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BNY Mellon to Pay $14.8 Million to Settle "Corrupt" Hiring Charges for Providing Internships to Sovereign Wealth Fund Officials' Family Members

Internships Given to Family Members of Foreign Officials to Obtain Business are Bribes; Internal Accounting Controls Insufficiently Tailored to Business-Specific Hiring Risks Violate FCPA; State-Owned Entities Should Avoid Reputational and Other Risks Connected to Anti-Corruption Enforcement

Financial Institutions' Relationships with Sovereign Entities Under Scrutiny

On August 18, 2015, the U.S. Securities and Exchange Commission (**SEC**) announced a $14.8 million settlement of charges with The Bank of New York Mellon (**BNY**) for BNY's having violated the Foreign Corrupt Practices Act (**FCPA**)[1] by providing to family members of Middle East sovereign wealth fund (the "**SWF**") officials "valuable student internships" for which they were not qualified, for the purpose of retaining and increasing business with the SWF.[2]

The BNY Settlement is noteworthy both for its application of the FCPA to connected hiring and its apparent status as the first official resolution by a U.S. authority of a number of reportedly pending investigations (by U.S., Asian, and potentially other authorities) of the hiring by financial institutions of "princelings" and other family members of foreign government officials (particularly officials of sovereign wealth funds and other state-owned enterprises).[3]

The BNY case and related investigations demonstrate how the relationship-based nature of the financial services business can trigger peculiar legal risks related to new markets and client types (*i.e.*, state-owned or affiliated enterprises). Recognizing the "unique corruption risks" faced by financial institutions trying to win business overseas, the SEC has pledged to continue its scrutiny of "'industries that have not been vigilant about complying with the FCPA.'"[4]

The BNY Settlement is discussed below, as are key takeaways.

Related MassPoint Publications

- Cross-Compliance for Financial Institutions: the Anti-Corruption – AML Nexus (and compilation of links to materials discussing corrupt hiring investigations).
- The World Wide Web of Anti-Corruption Enforcement: Direct and Collateral Consequences for U.S. and Non-U.S. Parties (private and state-owned).

Related Legal Materials*

- Foreign Corrupt Practices Act
- 反海外腐败法的反贿赂与账簿和记录条款 通过公法
- الأحكام المتصلة بمكافحة الرشوة ومسك الدفاتر والسجلات الواردة في قانون مكافحة الفساد في الممارسات ال خارجية

*Provided by U.S. Dept. of Justice

Sovereign Wealth Funds/State-Owned Enterprises Derivative Reputational, Other Risk

State-owned and affiliated enterprises (**SOEs**) and foreign officials implicated in FCPA-related enforcement matters are often (*but not always*) beyond prosecutorial reach (and interest).[5] Nevertheless, to avoid derivative reputational or other risk, SOEs should take steps to educate and incentivize their personnel to refrain from conduct that may trigger foreign enforcement against their private sector counterparties. Such an approach would be particularly valuable to sovereign wealth funds and other SOEs engaged in outbound and/or strategic investment and business activities. Moreover—and obviously—SOEs will want to avoid the commercial and governance risks that flow when their personnel make business decisions based on personal, rather than institutional, interests (such as making the decision to increase funds under management by a particular asset manager contingent on the asset manager's provision of internships to family members).

Relevance of Local Anti-Corruption Measures

As discussed in related MassPoint publications, U.S. financial institutions and others required to comply with the FCPA should take concerted steps to

understand local anti-corruption laws and developments in real time, and incorporate such laws and developments in their anti-corruption programs and policy messaging to counterparties, including those who may have new, locally imposed incentives to refrain from corrupt activities.[6]

The BNY Settlement: "Corrupt" Hiring in Violation of FCPA Anti-Bribery and Internal Controls Provisions

The FCPA prohibits the offering or giving of "anything of value" to "foreign officials" for the purpose of obtaining or retaining business advantage.[7] In addition, the FCPA requires certain "issuers" of securities to maintain internal controls and keep books and records that, *inter alia*, facilitate and reasonably assure the integrity of transactions.[8] The BNY internships (paid and unpaid) were "things of value" specially arranged and provided to obtain business advantage. They violated the FCPA's anti-bribery and accounting/internal controls provisions.

Things of Value, "Personal" Value Derived by Foreign Official

"Things of value" have typically taken the form of readily quantifiable "things" (*e.g.*, cash, contract awards, gifts, kickbacks, etc.) that directly benefit foreign official recipients (even if transmitted to a foreign official through a third party). However, as the SEC and U.S. Department of Justice (DOJ) have indicated, "an improper benefit can take many forms."[9] The BNY Mellon case stands out for its application of the FCPA to connected hiring and because the internships conferred direct value on third parties, and thereby indirectly benefitted foreign officials. In the SEC's words: "The internships were valuable work experience, and the requesting [foreign] officials derived significant personal value in being able to confer this benefit on their family members."[10]

> *"Cross-functional training should be reciprocal: to enhance business knowledge among legal and compliance personnel; enable quick connections between legal, regulatory and business dots; and, potentially, facilitate productive relationships between legal and compliance and business functions (these relationships too often are limited, reactive, or unnecessarily antagonistic)."*
>
> - Cross-Compliance for Financial Institutions: The Anti-Corruption – AML Nexus

Corrupt Purpose/Intent

BNY provided the internships at the "personal" request of the SWF officials (apparently without the SWF's knowledge) at a time when it was seeking to retain and increase its business with the SWF. One of the requesting officials, who importantly was in a position to determine the status and scope of BNY's mandate, told BNY that the internships "'represented an 'opportunity'" for BNY and that similar internships could be obtained from "'a competitor of BNY Mellon if it did not satisfy his personal request.'"[11] A BNY employee told colleagues that "by not allowing the internships to take place, we potentially jeopardize our mandate with'" the SWF.[12]

Deviation from Generally Applicable Standards; Knowledge and Approval of Senior Management

The family members of the SWF officials did not meet the "rigorous" hiring and performance standards of BNY's "existing internship programs" or further BNY's objective of "converting student interns to full-time hires."[13] The internships were specially arranged and provided with "the knowledge and approval of senior BNY Mellon employees."[14]

Deficient Internal Controls, Insufficient Tailoring to Business Line-Specific Hiring Risks

The SEC found BNY's internal accounting controls to be "insufficiently tailored to the corruption risks inherent in the hiring of client referrals, and therefore inadequate to fully effectuate BNY Mellon's policy against bribery of foreign officials."[15] Specifically, the SEC described:

- **Insufficient tailoring**. While BNY had a code of conduct and an FCPA compliance policy, "employees were provided with little additional guidance that was tailored to the types of risks related to the hiring faced by BNY Mellon's' [relevant] international asset servicing unit and asset management business division."[16] The SEC also noted that BNY "had few specific controls relating to the hiring of customers and relatives of customers***, including foreign government officials***" (emphasis added; see endnote on noteworthiness of this language that appears to include private, non-foreign official, customers).[17]

- **Insufficient training**. BNY provided FCPA training to employees, "but did not ensure that all employees took the training or understood BNY's policies."[18]

- **Insufficiently checked discretion; lack of HR training and legal or compliance oversight**. The SEC highlighted as problematic the "wide discretion" of sales staff and client relationship managers in "making initial hiring decisions."[19] The wide discretion exercised by profit-incentivized staff was unchecked because BNY's human resources personnel were "not trained to flag hires that were potentially problematic . . . [and] . . . no mechanism . . . ensure[d] that potential hiring violations were reviewed by anyone with a legal or compliance background."[20]

Key Takeaways

- "Things of value" under the FCPA need not be readily quantifiable or given directly to a foreign official.
- A foreign official need not receive or derive business or official value from a "thing" given or offered. "Personal value" derived by a foreign official is "value" for FCPA purposes.
- Employment/internships (paid and unpaid) trigger FCPA liability when given or offered to obtain or retain business advantage.
- The failure to apply programmatic or other policy-based hiring and performance criteria evidences corrupt intent or purpose, as well as internal controls deficiencies.
- To satisfy the FCPA's accounting/internal controls provisions, a compliance program must be sufficiently tailored to business line-specific risks relevant to client-facing *and* operational functions.
- Compliance programs and training protocols should be produced through cross-functional efforts: *i.e.*, by internal personnel and/or outside advisors that understand how business is actually conducted, applicable law, and the interplay of the two. As discussed in related MassPoint publications, companies should provide business training to legal and compliance personnel.
- While the children and other close family members of foreign government officials do not by themselves trigger FCPA prohibitions, they are Politically Exposed Persons subject to enhanced due diligence in the anti-money laundering context. Their special status should inform (but not determine) their treatment in non-financial transactions contexts. (*See, e.g.,* Cross-Compliance for Financial Institutions).
- The SEC has noted the "'unique corruption risks'" faced by financial services providers competing for business in international markets and will "'continue to scrutinize industries that have not been vigilant about complying with the FCPA.'"

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Notes

[1] Foreign Corrupt Practices Act of 1977, as amended, 15 U.S.C. §§ 78dd-1, et seq.

[2] U.S. Securities and Exchange Commission Release, *SEC Charges BNY Mellon with FCPA Violations*, August 18, 2015, *at* http://www.sec.gov/news/pressrelease/2015-170.html ("**SEC Release**"). *See also*, In the Matter of The Bank of New York Mellon, Order Instituting Cease and Desist Proceedings Pursuant to Section 21C of the Securities and Exchange Act of 1934, Making Findings, and Imposing a Cease and Desist Order, August 18, 2015, *at* http://www.sec.gov/litigation/admin/2015/34-75720.pdf (the "**BNY Settlement**").

[3] Some relevant news reports and financial institution disclosures are discussed in Hdeel Abdelhady, Cross-Compliance for Financial Institutions: the Anti-Corruption – AML Nexus, Butterworths Journal of International Banking and Financial Law, September 2014, and the companion thereto (compiling links to legal materials, news reports, and financial institution disclosures discussed therein). "Princelings" is a term that has appeared frequently in the news since 2013, in connection with reported investigations involving of the hiring of Chinese officials' sons and daughters (referred to in China as "princelings").

According to BNY, in January 2011 the SEC Enforcement Division informed BNY and "several financial institutions" that it had "commenced an inquiry into certain of their business practices and relationships with sovereign wealth fund clients." This was followed in the third quarter of 2014 with a Wells notices informing BNY that SEC staff had "made a preliminary determination to recommend enforcement" for FCPA violations "in connection with the provision of a limited number of internships to relatives of sovereign wealth fund officials." The Bank of New York Mellon Corporation, Quarterly Report (Form 10-Q) (July 30, 2015), 119-120, *at* https://www.bnymellon.com/_global-assets/pdf/investor-relations/form-10q-q2-2015.pdf.

[4] SEC Release (quoting Kara Brockmeyer, Chief, SEC Enforcement Division, FCPA Unit).

[5] *See, e.g.*, MassPoint Occasional Note, *The World Wide Web of Anti-Corruption Enforcement: Direct and Collateral Consequences for U.S. and Non-U.S. Persons (private and state-owned)* (stating that "foreign officials are beyond the FCPA's reach for bribe taking. But they are not beyond the reach of other, FCPA-related U.S. laws" and discussing collateral risk (*e.g.*, information disclosure) stemming from FCPA enforcement involving officials of state-owned enterprises).

[6] *See Cross-Compliance for Financial Institutions: The Anti-Corruption – AML Nexus, Butterworths Journal of International Banking and Financial Law*, September 2014 (discussing local anti-corruption developments in China) and *The World Wide Web of Anti-Corruption Enforcement: Direct and Collateral Consequences for U.S. and Non-U.S. Persons (Private and State-Owned)* (discussing local anti-corruption/governance developments in the Middle East and China).

[7] 15 U.S.C. § 78dd-1 (anti-bribery provisions applicable to "issuers") and 15 U.S.C. § 78dd-2 (anti-bribery provisions applicable to "domestic concerns"). A "foreign official" is: "[A]ny officer or employee of a foreign government or any department, agency, or instrumentality thereof, or of a public international organization, or any person acting in an official capacity for or on behalf of such government or department, or agency, or instrumentality, of for or on behalf of any such public international organization." 15 U.S.C. § 78dd-1(f)(1) (and parallel definitions applicable to non-issuers).

[8] The FCPA applies to: "Domestic Concerns" that are natural U.S. persons who are U.S. citizens, nationals, or residents of the United States; (2) "Issuers" that are foreign and domestic issuers of securities (including shares represented by American Depository Receipts) traded on a U.S. exchange or whose shares are traded over-the-counter in the United States and are required to file SEC reports; (3) other "Domestic Concerns" that are incorporated or unincorporated business or other organizations or associations that have their principal place of business in, or are organized under the laws of, the United States or any of its subdivisions; and (4) the officers, directors, employees, or agents of Issuers or Domestic Concerns, and their stockholders or others acting on their behalf. See also 15 U.S.C. § 78m(b) (Form of report; books, records, and internal accounting; directives provisions applicable to "issuers"). Persons that commit or facilitate acts prohibited by the FCPA within the United States or by means of the "instrumentalities" of U.S. interstate commerce come with U.S. authorities' prosecutorial reach.

[9] U.S. Department of Justice and U.S. Securities and Exchange Commission, *A Resource Guide to the U.S. Foreign Corrupt Practices Act*, 14, at http://www.justice.gov/sites/default/files/criminal-fraud/legacy/2015/01/16/guide.pdf (explaining that "[i]n enacting the FCPA, Congress recognized that bribes can come in many shapes and sizes. . . .").

[10] BNY Settlement at *para.* 21.

[11] BNY Settlement at *para.* 15.

[12] *Id.* at *para.* 16.

[13] *Id.* at *para.* 20.

[14] *Id.* at *para.* 23, and generally at *paras.* 19-24.

[15] *Id.* at *para.* 27.

[16] *Id.* at *para.* 25.

[17] *Id.* at *para.* 27. The SEC's language here is noteworthy. The FCPA is concerned with foreign officials. In the hiring context, the FCPA is concerned with the corrupt provision or offering of employment/internships (and, presumably, similar "things of value" such as board appointments). It is noteworthy that the SEC speaks to the "the hiring of customers and relatives of customers" that *"include*" foreign government officials, rather than focusing exclusively on foreign government officials. This seemingly expansive language, which seems beyond the foreign government official focus of the FCPA, fits more with anti-corruption laws, such as the UK Bribery Act, that reach corruption involving *private and public* actors.

[18] *Id.* at *para.* 26.

[19] *Id.* at *para.* 27.

[20] *Id.*