

Client Alert

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Effective Compliance Program Helps Investment Bank Avoid FCPA Criminal Charges

When a former Morgan Stanley Managing Director pled guilty recently to a criminal violation of the U.S. Foreign Corrupt Practices Act ("FCPA"), the effectiveness of the bank's pre-existing anti-corruption compliance program convinced enforcers at the U.S. Department of Justice ("DOJ") and Securities and Exchange Commission ("SEC") not to charge the bank itself.

Garth Peterson pled guilty to one count of conspiring to circumvent the system of internal controls that the bank maintained to prevent violations of the FCPA. United States v. Peterson, Cr. No. 12-224 (JBW) (E.D.N.Y. April 25, 2012). The SEC also charged the executive with violating the FCPA and securities laws for investment advisors. SEC v. Peterson, No. 12-2033 (JBW) (E.D.N.Y. April 25, 2012). Peterson, who was terminated by Morgan Stanley, is scheduled to be sentenced in the criminal case in June. He also settled with the SEC by surrendering his \$3.4 million interest in Shanghai real estate, agreeing to disgorge \$250,000, and accepting a permanent bar from the securities industry.

The case is instructive for multinational companies in several respects. First, for some time now the DOJ and SEC have said they are closely scrutinizing the financial services industry for FCPA violations, and this case is the first FCPA prosecution involving a private fund investment advisor. We expect more to follow in the near future. Second, the case arises out of conduct involving a Chinese state-owned enterprise ("SOE"), which is the basis for a growing number of FCPA enforcement actions. Finally, and most significantly, both the DOJ and SEC elected not to charge Morgan Stanley itself, and cited the company's effective ethics and compliance program as the primary basis for the decision. The enforcement agencies have for some time been broadcasting the message that self-disclosure, cooperation, and investment in compliance count, but until now there has been little tangible evidence of the benefits in doing so. These cases send that message very strongly and clearly.

Facts of the Case

Peterson, 42, was a Managing Director in Morgan Stanley's Chinese real estate investment and fund advisory group. His principal responsibility was to evaluate, negotiate, acquire, manage, and sell real estate investments on behalf of Morgan Stanley's advisors and funds. He had a personal friendship and secret business relationship with the former Chairman of Yongye Enterprise (Group) Co., a Chinese SOE with the influence to be able to assist Morgan Stanley's investment business in Shanghai. Between 2004 and 2007, Peterson secretly arranged to have at least \$1.8 million paid to himself and the Chinese official. He disguised the payments as finder's fees that Morgan Stanley's funds owed to third parties. Peterson also secretly arranged for him, the Chinese official, and an unidentified

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Canadian attorney to acquire a valuable Shanghai real estate interest from a Morgan Stanley fund. The Chinese official helped Peterson and Morgan Stanley obtain business in exchange for payments from Peterson.

Assistant Attorney General Lanny Breuer said, "Mr. Peterson admitted [] that he actively sought to evade Morgan Stanley's internal controls in an effort to enrich himself and a Chinese government official. As a Managing Director for Morgan Stanley, he had an obligation to adhere to the company's internal controls; instead, he lied and cheated his way to personal profit. Because of his corrupt conduct, he now faces the prospect of prison time."

The DOJ and SEC Decline to Charge Morgan Stanley

Given the facts and Peterson's executive position, the DOJ and SEC arguably could have charged Morgan Stanley with criminal and civil violations of the anti-bribery and books and records and internal controls provisions of the FCPA. Morgan Stanley benefitted from self-disclosing the conduct, cooperating with the government investigations, and taking remedial action by firing Peterson. But the biggest reason for the decisions by the DOJ and SEC not to prosecute was the bank's pre-existing ethics and compliance program, and it was that factor that the enforcers highlighted in their press releases and public comments.

The DOJ press release stated, "After considering all the available facts and circumstances, including that Morgan Stanley constructed and maintained a system of internal controls, which provided reasonable assurances that its employees were not bribing government officials, the Department of Justice declined to bring any enforcement action against Morgan Stanley related to Peterson's conduct. The company voluntarily disclosed this matter and has cooperated throughout the department's investigation."

The SEC Complaint expressly laid out the details of Morgan Stanley's anti-corruption compliance program and how it directly related to Peterson. The Complaint specified:

- (1) Morgan Stanley trained Peterson on anti-corruption policies and the FCPA at least seven times between 2002 and 2008. In addition to other live and web based training, Peterson participated in a teleconference training conducted by Morgan Stanley's Global Head of Litigation and Global Head of Morgan Stanley's Anti-Corruption Group in June 2006.
- (2) Morgan Stanley distributed to Peterson written training materials specifically addressing the FCPA, which Peterson maintained in his office.
- (3) A Morgan Stanley compliance officer specifically informed Peterson in 2004 that employees of Yongye, a Chinese SOE, were government officials for purposes of the FCPA.
- (4) Peterson received from Morgan Stanley at least 35 FCPA-compliance reminders. These reminders included FCPA-specific distributions; circulations and reminders of Morgan Stanley's Code of Conduct, which included policies that directly addressed the FCPA; various reminders concerning Morgan Stanley's policies on gift-giving and entertainment; the circulation of Morgan Stanley's Global Anti-Bribery Policy; guidance on the engagement of consultants; and policies addressing specific high-risk events, including the Beijing Olympics.

- (5) Morgan Stanley required Peterson on multiple occasions to certify his compliance with the FCPA. These written certifications were maintained in Peterson's permanent employment record.
- (6) Morgan Stanley required each of its employees, including Peterson, annually to certify adherence to Morgan Stanley's Code of Conduct, which included a portion specifically addressing corruption risks and activities that would violate the FCPA.
- (7) Morgan Stanley required its employees, including Peterson, annually to disclose their outside business interests.
- (8) Morgan Stanley had policies to conduct due diligence on its foreign business partners, conducted due diligence on the Chinese official and Yongye before initially conducting business with them, and generally imposed an approval process for payments made in the course of its real estate investments. Both were meant to ensure, among other things, that transactions were conducted in accordance with management's authorization and to prevent improper payments, including the transfer of things of value to officials of foreign governments.

Similarly, the charging document in the criminal case devoted five pages to describing in great detail Morgan Stanley's internal controls. And the DOJ's press release, which made clear that the decision not to charge the bank was based on the voluntary disclosure, cooperation, and pre-existing compliance program, pointed out that Morgan Stanley:

- Maintained a system of internal controls meant to ensure accountability for its assets and to prevent employees from offering, promising or paying anything of value to foreign government officials;
- Developed internal policies which prohibited bribery and addressed corruption risks associated with the giving of gifts, business entertainment, travel, lodging, meals, charitable contributions and employment, and updated those policies regularly to reflect regulatory developments and specific risks;
- Frequently trained its employees on its internal policies, the FCPA and other anti-corruption laws. Between 2002 and 2008, Morgan Stanley trained various groups of Asia-based personnel on anti-corruption policies 54 times. During the same period, Morgan Stanley trained Peterson on the FCPA seven times and reminded him to comply with the FCPA at least 35 times;
- Compliance personnel regularly monitored transactions, randomly audited particular employees, transactions and business units, and tested to identify illicit payments; and
- Conducted extensive due diligence on all new business partners and imposed stringent controls on payments made to business partners."

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Lessons for Multinational Businesses

This case provides important guidance to companies as to what the DOJ and SEC think is important. Combined with the guidance provided in Attachments C and D in several DOJ dispositions (most notably the recent Johnson & Johnson Deferred Prosecution Agreement), companies now have substantive guidance as to what the enforcement agencies expect a compliance program to look like.

Assess risks and update policies and procedures regularly. Corporate ethics and compliance programs are not static. The DOJ has made clear that it expects companies to regularly assess risks and to review and update their policies to reflect evolving best practices.

Training should be frequent. The fact that Morgan Stanley provided frequent anti-corruption training was a clear signal that the organization was truly committed to anti-corruption compliance.

Compliance reminders. Peterson received FCPA compliance reminders at least 35 times over seven years. Morgan Stanley effectively used these simple and inexpensive reminders to hammer home its message of compliance.

Document training. The importance of being able to document and reconstruct an organization's compliance efforts can not be understated. The charging documents in this case are filled with exact numbers specifying just how many times Peterson received FCPA training, and how many compliance reminders he had received. Morgan Stanley effectively documented and tracked the training it provided, and as a result received an enormous benefit.

Due Diligence. Morgan Stanley monitored transactions, conducted random audits of employees, transactions and business units, and tested to identify illicit payments. Moreover, the organization conducted extensive due diligence on all new business partners and imposed stringent controls on payments made to business partners.

Although DOJ and SEC officials have many times claimed that companies receive a benefit from investing in ethics and compliance programs, up to this point there has been little solid evidence of that benefit. With this case, however, the enforcers have made clear just how important an effective ethics and compliance program can be, and just what an enormous benefit investment in the program can bring.