Overview

Skirting over financial crime due diligence when considering a quick transaction in an emerging market can cost you dearly down the line when regulators or shareholders discover issues with regulatory compliance after your transaction. The safer and ultimately more cost-effective course may be an independent assessment of the financial crimes compliance risks before completing cross-border transactions. Recent, high-profile government enforcement actions against respected companies and high-stakes civil litigation by shareholders, investors, and corporate officers, reinforce what is at stake.

In a typical deal, whether a merger or acquisition, a joint venture, or a significant third-party engagement, each side may hire a law firm to manage the transaction, draft agreements and filings, and conduct due diligence. The due diligence process generally includes a financial crimes compliance (FCC) component to identify FCC risks such as money laundering (AML), anti-bribery and corruption (AB&C), economic sanctions, and export controls based on information collected during the due diligence process. In addition, we have increasingly seen interest by investors in understanding international trade risk and this new component, driven by the US-China trade war, has further increased the complexity of traditional compliance-related due diligence.

This work often falls to deal counsel, along with other tasks required to "get the deal through." However, there is a case to be made for hiring independent compliance counsel for FCC due diligence.

For starters, an independent counsel can bring a neutral perspective from the deal counsel who may overlook issues that are not central to completing the transaction. This is especially true where the deal team lacks bandwidth or expertise to carry out a fulsome FCC review. Too many due diligence reviews consist of a one-size-fits-all questionnaire or pre-acquisition checklist. Above all, a law firm that specializes in FCC due diligence can bring know-how—and credibility—to problem-solving that is tailored for the client’s needs. The market is littered with failed enterprises that could have been saved with a little extra attention early on.

What could go wrong?

There is no shortage of examples of internal investigations, enforcement actions (criminal and administrative), and litigation arising from inadequate pre-transaction due diligence. An independent and informed voice can raise genuine concerns about serious FCC risks that may not be apparent to an untrained eye.

Consider the following situations, which are based on real cases:
• A mining company faces civil litigation regarding its acquisition of mining rights in a West African country where the pre-acquisition due diligence failed to identify potential bribery-related risks.
• The US government charges employees of a multinational bank, alleging they deceived investors over the purpose of loans to a borrower in a developing country and circumvented the bank’s internal controls to conceal the alleged fraud.
• An international oil company suffered major reputational damage after failing to detect suspicious payments to a third-party business partner in an investment.
• A South American airline inadvertently breached US sanctions after a restructuring brought in US ownership, and thus, US Office of Foreign Assets Control (OFAC) jurisdiction.
• A US-based investment firm acquired companies with business in Iran and Cuba, which later formed the basis of a highly-publicized OFAC penalty.
• An acquisition valuation was incorrectly inflated based on a misunderstanding of US tariffs under the assumption that moving some of the target’s manufacturing from China to Vietnam would enable the company to escape the imposition of China-specific tariffs on its manufactured goods exported to the United States.

**Benefits and costs**

Below are the top ten reasons to consider independent compliance counsel the next time your company needs to undertake pre-transaction due diligence.
Independence and neutrality. While it is important not to disrupt the deal flow unnecessarily, a clear-eyed, "big picture" view of a transaction and relevant parties can help ensure the ongoing value of the deal post-closing. Compliance risks that are not identified and mitigated before signing are scrutinized by the regulators with 20/20 hindsight.

2. Board oversight. Corporate boards have their own oversight responsibilities in relation to compliance and instructing independent counsel to conduct the due diligence can provide greater comfort to the board that the compliance issues have not been glossed because of management's rush to get the deal done.

3. Due diligence expertise. Experienced due diligence counsel can dispense with overly-broad and out-of-date templates to bring a streamlined methodology for particular industries, markets, corporate structures, and transactions. With the benefit of experience, special due diligence counsel can put compliance issues in perspective, drawing on past examples and current trends to assess the likelihood of enforcement or reputational damage based on similar cases. They can also offer sustainable mitigation measures with an eye on market practice.

4. Post-closing implementation. Issues identified in the pre-acquisition due diligence, including insufficient access to data and documents, must be adequately addressed post-closing. Counsel with sector and jurisdiction-specific experience, rather than the deal team, will be best positioned to develop the post-closing implementation plan.

5. Company familiarity. Deal teams and transaction parties change. Having tried-and-true due diligence counsel allows for continuity and focus. Familiarity with the client's structure and operations, as well as its expectations and decision making process, not to mention the personalities of key stakeholders, promotes efficiency and positive outcomes.

6. Local connections. US and UK legal knowledge is vital. Where needed, it's also essential to have access to lawyers and service providers with experience in local jurisdictions to identify and mitigate unforeseen risks. Understanding local market practices can help avoid 11th-hour deal disruptions. Compliance counsel should have experience working with local counterparts.

7. Reputation. If a question arises about the adequacy of pre-transaction due diligence, it helps to have credible counsel. Experienced counsel can anticipate regulators' expectations about the level of due diligence needed and give insights into approaches that have been accepted in the past. While not "bullet-proof," regulators notice the care and attention paid in selecting due diligence counsel.

8. Special topics. There are nuanced areas of law such as sanctions administered by OFAC, export controls under the International Traffic in Arms Regulations (ITAR), the Export Administration Regulations (EAR), investments reviewed by the Committee on Foreign Investments in the United States (CFIUS), and international trade regulations. Even in areas of relative familiarity such as the US Foreign Corrupt Practices Act (FCPA) and the UK Bribery Act (UKBA), there are significant gray areas that require greater experience and informed judgement precisely because there is less black letter law. These issues cannot be handled with a templated checklist. Experienced counsel can guide clients on both sides of the deal to identify and mitigate risks, interact with relevant regulators, and provide ongoing post-transaction legal counsel to protect the deal's value in the long term.

9. Attorney-client privilege. The attorney-client privilege becomes even more necessary when due diligence triggers an internal investigation leading to a regulatory disclosure. Having legal counsel experienced in handling investigations minimizes effort and expense while protecting information from disclosure to third parties.

10. Cross-over expertise. An effective and accurate overall risk analysis will require an integrated approach, where the due diligence teams are not focusing on specific silos and are instead able to closely work with each other to explain and mitigate the risks, which may appear to be insignificant within a particular area or silo, but could be material when considered together with the risks identified in other areas.

Whatever the deal type, adequate FCC due diligence is essential in identifying risks to protect the value of your investment, prevent costly fines and litigation, and avoid reputational damage. As stakes rise, companies have several good reasons to include independent compliance counsel in their team of deal advisors.

Practices
FCPA/Anti-Corruption
Economic Sanctions
Export Controls
Anti-Money Laundering
Financial Services