Compliance in South America: Challenges and Effective Strategies

Shin Jae Kim, Partner, TozziniFreire Advogados
Renata Muzzi, Partner, TozziniFreire Advogados
Fernanda Beraldi, Ethics & Compliance Director, Latin America & Corporate Counsel, Cummins Inc.

Facts – South America

South American countries still underperform in terms of corruption perception, exceptions made to Chile and Uruguay (Transparency International Corruption Perception Index 2015):

<table>
<thead>
<tr>
<th>Country</th>
<th>Score</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>38</td>
<td>76/168</td>
</tr>
<tr>
<td>Chile</td>
<td>70</td>
<td>23/168</td>
</tr>
<tr>
<td>Argentina</td>
<td>32</td>
<td>107/168</td>
</tr>
<tr>
<td>Colombia</td>
<td>37</td>
<td>87/168</td>
</tr>
<tr>
<td>Peru</td>
<td>36</td>
<td>88/168</td>
</tr>
<tr>
<td>Uruguay</td>
<td>74</td>
<td>21/168</td>
</tr>
<tr>
<td>Venezuela</td>
<td>17</td>
<td>158/168</td>
</tr>
</tbody>
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Transparency International also concluded that emerging market multinationals continue to fall short of the corporate transparency standards that are expected of multinationals operating internationally. In Latin America, only Brazilian Embraer and Chilean Falabella rated more than 5.0 and reached the ‘approved’ status under TI’s criteria: Anticorruption programmes, Organisational Transparency and country-by-country reporting.
Facts – South America

Common risks in South America

- Judiciary system – bribing for favorable sentences or to avoid prosecution
- Police force – Off-duty police officers
- Bribes for public services – medical services or public utilities
- Bribes to enforce (or to avoid the enforcement) of intellectual property rights
- Customs – facilitation payments and bribes to import restricted products
- Local governments (municipalities) – high levels of misappropriation of public funds (donations, contributions, etc.)
- Bribes to ignore environmental regulation
- Bribes for the obtaining of public contracts

Some High Profile Cases in South America

- ARGENTINA - Hotesur case: The Argentine ex-President, Ms. Cristina Fernández de Kirchner and her sons are the main shareholders of Hotesur S.A. (“Hotesur”). The First Instance Federal Criminal of Buenos Aires is currently investigating if: (i) the purpose of certain operations was to legalize the payment of bribes in exchange for awarding public tenders to companies related to Mr. Lázaro Báez (ex-Public Works Secretary), and if (ii) the ex-President entered into a conflict of interest by renting the Hotel’s rooms to a state-owned company, such as Aerolíneas.

- PERU - Gaseoducto Sur Peruano Case: A US$ 4.400 million infrastructure project and the biggest of its kind in Peru. There is currently a criminal anticorruption investigation ongoing against the representatives of the Consortium that won the bid due to alleged irregularities during the bid. It is said that certain former member of Proinversion (Peruvian Government Agency that ran the bid) gave an undue advantage to the Consortium based on his prior professional relationship with a member of the consortium.

- COLOMBIA - Pretelt Case: In 2015 Jorge Pretelt, a magistrate of the Constitutional Court was accused of corruption for favoring a fiduciary entity (financial service), FIDUPETROL. Allegedly, Pretelt requested 500 million pesos to the attorney of FIDUPETROL in order to render a favorable decision for this company. The Colombian Congress decided to charge the Magistrate after an investigation. However, Pretelt refuses to abandon his position in the Constitutional Court.

Brazil: Scenario

The number of investigations being conducted by the Federal Police in Brazil has jumped from 18 in 2003 to 516 in 2015.

Massive wave of enforcement with two ground-breaking investigations on corruption:

- Operation Lava Jato (“Car Wash”)
- Operation Zelotes
Brazil: Scenario

Operação Lava Jato (Car Wash)

- The operation started with the investigation of money brokers that laundered money from illicit activities through a petrol station and car wash business chain in Brasilia.
- Car wash Operation started on March 17, 2014
- Allegations of corruption at Petrobras - Petrobras’ executives and public officials accepted bribes for awarding contracts to EPC contractors at inflated contractual prices. The alleged bribes varied between 1% and 3% over the contract value.
- Since March, 2014, the Car Wash Operation launched 33 rounds of focused investigations.

Brazil: Scenario – Operation Car Wash

- Arrested individuals: 171
- Warrants for mandatory depositions: 175
- International cooperation request: 108
- Prosecutions against: 216
- Search and seizure warrants: 643
- Alleged improper payments: R$6,4 bi; US$ 1,95 bi
- Recovered Amount: R$ 2,9 bi; US$ 887 mi

Brazil: Scenario

- Increase of concern on reputational risks
- Strong media pressure
- Active Public Prosecutor Office, with experts in different sectors
- Active and strong regulatory agencies
- Increase of administrative penalties – more severe
- Efforts to increase transparency on government spending
- Sense of impunity for corrupt conduct – increasing efforts to investigate and punish corrupt acts
- Increasing efforts against corruption
- Increasing international cooperation to combat corruption
Brazil: Scenario

- Increasing awareness on the need of a compliance culture:
  - Recent research by the American Chamber of Commerce – Amcham in Brazil**:
    - 73% of the companies already have a formal compliance program
    - 31% of the companies have a mature program. 69% have programs on its initial implementation phase
    - 61% said the Brazilian Clean Company Act (“BCCA”) changed the company’s conscience on compliance matters

** The research involved around 250 respondents during an event held on July 27, 2016

Brazil: Scenario

Compliance Program Survey 2015

- According to the research “2015 Outlook for Legal Issues in Brazil” conducted by Latin Finance and the European consulting firm Management & Excellence (M&E) at request of TozziniFreire:
  - “More than 90% of the respondents intend to adopt compliance programs as a preventive measure to avoid risks and reduce the possible sanctions that may result from illegal or improper conducts by their employees.” (100 executives respondents)
  - “In one of the questions the respondents were asked to classify from 0 to 10 the priority on different areas. 69% of the respondents classified compliance as the number one priority”** (*classified as 8, 9 and 10).

**

Brazil: Scenario

- New law and investigative tools
  - Leniency agreements
  - Cooperation agreements

- Overlapping jurisdiction and multiple authorities
  - Federal Comptroller General (CGU), Federal Audit Court (TCU), Federal Attorney’s Office (AGU), Public Prosecution Office (MPF), Courts, Petrobras, State and Municipal authorities, and also foreign authorities (DoJ, SEC, others).

- Focus on prevention
  - Incentives for compliance programs
Brazil: Legal Framework

- Federal Constitution (Federal Law No. 5.869/1973)
- Administrative Procedures Act (Federal Law No. 9.099/1995)
- Private Law (Federal Law No. 12.949/2013)
- Public Procurement Act (Federal Law No. 8.666/1993)

Brazilian Clean Company Act

Sanctions:

- **Administrative**
  - Fines - ranging from 0.1 to 20% of the company’s turnover
  - Publication of the condemnatory decision

- **Judicial**
  - Forfeiture of assets, rights, or funds that constitute an advantage or profit obtained from the violation
  - Prohibition from receiving incentives, subsidies, grants, donations, or loans from public agencies (including public or government-owned financial institutions), for a period from 1 to 5 years
  - Suspension or partial interdiction of its activities
  - Compulsory dissolution of the legal entity in more severe cases

Brazilian Clean Company Act

Sanctions: Parameters for calculation of fine

<table>
<thead>
<tr>
<th>Aggravating factors</th>
<th>Mitigating factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of company’s turnover</td>
<td>Percentage of company’s turnover</td>
</tr>
<tr>
<td>1%-2.5% - Continuing violation</td>
<td>1% - If the violation was not accomplished</td>
</tr>
<tr>
<td>1%-2.5% - Tolerance from top management</td>
<td>1.5% - Restitution of the damage</td>
</tr>
<tr>
<td>1%-4% - Interruption of public service or works</td>
<td>1%-1.5% - Level of cooperation of the company in the investigation</td>
</tr>
<tr>
<td>1% - Positive economic situation of the company</td>
<td>2% - Self disclosure by the company</td>
</tr>
<tr>
<td>1%-5% - Real value of the ongoing or intended government contracts</td>
<td>1%-4% - Existence of an effective compliance program</td>
</tr>
</tbody>
</table>

Fines: ranging from BRL 6 thousand to BRL 60 million if the turnover cannot be determined
Brazilian Clean Company Act

Leniency Agreement:

- The company has to:
  - acknowledge its involvement in illegal conduct
  - cease illegal conduct
  - cooperate effectively with the investigations so that it results in (i) identification of third parties involved and (ii) identification of information and documents that evidence illegal acts
  - appear before the authorities anytime it is required
- Entering into a leniency agreement will result in a reduction of up to 2/3 of the fine and exemption of certain sanctions (i.e.: publication of the decision, prohibition to access credit benefits from public institutions)
- It does not exempt the company from the obligation of full restitution of the damage
- The Leniency Agreement must contain clauses on the adoption or improvement of the Compliance Program

Brazilian Clean Company Act

Leniency Agreement:

Brazilian Federal Prosecutors have entered into leniency agreements with four companies in Operation Car Wash:

- **Toyo Setal**: October, 2014 - BRL 15 million (USD 4.5 million).
- **Camargo Correa**: August, 2015 - BRL 700 million (USD 212 million).
- **Andrade Gutierrez**: May, 2016 - BRL 1 billion (USD 303 million).
- **Carioca Engenharia**: March, 2016 - BRL 100 million (USD 30 million).

Compliance Program

Ministry of Transparency Guidance: five pillars

- **1st - Tone at the Top**
- **2nd - Responsible Area**
- **3rd - Risk and Profile Analysis**
- **4th - Rules and Mechanisms**
- **5th - Continuous Monitoring**
Compliance Program

1. Tone of the top
   - Permanently or frequently discuss the effectiveness of the compliance program in management meetings
   - Allocate adequate financial resources
   - Express support by talking about compliance matters and the importance of the company’s ethical values
   - Make sure that the middle management is aware of the top management’s commitment and act as compliance multipliers
   - Participation in trainings to show engagement

Compliance Program

2. Responsible area
   - Independence
   - Structure – budget and headcount appropriate to the company’s profile
   - Authority to investigate irregularities, even if they involve top management
   - Autonomy to take decisions and implement required actions
   - Mechanisms to avoid retaliation of the compliance officer and of employees of the compliance area.

Compliance Program

3. Risk and Profile Analysis
   - Program shall be designed in accordance with the company’s profile and risks
   - Need to analyze:
     - Geographical risk
     - Market sector risk
     - Level of government interaction
     - Relevance of regulatory licenses to the business
     - Risk of business partners
     - Etc.
   - Profile analysis must focus on corruption and fraud risks
   - Periodic
   - Consider acquisitions and change in business
Compliance Program

4. Rules and Mechanisms

- Code of Conduct, Policies and Procedures (policy for government interaction; gifts and entertainment policy; donations and sponsorship policy)
- Policies extended to third parties
- Third-party due diligence
- Communication and training
- Reporting channels
- Adequate internal controls
- Clear and accurate accounting records

Compliance Program

5. Continuous Monitoring

- Development of a monitoring plan to:
  - verify the effective implementation of the program
  - enable identification of gaps to be fixed and improved

- Collection and analysis of:
  - Reports regarding the compliance program routines and/or investigations
  - Information obtained from the communication channel
  - Reports from government regulatory agencies

TRENDS

- No longer a matter of foreign legislation (FCPA, UKBA)
- Increase of compliance due diligence (prior or and post M&A, Consortium, JV)
- Compliance program implementation
- Increase of internal investigations
- Active enforcement bodies and prosecutors
- More active and well prepared regulatory agencies - Cooperation
- Investments in the Federal Police – hiring of qualified staff
  - number of investigations and operations has increased
- Leniency Agreements and Plea Bargaining Agreements
- More severe penalties
- Reputational Risk
What is Cummins’ presence in Latin America?

- ~20 facilities in Mexico and Central America
- 5 facilities in Brazil, 8 in other South American countries
- ~9,100 employees
- More than 600 third-party distribution facilities

Current Areas of Focus in Latin America

- Training/Communication
- Speak-up Culture
- Anti-Bribery
- Export Controls
- Third Party Risk
- Government Sales
Issues/Concerns

- Training our own employees before focusing on third-parties
- Fit-for-market training/communication: “FCPA” what???
- Encourage speak-up culture
- Economy is really struggling: how to sell more?
- Export control questions: Cuba/Iran/Venezuela
- Understanding the extent of our business with SOEs
- Understanding the extent of our business using agents, consultants, logistic companies, customs brokers etc.

Plan for Region

Objective:

- Create a world-class & robust compliance program / best-in-class and fit for market

How?

- 5 focus areas:
  - Tone at the top
  - Risk assessment
  - Communication
  - Training
  - Oversight and monitoring

Plan for Region (cont.)

- Tone at the top
  - Constant engagement with leadership
  - Communication from leadership to all employees about meaningful subjects

- Risk Assessment
  - Being worked on by Corporate
  - “Bucket” approach with Regional BU leaders: “what concerns you the most?”

- Communication
  - Posts on Internal communication page for the country
  - Use internal communication tools as E&C tools (magazines)
  - LATAM RoadMap

- Training
  - Office and Employees will receive at least one face-to-face training
  - Emphasis on Fraud, Export Control, Bribery, Fair Comp, Conflict of Interest, Cont. Sales
  - Speak-up Culture

- Oversight and Monitoring
  - Compliance Champion Network