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ANTI-CORRUPTION COMPLIANCE AND FCPA ENFORCEMENT IN LATIN AMERICA

In this article the author addresses the SEC's enforcement action against WAC for large-scale bribery in its Mexican subsidiary. He finds the case of particular interest because the business model itself was high risk, red flags were ignored, and union and government officials were joined in the misconduct. It also highlights the new requirements in Latin America for companies to have compliance programs and, as part of such programs, to conduct third-party due diligence.

By Jose Martin *

In the past few months, we have seen some very important developments in global anti-corruption enforcement. One of the most intriguing cases was announced on August 6, 2020. The World Acceptance Corporation ("WAC") consented to the entry of an SEC order to cease and desist violating the anti-bribery, books and records, and internal controls provisions of the Foreign Corrupt Practices Act.[1] As is often the case, WAC did not admit or deny the SEC's findings, but did agree to pay $17,826 million in disgorgement, $1.9 million in prejudgment interest, and a $2 million penalty.[2] While the amounts are not massive, especially compared to other recent FCPA settlements, this ill-fated foray into Mexico, and the company's response to the challenges of doing business there, offer very useful insights into FCPA's internal controls enforcement, and serves as an excellent example of how not to do business in Latin America, and, specifically, in Mexico.[3]

As the business community becomes familiar with Brazil's *Lava Jato* (Car Wash) prosecutions and the ensuing multi-billion-dollar settlements in Brazil, the US, and Europe, it can be easy to think that anti-corruption compliance programs are now the norm. Companies conducting international business have learned their lesson, we often hear, and consider compliance a must-have before investing abroad. The facts in the WAC case are a good reminder that anti-corruption compliance controls are not the norm, and that failing to act in the face of clear red flags, can have material adverse effects. This case also highlights the

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

[2] *Available at*: http://fcpa.stanford.edu/fcpac/documents/5000/004106.pdf.

[3] The DOJ declined to prosecute the case. https://www.justice.gov/criminal-fraud/file/1301826/download.

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FCPA's broadening scope, by referring to union and government officials within the scope of misconduct the SEC may be suggesting that, under certain conditions, union officials could be equated to government officials in FCPA enforcement actions.[4]

WAC'S BUSINESS IN MEXICO

WAC is a South Carolina corporation that operates a small-loan consumer finance business in 12 states. It entered the Mexican small-loan market in late 2010 through WAC de Mexico, S.A. de C.V., a Mexican wholly owned subsidiary.[5] In Mexico, it provided small loans directly to private consumers and to state and federal government employees, and was repaid through direct payroll deductions. Much like in the U.S., Mexican state and federal public school teachers are unionized and the WAC Mexico loans were intermediated by the state and Federal Teachers Union.[6] WAC Mexico´s private sector loans were marketed as *Avance* loans and its public sector loans as *Viva* loans.

WAC Mexico executed over 30 agreements with Federal and State Teachers Unions to provide small-loans to their members.[7] If an employee took a loan, the union would make direct payroll deductions and transfer the repayment to WAC Mexico. While WAC Mexico could, theoretically, provide these loans directly to government employees, the reality is that it needed the union's platform and outreach to reach its target and capture employee clients.[8]

Local press reports indicate that WAC Mexico was also the beneficiary of a loan relief program offered to members of Mexico's Public Teachers Union by the Peña Nieto Administration in 2013. Under the program, the government bought the teachers' existing short-term or consumer loans, and sold these loans to WAC Mexico and others who would provide better terms and rates. These new loans would be repaid directly through payroll deductions. WAC Mexico would also market new payroll loans to the Teachers' Union members. WAC Mexico continued with its *Avance* consumer loans and its *Viva* government loans in Mexico until 2018, when it divested its Mexican operations.[9]

THE BRIBERY SCHEME

As described in the SEC's cease-and-desist order, WAC paid approximately $4.1 million in bribes, directly or through third-party intermediaries, to Mexican government officials and union officials, from at least December 2010 through June 2017. These payments were needed to "obtain and retain" business related to WAC Mexico loans to state and federal public government officials, most of whom worked in the public school or public health systems. The payroll deductions were mediated by the federal or state teachers' unions, who collected the monthly repayments and transferred the money to WAC Mexico.

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[4] This is especially true in Latin America, where the line between union official and government official is often hard to see. It is thus recommended to treat high-ranking union officials as government officials for purposes of FCPA compliance.

[5] The SEC's cease-and-desist order and press release leave many details out. This note is based entirely on publicly available information and not on any direct knowledge or information from WAC, its negotiations with the DOJ and SEC, or the investigations.

[6] Mexican Teachers Unions do not fit the strict definition of "government official" under the FCPA. That said, in some cases the situation could be less clear-cut considering that union officials move in and out of politics and official government positions regularly. Depending on their risk tolerance, companies may want to consider union leaders as government officials for FCPA compliance purposes.

[7] WAC Mexico was dealing with the teachers and health workers union. Even the most cursory background check would have

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revealed serious red flags on the risks of doing business with these unions.

[8] WAC Mexico could have insisted that the payroll deductions go directly to it – Mexican law allows for it – but this would have meant the union would lose some control of its members, and a potential revenue stream.

[9] *Available at*: https://revistaespejo.com/reflexiones/el-snte-renovarse-o-morir-los-maestros-tienen-la-palabra/.

As described in the cease-and-desist order and press reports, WAC Mexico paid bribes to government officials to secure the assignment of the *Viva* government loans acquired by the Mexican government as part of its debt relief program and to union officials to ensure that the payroll deduction repayments were timely transferred to WAC Mexico. In all, WAC Mexico paid Mexican government officials $1.5 million, another $580,000 to union officials, and $480,000 to third parties who used part of the funds to pay government and union officials. According to the SEC, WAC itself was unable to determine where the remaining $1.5 million went because it lacked appropriate recordkeeping.[10] These bribe payments were made in the usual manner; some in cash, others to the bank account of the official, or one of his relatives or friends. When intermediaries were used, some payments were made using "large bags of cash." The intermediaries, naturally, kept a portion of the payments as commissions.

The bribery scheme itself was not overly complex or particularly creative. Nevertheless, the company's management of the risks posed by its business model in Mexico is emblematic of ways in which companies react to profitable international ventures and can serve as an excellent example of how not to handle international operations, especially in Latin America.

COMPLIANCE AND RED FLAGS

Doing business in Latin America can be very profitable and no company should shy away from the region based on corruption concerns. The people are hardworking, honest, and diverse culturally and educationally. Furthermore, investing long term in the region gives foreign companies a talent pool of outside-the-box thinkers who thrive in complex, challenging situations. While Transparency International´s Corruption Perception Index suggests that Latin America poses significant corruption risks,[11] these can be managed and avoided if adequately addressed, both in the planning stages and during the life of the investment. That is, companies should not go into a country without conducting serious country-specific due diligence and understanding the soundness of the local business model from an FCPA compliance perspective.

Based on the description of WAC´s Mexican business model described in the cease-and-desist order, it does not seem that WAC ever engaged in this crucial first step before going into Mexico. Had it done so, it would have learned that Mexico´s unions have a reputation for corruption. It would also have found some important red flags in the way the government´s debt relief program was implemented and how it was managed. Inquiries with local counsel and business experts would have shown WAC the inherent risks in the *Viva* loans business model, thus allowing it to establish adequate internal controls to minimize those risks. Adequate due diligence would have allowed WAC to see the obvious corruption risks posed by (i) government officials being given discretion to decide which company to transfer relief program loans to and (ii) Mexican unions mediating payroll repayments from its members to the loan-managing company.

When companies consider entering a Latin America country, they should add compliance as part of their approval checklist and not limit their review to financial considerations. In the case of WAC, an initial risk assessment would have included information on the country risk, an analysis of the risks posed by the specific business model, red flags about the participants, and due diligence on local business partners and personnel. This initial compliance risk assessment should have included input from local legal, business, and financial advisors who were familiar with the FCPA and local corruption risks. Their input would have given WAC an accurate assessment of the risks, both contingent and inherent, to the Mexico business model, and the likelihood of corruption occurring.

If a company´s business model depends on the discretion of government officials to obtain the business and on the good will of union leadership to collect repayments, it would seem that the risks of corruption are inherent in the business and unavoidable. Given these inherent risks, the proponent of this business model should be able to answer convincingly to upper management how the business model can succeed

[10] While this may be true, it is a rare instance of opacity. Generally, bribe payers keep secretive but detailed records of the money paid, recipients, and their expected purpose. Without adequate recordkeeping, it is very difficult to ensure the right outcomes and justify the payments.

[11] Transparency International publishes an annual Corruption Perception Index ranking countries from those perceived to be most corrupt to those perceived to be least corrupt. This index, while not perfect, is often used by companies to determine a country's inherent risks. https://www.transparency.org/en/cpi#. Based on these rankings, Mexico currently ranks 130/198 most corrupt countries in the world. This is better than last year's ranking of 138/198, but much worse than its 98/198 ranking in

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2010, as shown in this helpful chart by TradingEconomics.com at https://tradingeconomics.com/mexico/corruption-rank.

without improper payments. Upper management would then condition its approval on the implementation of significant anti-corruption controls and oversight. If the proponent of a new international venture cannot make the case for a reasonably safe business model, companies concerned with FCPA enforcement and ethical business practices should reject the project, regardless of profitability.

RISK MANAGEMENT AND INTERNAL CONTROLS

Latin America is a plentiful market with a rainbow of opportunities and potential, but companies should be aware of the risks specific to each venture, and conduct serious diligence on the opportunity and relevant partners. Once risks are adequately assessed, the company should manage them accordingly. What adequate risk management means depends on the risks of each particular business, but to enter a new international market, there are three basic requirements, (i) tone at the top, (ii) regular risk assessments, and (iii) payment management.[12]

Tone at the top may be the least expensive and most effective of all internal controls. It means that a company´s management's belief in ethical business practices is loudly conveyed and demanded from all employees. It may be inexpensive, but it is not easy. For it to work, it must be made clearly and without cynicism or C-suite exceptions. It requires making consistent statements about doing the right thing, of course, but above all, requires actions consistent with those statements. It also requires adequate training and clear communication of management´s expectations to employees. That means adequate funding for the compliance and audit roles, and giving them a seat at the table. Companies should strive to encourage whistleblowers and avoid factors that could silence employees who voice concerns or raise compliance issues.

Companies' regular reassessment of their business risks in Latin America is a basic tenant to ensure adequate internal controls. These periodic assessments should not be limited to financial risks, but include a component to evaluate risks and modulate compliance with internal policies. While this assessment can be conducted by a financial audit function, a regular assessment of local operations should include input from legal compliance. As part of this ongoing risk and compliance assessment, periodic in-person visits – if possible – and regular trainings are helpful ways to verify that risks continue to be managed adequately. Proactive risk assessments, to be effective, are part of a working FCPA compliance program that relies on artificial intelligence tools to track and detect deviations, on accounting and audit reviews, and dedicated personnel to manage the cultural and personal aspects of the company´s business.

Payment management, or more broadly, third-party due diligence and management,[13] is an essential feature for companies that rely on third-party intermediaries in their international business. Statistics show that close to 90% of all FCPA cases involved third-party intermediaries,[14] and many of these were hired precisely to funnel bribes to government officials. While the best and most dynamic payment management system may not avoid all improper payments when the local business is behind the scheme, a well-developed third-party due diligence process, including independent approvals, will minimize the risk of rogue hires.

The three elements discussed here, coupled with good hiring practices, and open communications (including a whistleblower protections) with employees, should be an essential part of any investment plan in Latin America.

LATIN AMERICAN ANTI-CORRUPTION ENFORCEMENT AND COMPLIANCE

Most countries in Latin America have passed their local versions of the FCPA (or more precisely, transnational anti-corruption laws),[15] and require

[12] In June 2020, the DOJ updated its Evaluation of Corporate Compliance Programs "to assist prosecutors in making informed decisions as to whether, and to what extent, the corporation´s compliance program was effective at the time of the offense" and to determine its effectiveness during any FCPA resolution process. This document is an excellent tool to use as a guide when formatting a compliance program and can be used to evaluate its effectiveness. https://www.justice.gov/criminal-fraud/page/file/937501/download.

[13] A third-party program includes onboarding KYC and due diligence, anti-corruption contractual language, and payment management through regular monitoring.

[14] *Available at*: http://fcpa.stanford.edu/statistics-analytics.html?tab=4.

[15] While the FCPA is a standalone transnational anti-corruption law, applicable only for business conduct outside the US (with a US nexus), other countries simply include foreign and domestic government officials within their domestic anti-corruption criminal statute. Mexico follows this structure, and punishes domestic bribery in section 222 and foreign bribery in section 222bis of the criminal code. For an English translation of Mexico's criminal code, refer to the Organization of

companies doing business there to have a working compliance program. While a compliance program is not a substitute for solid planning and a clear-eyed assessment of the inherent risks of any proposed venture, it will help companies minimize known risks and perceived challenges.

A recent survey conducted by PWC found that on each of the eight countries under review – Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Peru, and Venezuela – all either required or encouraged companies to have working compliance programs.[16] What "compliance program" means in each country is different, but the general elements described here are considered a part of all of these. In some cases like Chile, where corporate criminal liability has been around since 2009, corporate compliance is well-known. In others, like Argentina, Brazil, and Colombia, where corporate criminal liability is more recent, compliance programs have gained many advocates, as these countries increase enforcement of their domestic bribery programs.

These compliance program requirements, as is often the case in Latin American legal systems, emphasize form and structure and not outcomes or intent. Companies that want to implement a robust compliance program in the region need to both cover all listed legal requirements and strive to secure local buy-in for the program's success. Local buy-in may seem challenging in Latin America, but recent changes suggest that employees there value working for companies perceived to do the right thing. Companies, then, need to channel these good intentions with strong compliance policies and incentives that match corporate expectations.

Going back to the SEC cease-and-desist order and its narrative of the facts, WAC had several moments where a basic compliance program would have limited chances of misconduct. It does not seem to have conducted an adequate country risk assessment, and thus proceeded with a business model that had a very high likelihood of bribery. It appears to have dismissed red flags and failed to strike a strong pro-compliance tone at the top. The SEC cites an example that in October 2015, the then-CEO of WAC terminated WAC's head of internal audit after he raised compliance concerns about the lack of accounting controls in WAC Mexico. He also combined the audit and the compliance functions, had them report to the head of legal, instead of the Audit Committee of the Board of Directors, and significantly eliminated staffing. When the compliance and audit vice president voiced concerns over this less than ideal arrangement, the then-CEO terminated her and had the general counsel take over the compliance and audit functions, even though he had no audit or accounting experience.

That was not all. According to the SEC, WAC Mexico employees did not receive adequate anti-corruption training, nor any formal monitoring of compliance with the corporate anti-corruption policy. It also did not set up any third-party onboarding controls, or a reasonable payment management structure to such an extent that even its bribes went unaccounted for. Lastly, it failed to conduct regular audit reviews of the business in Mexico. WAC's apparent indifference to anti-corruption compliance increased the likelihood of misconduct.

Enforcement of local anti-bribery laws remains a work in progress in Latin America, especially in Mexico. There is a growing trend where local authorities pursue domestic bribery cases against individuals who were named or described by US authorities as part of an FCPA settlement or cease-and-desist order.[17] A working compliance program and adequate training on the domestic and global risks of corruption both to the company and, more importantly, to the employees, are often well-received. Not only do they give employees a clear set of principles to guide their work, but also an avenue to report to the company any observed evidence of potential misconduct. Most Latin Americans view corruption as a serious problem and believe they can do something to change it, if given the right tools and support. Such collaborative effort between a company and its personnel will reduce the importance of local enforcement and maximize the effectiveness of a compliance program which can serve as a real source for change.

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American State's website *at* http://www.oas.org/juridico/Spanish/mex_res13.pdf.

[16] PWC Corruption in Latin America – Opportunities, Challenges and Risks. https://www.pwc.com/us/en/services/forensics/pdf/pwc-corruption-in-latin-america-opportunities-challenges-and-risks-february-2020.pdf.

[17] This trend, while positive, has the unintended consequence of making cooperation by foreign nationals riskier. It would be hard to convince a Colombian client to assist the DOJ in the US if it thought that her testimony would be used by Colombian prosecutors against her in Colombia.

CONCLUSION

From a corporate perspective, many FCPA cases seem obvious in retrospect. The company should have known that a branch office in some remote location was up to no good. All the signs were there: a business model overly reliant on third-party intermediaries, an opaque income stream dependent on government contacts, and unexpectedly high margins in government contracts. Limited experience with international business is not an excuse for failing to perform an adequate risk assessment. The US Department of Justice has set forth the model to follow when it comes to anti-corruption compliance.[18] This model should be applied when conducting business abroad. At a minimum, companies should provide its compliance personnel with adequate resources and empowerment to regularly re-assess risks and raise concerns. In Latin America, to have a truly effective compliance program, companies should also give local employees some ownership of the program's implementation to build on their commitment for change. ■

[18] *Available at*: https://www.justice.gov/criminal-fraud/page/file/937501/download.