

# U.S. Regulatory and Criminal Cross-Border Enforcement



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## ■ Overview

The players in U.S. cross-border enforcement:

- SEC – Securities and Exchange Commission
- DOJ – Department of Justice.
- IRS – Internal Revenue Service.
- PCAOB – Public Company Accounting Oversight Board.
- FINRA – Financial Industry Regulatory Authority.

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## ■ Overview (continued)

The SEC and other U.S. authorities are significantly expanding their enforcement efforts, including overseas.

- Surveillance units of U.S. regulatory authorities are more thoroughly scanning the securities markets looking for fraudulent activities.
- The number of serious SEC investigations ("Formal Orders" issued) has more than doubled from 126 as of August 2008 to 275 as of August 2009.
- The U.S. Department of Justice (which often conducts criminal investigations while the SEC conducts civil investigations) is reported to have 120 to 130 companies under active investigation for overseas bribery under the Foreign Corrupt Practices Act (FCPA), a law largely dormant until the last several years. This year, two of the SEC's three largest corporate settlements have involved foreign bribery.

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## ■ Overview (continued)

- The Internal Revenue Service is cracking down on overseas accounts used to hide assets taxable in the U.S. Following, Switzerland's unprecedented agreement to reveal information on 4,450 secret Swiss bank accounts as a result of prosecution of UBS AG for assisting tax evasion, 14,700 taxpayers voluntarily disclosed foreign accounts to the IRS.
- Our experience shows a broader and more concerted effort to reach cross-border than we have seen in recent years. While in previous years our clients' cases focused on accounting irregularities and options backdating, today more cases relate to insider trading and FCPA violations.

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## ■ Reasons for Expanded Enforcement

There are various reasons for the increase in enforcement efforts.

- Global Financial Crisis and Perceived Regulatory Failings: The perceived lack of government regulation and oversight associated with the banking and stock markets crises led to calls for increased enforcement against fraudulent market activities of all kinds.
- New Leadership with New Attitudes: New leaders in Washington have brought a renewed focus on enforcement, including the SEC's new head of Enforcement Robert Khuzami, a former federal prosecutor.
- Madoff Scandal and Perceived SEC Failings: This \$65 billion Ponzi scheme continued for years as the SEC ignored credible and specific tips going back to at least 1999.

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## ■ Reasons for Expanded Enforcement (cont.)

- Significant changes in the SEC's Enforcement Division this year:
  - Permission for staff members in the Enforcement Division to subpoena documents, compel witness testimony, and negotiate settlements that include corporate penalties without prior approval from the five-member SEC commission.
  - Formation of specialized groups focusing on key, new SEC priorities, including a group focused on Hedge Funds and similar entities, a group focused on complex manipulation schemes, and a group focused on commercial bribery overseas.
- Increased International Enforcement and Ease of Obtaining Records:
  - More than 50 nations, including Israel, have signed a securities fraud enforcement treaty since 2002 making it easier to obtain records cross border.
  - At the same time, 38 nations, including Israel, have signed an anti-bribery convention to illegalize bribery outside their borders. Israel passed a law in 2008 making such payments illegal for the first time.

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## ■ Changes in Market Surveillance

In the last year, enforcement authorities have increasingly scanned market data for insider trading and other forms of manipulation.

- The SEC traditionally deferred market surveillance to a variety of private self-regulatory organizations (SRO's) with authority over investment professionals and the U.S. stock markets.
- Each SRO analyzed trading data and conducted initial investigations. Matters were referred to the SEC only regarding illegal conduct by a non-member or by a member requiring sanctions the SRO was unable to impose.
- These efforts were dispersed and uncoordinated. As a result, certain trading practices avoided detection, such as trading across multiple stock markets and trading platforms.

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## ■ Changes in Market Surveillance (cont.)

### ■ Two important changes:

1. The SRO's consolidated into one monopoly SRO in 2007 called the Financial Industry Regulatory Authority (or FINRA). Other than the NYSE, all U.S. listed securities are now examined by FINRA.
2. The SEC conducts its own serious market surveillance for the first time, seeking to ferret out suspicious market activity relating to multiple corporate announcements. The SEC is using advanced computer technology to identify firms and individuals routinely profiting from swings in share prices.

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## ■ How Market Surveillance Works

- Special software generates "alerts" based on movements in the price or volume of a security outside of set parameters.
- Such movements are linked to news about corporate transactions.
- Trade data identifies every individual and organization that traded in advance of the corporate transaction or event in question.
- A detailed chronology of events is obtained from the issuer and its investment bankers which includes deal milestones, such as the date of first contact between the parties and the date that pricing terms were first discussed.
- A list of all individuals who knew of these deal milestones before they were made public is obtained from the issuer and its investment banker.

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## ■ How Market Surveillance Works (cont.)

- This information is fed into powerful computers, which connect the people who traded with the people working on the corporate matter behind the scenes.
- Offenders from multiple deals and investigations are identified.
- Cases resulting from market surveillance have been increasing for years. The SEC opened 208 investigations in fiscal year 2006 from SRO referrals, up from 82 in fiscal year 2003. Nearly 80% of all SRO referrals to the SEC involve possible insider trading.

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## ■ Increased Insider Trading Enforcement

Assisted by the new data mining tools, the SEC and the DOJ have begun an unprecedented crackdown on insider trading by hedge funds and their advisory firms.

- In the last three months alone, more than 20 civil and criminal complaints have been filed by the SEC and DOJ, a scope of prosecution not witnessed since the late 1980s with Ivan Boesky.

This joint SEC-DOJ crackdown is unique for several reasons:

- Use of undercover techniques, including court-approved wiretaps – a first in insider trading cases.
- More extensive SEC subpoenas than in the past, for example seeking all emails rather than those on specific subjects.
- Greater insistence on interviewing everyone involved and not relying on document productions.
- High risk of parallel criminal prosecution by DOJ for virtually all insider trading cases the SEC investigates.

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## ■ FCPA Enforcement

Worldwide anti-bribery efforts are on the rise.

- The FCPA was enacted in the late 1970s. It prohibits the payment of anything of value to public officials overseas to secure business.
- Today, it is one of the most important weapons of both the SEC and the DOJ. The pharmaceutical industry is one of the biggest targets.
- Prosecution of individuals, and not just the corporations, is a key part of the new enforcement strategy. In 2009 to date, the DOJ has indicted 14 corporate managers and other persons under the FCPA and eight have been found or pleaded guilty.
- The FCPA also reaches:
  - U.S.-incorporated subsidiaries of non-U.S. companies.
  - Any foreign company registered or trading on U.S. stock markets.
  - U.S. nationals no matter where they work.
  - Non-U.S. companies who arrange bribes while in the U.S. or if U.S. travel is part of the bribe itself.

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## ■ FCPA Enforcement (cont.)

Two recent cases illustrate the expanding reach of FCPA enforcement:

- Frederic Bourke: An American investor in a privatization effort involving the state-owned oil company in Azerbaijan indicted not for paying a bribe, but for ignoring red flags indicating that bribes were being paid. Thus, he was indicted and later convicted for participating in the investment while he either knew of such bribes or showed "willful blindness" to such corrupt activities.
- Nature's Sunshine Products: This case invoked a provision of U.S. securities law allowing "control persons" to be held liable for the actions of those they fail to adequately supervise. In this case, the CEO and CFO settled FCPA charges against them individually despite no allegations by the SEC that they engaged in, knew about, or showed "willful blindness" to illegal payments made to Brazilian custom agents to permit entry of unlicensed medications.

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## ■ FCPA Enforcement (cont.)

Anti-bribery enforcement is not confined to U.S. authorities.

- Active anti-corruption investigations are underway in England, Germany, Norway, and Sweden, all of which have similar laws on the books.
- The Attorney General of Israel last month released guidelines for conducting Israeli investigations under the new Israeli law prohibiting the payment of commercial bribes outside of Israel.
- More likely than ever to be prosecuted in multiple jurisdictions for commercial bribery activity.

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## ■ How You Will Be Contacted If Subject to an Enforcement Action

- Cold call from Washington, D.C.
- Subpoena in the mail.
- Voluntary request letter from FINRA.
- Request from an Israeli authority based on cooperation agreements with U.S.
- In a worst-case scenario – arrest at JFK.

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## ■ Recommendations if Subject to an Enforcement Action

If contacted by a U.S. enforcement authority, recommended steps include:

- Preserve all related documents, including emails.
- Consider the advantages of cooperation with U.S. authorities.
- If you are a company, consider the advantages of conducting an internal investigation.
- Be truthful and straightforward – do not lie.
- Be careful about travel outside of Israel.
- Get a good lawyer.

