

SOVEREIGN WEALTH FUNDS AND THE FCPA

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In the beginning of the year, the SEC sent shockwaves through the financial community when it launched its inquiry into the relationship between financial institutions and sovereign wealth funds. The SEC issued letters to various companies requesting information about these interactions and anti-corruption compliance.

The SEC warned the financial community in 2008 about this inquiry. SEC officials made various public statements concerning the need for financial institutions to determine who their foreign customers were and what relationship they had to foreign governments. The SEC meant what they said.

Sovereign wealth funds, which are owned by foreign governments, control large amounts of capital. The foreign government use these funds to invest government money. Sovereign wealth funds invest a large amount of money in the US. They are an important source of capital. These funds are not interested in short-term plays in investments, but typically are interested in longer holds of investment interests. They are lucrative and valuable clients to financial institutions.

The government's inquiry assumes that sovereign wealth funds fall under the FCPA's definition of "foreign [government] officials." For the Justice Department and the SEC, there is little doubt on this legal issue. Under the government's view, every employee of the sovereign wealth fund is a foreign official under the FCPA. The government also cites the two cases it won this year -- Noriega and Carson, as precedent for its interpretation of "foreign official."

I hate to use the phrase coined by former CIA Director George Tenet, but I am not so sure that the government's interpretation is a "slam dunk."

In Noriega, the court ruled that the Mexican-owned electric company fell within the definition, and listed five, non-exclusive factors, in its analysis:

- The entity provides a service to its citizens, in many cases to all the inhabitants of the country.
- The key officers and directors of the entity are government officials or are appointed by government officials.
- The entity is financed, at least in large measure, through governmental appropriations or through revenues obtained as a result of government-mandated taxes, licenses, fees or royalties, such as entrance fees to a national park.
- The entity is vested with and exercises exclusive or controlling power to administer its designated functions.

- The entity is widely perceived and understood to be performing official functions.

In the Carson case, the court ruled in favor of the government, and identified six, non-exclusive factors supporting its decision, including:

- The foreign state's characterization of the entity and its employees;
- The foreign state's degree of control over the entity;
- The purpose of the entity's activities;
- The entity's obligations and privileges under the foreign state's law, including whether the entity exercises exclusive or controlling power to administer its designated functions;
- The circumstances surrounding the entity's creation; and
- The foreign state's extent of ownership of the entity, including the level of financial support by the state (e.g., subsidies, special tax treatment, and loans).

There is nothing inherently "governmental" in the operation of sovereign wealth funds. Hypothetically, the government could hire an investment banking firm, turn over all the money, and have them manage the funds. Instead, the foreign government creates its own fund, hires managers (typically from well-known investment banking firms), and has them manage the funds.

Admittedly the factors under the Carson test are more supportive of the government's position, while the factors under the Noriega case, as listed, provide some interesting arguments for sovereign wealth funds.

Given the frequent criticism that there is no judicial oversight of the Justice Department's interpretations of the FCPA, it is very unlikely that this issue will be brought before a court for a meaningful review. The only way in which that may happen is if the Justice Department prosecutes individuals under this theory and then the individuals challenge the interpretation. For now, the Justice Department is continuing its investigation which is premised on this interpretation of the FCPA.