# U.S. Regulators Penalize Fund Advisers

In recent enforcement actions, fund advisers have run afoul of U.S. regulatory authorities. In a case involving the U.S. Foreign Corrupt Practices Act ("FCPA"), an individual, but not the company, was charged. On the other hand, in a proceeding before the Office of Foreign Assets Control ("OFAC"), a U.S. company was penalized for the action of its non-U.S. agent. Both cases offer lessons for compliance personnel.

## *1. FCPA: Lessons from Morgan Stanley's "Rogue" Employee*

Former Morgan Stanley employee Gareth Peterson reached a settlement with the U.S. Securities and Exchange Commission ("SEC") that will permanently bar him from the securities industry, as well as require disgorgement of more than $3 million in cash and real estate the SEC alleges was obtained via violations of the FCPA.[1] In addition to these civil penalties, Peterson will appear for criminal sentencing in June.[2] Peterson may be sentenced to up to five years in prison and ordered to pay up to $250,000, in addition to the civil penalties already paid.

The complaint against Peterson alleges that Peterson made corrupt payments to a Chinese official to secure business for Morgan Stanley's real estate fund. In what the SEC described as "cross[ing] the line twice," Peterson then secured part of the investment for himself — so that he could profit personally from the corrupt payment to the Chinese official.[3]

### *Why wasn't Morgan Stanley charged, too?*

The government took pains to note that Peterson was a "rogue" employee, based on Morgan Stanley's robust compliance program and cooperation with the U.S. government's probe. As the SEC noted in its press release, Morgan Stanley compliance personnel notified Peterson at least *35 times* about his obligations under the FCPA. In fact, Peterson even was advised that the Chinese official was a foreign official under the FCPA.[4] Morgan Stanley terminated Peterson when the FCPA violations came to light and cooperated with the SEC and the U.S. Department of Justice ("DOJ") by conducting its own extensive internal investigation. The U.S. government and Morgan Stanley internal investigations revealed the extensive efforts by Peterson — a "web of deceit" — to evade internal controls.

Morgan Stanley's internal compliance controls included:

- Frequent training, including in-person training by high-ranking persons within the organization;
- Customized advice regarding high-risk practices and even special events (such as the Beijing Olympics);
- Annual certifications of compliance;
- Annual disclosure of outside business interests of employees; and
- Due diligence of foreign transaction partners.

Notably, the government found no willful blindness on the part of Morgan Stanley. The U.S. authorities likely would have taken a different view of Morgan Stanley's actions had it ignored red flags and warnings.

### *What's next on the FCPA Front?*

This is the first FCPA enforcement action involving a private fund investment adviser. Rather than an anomaly, this case more likely is a harbinger of things to come. A trend in FCPA enforcement is an industry-wide probe following an enforcement action against a company within that industry. Examples in the past five years include

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the investigations against Bristol-Myers Squibb in the pharmaceutical and medical device industries, or Alcatel-Lucent in the telecommunications industry.

Companies should take this moment to examine internal controls:

- When was the last time the effectiveness of the company's FCPA compliance program was assessed?
- Is the program designed to effectively militate against the types of violations that can occur in today's business environment?
- Does the program provide adequate guidance and training to key employees?

Rigorous periodic review, to include independent auditing, will help ensure that your internal controls continue to prevent violations and identify, isolate, and eliminate problems before they become violations. In the Peterson case, a rigorous compliance program protected the company from the violative actions of a "rogue" employee.

## 2. OFAC: U.S. Party Penalized On Apparent Agency Theory

In contrast to the Morgan Stanley FCPA case, in a recent OFAC determination, a U.S. company was held responsible for the actions of its foreign subsidiary. On May 21, 2012, OFAC released information on a penalty action involving Genesis Asset Managers, LLP ("GAM US"). GAM US agreed to settle the proceeding by paying $112,500 for an apparent violation of the Iranian Transaction Regulations ("ITR").

Interestingly, GAM US did not take any action with respect to Iran. Instead, GAM US, as the investment manager for Guernsey-organized Genesis Emerging Markets Fund ("GEMF") had a contract with its London-based subsidiary, Genesis Investment Management LLP to provide investment advice and recommendations to GAM US relating to an investment fund in Guernsey. Pursuant to that contract, the London entity purchased approximately $3 million in shares for GEMF in First Pension Equity Fund, a Cayman Islands entity that invests exclusively in Iranian securities. Thus, the London entity, presumably, was acting as an agent of GAM US, leading to liability for GAM US.

OFAC noted that GAM US failed to "exercise a minimal degree of caution or care in the conduct that led to the apparent violation of the ITR," GAM US officers were "aware of the conduct giving rise to the apparent violations," and GAM US did not have an OFAC compliance program in place at the time the apparent violations occurred.[5] OFAC identified these issues as aggravating factors. On the other hand, OFAC identified as a mitigating factor the fact that "GAM US may not have fully understood its OFAC obligations under U.S. law."[6] This penalty case shows that U.S. parent companies of foreign subsidiaries can be held liable under the ITR for the activities of their foreign subsidiaries under certain circumstances. To avoid such liability, U.S. entities should ensure that they implement procedures to prevent foreign subsidiaries from acting on their behalf in transactions related to sanctioned countries or entities.

1 http://www.sec.gov/news/press/2012/2012-78.htm

2 http://www.law360.com/articles/339608/the-latest-fcpa-target-private-fund-advisers

3 http://www.sec.gov/news/press/2012/2012-78.htm

4 http://www.sec.gov/news/press/2012/2012-78.htm; http://www.sec.gov/litigation/complaints/2012/comp-pr2012-78.pdf

5 http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20120521.aspx

6 *Id.*

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