Re-Ensuring Compliance With The FCPA

Law360, New York (March 12, 2012, 1:26 PM ET) -- The reinsurance industry has been in existence for several centuries and has developed its own ways of doing business and cultivating relationships, often based on personal interactions and a healthy dose of entertainment.

The Foreign Corrupt Practices Act (FCPA)[1], a U.S. statute that generally prohibits bribery of foreign government officials, has been in existence since 1977, but has seen a tremendous growth in enforcement only in the past 10 years.

It is time for the reinsurance industry players to “meet” the FCPA, understand its provisions and assess their compliance. The risk of FCPA violations is far greater in the reinsurance industry than one might think. What industry participants may view as completely acceptable entertainment and other expenses in order to win business, the U.S. enforcement authorities[2] may consider as corrupt payments.

Consider the following hypothetical: A broker tells prospective reinsurers for a treaty covering risks written by a cedent owned or controlled by a foreign government that a portion of the premium due reinsurers will be set aside to pay for the education and training of the cedent’s employees.

The reinsurers sign on to the treaty, the broker withholds a portion of the premium as advised and then uses the money to pay for the cedent’s employees’ trips to the United States — or elsewhere for that matter — to attend training and other educational conferences. As usually happens with the educational and training conferences, the cedent’s employees spend quite a bit of time, essentially with reinsurers’ money, attending to personal business or sightseeing.

Question: Did the reinsurers and the broker violate the FCPA in authorizing and administering such payments for the cedent’s employees’ trips?

The answer might not be as easy as one thinks, and the fact that the FCPA is a U.S. statute should give no comfort to the non-U.S. reinsurance industry participants, especially those having substantial ties to or presence in the United Kingdom. Their involvement with any improper payments “while in the territory of the United States” could give rise to a liability under the FCPA as well as its British “cousin,” the U.K. Bribery Act.

The FCPA in a nutshell:

Anti-Bribery Provisions

The FCPA’s “anti-bribery” provisions[3] forbid issuers of U.S. securities, companies domiciled in the United States, and their officers, directors, employees and agents, as well as stockholders acting on the company’s behalf, from corruptly paying money or anything else of value to influence any act or decision — including a decision not to act — of a foreign government official, political party or political party official, or candidate for political office, in his official capacity or to induce the official to use his influence to affect a government act or decision so as to assist a company in obtaining or retaining business or directing business to any person or to secure any improper advantage.

Jurisdiction

For U.S. issuers of securities or other private companies domiciled in the United States — as well as for their officers, directors, employees, agents and stockholders acting on the company’s behalf, irrespective of nationality, e.g., a French employee of a U.S.-domiciled entity — the anti-bribery provisions apply to conduct taking place anywhere in the world, irrespective of whether U.S. interstate commerce was used.

For non-U.S. domiciled issuers, including foreign companies whose American depositary receipts (ADRs) trade on a U.S. stock exchange, in order for anti-bribery provisions to apply, a violation must be committed using means or instrumentalities of U.S. interstate commerce.

However, because “interstate commerce” is so broadly defined — e.g., mail, telephone, telex — a wire transfer of funds to a U.S. bank by a foreign company or a phone call using U.S. lines would meet the interstate commerce test.

The FCPA’s anti-bribery provisions also apply to any foreign company or individual who violates the law “while in the territory of the United States.” The U.S. enforcement authorities interpret this provision very aggressively, and there have been several enforcement actions against foreign companies that took actions entirely outside the United States but were, nevertheless, subject to prosecution because they “caused” actions to take place within the United States in furtherance of a prohibited payment.

Foreign Official

The FCPA defines “foreign official” to include any officer or employee of a non-U.S. government or any instrumentality of the government, or any person acting in an official capacity for or on behalf of the non-U.S. government or its instrumentality.

Because an instrumentality is broadly construed by the U.S. enforcement authorities to cover commercial organizations where there is some level of state ownership or control, this means even officials who are performing purely commercial functions can still be covered by the FCPA.

The U.S. enforcement authorities’ position is that every employee of an instrumentality, from top to bottom, is a government “official,” regardless of how the person would be classified under local law. Thus, in the eyes of U.S. enforcement authorities, an employee of an insurance company, which is owned in total or in part by a foreign government, is a foreign government official.

Prohibited Payment

The FCPA prohibits not only corrupt payment of bribes, in a classical definition of the word, but also “anything of value.” There is no de minimus value, and cases have involved payments of as little as $100, trips, college tuition, as well as payments to favorable charities of a foreign government official.

U.S. enforcement authorities are of the opinion that payments made or benefits conferred on relatives or friends of foreign government officials would be covered, if they were made as a quid pro quo for the official’s action.

Payments, authorizations, promises or offers of payments to any other person also are prohibited if there is knowledge that any portion of the payment is to be passed along to a foreign official for a prohibited purpose under the FCPA. Knowledge is defined very broadly and is present when one knows an event is certain or likely to occur; even purposely failing to take note of an event or being willfully blind can constitute knowledge.

In Order to Obtain or Retain Business

The FCPA reaches only conduct in furtherance of proscribed payments made to assist the firm in obtaining, retaining, or directing business to any person. In United States. v. Key, 359 F.3d 738 (5th Cir. 2004), one of few FCPA judicial decisions, the court of appeals interpreted this provision broadly to find a violation where the improper payments were used to obtain low import taxes and customs duties, not necessarily to obtain new business.

Inducing Decision of a Foreign Official

The FCPA only prohibits corrupt payments or offers of payments of anything of value for the purpose of inducing an act, or decision not to act, by a foreign government official. This element has been subsumed by the expansive definition of “obtaining or retaining business” element. It is clear that the FCPA covers any payment to a foreign government official to secure a legislative, regulatory, or administrative action, or to influence the official’s execution of any action that falls within the official’s duties, i.e., signing of a contract.

Corruptly

Only proscribed payments made with corrupt intent are subject to the FCPA. In this instance, “corruptly” means a purpose to influence a foreign official to misuse his official position. The closest thing there is to a test of this element is whether the payment is part of a quid pro quo for governmental action.

Books and Records Provisions

FCPA’s “books and records” and “internal control” provisions apply only to issuers of U.S. securities, whether domiciled in the United States or abroad, and their majority-owned subsidiaries.[4] With respect to subsidiaries, or joint ventures, in which issuers hold 50 percent or less of the voting power, the FCPA requires the issuer to make a good-faith effort that the subsidiary complies with the law.

These provisions require:

•That books, records and accounts are kept in reasonable detail to accurately and fairly reflect transactions and dispositions of assets; and
•That a system of internal accounting controls is devised:
◦To provide reasonable assurances that transactions are executed in accordance with management's authorization;
◦To ensure that assets are recorded as necessary to permit preparation of financial statements and to maintain accountability for assets;
◦To limit access to assets to management's authorization; and
◦To make certain that recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.
If the U.S. Department of Justice (DOJ) brings criminal charges against a company under the recordkeeping and accounting provisions, any intentional misrecording of a payment is a violation, so the prosecutor does not have to prove that the payment was a bribe.

In addition, failure to describe what actually occurred also is a potential violation. For example, recording a corrupt payment in the books as "travel and entertainment" could be a violation.

Penalties

Criminal and civil penalties for violations of the FCPA's anti-bribery and book and records provisions can be quite severe. Corporations and other business entities are subject to a fine of up to $2 million per violation. Officers, directors, stockholders, employees and agents are subject to a fine of up to $250,000 per violation and imprisonment for up to five years.

Under the Alternative Fines Act, the actual fine may be up to twice the benefit that the defendant sought to obtain by making the corrupt payment. Fines imposed on individuals may not be paid by their employers or principals.

The U.S. attorney general or the U.S. Securities and Exchange Commission (SEC) may bring a civil action for a fine of up to $10,000 per violation against any issuer as well as any officer, director, employee or agent of a firm, or stockholder acting on behalf of the issuer, who violates the anti-bribery provisions.

Penalties for books and records violation can be even more severe. Any person who willfully violates the FCPA books and records provisions or any person who willfully and knowingly makes, or causes to be made, any statement in any application, report or document required to be filed in violation of those can be fined as much as $5 million, or imprisoned up to 20 years, or both, except that when the violation is made by an issuer rather than a natural person, a fine not exceeding $25 million may be imposed.

As before, the Alternative Fines Act applies, so that the monetary fine can be up to twice the benefit that the defendant sought to obtain through the violation.

Exception and Affirmative Defenses

There is one exception and two affirmative defenses under the FCPA. The “facilitating” payments exception permits facilitating payments, or "grease payments," to foreign officials in order to expedite or secure the performance of a “routine governmental action.”

“Routine governmental action” means only those actions that are ordinarily and commonly performed by a foreign official. Many FCPA practitioners view this exception as nonexistent in light of the U.S. enforcement authorities’ broad interpretation of the law.

As to the first affirmative defense, a payment may be made to foreign officials when the payment is “lawful under the written laws of the foreign country.” Such payments, however, are rarely, if ever, permitted under local law. Many countries around the world now have their own anti-corruption laws. Thus, this affirmative defense is of little help.

Lastly, and more important to the reinsurance industry, is the “marketing expenses” affirmative defense. This defense is intended to exclude from the FCPA liability expenses such as minor gifts given for product evaluation purposes, or paid trips to a company’s facility to educate the counter-party regarding the operations.

The key to these expenses is that they have to be reasonable under the circumstances and not made in order to obtain an official act. These expenses are bona fide only where no corrupt purpose is present.

While it might be acceptable for a broker or a reinsurer that tries to win a cedent’s business for the first time to invite the delegation from the cedent to visit the reinsurer’s offices and learn about the reinsurer’s operations, the enforcement authorities may see a golf outing with an expensive bar tab after the meeting as a corrupt payment.

As a practical matter, this suggests the need for significant caution in paying the promotional expenses of any foreign officials with discretion to make business decisions affecting the company subject to the FCPA.

Examples Affecting the Reinsurance Industry

Being truly a global industry, reinsurance market participants often come in contact with those whom the U.S. enforcement authorities consider “foreign government officials” for purposes of the FCPA. Examples abound: a risk manager employed by an oil and gas giant owned or controlled by the Russian government is a foreign official; a manager in charge of ceded reinsurance at an insurance company owned or controlled by the government of Brazil is a foreign official.

The reinsurance industry participants subject to the FCPA should take a good look at whether they are dealing with “foreign government officials” and whether their dealings would pass the FCPA test. For those in the industry having a substantial presence in the United Kingdom, the analysis could be even more complicated, as the U.K. Bribery Act, which went into effect July 1, 2011, prohibits all commercial bribery — giving and taking — and bribery of foreign government officials, and makes it a crime for commercial organizations to fail to take measures to prevent bribery.

While it is too early to tell whether the U.K. Serious Fraud Office (SFO), charged with the enforcement of the U.K. Bribery Act, will be as aggressive as its U.S. counterparts are in enforcing the FCPA, there are early signs in both countries that the reinsurance industry is being watched.

Thus, in July 2011, the U.K. equivalent of the SEC — the Financial Services Authority (FSA) — published a final notice to a large brokerage firm alleging it had failed to implement anti-bribery controls and systems in connection with payments made to foreign third parties.

The broker was fined nearly £7 million for breaches of the FSA's Principles for Business and the FSA Handbook. It was also alleged the third parties at issue had helped the broker win and retain business from overseas clients.

In December 2011, the DOJ and the SEC announced a combined resolution of their FCPA enforcement actions against another brokerage firm, pursuant to which the broker agreed to pay $16.3 million to the U.S. enforcement authorities. This sum was paid in addition to the £5.25 million (about $8.2 million) paid by the broker to the FSA in 2009 for alleged failures to maintain effective controls.

Some of the alleged actions in the SEC and the DOJ enforcement actions mentioned above track the hypothetical example stated in the beginning of this article. It may only be a matter of time before the U.S. enforcement agencies expand the theories of liability applied in these matters to the participating reinsurers.

When that happens, no insurer or a reinsurer would want to be in the unenviable position of having to explain whether it has anti-corruption policies and what steps have been taken to reasonably assure that they have been complied with.

The U.S. authorities are on record saying the enforcement of the FCPA is their greatest priority behind fighting terrorism. These FCPA enforcers are loaded for bear and can point to many "success" stories of companies paying penalties in the millions and hundreds of millions. The reinsurance industry must take note of the broadening enforcement regime and take proactive steps to comply with the FCPA and other anti-corruption measures.

--By Max B. Chester, Foley & Lardner LLP

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