Get These 10 Things Right: What We’ve Learned So Far

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Get These 10 Things Right –

What We’ve Learned So Far

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We’ve Been At This a While (Scott and Win Circa 1997)
So Much to Say, So Little Time

- This presentation is intended to spark thoughts and ideas.
- We're offering up 10 of them.
- The challenge is that we could spend an hour talking about any single one of them.
- We're allocating about 5-7 minutes each.
- We'll therefore be skimming through material by necessity, not because a deeper exploration isn't warranted.
- Our hope is that you'll find a few points that you want to explore deeper as you move forward in your roles.

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Thing #1

Check Causes, Not Boxes
1. Check Causes, Not Boxes

- Early stage programs tend to focus on checking the box to ensure “all the right elements are in place”
  - Code of conduct and related policies
  - Communications and awareness-building
  - Training
  - Hotline
  - Certifications
  - Investigative functions
  - etc.

- All good stuff. But it tends to leave people asking, “Now what?”

  Or worse…If you had all these things in place, why didn’t it work?

Thinking Outside “The Box”

- Some of the best ideas for your program may not come from a government checklist
  - Those checklists are fine, but were developed in response to a particular set of circumstances…not necessarily yours.
  - They also have a way of breeding false comfort once all the boxes are checked.

- The best ideas come from thinking about the root of the problem…
  - i.e., the root causes of program ineffectiveness.
Core Objectives of an Effective Program

- Prevent wrongdoing
- Detect occurrence
- Respond appropriately once discovered
## Getting to the Root of Misconduct

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<thead>
<tr>
<th>Unintentional Misconduct to Benefit the Organization</th>
<th>Unintentional Misconduct to Benefit the Individual</th>
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<tbody>
<tr>
<td>Example: A new employee shares proprietary information from his former employer.</td>
<td>Example: An R&amp;D engineer accepts an off-hours consulting contract from a supplier.</td>
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<td>Example: An accounts payable clerk creates a fictitious vendor and makes payments to himself.</td>
<td>Example: A division head artificially inflates sales to meet revenue targets.</td>
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## Core Objectives of an Effective Program

- **Prevent wrongdoing**
- **Detect occurrence**
- **Respond appropriately once discovered**
Getting to the Root of Silence

- Awareness that a helpline exists
- Confidence that it will really help on matters
  - big and small
  - that challenge the status quo
  - involving senior people
- Trust in the safeguards
  - confidentiality
  - non-retaliation
  - visibility

Core Objectives of an Effective Program

- Prevent wrongdoing
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- Respond appropriately once discovered
Getting to the Root of Response Breakdowns

- **Fragmented investigative authority**
  - turf battles
  - missed hand-offs
  - off-radar matters

- **Weak structures**
  - inadequate objectivity / competency / resources
  - ineffective investigation protocols
  - disjointed authority on disciplinary decisions

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**Thing #2**

All Compliance is Local
2. All compliance is local – Each part of the business must see E/C not as Corporate’s CYA, but as their DNA

Recent localized compliance calamities:

- Glaxo in China
- Wal-Mart in Mexico
- JP Morgan’s “London Whale”
- BP Deep Water Horizon

Goal: Create a “tipping point” in each location, so that E/C is part of “how we do things”

Companies combine these to create the tipping point locally

- They “conscript” local management into the effort
  - How are the managers evaluated and compensated? Is E/C relevant?
  - Are growth expectations for that region or part of the company realistic?
  - How are the managers (particularly outside of the US) selected and acculturated with the company’s E/C expectations?
  - What are their bosses – say, the regional VPs – saying to these local managers about expectations?
  - Are they asked and given tools to promote ethics locally?
Companies combine these to create the tipping point locally

- They support local management with locally based ethics officers who can be the eyes, ears and mouths for E/C at the local level.

**Keys to success:**

- The local EO should have strong ties to the central E/C function
  - Regular face to face meetings
  - Protocols of what must be discussed with the local EO

- Making sure that, even if part-time, the local EO is compensated and evaluated for performing the EO role, and that the role is career enhancing.

- Vetting ahead of time with local management what the expectations are for this role – including time required.

- Training and tools.

Companies combine these to create the tipping point locally

- They don’t allow local “mistakes” that breed cynicism to go unaddressed:

- Policies in wrong language

- Training that uses poor translation

- G&E violations by local management, etc.
Companies combine these to create the tipping point locally

- They audit and evaluate with boots on the ground.

**Thing #3**

“Local” Includes That Rarified Place Called “the C-Suite” Too
3. Local is the C-Suite Too

- Many programs are appropriately designed with the idea that misconduct takes place in far off locations by rank and file managers/employees

- But some of the biggest company meltdowns happen because of misconduct and failures at the top
  - ADM Vice Chair imprisoned for price fixing
  - Boeing CFO imprisoned for fraud
  - Halliburton Division President imprisoned for bribery
  - Martha Stewart imprisoned for insider trading
  - SAC Capital CEO, Steven Cohen, targeted by SEC

Stress Testing

- Governance systems should be designed in a way that anticipates worst case scenarios...
  - executive wrongdoing
  - internal control override
  - co-opted gatekeepers

- The ability of the CECO to act with authority and objectivity in these scenarios is critical
Promoting Authority and Objectivity

From the Edison International Audit Committee Charter

Ethics and Compliance

1. **The Committee shall concur in the appointment and the dismissal of the CECO and in significant changes to the internal ethics and compliance budget or resource levels.** The Committee shall annually review the performance of the CECO. At least quarterly, the Committee shall receive a written report from the CECO regarding the status of the E&C program, including information about Ethics and Compliance Helpline calls and investigation trends, training, and other information. The Chair shall be notified promptly, and in no event subsequent to the final disposition of the matter, by the CECO of any “significant” matters, as defined in the CECO position charter. **The Committee shall approve any material changes to the CECO position charter.**

2. **The CECO shall annually present to the Committee for review and approval of the annual ethics and compliance goals and plans for future activities relating to ethics and compliance.** The CECO will also annually present a report on the effectiveness of the progress made with respect to executing the approved goals and future plans and on the effectiveness of the Ethics and Compliance Program.

4. **The Committee shall conduct executive sessions with the CECO as necessary to provide an opportunity to address any issues related to the ethics and compliance program that the Committee or the CECO believe are more appropriately addressed without management present.**
Beyond the Organizational Chart

- Organizational positioning matters, but it is not a silver bullet
  - Stature, respect and a seat at the table matter too... and these are tricky (if not impossible) to force

- Not all reporting relationships to the General Counsel are necessarily equal (or evil)
  - In some companies, the GC is an obstacle
  - In others, the GC is a highly useful mentor and backer of the CECO

- Internal and external optics can play a factor too

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Thing #4

“Tone at the Top” is Often an Empty Cliché
4. “Tone at the top” is often an empty cliché

- Most companies have:
  - A letter in the Code from the CEO
  - An occasional CEO message (such as a video clip) with CEO saying: “Ethics is just good business”
  - An honest belief by CEO: “We are an ethical company. I don’t tolerate unethical activity. Everyone knows that.”

- Except they don’t necessarily know.
  - These minimal communications do not move the needle.

What does move the needle?

- The CEO has an actual and earned internal reputation for supporting ethical conduct – whose commitment is essentially corporate legend.
  - When employees are interviewed about the ethical climate at the company, do they volunteer stories about what the CEO has said and done to make his/her support for ethics clear?
    - “He always talks about it”
    - Refused to go into that market because of ethical concerns
    - Fired a VP who was a big financial performer
  - Do they say management will forgive missing a number but not taking ethical shortcuts?
A challenge for publicly traded companies

- Among the large companies we have worked with, the CEOs who best accomplished this feat led non-publicly traded (but still very large) companies
  - “The corporate name is the family name”
  - “We are a mutual insurance company and don’t have to answer to Wall Street”
  - It’s probably harder for companies that do have to answer to Wall Street, but the objective is clear. See B. Heineman, *High Performance with High Integrity*.

Thing #5

Leadership Incentives and Accountability Matter
5. Accountability and Incentives Matter

- **Federal Sentencing Guidelines require “incentives,” but many struggle with what this means**
  - Paying employees to be ethical?
  - Bounty programs for whistleblowers?
  - 10% of performance rating tied to training completion?
  - Talking about ethics in the annual company speech?

- **Perhaps incentives at the top should be about…**
  - What leaders can do to foster ethical conduct and the business conditions that support it

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Tangible Things Leaders Can Do

- Promoting a long-term oriented vision to the market and recruiting directors, officers and investors who are committed to it

- Ensuring that annual goal setting, strategic planning, budgeting and resource allocation foster a culture that is goal-oriented and competitive, but nevertheless consistent with an effective compliance and ethics program

- Directing or sponsoring activities to determine whether compliance risks have been identified and effective controls are in place to mitigate those risks within their areas of responsibility

- Evidencing regularly, through words and deeds, in big ways and small, their commitment to ethical and lawful conduct
Things Leaders Can Do and Be Rewarded For

- Leading or sponsoring compliance campaigns and initiatives within their areas of the business
- Holding direct reports and other subordinates accountable for their individual roles in:
  - strengthening compliance within their areas of responsibilities
  - promoting an ethical culture
  - monitoring the conduct of subordinates
  - being positive role models on integrity

Some Incentive Frameworks

- Dis-incentivizing misconduct
  - Clawbacks when targets are achieved through fraudulent, illegal or unethical means
  - Skip-level accountability for wrongdoing
- Incentivizing compliance
  - Processes
  - Results
- Compliance as "gating condition" for incentive compensation eligibility
From Walmart’s 2013 Proxy Statement

In order to further emphasize our company’s ongoing commitment to such a program, beginning in fiscal 2014, the annual cash incentive payment of each of our NEOs and certain other Executive Officers will also be subject to achieving certain compliance objectives. During fiscal 2014, our company’s senior leadership will evaluate the company’s key compliance policies, processes, and controls, and prepare a timetable for implementing further enhancements on a prioritized basis (the “Fiscal 2014 Compliance Objectives”). These enhancements will address the key components of a corporate compliance program, including leadership and resources, standards and controls, communication, systems, training, and monitoring, among others. Senior management will provide quarterly reports to the Audit Committee on the progress in implementing the Fiscal 2014 Compliance Objectives. If, in the judgment of the Audit Committee, the company has not achieved adequate progress in implementing the Fiscal 2014 Compliance Objectives, and taking into account such other considerations with respect to compliance matters for fiscal 2014 as the Audit Committee in its judgment may deem appropriate, then the CNGC may reduce or eliminate fiscal 2014 annual cash incentive compensation for the relevant Executive Officers.

From Walmart’s 2013 Proxy Statement (cont’d)

In addition, to demonstrate the importance of accountability with regards to compliance matters, our CEO agreed to an additional compliance component to his fiscal 2013 cash incentive payment. At the conclusion of fiscal 2014, the Audit Committee and CNGC will have the authority to consider compliance matters for both fiscal 2013 and fiscal 2014 in evaluating the annual cash incentive for our CEO at the conclusion of fiscal 2014, and as a result of such evaluation, the CNGC may, in its discretion, elect to recover a portion of the annual cash incentive payment made to our CEO for fiscal 2013.
6. Transparency is a highly effective tool

- *It gives the lawyers heartburn, but sharing info (such as real cases and data generated by the E/C program) makes believers out of skeptics within the workforce.*

- The Best Buy (Kathleen Edmond) blog.

- "Organizational justice" is key to a "speak up culture" – The belief that action will be taken, and those who do speak up will be safe from retaliation.

- Data from employee focus groups around the world overwhelmingly demonstrate the power of:
  - Real cases showing how issue was raised and what happened
  - Data from helpline, investigations, discipline (e.g., senior people get disciplined too)
7. Helpline metrics tell only part of the story

- The 1%-3% of employee population as a “rule of thumb” is only one data point for determining whether the company has a “speak up” culture. Helpline usage levels vary among companies for both good and bad reasons.

- Some variance is a function of the “hand that is dealt” – factors such as
  - the age, education and turnover of the workforce that typifies that industry,
  - where the company operates,
  - whether the company is unionized or not,
  - how complex the operating business environment for that industry is, etc.
Some factors are more within the company’s control

- Some companies have a verifiably higher incidence of employees using to other resources and thus needing the helpline less:
  - Their manager
  - SMEs (particularly in some more regulated industries like insurance)
  - HR (especially when perceived not to have a pro-management bias)
- Some companies actually do get contacts from outside the U.S.
- Overall, we have learned that gauging a company’s culture for speaking up is more complicated than the number of reports to its helpline and that a range of data points is relevant.

Thing #8

The good news? The Government cares about your E/C program.

The bad news? The Government cares about your E/C program
U.S. Department of Justice and SEC

“In addition to considering whether a company has self-reported [and]... cooperated, DOJ and SEC also consider the adequacy of a company’s compliance program when deciding what, if any, action to take.”

Good news: The Government cares

- Johnson and Johnson – April 8, 2011

“Due to J&J’s pre-existing compliance and ethics programs, extensive remediation ... as well as the enhanced compliance undertakings included in the agreement, J&J was not required to retain a corporate monitor, but it must report to the department on ... its ...enhanced compliance efforts every six months.”

- DOJ press release
Good news: The Government cares

Effect of a good program:

- *Ralph Lauren* – April 22, 2013

“This NPA shows the benefit of implementing an effective compliance program. Ralph Lauren Corporation discovered this problem after it put in place an enhanced compliance program …. That level of self-policing along with its self-reporting and cooperation led to this resolution.”

– SEC’s FCPA Unit Chief

Good news: The Government cares

Effect of a good program:

- *Morgan Stanley* – April 25, 2012

*In press release announcing indictment of a MS employee, the Government details extensive efforts by Morgan Stanley to establish a strong FCPA compliance program in China. The indicted employee “used a web of deceit to thwart” the Company’s compliance program.*

Result: Declination.
Bad news: The Government cares

Reverse effect of a poor program:

- “Biomet’s compliance and internal audit functions failed to stop the payments to doctors even after learning about the illegal practices…. A company’s compliance and internal audit should be the first line of defense against corruption, not part of the problem.”

Result: DPA with DOJ, and SEC order which included a third-party “consultant”.

The most important trend is: Is it real?

- The government is looking “behind the curtain” to see how the E/C program is actually functioning
  - Morgan Stanley: A rogue employee intentionally “thwarted” the E/C program
US Attorney Preet Bharara (SDNY)

“There are lots of situations in which compliance programs are simply lip service and they are on paper and nobody actually cares … and they are just to be used in a conference room with prosecutors when you say, ‘Don’t indict us because we have this thick compliance program.’”

“In all these frauds… you have the bad guys that are doing them, but you also have the good guys who didn’t say anything… because there is not a climate where people think they can elevate things, and its all lip service and … all these frauds … would have been avoided … if good people… did something about it. That’s the big lesson you learn after doing this job after four years.”

— At CNBC “Delivering Alpha” conference, July 2013 (a few days before indictment of SAC Capital).

USA Preet Bharara Announcing Indictment of SAC Capital

“Today’s indictment, though, is not just a narrative of names and numbers. It is, more broadly, an account of a firm with zero tolerance for low returns but seemingly tremendous tolerance for questionable conduct.

“And so, S.A.C. became, over time, a veritable magnet for market cheaters.

The S.A.C. Companies operated a compliance system that appeared to talk the talk, but almost never walked the walk.”
James B. Stewart, NY Times on SAC Capital cases

“Whether the elaborate compliance system at SAC Capital was little more than a Potemkin Village will be at the center of both the SEC’s civil enforcement [case against the CEO] and this week’s criminal indictment against the firm.”


Thing #9

Stakeholders Will Help, But They Need Good Information
Stakeholders Will Help But They Need More Information

- Programs are under-measured, which leaves board members and managers under-engaged
  - Code updates and certifications
  - Training completion rates
  - Hotline statistics

- You get what you measure

- Process measuring is good, but those processes are intended to generate outcomes
  - Safety incidents
  - Emission levels
  - Diversity levels
  - On-time, on-budget deliveries
  - Customer charge-backs
  - Suppliers terminated
  - Regulatory findings
  - Employee retention levels
  - Governance ratings
  - Shareholder support

Some Good E&C Annual Report Elements

- Description of key aspects of the program

- An introduction to the people and faces across the Company who play roles (e.g., Audit Committee Chair, General Compliance Officer, Ethics and Compliance Program Specialist, HR Generalist, QA Inspector, etc.);

- Metrics and targets around key compliance indicators (e.g., accident figures, employee diversity levels, emission reductions, customer satisfaction levels);

- Key ethics and compliance initiatives undertaken or planned;
Some Good E&C Annual Report Elements

- HelpLine metrics, including examples of real cases resolved in the prior year
- “Defining moments” that tell the story of a company’s values and standards being applied in both big and small ways.

What Good Reporting Can Achieve

- Make multiple stakeholders (including, per Guidelines requirements, high-level and substantial authority personnel) knowledgeable about the content and operation of the compliance and ethics program
- Bring to life what might otherwise be perceived as abstract or bland concepts in ways that help people “get” what the program is about and “see” evidence that it works
- Weave into the company’s culture, lexicon and memory real stories and examples that can inspire behaviors and inform instincts
- Targets, action plans, accountability for measurable improvements
Thing #10

If Senior Management Doesn’t Fully Get it, You Aren’t Necessarily Stuck

10. If senior management doesn’t fully get it

- The benefits of a third-party review
  - According to a recent Deloitte study, 41% of responding companies said they used an outside consultant to evaluate the company’s program
  - Sometimes (unfortunately) senior executives hear independent experts when they don’t hear their own internal experts.
Thank You

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We want your feedback! Please complete the e-mail survey you receive tonight.

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