

# The Alarm of the Foreign

## Eleven Reasons to Wake Up and Take Heed

KATHERINE AUGUSTINE

**F**OR THOSE OF US IN THE BANKING WORLD, every few years a certain law creates a buzz. Anti-money laundering legislation (AML) was a recent, and still very loud, buzz maker. Fair lending rules are always top noise makers, as are RESPA and flood insurance. What aspects of these rules create such a clamor? Perhaps it's the enhanced diligence of the regulators' reviews, or the high number and dollar amounts of the fines imposed. Regardless of the reasons why certain laws sound so loudly, as compliance officers, we know that when the alarms go off, it's time to pay attention and take action, we hope before we find ourselves reacting to a regulatory review or finding.

The Foreign Corrupt Practices Act (FCPA) is currently sounding a warning signal for all global industries including the financial industry. Though it's been on the books since 1978, the FCPA has been banging and clattering much more loudly in the past five years, with last year being the loudest, judging by the amounts of the settlements. If you haven't heeded the FCPA buzz yet, this article will give you a number of reasons why you should be aware and take notice.

Both the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) have promised to take bribery, specifically bribery of foreign officials, very seriously, and a number of high-cost FCPA settlements have already proved that they are doing just that. In his speech during International Anti-Corruption Day, December 9, 2010, Assistant Attorney General Lanny A. Breuer said, in part,

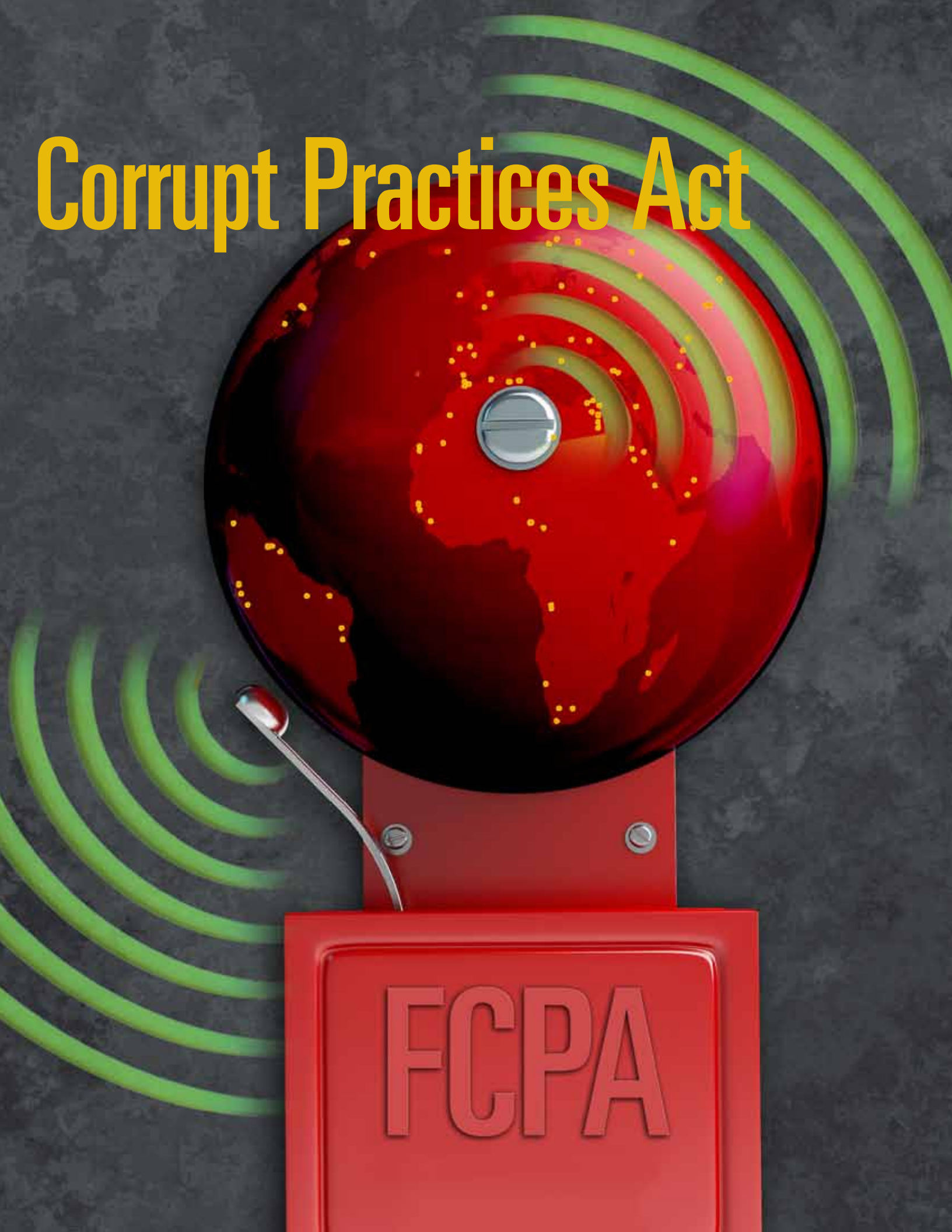
As many of you are aware, we in the Criminal Division of the Department of Justice have dramatically increased our FCPA enforcement over the past two years. As one metric,

in the last year, we have imposed the most criminal penalties in FCPA-related cases in any single 12-month period ever—well over \$1 billion. In addition, last year and this year combined, we have charged more than 50 individuals with FCPA-related offenses—compared, for example, with two individuals in 2004, and five individuals in 2005.

Additionally, the Organization for Economic Co-operation and Development (OECD) released a report in October 2010 (two months before the DOJ's specific announcement that FCPA prosecutions and settlements were “dramatically” increasing) that commended the United States on its increased FCPA enforcement and its “... dedication of resources to specialized units in the Department of Justice (DOJ), the Federal Bureau of Investigation (FBI) and Securities and Exchange Commission (SEC).”<sup>1</sup> This international acknowledgement reinforces the perception that FCPA enforcement by the U.S. government will continue to strengthen.<sup>2</sup>

Companies, including banks, need to listen and take heed. The settlements and penalties for FCPA violations are high and

# Corrupt Practices Act



FCPA



may include disgorgement and additional fines imposed by other countries under similar laws. The settlements may also provoke civil cases of fraud or related assertions. Plus, under the settlement agreements, companies may also be required to hire FCPA consultants for as long as four years. Individuals, such as the 22 people arrested at a show for defense and security products through a sting operation, may be looking at jail time.<sup>3</sup> The 2009 case against Nature's Sunshine, a nutritional supplement provider, included a "control person" standard,<sup>4</sup> which certainly raised the bar for management awareness.

### The FCPA's Purpose

According to the U.S. Department of Justice, the basic purpose of the FCPA is as follows:

The Foreign Corrupt Practices Act of 1977, as amended, 15 U.S.C. §§ 78dd-1, et seq. ("FCPA"), was enacted for the purpose of making it unlawful for certain classes of persons and entities to make payments to foreign government officials to assist in obtaining or retaining business. Specifically, the anti-bribery provisions of the FCPA prohibit the willful use of the mails or any means of instrumentality of interstate commerce corruptly in furtherance of any offer, payment, promise to pay, or authorization of the payment of money or anything of value to any person, while knowing that all or a portion of such money or thing of value will be offered, given or promised, directly or indirectly, to a foreign official to influence the foreign official in his or her official capacity, induce the foreign official to do or omit to do an act in violation of his or her lawful duty, or to secure any improper advantage in order to assist in obtaining or retaining business for or with, or directing business to, any person.<sup>5</sup>

Basically, the act requires that U.S. individuals and corporations (U.S. issuers including their subsidiaries, and domestic concerns<sup>6</sup>) not corruptly pay, offer, or promise anything of value to foreign officials in order to obtain or retain business. Included in the act is a requirement that corporations meet certain accounting standards, including maintaining books and records that accurately reflect transactions, and a system of internal accounting controls. This article will not discuss the books and recordkeeping aspects of the FCPA. However, it is important to be aware that many of the recent FCPA penalties against companies are based on inaccurate accounting records the companies kept in order to hide the corrupt payments. This recordkeeping provision could also ensure more documentary evidence for a prosecutor to rely on if a case makes it to the court system,<sup>7</sup> and the penalties under these accounting provisions are much higher than under the bribery provisions.<sup>8</sup>

## Eleven Reasons to Listen, as FCPA May Apply

Even if your bank does not execute business outside of the United States, the FCPA may still have some applicability due to its broad provisions and definitions. As FCPA settlements are coming out almost daily, this article can only touch on the basics of the law and its early enforcement considerations. But as a compliance professional, raise your level of awareness by at least reviewing the act further as it relates to your bank. Doing so may offer the impetus to create a compliance program to ensure your bank and its employees are aware of and complying with the FCPA provisions.

### REASON 1: The Drone—SEC Request Letters Targeting Financial Institutions

The SEC request letters that 11 large financial institutions and firms received at the start of 2011 are validation that banks are prime candidates for investigations. These request letters asked for information on the financial institutions' sovereign wealth funds and how those investments were managed in accordance with the FCPA.<sup>9</sup> According to Mayer Brown, the letters also asked for details on the institutions' FCPA programs, an open-ended question that indicates the government is also concerned with the institutions' overall FCPA compliance controls.<sup>10</sup>

Now that the exchange of funds being invested into the bank or managed by the bank is part of the FCPA equation, compliance professionals should realize that transactions with or to foreign governments or officials will be reviewed by the institutions' regulatory agencies, if not the SEC or DOJ. Though the request letters focused on large institutions and international funding, they also offer an alert to banks of all sizes that FCPA compliance programs and controls are expected to be in place. During agency reviews, the primary expectations of financial transactions will be twofold: (1) the transactions consist of appropriate payments that are clean of any bribery, and (2) the transactions are accurately recorded within internal accounting standards and controls.

The letters also validate that FCPA investigations are expanding into all types of international businesses. Many of the early FCPA settlements were with companies in industries such as oil and energy, food and tobacco products, transportation, and telecommunication. For instance, the settlement against *Siemens and its subsidiaries* is still the largest to date, with a U.S. fine of \$450 million and disgorgement of profits of \$350 million (German penalties brought the combined payments to \$1.6 billion).<sup>11</sup> However, recent settlements involve all types of industries; any type

of company may be at risk if an international aspect and corrupt dealings are involved. Between the SEC request letters and various industries' being the focus of investigations, the conclusion is that banks of all sizes will be expected to have compliance programs in place in order to meet the FCPA's requirements.

### **REASON 2: The Sound and Strength of a Tornado—We're Not Just Covering Kansas Anymore!**

If you read "global" above and thought your community bank was exempt from the FCPA, please continue reading. The FCPA's coverage is broad in a number of ways. For instance, the act applies to the SEC's definition of issuers of securities, which includes foreign-based companies holding stock under one of the U.S. exchanges. Moreover, for non-U.S. companies, "corrupt" business could still be captured under the FCPA through the use of U.S. mail or other "interstate commerce."<sup>12</sup>

Perhaps more importantly, the DOJ's *Lay-Person's Guide* to the FCPA clarifies that "interstate commerce" does not have to apply if the bribery occurred in the United States:

A foreign company or person is now subject to the FCPA if it causes, directly or through agents, an act in furtherance of the corrupt payment to take place within the territory of the United States. There is, however, no requirement that such act make use of the U.S. mails or other means or instrumentalities of interstate commerce.<sup>13</sup>

In addition, recent settlements are holding to the broad inclusion, as subsidiaries of U.S. issuers are being investigated, even if the subsidiaries are not U.S.-based. For instance, the 2009 KBR, Inc./Kellogg Brown & Root LLC/ Halliburton Co. settlement is just one example in which multinational (including non-U.S.) subsidiaries were heavily penalized (KBR/Halliburton paid \$177 million in disgorgement; Kellogg Brown & Root paid a \$402 million fine and must retain a compliance monitor).<sup>14</sup>

Lastly, if your bank conducts business through vendors or other third parties from or doing business in foreign countries, liability could be implicated through an agency theory (discussed in Reason 7).

### **REASON 3: Whoa! Don't Be Surprised by Who's Considered a "Foreign Official"!**

The most frustrating aspect of the FCPA is perhaps its broad, all-encompassing definitions. For instance, when most employees hear that the FCPA applies to business transactions with "foreign officials," they think of a person in a high-level government position, and hence that the act won't apply to their interactions. However, as compliance professionals, our duty is to emphasize that the FCPA is a law of broad requirements and applicability. Train your bankers that foreign officials can include employees of any state- or government-owned company—that is, an employee

## **Explain to bankers that the negotiation tools of the past now raise risk not only for the bank, but also for the banker personally.**

at any level of any state-owned company. And in many countries, the government owns or has invested in the hospitals, the bridge and road systems, and other industries. "State-owned" may be considered with a government contribution as small as 1 percent, which could encompass a considerable number of companies in some countries. Therefore, warn your bankers that situations such as paying an extra fee to an administrator working at a county-owned toll road may fit the FCPA bill, so to speak.

### **REASON 4: Fore! Golfing, Gifts, and Other Entertainment—Where to Draw the Line in the Sand?**

The FCPA sand trap can be quite deep, as the FCPA's definition of "anything of value" is also broad. Discuss with your retail bankers gifts and entertainment that are already restricted by your code of ethics or other policies, because the U.S. FCPA and other countries' anti-bribery laws are focusing on the expense of items and any elaborate events or dinners. Emphasize that any items or outings that are more than nominal in cost must be approved by compliance. Explain to bankers that the negotiation tools of the past now raise risk not only for the bank, but also for the banker personally. The FCPA may encompass any barbers, even those once considered professional courtesies such as job opportunities for family or friends.

Unfortunately, this new reality under the FCPA is emphasized with each enforcement action, and the U.K. Bribery Act (discussed below) only strengthens this broad "anything of value" interpretation.

### **REASON 5: The Clanging and Clattering of the "Facilitation Payment"**

Perhaps certain laws buzz louder than others because they eliminate years of *modus operandi*. For instance, lending discrimination and kickbacks were once the norm, unfortunately, and laws against such acts are still viable after years of enforcement. Forcing change can create a ruckus, especially on the retail side of the house. While compliance professionals may understand the need for new procedures, relationship builders are given sometimes-conflicting responsibilities: bringing in business on the one hand and heeding the numerous ways they are prohibited from conducting business on the other. The conflict is especially apparent with banks that conduct business in other countries, because in some countries the reality underlying most transactions is bribery. The FCPA and other anti-bribery laws are holding corporations accountable to higher standards than the laws of the countries in which they are conducting business, and therefore routine business operations

in those countries may be considered bribery. This is especially true in high-risk countries such as India, Russia, and Nigeria.

The FCPA does include a “routine governmental action” exception. This exemption allows for some of the payments more commonly referred to as “facilitation payments.” According to the act, the exception for “routine governmental action” is described as

... any facilitating or expediting payment to a foreign official, political party, or party official the purpose of which is to expedite or to secure the performance of a routine governmental action by a foreign official, political party, or party official.<sup>15</sup>

For instance, a routine way of doing business in some countries is to pay nominal fees for licenses, building permits, or needed utility services, and so far, some of these payments are still acceptable under the FCPA. This exception lurks in a very gray area, however. First, what is considered routine or nominal? Other countries’ laws do not allow for such exemptions, so will the allowable exception tighten? Certainly under today’s scrutiny, bankers, including our sourcing experts, may not want to decide what fees should be paid without a compliance or legal expert to make an all-encompassing determination as to whether the fee would really meet the FCPA exception and current standards.

#### **REASON 6: The Related and Almost-Deafening U.K. Bribery Act**

Though this article focuses on the FCPA, it’s difficult to mention the act without mentioning the long-awaited revised U.K. Bribery Act. Many experts expect the U.K. Bribery Act, finally effective in April 2011, to be louder and more tedious than the FCPA for a couple of reasons. First, the U.K. Bribery Act covers business with “foreign officials” and with commercial businesses. Second, the act does not allow for facilitation payments. Third, while the FCPA includes an affirmative defense for necessary travel, lodging, demonstration of products, and other expenditures, the U.K. Bribery Act does not.<sup>16</sup>

Additionally, a higher standard is expected because the U.K. Bribery Act includes liability for “failing to prevent” bribery. In September 2010 the U.K. Ministry of Justice released draft guidance of six principles needed in an anti-bribery program to meet this higher standard:

1. Regular assessments of the bribery risks faced by the organization
2. Top-level commitment from management to the prevention of bribery
3. Due diligence procedures covering all parties to the business relationship
4. Clear, practical, and accessible anti-bribery policies and procedures
5. Effective implementation of anti-bribery policies and procedures
6. Monitoring and review mechanisms to ensure compliance<sup>17</sup>

From the guidance, it appears that only those companies that

have anti-bribery programs in place, including risk assessments, policies, and procedures, will be able to adequately defend themselves under the U.K. act. The act’s potential implications caused enough concern that a joint effort of the U.K. Treasury and Department of Business, the Growth Review, examined the act to identify challenges it may bring to economic growth. In regard to the review, however, a spokesperson from the Ministry of Justice clarified that corruption would not be tolerated, and further guidance would be issued to assist companies with implementation on compliance with the act.<sup>18</sup> Because the review spurred guidance but not leniency, have a U.K. Bribery Act compliance program in place by April if your bank or any of its subsidiaries transacts business in the U.K.

#### **REASON 7: Are You Knocking on Third Parties’ Doors? Their Liability Could Be Knocking Down Yours**

Due to your bank’s limited business scope and international transactions, before reading this article you might have been thinking that the FCPA did not apply to your institution. However, if your bank hires third parties, be they vendors, subcontractors, attorneys, collection agents, call centers, or any others, these parties are subject to the FCPA provisions, and their liability could implicate your bank. For instance, if your bank or a subsidiary hires a construction company that is building a branch in another country, and the contractor pays excess fees for special allowances, the bank will be held accountable for the third-party contractor’s actions.

The DOJ warned about third-party liability with agents (intermediaries) in its *Lay-Person’s Guide*:

The FCPA prohibits corrupt payments through intermediaries. It is unlawful to make a payment to a third party, while knowing that all or a portion of the payment will go directly or indirectly to a foreign official. ... Intermediaries may include joint venture partners or agents. To avoid being held liable for corrupt third party payments, U.S. companies are encouraged to exercise due diligence and to take all necessary precautions to ensure that they have formed a business relationship with reputable and qualified partners and representatives.

Further considered on the third-party spectrum are customers. Recent enforcement actions against a Swiss freight forwarder, Panalpina World Transport (Holding) Ltd., and six related oil or oil service companies (together referred to as “Panalpina”) confirmed that customers are not out of reach of the long arm of the FCPA. According to the *2010 Year-End FCPA Update*, “Generally speaking, the SEC lacks enforcement jurisdiction over companies that are not publicly traded in the United States, but it reached Panalpina by charging that it aided and abetted and acted as an agent of its U.S.-issuer customers in their violations of the statute.”<sup>19</sup>

For bankers, the important takeaway from the Panalpina settlement is validation of the FCPA’s reach to customers. This reminds bankers to include clients in their FCPA reviews, because it’s not far-fetched to assume that the future of the FCPA will

include holding a bank liable for a client's corruption. Though bank compliance programs already include "know your customer" provisions, it's time to link portions of the bank's AML compliance program to an FCPA compliance program in order to review larger clients that are either foreign companies or U.S. companies that deal in international transactions. In addition, AML fraud reviews may also include FCPA concerns.

**REASON 8: How Loud Is It in a Prison Cell? Your Management Team and Board Don't Want to Know!**

As mentioned above, using a "control person" standard, in July 2009 the president and CEO and the former CFO of Nature's Sunshine, without admitting guilt, each consented to civil injunctions with the SEC and paid penalties of \$25,000. These civil injunctions and penalties were in addition to the company's consent to an entry of a permanent civil injunction and penalty of \$600,000.<sup>20</sup> The Nature's Sunshine case validates that control person liability is not dependent on whether or not the individual was involved in the actual bribery, and also substantiates that the liability could apply despite the fact that the control person was unaware of the crime perpetrated. While control person liability is not specified in the FCPA, the term "knowing" is defined as follows:

- A. A person's state of mind is "knowing" with respect to conduct, a circumstance, or a result if
  - i. such person is aware that such person is engaging in such conduct, that such circumstance exists, or that such result

- is substantially certain to occur; or
  - ii. such person has a firm belief that such circumstance exists or that such result is substantially certain to occur.
- B. When knowledge of the existence of a particular circumstance is required for an offense, such knowledge is established if a person is aware of a high probability of the existence of such circumstance, unless the person actually believes that such circumstance does not exist.<sup>21</sup>

The second part of the definition clarifies that even if management is not specifically aware of a particular situation, the "knowing" standard can be met if it's probable that the situation exists. The Nature's Sunshine injunctions reiterate this high standard, further emphasizing that your role as a compliance professional includes creating a program strong enough to protect against bribery to the degree that management would never presume it was occurring.

Former Senator Alan Specter (D-Pa.) emphasized the importance of individuals' being prosecuted for FCPA violations at a Senate subcommittee hearing on November 30, 2010. Specter questioned the DOJ on the imbalance of prosecutions, noting the numbers of individuals prosecuted from smaller companies versus large multinational companies paying high penalties without the individuals receiving criminal charges.<sup>22</sup> Butler University's Mike Koehler, known as the "FCPA professor" for his FCPA Blog, wrote an article in late 2010 titled "The Façade of FCPA Enforcement" that details the imbalance of individual prosecutions.<sup>23</sup> If Specter

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and Koehler's message is heard, regardless of penalties being paid by the company involved, individuals will also be prosecuted. Following the broad implications of the FCPA in other respects, management will then also be prosecuted.

**REASON 9: The Sound Only the DOJ and SEC Can Hear—an Extraordinary Lack of Case Law**

“Settlements, settlements, settlements!” Frustration is building with regard to the almost-perfect situation the government has created on the FCPA front. Primarily due to the expense involved, companies are settling before FCPA cases are fully prosecuted. For that reason, case law precedence is lacking and the FCPA remains open to interpretation—which, based on the high dollar amounts of the penalties, seems to work in the agencies' favor. This area of undeveloped case law supports the SEC's and DOJ's enforcement power<sup>24</sup> and leaves the companies uncovering potential FCPA violations feeling like they have limited options and are, frankly, covered with freckles.

**REASON 10: If an FCPA Violation Occurs and Compliance Isn't Around to Disclose It, Will It Still Make a Sound? The Importance of a Strong Compliance Program, Discovery, and Disclosure of Violations**

The number of FCPA investigations keeps rising, and many of those were brought to the DOJ or SEC by the companies involved when they uncovered potential violations. While the initial investigations are not always made public, many companies are now disclosing on their financial statements monies set aside for upcoming investigations, negotiations, and potential settlements. These companies may be heeding the DOJ's suggestion that disclosure of a violation and cooperation during the investigation will lead to more lenient settlements. Of course, questions arise regarding the reality of the supposed disclosure leniency, especially for smaller violations, because once disclosed, costs are then probable for a detailed government investigation, the potential settlement, reputation risk, and therefore potential civil or other settlements abroad.

The other hint at leniency is that it will be given to institutions having strong compliance programs. A company may receive credit during sentencing for a compliance program if, for instance, the company can show that the individual “briber” was acting out of alignment with company policy, or if a compliance program either raised the violation or was in place to prevent such situations. The good news is that in 2010 the DOJ noted in its enforcement decisions for at least two companies that it credited the companies for their “pre-existing compliance programs.”<sup>25</sup>

Of course, your bank should have a strong FCPA compliance program in place because it will soon become a required measure (if it's not already, based on the SEC request letters mentioned above). The program should include a detailed investigation of any potential bribery, escalation measures to raise the issue to senior management and appropriate committees, and escalation of any potential FCPA violations to legal counsel in order to pro-

tect discovery and determine the appropriateness and timing of disclosure. Additionally, the U.K. Bribery Act has reinforced the need for a compliance program because the ministry has stated quite clearly that an adequate program will lessen company liability. If your bank or any of its subsidiaries does business in the U.K., create an overall anti-bribery compliance program to include both the FCPA provisions and the U.K. Bribery Act.

One more important awareness to have regarding an FCPA compliance program is what to look for during due diligence reviews of new vendors and when acquiring or merging with other banks. The acquiring bank will be found liable for the sins of the company it acquires, even if it did not own the company during the corruption. If the vendor or bank being reviewed did not have a compliance program in place or any bribery or FCPA bank awareness, the risk of taking on another's FCPA violation is great, especially if the company or bank has international subsidiaries, vendors, or clients, or deals in international transactions.

**REASON 11: The Whistle We Can All Hear—the Whistleblower Provisions and FCPA**

Compliance professionals are already well aware of banking reform taking shape through the Dodd-Frank Wall Street Reform and Consumer Protection Act, which includes a new whistleblower provision, Section 922. This section covers the FCPA and includes very large rewards for employee whistleblowers, who can receive between 10 percent and 30 percent of successful monetary sanctions over \$1 million (including “penalties, disgorgement, and interest”). The percentage received depends on the level of assistance the whistleblower's information gives the DOJ/SEC toward the monetary settlement. A few other requirements apply for the whistleblower to receive payment, including that the information must be “original information” that was not already known to the SEC or part of a government investigation, audit, or exam. The whistleblower can obviously not be criminally charged in relation to the corruption. Certainly, however, employees now have a huge incentive to blow the whistle, which increases companies' voluntary disclosure of FCPA violations and overall increases the FCPA alarm warning banks to prepare sound FCPA compliance programs.<sup>26</sup>

If the 11 reasons above are not enough to jolt you into creating an FCPA compliance program, certainly the penalties of over a billion dollars in 2010 are strong motivation. Because individuals are being investigated and penalized, especially those at small to mid-sized companies, even small or community banks should train their employees and management. Then there are a variety of additional expenses related to FCPA settlements due to disgorgement, required hiring of compliance consultants, civil cases, and penalties from other countries with their own anti-bribery laws. Furthermore, the upcoming whistleblower provisions of the Dodd-Frank Act and the SEC letters specifically targeting financial institutions' compliance programs emphasize that it's time for banks to hear the FCPA alarm and take compliance action. ■

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