In Pursuit of Clean Earnings:
Dodging an SEC Investigation or Litigation

Presented by Susan Goetz Markel, Former Chief Accountant - Division of Enforcement, US Securities and Exchange Commission, Managing Director, AlixPartners

What are Clean Earnings?
• SEC enforcement landscape and hot topics
  - Focus on Financial Reporting and Internal Controls
  - What gets their attention?
  - Other areas of focus
  - The lifecycle of an enforcement investigation
• Making the case to invest in a strong corporate governance, compliance and controls system
  - Cost center versus Cost prevention center
  - Measuring the ROI

‘Clean Earnings’
• What is it?
• How do you get there?
• How to spread the word?
Luis A. Aguilar– Former Commissioner U.S. SEC

Remarks from the Regulatory Compliance Association, Regulation, Operations & Compliance (ROC) – "Doing the Right Thing: Compliance That Works for Investors" (April 18, 2013)

“Building a strong culture of compliance is important, especially when the success of your business depends largely on investor trust and confidence. A compliance program that focuses on investor protection also protects your business. This is true because the potential costs of serious compliance failures and violations of the federal securities laws can be much higher than any sanctions imposed by regulators. In the end, the reputational harm to your business may be more severe.

Financial reporting rules and regulations:

Who are the Enforcers?

U.S. Department of Justice  U.S. Securities and Exchange Commission

Primarily DOJ and SEC, but also...
- State and other federal authorities
- Independent securities regulators, FINRA, CFPB
- PCAOB – Public Company Accounting Oversight Board

SEC and DOJ – similarities and differences

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<thead>
<tr>
<th></th>
<th>SEC</th>
<th>DOJ</th>
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<tr>
<td>Disgorgement and penalties/fines</td>
<td>X</td>
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<td>Guns and wire taps</td>
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<td>Jail</td>
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Tone at the top enforcement in a post-Madoff world

Mary Jo White
Chair of SEC
(2013-Present)

Andrew Ceresney
ENF Director
(2013-Present)

• Specialized units – now entrenched
• More former criminal prosecutors in leadership positions (Regional Directors include: SF, Boston, Chicago, Salt Lake, Ft. Worth) = SEC looking more like DOJ (e.g., Cooperation Program, FBI agents now embedded in SEC’s Office of Market Intelligence)
• Repeated requests for more resources

Increased emphasis on compliance and controls

Broken Windows Theory

• Cases brought which indicate that
  − Issues were not discovered
  − Issues were not escalated
  − Management ignored issues raised by the compliance staff
  − Internal controls were insufficient for size of company’s risk
  − Management leaves impression that issues not important
• SEC Staff has commented that
  − Companies less often try to persuade the SEC at the front end of an investigation that the company’s compliance and control system is adequate
  − Issue typically comes up during settlement negotiations

Recent Internal Controls Cases (all settled):

Analogic Corporation (Jun. 22, 2016): $11.48 million penalty
• Violations of books and records and internal accounting provisions of the Foreign Corrupt Practices Act

Magnum Hunter Resources Corporation (Mar. 10, 2016): $250,000 penalty from a bankrupt entity
• Deficient evaluation of the company’s internal controls over financial reporting, and failure to maintain proper ICFR; material weakness not properly identified or disclosed.

The St. Joe Company (Oct. 27, 2015): $2.75 million penalty
• Improper accounting for declining value of real estate developments and inadequate controls

Home Loan Servicing Solutions (Oct. 5, 2015): $1.5 million penalty
• Improper accounting for declaring value of real estate developments and inadequate controls

Stein Mart, Inc. (Sept. 22, 2015): $800,000 penalty
• Discount retailer had allegedly inadequate controls over inventory resulted in materially overstated pre-tax income
• Decisions about characterizations of mark-downs done by personnel with inadequate understanding of valuation accounting

Increased emphasis on issuer compliance and controls
Sources of SEC enforcement cases

- News articles
- Self-reporting
- Restatements
- PCAOB
- Other SEC divisions
- Auditors
  - Change in Auditors – Form 8-K
  - Section 10A reports
- Class action lawsuits
- Informants/tips
- Sweeps or ‘Voluntary’ inquiry letters
- Internal SEC analysis and analytics

Renewed focus on financial fraud

- From fiscal year 2013 through the end of 2015, the SEC has more than doubled its actions in issuer reporting and disclosure – from 53 in fiscal year 2013 to 114 in fiscal year 2015.
- In 2015, the SEC brought enforcement cases against 191 parties (in contrast to 128 parties in 2014), a significant increase over prior years.
- Between 2003-2005, accounting and disclosure cases accounted for 25% of enforcement actions; for FY 2013 accounted for only 11%.

"You're always going to see a lot of insider-trading cases being done, a lot of FCPA. That will continue. We bring cases against investment advisors. Recently you've seen cases brought against the SROs, and those are important to do. I think financial statement fraud, accounting fraud has always been important to the SEC, and you're going to see more targeted resources in that area going forward."

- Mary Jo White, Chairman of SEC
  (June 23, 2013)


Where is all the Financial Accounting Fraud?

- Financial Disclosure + FCPA
- All Other

[Bar chart showing financial disclosure and FCPA cases from 2003 to 2015]
Enforcement cases and focus

- Usual suspects – revenue recognition, cookie jar reserves, etc.
- Accounting estimates
- Valuations
- Subprime/credit crisis cases
- Disclosure issues, including FAS 5
- Process/internal controls cases
- 13a-14 Certifications – and sub certs
- FCPA
- Sweeps – FCPA or accounting issues
- Outlier inquiries
- More negligence (non-fraud) cases possible

Enforcement actions involving financial reporting and issuer disclosure

- Issuers
- Management
- CEO
- CFO
- Treasurer
- Others
  - BOD/Audit committee
  - Chief Risk Officer
  - Chief Compliance Officer
- Auditors
- Third parties

Operation Broken Gate

- SEC is acutely focused not just on issuers, but the ‘gatekeepers’ of reliable financial reporting – audit committees and auditors:
  - Audit committee focus heightened post Sarbanes Oxley.
  - Auditor independence and audit quality reviewed by SEC and PCAOB.
- Heightened focus on auditors is being felt by corporations during the audit process.
Audit committee under review

"I think it also is important to focus on audit committees, which serve as a gatekeeper for quality financial reporting. These committees play a critical role by overseeing and monitoring the financial reporting process. We have brought actions against audit committees in the past for failing to recognize red flags and we intend to continue holding committees and their members accountable when they shirk their responsibilities.”

Andrew Ceresney,
Director of Enforcement, Sept. 19, 2013

Information about Enforcement

U.S. SECURITIES AND EXCHANGE COMMISSION

Chairman Mary Jo White – former federal prosecutor
- ‘Bold and Unrelenting’ enforcement
- Broken windows theory of enforcement
- Interest in pursuing negligence only cases
- Increased cooperation with Criminal Authorities – DOJ, State Attorney Generals
- Increased cooperation with International counterparts
- Formation of Financial Reporting and Audit Task Force
- Operation broken gate
- Focus on holding individuals accountable
- Stepping away from "Neither admit nor deny" settlement language
SEC Financial reporting initiatives

"Good financial reporting and vigilant auditing obviously go to the heart of the integrity of our markets and strong investor protection — which is why we have again intensified our focus on this area."

Mary Jo White, Chair of SEC, March 31st 2014

The Financial Reporting and Audit Task Force

Announced by SEC on July 2, 2013. Not the First Time SEC Has Created Specialized Units (e.g. FCPA)

Mission and purpose: to identify and prosecute securities law violations related to financial reporting and audit failures.

Often, when you get a group of smart people in a room focused on a problem, you can find the answer. Kind of reminds me of that scene in Apollo 13 where they bring all of the disparate tools available on the space capsule into a room, dump it on to a table in front of a bunch of smart people, and say find a way to fix the problem. And so we created the Financial Reporting and Audit Task Force — what we like to call the Fraud Task Force. This is our Apollo 13 moment.

– Andrew Ceresney, Director of Enforcement, Sep. 19, 2013

The Financial Reporting and Audit Task Force

Methods and Tactics

• Monitoring high risk companies.
• Analyzing issuer filings/restatements.
• Analyzing performance trends by industry.
• Accounting quality model and data analytics.
• Conduct street sweeps on industries and particular accounting areas.
• Staffed by Enforcement, Corporate Finance and Office of the Chief Accountant.
• Seeking 'Task Force' Results like in other areas – insider trading, FCPA.
SEC Data analytics tools

- Crunching big data – Buzz Phrase of 2014 for the SEC – using the data it gets daily to monitor the financial markets, investment advisers and publicly traded companies.
  - NEAT ('National Exam Analytics Tool') – Designed to identify potential insider trading around specific events in time. Analytics could indicate insider trading, front running, window dressing or other misconduct.
  - Midas (Market Information Data Analytics System) – Collects one billion trading records every day to help the SEC understand how the markets are working (or not).
  - Worldwide Capital Reg (Short-Selling) Case. Uses high speed data crunching tool to analyze stock sales.

SEC Data analytics tools (cont’d)

- The Accounting Quality Model – AQM – affectionately known as ‘Robocop’
  - Most SEC filings are in XBRL
    - Data can be analyzed, categorized and scored.
    - Scoring may lead to inquiry:
      - Division of Corporate Finance Letter;
      - Division of Enforcement Inquiry;
      - Division of Enforcement Investigation.
    - Use is developing.

Focus on conduct of individuals

Mary Jo White has said that the SEC would pursue charges against individuals 'wherever possible,' rather than charging companies. The instructions to staff (as a 'subtle shift') are to look first at misconduct at the individual level, 'working out to the entity, rather than starting with the entity as a whole and working in'

Bloomberg.com – SEC to Shift Enforcement Focus to Individuals, White Says – 9/26/13

'When people fear for their own reputations, careers or pocketbooks, they tend to stay in line'

Sec.gov – Deploying the Full Enforcement Arsenal – Speech by Chair Mary Jo White at Council of Institutional Investors Fall Conference in Chicago, IL on 9/26/13

According to Andrew Ceresney – The SEC 'must ensure' that individuals 'feel the pain of our remedies'

WSJ.com – SEC Ramps Up Fine Amounts to Deter Misconduct – 10/1/13
The Financial Reporting and Audit Task Force 
EVOLVED to a Permanent Group Status
Mission and purpose: Develop methodologies to identify and prosecute securities law violations related to financial reporting and audit failures

Methods and Tactics
- Monitoring high risk companies
- Analyzing issuer filings/restatements
- Analyzing performance trends by industry
- Accounting quality model and Data analytics
- Conduct street sweeps on industries and particular accounting areas

The Financial Reporting and Audit Task Force 
EVOLVED to a Permanent Group Status
• In 2015 – became a permanent Enforcement Group with six members
• Data analysis tools populated throughout the Division
• Liaison with 35 accountants and attorneys throughout the Division
• CIRA – Corporate Issuer Risk Assessment tool
  - Harnesses data from Edgar and other sources
  - Looks at data more broadly
    - Across geographies
    - Across industries
    - Comparison to peers
    - Etc.

Cooperation update and the DOJ yates memo
• SEC guidelines mimic DOJ cooperation guidelines
• Yates memo source of concern for GCs
• Uncertainty and risk for co-operators
  - Pros and cons of self-reporting
• Cooperation by companies
  - April 2013: Ralph Lauren
• Cooperation by individuals
  - March 2012: AXA Rosenberg
  - November 2013: Deferred prosecution agreement: Hepplewhite Fund
SEC Financial reporting initiatives

- What does 'Cooperation' mean anymore?

2010 SEC Cooperation Initiative – Three Areas of Focus

1. Cooperation Agreements – Formal written agreements in which the Division of Enforcement agrees to recommend to the Commission that a co-operator receive credit for cooperating in its investigations or related enforcement actions. Such credit will only be extended if the co-operator provides 'substantial assistance.'

2. Deferred Prosecution Agreements – Formal written agreements in which the Commission agrees to forego an enforcement action against a co-operator – if the individual or company agrees to cooperate fully and truthfully and to comply with certain reforms, controls and other undertakings.

3. Non-prosecution Agreements – Formal written agreements, entered into under very limited and appropriate circumstances, in which the Commission agrees not to pursue an enforcement action against a co-operator.

SEC Financial reporting initiatives

- What does 'Cooperation' mean anymore?

  - Does co-operation really matter?:
    - Difficult to tell results
    - What does it mean to co-operate?
    - Must you waive privilege?
    - What does 'prompt co-operation' mean?
    - What value is there in self-reporting?
    - Lots of unanswered questions on value of co-operation.

Enforcement environment – post Dodd-Frank

Post Dodd Frank

- Whistleblowers
- FCPA
- Clawbacks
- Insider trading
SEC Whistleblower program

Courtesy of sec.gov

U.S. Securities and Exchange Commission

Whistleblower Information Hotline

general info, learn about the program, or obtain an award

SEC Whistleblower rules – post Dodd-Frank

Whistleblower bounty provision rules

• Person who voluntarily provides SEC with original information that leads to successful enforcement action resulting in sanctions greater than $1 million may be entitled to 10-30% of the funds recovered.
• Covers tips provided to SEC from July 21, 2010 to present.
• Office of Whistleblower established:
  - Sean McKessy hired February 27, 2011 – recently left to go to private sector Whistleblower bar.
  - Supported by many staff.
  - Required to report on activity.
  - Subject to Inspector General (‘IG’) oversight.

Persons who may qualify as a ‘Whistleblower’

• Employees, consultants, agents, vendors, competitors, customers, etc.
• Excluded persons: Entities, govt. employees, person knowingly making false statement or convicted of crime related to the action
• MAY include, if certain conditions met: Attorneys, auditors, internal compliance staff, officers/directors who learn through compliance;
  - If report to audit committee, chief legal officer or chief compliance officer and 120 days lapse.
  - Entity impeding investigation.
  - Necessary to prevent substantial injury to investors.
SEC Whistleblower rules:
Reported activity – FY 2015

• The Office received 3,923 whistleblower tips:
  • From all 50 states – California, New York, Florida/Texas had the highest number
  • From 60 countries – UK, Canada, and China had the highest number
• Covering all categories
  - 17.5% related to Corporate Disclosures and Financials (687)
  - 15.6% related to Offering Fraud (613)
  - 12.3% related to Manipulation (482)
  - 4.6% related to FCPA (186)
• During the 2015 calendar year, the Office of Whistleblower issued 148 Notices of Covered Action (NoCAs) and over 100 to date in 2016.

Current environment for SEC Whistleblowers

• Awards issued to date
  - First award in September 2012 of $50,000 which grew to $200,000
  - Second award of $150,000 – related to an action of another government agency
  - Third award – $14 million
  - Largest award – $30 million in Sept 2014
  - More than $1 million awarded to Compliance Officer in 2015
  - Maximum whistleblower award of 30% (over $600,000) in the first anti-retaliation case in 2015 (Paradigm Capital Management, Inc.)
  - Awarded $500,000 to a former company officer after company fails to take action.
  - First enforcement action against a company for use of confidentiality agreements that impeded whistleblowers (KBR Inc. $130,000 settlement)
  - More than $22 million awarded to former Monsanto executive
  - Approximately $110 million distributed to date to over 30 whistleblowers

Current environment for SEC Whistleblowers

• Ripe for Whistleblowing – claims encouraged.
• By-product of economic conditions and recession:
  - Layoff casualties/employees scorned.
  - Reductions in staff/resources to address prior complaints.
• First to file creates an incentive to report.
• Outlet to counter the ‘Smartest guy in the room’ scenario?
• Outlet for differences of opinion relating to accounting treatment?
• SEC in a Post-Madoff world.
• Other governments interested.
Dodd-Frank act

Whistleblower bounty provision rules

• 305 page rules describes who qualifies – Not your issue
  - (unless you want to become a Whistleblower one day)
• Corporate Focus should be on how to handle complaints/issues as they arise
• And – be careful not to shoot the messenger
• SEC has emphasized that they will bring actions related to the Anti-Retaliation provisions
• Recent ruling on retaliation claim qualifications

Balancing Whistleblower rights with protection of company

• Whistleblower does NOT have any right to be informed of developments with respect to their tip:
  - But could be beneficial for evaluating results of investigation
  - May go a long way to lessen the concerns of the employee
• Retaliation is not allowed
  - It is illegal to discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a Whistleblower.
  - Violating these provisions 1) gives rise to a private right of action by the Whistleblower; and 2) subjects the company to potential criminal liability or SEC sanctions.
• Retaliation Provision
  - Employee must file retaliation claim with Department of Labor within 180 days of the alleged violation (or when employee became aware of violation)
  - Claim handled by Occupational Safety and Health Administration (OSHA)
Whistleblowers get their own chapter in FCPA guidance

SEC emphasizes importance of Whistleblowers

Andrew Ceresney, SEC Co-Director of Enforcement
“We expect FCPA violations to become an increasingly fertile ground for Dodd-Frank Whistleblowing”

“Companies should know that the risk of not coming forward grows by the day as our whistleblower program continues to pick up steam”

Kara Brockmeyer, SEC FCPA Unit Chief
“We have gotten some very good Whistleblower complaints that are very detailed from people who have personal knowledge of the conduct that we would have never known”

Whistleblowers “are reporting internally first, and it’s only when they feel that the company isn’t taking sufficient action that they are coming to us”

Statements made at ACI FCPA Conference Nov. 19-20, 2013

Enforcement environment
Post Dodd Frank
• Whistleblowers
• FCPA
• Clawbacks
• Insider trading
FCPA and anti-corruption in focus

- Increased emphasis in recent years by SEC and DOJ – aggressive DOJ tactics
- Increased interest by international regulatory counterparts
- Increased international cooperation and coordination
- Disgorgement of profits and fines can be massive
- Investigations are lengthy and expensive

FCPA

- The Foreign Corrupt Practices Act is a US federal law enacted in 1977 to prohibit companies from paying bribes to foreign government officials and political figures for the purpose of obtaining or retaining business.
- Enforcement of the regulation has increased dramatically in the past three years – focusing on:
  - The anti-bribery provisions and
  - The book and records and internal control provisions
Books and records provision

- Applies to all US and non US companies with registered securities, including ADRs, or that file reports with the SEC.
- Requirements:
  - Maintain accurate books, records and accounts that:
    - Have reasonable detail
    - Accurately and fairly reflect nature of transactions (e.g. nature of payments to government officials)
    - Show dispositions of assets
  - Must keep these records for five years

FCPA – Basic provisions

- Forbids companies and individuals from:
  - Corruptly.
  - Making a promise or offer, or authorizing the payment of.
  - A bribe or anything of value.
  - Directly or indirectly.
  - To a foreign official.
  - To obtain or retain business or to gain an improper business advantage.
- Books and records and internal controls provisions apply to public companies.

FCPA

Total actions – SEC and DOJ combined

- Increased emphasis in recent years by SEC and DOJ – aggressive DOJ tactics
- Increased interest by international regulatory counterparts
- Increased international cooperation and coordination
- Disgorgement of profits and fines can be massive
- Investigations are lengthy and expensive
## Certain FCPA settlements over $100 million by company (SEC and DOJ)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Company</th>
<th>Amount in USD (millions)</th>
<th>Connection to US</th>
</tr>
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<tbody>
<tr>
<td>1</td>
<td>Siemens (Germany, 2008)</td>
<td>800.0</td>
<td>ADRs</td>
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<td>2</td>
<td>Alstom (France, 2014)</td>
<td>772.0</td>
<td>ADRs</td>
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<td>3</td>
<td>KBR / Halliburton (USA, 2009)</td>
<td>579.0</td>
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<td>4</td>
<td>BAE (UK, 2010)</td>
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<td>5</td>
<td>Total S.A. (France, 2013)</td>
<td>398.0</td>
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<td>6</td>
<td>VimpelCom (Holland, 2016)</td>
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<tr>
<td>7</td>
<td>Alcatel (US, 2014)</td>
<td>384.0</td>
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<td>8</td>
<td>Snamprogetti Netherlands B.V. / ENI S.p.A (Holland/Italy, 2010)</td>
<td>365.0</td>
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<tr>
<td>9</td>
<td>Technip S.A. (France, 2010)</td>
<td>338.0</td>
<td>Issuer</td>
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<tr>
<td>10</td>
<td>JGC Corporation (Japan, 2011)</td>
<td>218.8</td>
<td>US bank accounts</td>
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### FCPA

Could this happen to you?
- High risk countries not always who you might think.
- Often covers ‘old’ conduct.
- Can be books and records based – no materiality threshold.
- Opportunity for large rewards for Whistleblowers.
- Range of persons considered ‘government officials’ has been broadly interpreted.
- Hundreds of tips received related to FCPA.
- Tips received from more than 50 countries.
- Effective compliance programs are critical to this area.

### Country risks

2015 Corruption perception index
Criminal and civil penalties for violation

- **Corporations:** criminal fine up to $2 million per violation, and civil penalties up to $10,000 per violation and forfeit all profits.

- **Individuals:** criminal sentence up to five years in prison and/or fine up to $100,000 per violation, and civil penalties up to $10,000 per violation, plus discretionary additional fines imposed by court.

NOTE: Company CANNOT pay convicted individual's fines

Recent FCPA Enforcement emphasis

**Trends**

- Significant costs of settlement and length of investigations.
- Increased use of FCPA 'industry sweeps'.
- Focus on high-risk industries as well as lesser-involved industries such as retail.
- Focus on charging individuals.
- DOJ Yates memo stresses emphasis on individuals.
- Can be investigated by SEC and/or DOJ and/or foreign jurisdictions.

Analysis of actions brought

- Most DOJ and SEC FCPA enforcement actions were the result of voluntary, self-reporting by the company following investigations
- Incentive: DOJ and SEC co-operation programs
  - Can result in declination or deferred prosecution agreements for issuer
  - November 30, 2012: DOJ declines prosecution of Grifols, SA due to prompt investigation, disclosure and remedial efforts
- Increased cooperation among multi-jurisdictional agencies
- Over 100 companies with ongoing FCPA investigations
- Wal-Mart's has reported that since 2013 it has spent more than $791 million in expenses related to its FCPA investigations and compliance programs.
- Siemens spent more than $500 million plus additional costs of the monitor
AlixPartners anti-corruption survey:

Key findings

• 23% of companies lost business or customers as a result of a potentially illicit payment by a competitor to a government official.
• 90% believe their industry is exposed to business practices that may constitute corruption.
• 75% of companies say they have dedicated anti-bribery and anti-corruption policies.
• 36% stated that they pulled out of or delayed an acquisition due to possible corruption at the target.
• The biggest challenges facing companies in their anti-corruption and compliance programs: variation of policies and procedures on country-by-country basis (75%), inadequate staffing (69%), compliance viewed as a lower priority (64%).
• Companies cited internal audits, (85%), compliance policies (85%) training (82%), and increased scrutiny of books and records (80%) as the most effective means of reducing risk.

Enforcement trends

Compliance monitoring obligations

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<th>Company</th>
<th>Monitor</th>
<th>DPA/NPA</th>
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</tr>
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<td>Avon Products Inc.</td>
<td>Yes / Self-Reporting</td>
<td>NPA</td>
<td>18 months / 18 months</td>
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<td>Archer Daniels Midland</td>
<td>Self-Reporting</td>
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<td>36 months</td>
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<td>BHP Billiton SE</td>
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<td>DPA</td>
<td>36 months</td>
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<td>Diebold</td>
<td>Yes</td>
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<td>36 months</td>
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<td>Parker Drilling</td>
<td>Self-Reporting</td>
<td>DPA</td>
<td>36 months</td>
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<td>Prada</td>
<td>Yes</td>
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<td>Ralph Lauren Corp.</td>
<td>Self-Reporting</td>
<td>NPA</td>
<td>24 months</td>
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<td>No</td>
<td>NPA</td>
<td>Unspecified</td>
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<tr>
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<tr>
<td>Weatherford International</td>
<td>Yes</td>
<td>DPA</td>
<td>36 months</td>
</tr>
</tbody>
</table>
2015 FCPA Enforcement actions

- **Bristol-Myers Squibb**: SEC charged the New York-based pharmaceutical company with violating the FCPA when employees of its China-based joint venture made improper payments to obtain sales. Bristol-Myers Squibb agreed to pay more than $14 million to settle charges.

- **Hitachi**: SEC charged the Tokyo-based conglomerate with violating the FCPA by inaccurately recording improper payments to South Africa’s ruling political party in connection with contracts to build power plants. Hitachi agreed to pay $19 million to settle charges.

- **BNY Mellon**: SEC charged the global investment company with violating the FCPA by providing valuable student internships to family members of foreign government officials affiliated with a Middle Eastern sovereign wealth fund. BNY Mellon agreed to pay $14.8 million to settle charges.

- **Vicente S. Garcia**: SEC charged a former SAP SE executive with violating the FCPA by bribing Panamanian government officials through an intermediary to procure software license sales and receiving more than $85,000 in kickbacks. Garcia agreed to settle the case and return the kickbacks plus interest.

- **Mead Johnson Nutrition**: SEC charged the infant formula manufacturer with violating the FCPA when its Chinese subsidiary made improper payments to health care professionals to recommend the company’s product to new and expectant mothers. Mead Johnson Nutrition agreed to pay $12 million to settle the case.

2016 FCPA Enforcement actions

- **Jun Ping Zhang**: The former chairman/CEO of Harris Corporation’s subsidiary in China agreed to pay a $46,000 penalty for violating FCPA by facilitating a bribery scheme that provided illegal gifts to Chinese government officials in order to obtain and retain business for the company.

- **AstraZeneca**: The U.K.-based biopharmaceutical company agreed to pay more than $5 million to settle FCPA violations resulting from improper payments made by subsidiaries in China and Russia to foreign officials.

- **Key Energy Services**: The Houston-based oil-field services company agreed to pay $5 million to settle charges that it violated the FCPA as a result of payments made by its Mexican subsidiary to an official responsible for negotiating contracts at Mexico’s state-owned oil company.

- **LAN Airlines**: The South American-based airline agreed to pay more than $22 million to settle parallel civil and criminal cases related to improper payments made during a dispute between the company and union employees in Argentina.

- **Johnson Controls**: The Wisconsin-based global provider of HVAC systems agreed to pay more than $14 million to settle charges that its Chinese subsidiary used sham vendors to make improper payments to employees of Chinese government-owned shipyards and other officials to win business.

- **Analogic Corp. and Lars Frost**: The Massachusetts-based medical device manufacturer agreed to pay nearly $15 million to settle parallel SEC and DOJ actions after its Danish subsidiary acted as a conduit for distributors to funnel money to third parties in hundreds of highly suspicious transactions. Frost, the subsidiary’s CFO at the time, agreed to settle SEC charges and pay a penalty.
2016 FCPA Enforcement actions

- **Akamai Technologies**: SEC announced a non-prosecution agreement (NPA) with the Massachusetts-based internet services provider in which the company will disgorge more than $650,000 in profits connected to bribes paid to Chinese officials by a foreign subsidiary. Akamai promptly self-reported the misconduct and cooperated extensively with the SEC’s investigation.

- **Nortek**: SEC announced a non-prosecution agreement (NPA) with the Rhode Island-based residential and commercial building products manufacturer in which the company will disgorge nearly $300,000 in profits connected to bribes paid to Chinese officials by a foreign subsidiary. Nortek promptly self-reported the misconduct and cooperated extensively with the SEC’s investigation.

- **Las Vegas Sands**: The casino and resort company agreed to pay $9 million to settle charges that it failed to properly authorize or document millions of dollars in payments to a consultant facilitating business activities in China and Macao.

- **Novartis AG**: The Swiss-based pharmaceutical company agreed to pay $25 million to settle charges that it violated the FCPA when its China-based subsidiaries engaged in pay-to-prescribe schemes to increase sales.

- **Nordion Inc. and employee**: The Canadian-based health science company and a former employee agreed to collectively pay more than $500,000 to settle FCPA charges. Mikhail Gourevitch, an engineer, arranged bribes to Russian officials for drug approvals and received kickbacks in return. Nordion lacked sufficient internal controls to detect and prevent the scheme.

2016 FCPA Enforcement actions

- **Qualcomm**: The San Diego-based company agreed to pay $7.5 million to settle charges that it violated the FCPA when it hired relatives of Chinese officials deciding whether to select company’s products.

- **VimpelCom**: The Dutch-based telecommunications provider agreed to a $795 million global settlement to resolve its violations of the FCPA to win business in Uzbekistan.

- **PTC**: The Massachusetts-based tech company and its Chinese subsidiaries agreed to pay more than $28 million to settle FCPA cases involving bribery of Chinese government officials to win business.

- **SciCure Pharmaceuticals**: The California-based pharmaceutical firm agreed to pay $12 million to settle SEC charges that it violated the FCPA when international subsidiaries increased sales by making improper payments to health care professionals employed at state health institutions in China.

- **Ignacio Cueto Plaza**: The airline executive agreed to pay a $75,000 penalty to settle SEC charges that he violated the FCPA when he authorized improper payments to a third-party consultant who he knew could route portions of the money to union officials in the midst of a labor dispute.

- **SAP SE**: The software manufacturer agreed to give up $3.7 million in sales profits to settle SEC charges that it violated the FCPA when its deficient internal controls enabled an executive to pay bribes to procure business in Panama.

"...while corruption has always been a problem, things such as the Sarbanes-Oxley reporting requirements and more Whistleblower tips have shined additional light on illicit payoffs and other nefarious activities...technology and interconnectivity make for a smaller, less-isolated world and this translates into more reporting. In addition, the DOJ follows the trail of evidence wherever it leads, sometimes making for larger, more-publicized results."

*Charles Duross,*
*Deputy Chief of the Department of Justice’s Fraud Section and the head of the DOJ’s FCPA unit*
FCPA Whistleblowers

Past, present and future

To date, FCPA’s most infamous Whistleblower is likely Frederic Bourke:

- Dooney and Bourke co-founder reported case of investor fraud against Viktor Kozeny, only to become ensnared in FCPA prosecution predicated upon corrupt payments Kozeny allegedly made with Bourke’s investment.
- Bourke ultimately convicted of conspiracy to violate FCPA on ‘willful blindness’ theory.
- Since 2012, the number of tips received pertaining to FCPA allegations has grown steadily and remains approximately 5% of total tips received.
  - 2012 – 115 tips (4%)
  - 2013 – 149 tips (5%)
  - 2014 – 159 tips (4%)
  - 2015 – 186 tips (5%)

What is the current status on the applicability of FCPA without a US company/individuals being involved?

- Anti-bribery provisions apply to ‘issuers’, ‘domestic concerns,’ and ‘persons’
- Issuer – company that issues securities within the US or files reports with the SEC – includes ADRs and requirement to file Form 20-F
- Domestic Concern – US citizen, national, or resident, or a business entity with its principal place of business in the US or organized under US law
- Person – acts in furtherance of a corrupt payment within the territory of the US, including foreign entities or persons
  - Wire fraud provisions
  - Charge for acting as ‘agent’ of US entities – Panalpina
- Books and records provisions only apply to Issuers

Some Companies That Have Faced FCPA Issues
Enforcement environment
Post Dodd Frank
• Whistleblowers
• FCPA
• Clawbacks
• Insider trading

Clawback
• SEC’s aggressive posture
• SOX Section 304
• Dodd-Frank rules to come – much broader

Compensation ‘Clawbacks’
New rules have yet to be formally adopted by the SEC
• Dodd-frank sec. 954 – recovery of erroneously awarded compensation
• Would require the SEC to direct the exchanges (e.g. NASDAQ) to require listed issuers to have compensation recovery/“clawback” policies
• Company policy would need to provide that if a restatement occurs, the company will clawback certain incentive-based compensation
• Significantly more expansive than current requirements of the current rules of Sox sec. 304 – forfeiture of certain bonuses and profits
Compensation 'Clawbacks'

SOX Section 304 Clawback: Current/former executives
Dodd-Frank Section 954 Clawback: All restatements

- Clawback of any bonus or other incentive-based or equity-based compensation
- Clawback of any bonus or other incentive-based or equity-based compensation
- Clawback of any bonus or other incentive-based or equity-based compensation
- Clawback of any bonus or other incentive-based or equity-based compensation

Limited to CEO and CFO only
Current/former executives
Restatements related to misconduct
All restatements
Clawback of any incentive-based compensation resulting from the sale of securities of the issuer during the relevant period
Clawback of any incentive-based compensation resulting from erroneous results

Covers 12 month period after the filing of the erroneous financial statements
Covers three years prior to restatement
Issuer MISCONDUCT (not individual)
NO MISCONDUCT required

Clauseback: SEC §304

certain examples

Settled
- ModusLink Global Solutions – CEO/CFO (Mar. 2016)
- Computer Sciences Corporation – CEO/CFO (Jun. 2015)
- Symmetry Medical – CEO Moore (Jan. 2012, non-participant) – Settled for $450,000 in bonuses, incentive comp, and stock profits
- CSK Auto – CEO Jenkins (Nov. 2011, non-participant) – Settled for $2.8 million in bonus compensation and stock profits
- Koss Corporation – CEO/CFO Koss (Oct. 2011, non-participant) Returned bonuses and stock options
- Diebold – CEO/CFO (Jun. 2010, non-participant)
- United Health Group – CEO McQuire (Dec. 2007, participant)

In litigation
- Arthrocare – CEO and CFO (Apr. 2012, non-participants)

Enforcement environment

Post Dodd Frank
- Whistleblowers
- FCPA
- Clawbacks
- Insider trading
Insider Trading

- High priority and high profile area for the SEC
- SEC has technology to connect trading relationships across public companies and the securities industry
- DOJ is using undercover techniques – including wiretapping, turning witnesses, and executing search warrants
- Greater coordination with international regulatory enforcement counterparts and cross-border assistance

Recent Insider Trading Actions

Who Tipped or Traded?

- Expert Networks
- Hedge Fund Managers
- Corporate Executives or Board Members
- Professionals
- Government Employees
- Family Members

Recent Insider Trading Actions

What Information Did They Trade On?

- Pending mergers or acquisitions
- Offers to sell
- Earnings announcements – positive or negative
- Negative drug testing results
- Single instance
- Other significant company events or transactions
Recent Insider Trading Actions
How Much Did They Profit?

• Size of Unjust Enrichment Varies Widely – ranging from thousands to hundreds of millions
• Number of tippers/ tippees/ traders varies widely
• Some trades involve complex schemes
• Some trades are very simple

• Penalties can be quite severe
  - Disgorgement of profit, penalties, liability for others’ trades
  - Loss of employment, professional licenses and reputation
  - Reputational damage to companies
  - Significant jail time

How might it end?

That was then...

No action  Enforcement

This is now...

No action  NPA  DPA  Cooperation Agreement

Enforcement Action

So – what do you do?
**How do you pay for a strong corporate governance, internal controls and compliance system**

Costs of a strong system versus costs of not-having a strong system

- How do you measure the ROI?
- Are there any benchmarks?
- What steps are important?

**So what can or should you be doing now?**

- Continue emphasis on Compliance – Invest upfront to prevent problems
- Risk Assessment – including FCPA
- Whistleblower Hotline
  - Address matters immediately
  - Respect the source
  - Consider a “Quick Strike®” approach
- Be prepared to take the investigation where it goes
- Lock down the documents and other data
- Emphasize a SHOW ME versus a TELL ME review process

**Final thoughts**

- Don’t underestimate the importance of the “Get It” factor.
- Remember that – You never have time (or money) to do it right but you always have time to do it over!
- “It’s all about credibility”

All in Pursuit of ‘Clean Earnings’
### About Me

**Susan Markel**  
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Susan oversees matters for clients involving an array of areas in corporate financial reporting, including regulatory investigations, relevant experience.

SUSAN’S EXPERTISE COVERS: SEC enforcement, FCPA, internal control reviews, risk assessments, PCAOB investigations, expert-witness testimony, whistle-blower investigations.

### Relevant experience

- Provided litigation support in matters of financial accounting, internal audit, internal control, and issuer reporting, including SEC, DOJ, Department of Justice, and Public Company Accounting Oversight Board (PCAOB) investigations regarding the conduct of corporations, individuals, and auditors.
- Conduct investigations of public companies and of the related conduct of auditors in a wide range of industries and sizes of entities.
- As Chief Accountant of the SEC Enforcement Division, oversaw and directed hundreds of financial fraud investigations and participated in decisions regarding appropriate resolution of matters as they pertained to corporations, corporate officers, employees, and independent auditors.
- Led leadership matters and investigations of FCPA, internal-control reviews, and issues related to acquisitions in multiple foreign countries.
- Testified as an expert witness.
- Presented investigational findings to management and boards of directors.