

Nepotism

SEC Investigation of JPMorgan Hiring Practices Demonstrates FCPA Nepotism Risks

By Rebecca Hughes Parker and Nicole Di Schino

Should banks with global presences be concerned that their hiring practices may cause FCPA headaches? The recent revelation that JPMorgan Chase & Co., the nation's largest bank, is being investigated by the SEC for possible FCPA violations stemming from its hiring of the children of two high-placed Chinese officials, may cause other banks to scrutinize who they are hiring and how they are documenting their hiring decisions, especially if the new hires are related to foreign officials.

"If a company is doing business with particular government entities or government-controlled companies, it would be prudent for that company to implement a ban on hiring the children of any foreign officials working for such entities or government-controlled companies unless it is specifically cleared by the company's compliance group or legal counsel. Otherwise, the hiring of such officials' children may create an appearance of impropriety that could trigger an FCPA investigation," Daniel Fetterman, a partner at Kasowitz, Benson, Torres & Friedman LLP, told *The FCPA Report*. "In today's environment of increased FCPA enforcement, an investigation alone can be very expensive and potentially damaging for a company."

SEC Investigates JPMorgan's Hiring Practices

JPMorgan may be facing such an expensive and potentially damaging investigation. Its apparent hiring of two offspring of Chinese officials close in time to business deals with the

companies with which those officials are associated raised red flags within the SEC's FCPA unit. On August 17, 2013, *The New York Times* reported, based on what it called a "confidential government document," that in May 2013, the SEC requested a "battery of records" from JPMorgan about two former employees, Tang Xiaoning and Zhang Xixi.

According to the *Times*, Xiaoning is the son of Tang Shuangning, chairman of the China Everbright Group, a state-controlled financial conglomerate. Soon after he was hired, "JPMorgan secured multiple coveted assignments from the Chinese conglomerate, including advising a subsidiary of the company on a stock offering, records show."

The other target of the request, Zhang Xixi, is the daughter of an official of the Chinese Railway Group, which went on to select JPMorgan to work on its \$5 billion public offering. Before working for JPMorgan, Zhang attended Stanford, according to her profiles on social media, the *Times* reported.

The document request does not definitively link any corrupt intent to the hirings and JPMorgan does not currently stand accused of any wrongdoing. But, the *Times* notes, "the S.E.C.'s request outlined in the confidential document hints at a broader hiring strategy at JPMorgan's Chinese offices. Authorities suspect that JPMorgan routinely hired young associates who hailed from well-connected Chinese families that ultimately offered the bank business. Beyond the daughter of the railway official, the S.E.C. document

inquired about ‘all JPMorgan employees who performed work for or on behalf of the Ministry of Railways’ over the last six-plus years.”

Fetterman believes that the government may already have gathered some evidence that the hirings violated the FCPA. “According to public reports, there are a couple of facts that the SEC likely will argue to support the position that JPMorgan provided those jobs with a corrupt intent,” he said. “Jobs were given to the children of certain Chinese officials, and JPMorgan obtained business from the state-controlled entities managed by such officials shortly after their children were hired. If the SEC finds evidence suggesting that these jobs were provided for the improper purpose of obtaining that business, then it likely will proceed with an enforcement action.”

Fetterman predicted that “the SEC’s inquiry is going to focus on how these children came to apply for these jobs.” He believes that “the SEC will be looking for any communications which reference both that JPMorgan was being considered for work and that these children were seeking jobs from the company. Finally, the SEC will look for any other evidence linking the work obtained by JPMorgan with the hiring of these Chinese officials’ children.”

Responding to the *Times* story, JPMorgan said that it had referenced the SEC document request in a public filing. Its August 7, 2013 filing stated, under the heading “Regulatory Developments”:

A request from the SEC Division of Enforcement seeking information about documents relating to, among other matters, the Firm’s employment of certain former

employees in Hong Kong and its business relationships with certain clients.

See “A Guide to Disclosing Corruption Investigations in SEC Filings (Part Three of Four),” *The FCPA Report*, Vol. 2, No. 11 (May 29, 2013) (crafting and timing FCPA disclosures).

A Proper Hire or Something of Value Given to Retain Business?

Nepotism can form the basis for a FCPA violation. The “anything of value” language in the FCPA encompasses more than just payments – the hiring of a relative of a foreign official can be a “thing of value” and, according to past cases, can violate the FCPA if the job was offered to obtain or retain business. The crux is whether the relative was hired with corrupt intent.

As Joel Cohen and Matthew Knox wrote in *The FCPA Report* in October 2012, if the job the relative of the official is offered is a sham position with no responsibilities, “it is easy for regulators to determine that the actual benefit will accrue later – i.e., an improper quid pro quo – as the company does not gain anything from the actual hiring of the employee.” See “Friendly Relations? When Nepotism May Violate the FCPA,” *The FCPA Report*, Vol. 1, No. 10 (Oct. 17, 2012).

In closer situations, Cohen and Knox said that the DOJ “will examine the circumstances of the engagement to determine whether the purpose of the relative’s hiring is to improperly influence the foreign official. If that is the case, regardless of the relative-employee’s bona fides, the arrangement likely will be perceived by the regulators to raise FCPA red flags.” Some previous cases include:

- *SEC v UTStarcom, Inc.*, in which the SEC alleged that UTStarcom made ten offers of employment for government customers or their family members in China. UTS paid salaries, but the employees never worked and UTS created fake annual performance reviews.
- *U.S. v. DaimlerChrysler China, Ltd.*, in which Daimler employed relatives of a Chinese government official to secure business from a state-owned energy company and The Bureau of Geophysical Processing (BGP). Daimler created a sham consulting agreement with the official's wife and provided an internship and employment for the son of a BGP employee who made purchasing decisions.
- *U.S. v. Siemens Bangladesh, Ltd.*, in which Siemens employed the daughter of an official of the Bangladesh Telegraph Telephone Board (BTTB) as it was making bids for a contract that was part of a BTTB project. Siemens seemingly hired the daughter as an engineer, even though the project did not call for an engineer and Siemens did not have the budget for the position. Siemens also hired the nephew of an employee of the Ministry of Post and Telecommunications, an agency also involved in the awarding of the BTTB contract. See "Lessons Learned on Crafting Compliance Programs From the Largest FCPA Case in History," *The FCPA Report*, Vol. 1, No. 3 (Jul. 11, 2012) (history of Siemens case).
- *SEC v. Tyson Foods, Inc.*, in which the SEC alleged that Tyson made improper payments to two Mexican government veterinarians responsible for certifying products and concealed those payments by putting the wives of the veterinarians on its payroll.

Secure Anti-Corruption Representations and Document Qualifications

Companies may wish to examine their historical hires. According to Cohen and Knox, if a company can show that its employment offer was backed by "robust FCPA considerations and based on legitimate considerations, it may withstand investigative scrutiny."

Fetterman said that companies should be wary of people who do not come in through the company's ordinary employment practices. "If a foreign official's family member is recommended to the company, the company should scrutinize the reason for that recommendation. The company's FCPA compliance group or legal counsel should look for any connection between the recommendation and work that the company has, or hopes to obtain, from the government entity at which the job applicant's relative works," he explained.

In DOJ Opinion Releases 84-01 and 82-04, the DOJ indicated it did not intend to take any action against the companies seeking the opinions based on the fact patterns presented. In 84-01, an American firm wanted to hire an entity as a marketing representative in a foreign country. That entity was run by relatives of that foreign country's head of state. In 82-04, an American company hired the brother of a foreign official as the agent for a transaction in that country without knowing the familial relationship.

In both of those cases, the companies obtained strong anti-corruption representations that factored into the DOJ's opinions. (In the case of 84-01, before the hiring, and in the case of 84-02, after, the company learned of the foreign official relationship.) Cohen and Knox wrote that while each

case is fact specific, generally, companies should take two steps when hiring the relative of a foreign official: First, incorporate a broad set of FCPA compliance representations in a written contract and second, establish and document that the new hire is “legitimately qualified, whether standing alone or compared to others under consideration for the same position.”

The JPMorgan investigation serves as a reminder that the DOJ and SEC are still actively pursuing bribery in all of its forms. Companies subject to the FCPA and hiring internationally should take this opportunity to reevaluate their processes and safeguards. “Prospectively, companies should assess their FCPA compliance policies to make sure that they have appropriate measures in place to avoid both

actual FCPA violations and the appearance of possible FCPA violations which could trigger unnecessary, expensive and distracting investigations,” Fetterman said.

As for JPMorgan specifically, hiring is only one aspect of JPMorgan’s business that regulators are scrutinizing: it faces six separate investigations from the DOJ. See, e.g., “JPMorgan Chase Anti-Money Laundering Consent Orders Highlight the Role of Risk in Structuring Compliance Programs,” *The FCPA Report*, Vol. 2, No. 2 (Jan. 23, 2013). The August 7 filing revealed that it could be forced to absorb \$6.8 billion in future legal losses above its existing reserves. See “Estimating Loss: When and How to Calculate and Disclose Financial Reserves for FCPA Settlements (Part Two of Three),” *The FCPA Report*, Vol. 2, No. 14 (Jul. 10, 2013).