeply embedded cultural practices, which may not be viewed as wrong in some countries." The education process is not simply one-way, far from it given it is often the leading western multinationals that have engaged in questionable means of winning overseas contracts. "There is real change now in the UK," says Kerridge, "as, for the first time in some cases, people begin to recognise what bribery looks like. In the past they may not have given much thought to payments to offshore companies for 'marketing services', introducing fees and commission-sharing arrangements. The *Bribery Act* and enforcement threat has made them stop and think."

The rhetoric has certainly been loud but the jury is out on whether it will translate into action: on the one hand, a third of the Serious Fraud Office's (SFO) workload is concerned with overseas corruption [2] but in its regulatory impact assessment of the Bribery Bill the government suggested that the statute would lead to an average of only 1.3 additional prosecutions a year for the corporate offence of failing to prevent bribery. [3] The prospective absorption of the SFO into the new Economic Crime Agency and cuts in police resources under the Comprehensive Spending Review of public sector finances may suggest to firms that all the excitement is overdone and that, in practice, they have little to worry about. Such complacency would be ill-advised, says Kerridge, since there are so many pinch points in corporate transactions, involving individuals with their own liability, whether under the *Bribery Act* or, more often, under the *Proceeds of Crime Act*: external auditors, bankers and transactional lawyers, for example, may decide they have to file a suspicious activity report if they come across suspicious payments or they face committing a criminal offence. "There is already evidence of auditors asking boards why certain offshore payments are being made." Internal whistleblowers are another ever-present risk and competitors may see a strategic advantage in informing on peers although Korenchuk advises clients to be very sure that their own house is in order before doing so.

"Directors also need to take the 'consent or connivance' [to bribery] offence in *section 14* of the Act seriously," says Kerridge, "They will face up to 10 years' imprisonment if found guilty on indictment."

The most effective ABC programmes, as for AML, involve the business at the design stage – they have to be workable – and training must be led from the top: "If you don't get that buy-in from executive management, everything becomes much more difficult," says Korenchuk. "One of the six principles that underpin the adequate procedures, according to the draft government guidance, is 'top level commitment'," Kerridge notes. The message has to be driven home to employees further down the organisation, who may well be commission-driven and unaware of their personal risk.

For its part, the SFO has borrowed heavily from US and UK Financial Services Authority (*section 166* notice) practice by effectively requiring corporates to commission and pay for their own investigations. "In the US, the authorities will meet with the corporate periodically to check on what's been found and to direct the investigations to look at this or that area." There is at least the advantage, says Kerridge, that the firm only has to deal with one set of investigators and retains some measure of control over their activities. The alternative prospect is parallel internal and external inquiries, which means trying to second-guess the agency's objectives.

The US authorities seem to have fine-tuned the FCPA approach such that no corporate in their sights has ever contested an action through the courts; they simply reach for their cheque-books. "The risk if they lose is so great that they don't fight. They may, for example, be prohibited from dealing with the US government, which could put them out of business." One might question whether a system so heavily weighted in favour of the prosecution is fair but as Korenchuk remarks, an increasing number of individuals are also subject to criminal proceedings and since they have more, personally, to lose, they are likely to push matters further: "But, so far, the government has never lost at trial. [Case] Law will be made when someone is convicted and appeals."

The US position mirrors that in the UK, says Kerridge. "In FSA actions, firms nearly always settle for a 30% discount for early and full cooperation while individuals are more likely to fight through the Tribunal." UK corporates convicted of corruption likewise face the risk that they will be unable to bid for public sector contracts under the EU Public Procurement Directive.

If a company believes that the stakes are high, institutes ABC controls and then suffers a breach it may question how it could have been prevented. "Success in 'adequate procedures' terms does not mean you will never experience a case of bribery," notes Korenchuk, "Rather, any instance that is uncovered should be one of individual rather than corporate misconduct." Firms cannot control for every determinedly corrupt employee or third party. They should be aware though of the close collaboration between the US and UK authorities: "Richard Alderman, SFO Director, has said, 'We talk every day at every level.' It makes the enforcement process more complex with the meshing of different regulatory regimes."

MLROs must keep in mind that the UK regime is 'all crimes' with both knowledge and suspicion of money laundering reportable: this can create problems in firms that insist on making facilitation payments, says Kerridge. "Many firms are putting the MLRO in change of anti-corruption compliance but they already have a lot on their plates and are not necessarily best placed to implement 'adequate procedures'." As with sanctions compliance, which is developing into a separate discipline, larger financial institutions are assigning a dedicated individual to manage their anti-corruption responsibilities.

Notes

1. www.justice.gov/opa/pr/2008/December/08-opa-1112.html
2. SFO annual report 2009/10/, p4 – www.sfo.gov.uk/about-us/annual-reports—accounts/annual-reports/annual-report-2009-2010.aspx
3. www.justice.gov.uk/publications/docs/draft-bribery-bill-impact-assessment-ii.pdf

Keith Korenchuk *(+1 202 942 5817, Keith.Korenchuk@aporter.com) is a partner, based in the Washington, DC office of Arnold & Porter LLP.* ***Oliver Kerridge*** *(+44 (0)20 7786 6220, Oliver.Kerridge@aporter.com) is an associate in the firm's London office.*

Editor: Timon Molloy • Tel: 020 7017 4214 • Email: timon.molloy@informa.com

Production editor: Frida Fischer **Sales:** Leyla Utman • Tel: +44 (0) 20 7017 4192 • Email: leyla.utman@informa.com
Renewals: Helen James • Tel: +44 (0) 20 7017 5268 • Email: helen.james@informa.com
Subscription orders and back issues: Please contact us on 020 7017 5532 or fax 020 7017 4781.
For further information on other finance titles produced by Informa Law, please phone 020 7017 4108.
Printed by Premier Print Group **ISSN 1462-141X**
Published 10 times a year by Informa Law, Telephone House, 69-77 Paul Street, London EC2A 4LQ. Tel 020 7017 5000. Fax 020 7017 4601. http://www.informa.com

informa
law & regulation
an informa business