

WEBINAR

CFTC; New Enforcer Countering Foreign Corrupt Practices

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WEBINAR

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Agenda

- I. CFTC and DOJ Public Statements
- II. CEA Overview
- III. Potential CEA Penalties and Credits
- IV. FCPA Overview
- V. Comparing the FCPA and CEA
- VI. Effective Compliance Steps



*CFTC and DOJ
public statements*



Public Statements

CFTC Statements

- The CFTC announced in March 2019 that the agency would pursue violations of the CEA involving foreign corrupt practices, such as:
 - 1) bribes to secure business in connection with regulated activities
 - 2) bribes to manipulate benchmarks underlying related derivative contracts
 - 3) corrupt practices to impact prices in commodity markets that drive U.S. derivatives prices
- Enforcement Division Director, James McDonald, explained that the CFTC will not “pile onto” other agencies’ investigations
 - The CFTC will “work closely with [other agencies] to avoid duplicative investigative steps”
 - And ensure that penalties “appropriately account for any imposed by any other enforcement body”

DOJ Statements

- A DOJ official explained that the agency does not believe the CFTC’s policy “is a sea-change” and that FCPA investigations will not significantly change
 - The CFTC is “not looking to break new ground and change up the way FCPA investigations have been done in the past few decades”
- The DOJ also stated that the CFTC’s stance is not “that different to the Fed,” referring to the Federal Reserve’s occasional penalization of financial institutions that are alleged to have engaged in corrupt practices



CEA overview



CEA Basics

The Commodity Exchange Act

- Civil and criminal statute
- Regulates commodity futures and swaps (except security-based swaps) and futures industry professionals
- Enforcement authority relating to fraud or manipulation of commodity contracts in interstate commerce
- Prohibits customer abuse by registrants or fraud, market manipulation or other disruptive trade practices
- Establishes various recordkeeping and reporting requirements for registrants and market participants and financial requirements for registrants

The CEA applies to:

- Persons transacting in, or intermediating, commodity interests or swaps
- Commodities include, among others, metals; energy and agricultural commodities; interest rates; foreign and digital currencies; indexes on intangibles; and broad-based stock index contracts

Enforced by:

- Department of Justice (criminal violations)
- Commodity Futures Trading Commission (civil violations)
- Private causes of action
- Self-regulatory organizations (e.g., NFA, designated contract markets (futures exchanges), and swap execution facilities)



CEA Violations: Manipulation and Fraud

The CEA prohibits market manipulation and attempted manipulation

- Manipulation is the intentional creation of an artificial price by forces other than supply and demand
- Attempted manipulation requires specific intent to create an artificial price and an overt act in furtherance of that goal
- Examples of manipulation include market squeezes, corners, and spreading false information to distort prices

The CEA also prohibits fraud

- It is unlawful for any person to cheat or defraud, or attempt to cheat or defraud, another person in connection with a contract for sale of a commodity in interstate commerce, a commodity futures contract, or a swap
- This includes intentional or reckless conduct that deceives or defrauds market participants



Illustrative examples involving foreign corruption

- Bribing executives of a state-owned commodity producer to withhold production from the market to affect market prices



Illustrative examples involving foreign corruption

- A commodity pool operator uses investor funds to pay a bribe and misrepresents the payment's true nature to investors
 - The CFTC could bring fraud charges in connection with such misrepresentation of bribery even if there is no connection to a futures contract or swap
- A commodity professional pays a bribe to a government official to obtain a state-owned investment fund as a client



CEA Violations: Other Disruptive Trade Practices

The CEA prohibits other trade practices as well

- **Wash trades:** a purchase and sale of the same contract for the same beneficial owner at or about the same time for approximately the same price to avoid a bona fide market position
- **Accommodation trades:** non-competitive trading entered into by a trader, usually to assist another with illegal trades, such as a sale at a below market price intended to create a short-term trading loss for tax purposes
- **“Insider trading”:** trading based on material, non-public information in violation of a duty
- **Others:** spoofing, fictitious sales, money passes, accommodation trades, and any other transaction that has no legitimate purpose or the purpose of which is to generate a non-bona fide price



Illustrative examples of prohibited trade practices that might involve foreign corruption

- Pre-arranged wash trades or accommodation trades on a futures exchange used to launder money by an officer of a state-owned foreign company
- Illicit, off-facility block trades made to hide bribes paid to or received by a foreign government official
- Trading by a government official on the basis of material, non-public information relating to the trades of a state-owned company obtained through bribery



CEA: Reporting and Recordkeeping Requirements

Reporting provisions

- It is unlawful to make false or misleading statements of material fact to the CFTC
- It is also unlawful to omit material facts when the omission renders a statement misleading

Recordkeeping provisions

- The CEA requires registrants, registered entities, and reportable traders to maintain accurate records of transactions involving commodity futures, commodity contracts for sale in interstate commerce, and swaps

Examples involving foreign corruption

- Making material misstatements or omissions to the CFTC to hide bribes
- Falsifying records to hide bribe payments
 - Falsely reporting the ownership of a position when recording a swap
 - Attempting to mask the true beneficial owner of a futures contract, option or swap



*Potential CEA
penalties and credits*



Consequences of Violating the CEA

Civil Penalties

- Civil fines of \$ 130K-\$1.2M per violation or triple the gain from misconduct
- Ban from trading on U.S. commodity and swaps markets
- Loss of registration
- Disgorgement of profits

Criminal Penalties

- Potential felony convictions
- Up to 10 years in prison
- Criminal fines of \$1M per violation plus cost of prosecution

Other Consequences

- Internal and external investigations
- Reputational harm
- Possible private right of action
- Disruption of business





Enforcement Advisories

The CFTC will consider reduced penalties for companies and individuals that cooperate with investigations based on three factors:

- Value of cooperation to the investigation
- Value of cooperation to the CFTC's broader law-enforcement interests
- Countervailing factors (e.g., involvement of senior management, pervasiveness and history of misconduct)

An individual or entity must self-report, fully cooperate, and remediate to receive full credit

Non-registrants that self-report enjoy a presumption of no monetary penalty

Registered entities, however, only receive a “substantial reduction” in penalty

- According to the CFTC, this is because registrants have an independent duty to self-report

Respondents will also receive credit for penalties imposed by other agencies, including a one-to-one offset for disgorgements



FCPA overview



FCPA Basics

The Foreign Corrupt Practices Act

- U.S. criminal and civil statute
- Prohibits bribery of foreign government officials
- Requires public companies to maintain accurate records and have vigorous internal accounting controls

The FCPA applies to:

- Publicly traded companies in the U.S.
- Companies incorporated or based in the U.S.
- Officers, employees, and agents of such companies
- U.S. nationals and residents wherever they may be
- Any person who furthers foreign bribery while “in” the U.S.

Enforced by:

- Department of Justice (including the FBI)
- Securities and Exchange Commission



Anti-Bribery Provisions

1. Offering, promising, paying, authorizing or giving

- Promise, authorization, offer or mere attempt to influence is punishable
- No requirement that the bribe be paid or successful in achieving the desired outcome

2. Anything of value

- Whether money or “in kind,” tangible or intangible
- No minimum value
- For example: cash, tickets, meals, job offers

3. Directly or through an intermediary

- You are responsible for both your actions and for those of a third party if you have knowledge (defined broadly to include willful blindness)

4. To a government official

- The rank of the official is irrelevant
- Includes individuals in government departments, government-owned or government-controlled businesses, political parties, and others that perform public functions

5. For the corrupt purpose of influencing the official or to gain any improper advantage

- To influence includes to act, to not act, or to redirect action
- The aim is “quid pro quo”

6. To obtain or retain business

- Whether new or renewal business
- “Business” can be permits/licenses, approvals, taxes, customs and immigration



Accounting Provisions



Books and Records

- The FCPA requires companies that issue registered securities to “*make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets*”
 - Records include all forms of business documentation
- These provisions **do not require proof of bribery**, and they apply to all financial transactions and reporting, with **no materiality requirement**
- Issuers are responsible for the books and records of their consolidated subsidiaries

Internal Accounting Controls

- Companies that issue registered securities should maintain internal accounting controls that provide **reasonable assurances** that:
 - transactions are executed in accordance with management’s authorization;
 - all transactions are recorded to permit GAAP accounting;
 - assets can only be accessed with management’s authorization; and
 - recorded asset values are compared at reasonable intervals to existing assets and appropriate adjustments are made
- Issuers are responsible for internal accounting controls of majority-owned subsidiaries and must use good faith efforts for minority-owned entities and joint ventures



*Comparing the
FCPA and CEA*



Comparing the FCPA and CEA

FCPA

- Jurisdiction over non-issuers or domestic concerns limited to actions taken in the U.S.
- Definition of “foreign official” specified by statute
- Covers any offer, payment, promise to pay, or authorization of anything of value to a foreign government official
- (Limited) exception for “routine government actions”
- (Limited) affirmative defenses for lawful payments in other countries, and bona fide business expenses

CEA

- Applies to conduct with a “direct and substantial” effect on U.S. markets
- No definition of “foreign official” specified by statute
- Covers “any manipulative or deceptive device,” similar to and modeled after section 10(b) of Securities Exchange Act of 1934
- No statutory exceptions or defenses similar to those in the FCPA





Effective compliance steps



Importance of Compliance Programs

Compliance programs increase awareness and provide ways to reduce likelihood of improper conduct

Some market participants are required to maintain policies that reasonably ensure compliance with the CEA

- For example, a swap dealer and major swap participant “shall establish and maintain a system to supervise, and shall diligently supervise, all activities relating to its business performed by its partners, members, officers, employees, and agents Such system shall be reasonably designed to achieve compliance with the requirements of the Commodity Exchange Act and Commission regulations.” 17 C.F.R. § 23.602.

Should wrongdoing come to light later on, enforcement authorities will credit carefully planned and implemented compliance programs

- **Peterson (*Morgan Stanley*) (2012)**: The DOJ and SEC charged the former head of Morgan Stanley’s real estate investing in China with violating the FCPA by paying bribes to a Chinese official. The agencies, however, publicly announced that Morgan Stanley would not be charged in light of its robust anti-corruption internal controls, which the defendant intentionally circumvented.
- **Bourne (*Deutsche Bank*) (2018)**: The CFTC charged Deutsche Bank managing director with fraudulently mismarking the valuations of inflation swap instruments to hide significant trading losses. In its first public declination letter, the agency stated that it would not charge Deutsche Bank because the bank had identified the misconduct using its internal controls and self-reported the violations to the CFTC.



Elements of an Effective Compliance Program

Tone from the top

- Senior management should show commitment and demonstrated leadership in compliance efforts

Autonomy and resources

- Compliance personnel should have authority and independence and the program should be sufficiently sized and funded

Policies and procedures

- Policies and procedures should unequivocally prohibit conduct that would violate anti-bribery laws

Training and communications

- Compliance guidelines must be effectively communicated

Confidential reporting and investigations

- Employees, and relevant third parties, should know that they have a duty to report suspected violations, and can do so without fear of retribution

Incentives and disciplinary measures

- Discipline should be enforced fairly throughout the ranks of the organization

Continuous improvement, periodic testing, and policy reviews

- Risk assessments should guide the development and execution of the compliance program and ensure the program is appropriately tailored to business operations
- Company should be able to demonstrate how it has tested, audited, and updated its compliance program

Third-party management

- Due diligence, contractual representations and ongoing monitoring of relevant third parties

Analysis and remediation of underlying conduct

- Compliance program should include a root-cause analysis of any misconduct and consider how to reduce the risk of future misconduct



Due Diligence Considerations

- Consider whether the trade, advice, or transaction may be affected by bribery or other conduct that would be unsustainable or create unacceptable legal, regulatory, or reputational risks for the company
- Assess whether there are adequate systems in place that can flag transactions potentially affected by improper conduct
- Ensure brokers and other third-party participants are reputable and there are no red flags suggesting corrupt behavior; obtain appropriate contractual representations
- Determine whether the company's policies and governance structure enables it to take appropriate measures to ensure compliance



Conclusion



Questions

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