

UNITED STATES OF AMERICA REPORT ON COMPLIANCE AND ETHICS PROGRAMS

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Introduction and Background



- Lockheed and other transnational corporate misconduct (Sen. Church)
- Political finance malpractice
- 1977 FCPA
- Treadway Commission (1985) : private-sector initiative to analyze and make recommendations on fraudulent corporate financial reporting
- Sentencing Guidelines - 1991
- Sarbanes-Oxley (Enron and Worldcom) – work of auditors
- Sentencing Guidelines amended –ethical culture – 2004
- Peterson case - 2012

Outside Factors



- OECD and UNCAC
- OECD Good Practice Guidance on Internal Controls, Ethics, & Compliance (2010)
- UK Bribery Act
- Together with ICC, WEF, UN Global Compact, NGO initiatives, lots of law, principles, guidance, documents
- Yet, compliance, practice and ethical norms not easily aligned (Jamaica-Peru examples)

Key Governance Challenge



- Gradual convergence of what is
 - Customary
 - Legitimate
 - Legal

- Implications for Company and National or Regional AC Strategies and Programs

Back to USA



- Increased number of investigations and prosecutions by Department of Justice and Securities Exchange Commission
- Compliance programs integral in influencing government decision to prosecute and mitigation of penalties
- Other incentives : Public recognition; faster granting of approvals/permissions; reduced reporting/monitoring by government

Federal Sentencing Guidelines for Organizations

“To have an effective compliance and ethics program, ... an organization shall:

1. exercise due diligence to prevent and detect criminal conduct
 2. promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law
- CP should be reasonably designed, implemented, & enforced
 - General effectiveness in preventing and detecting criminal conduct sufficient
 - Failure to prevent or detect criminal conduct does not mean that program is not generally effective

Federal Sentencing Guidelines for Organizations

- Minimal requirements for due diligence and promotion of ethical and compliance friendly culture
 1. Establishment of standards and procedures to prevent and detect criminal conduct
 2. Knowledge and oversight of implementation and effectiveness of CP by organization's governing authority
- High-level personnel maintain overall responsibility for CP
- Specific individuals responsible for day-to-day operational responsibilities of CP and periodic reporting to governing authority.
- Compliance personnel granted adequate resources, appropriate authority, and direct access to governing authority

Federal Sentencing Guidelines for Organizations

3. Exclude individuals from positions of authority who have engaged in illegal activities or conduct inconsistent with CP
4. Practical and periodic communication (including training programs) of high level personnel, employees, and agents
5. Monitoring, auditing, periodic evaluation of CP; implementing and publicizing system (anonymous/confidential) for employees and agents to seek guidance or report criminal conduct without fear of retaliation

Federal Sentencing Guidelines for Organizations



6. Promotion and consistent enforcement of CP through incentives and disciplinary measures
 - ▣ Reasonable response to criminal conduct, including modifications to CP; periodic reassessment of CP.

Department of Justice Guidelines for Prosecuting Corporations and Other Business Organizations

- Derived from series of three memoranda drafted by Deputy Attorney Generals
- Charging standards currently incorporated into the US Attorneys' Manual
- One of the nine factors considered in whether to bring charges or negotiate a plea is “the corporation's remedial actions, ***including any efforts to implement an effective corporate compliance program or to improve an existing one***, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies”

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Factors to be weighed by prosecutors

- 1. the nature and seriousness of the offense, including the risk of harm to the public,
- and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime;
- 2. the pervasiveness of wrongdoing within the corporation, including the complicity in, or the condoning of, the wrongdoing by corporate management;
- 3. the corporation's history of similar misconduct, including prior criminal, civil, and regulatory enforcement actions against it;
- 4. the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents;
- 5. the existence and effectiveness of the corporation's pre-existing compliance program;
- 6. the corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies;
- 7. collateral consequences, including whether there is disproportionate harm to shareholders, pension holders, employees, and others not proven personally culpable, as well as impact on the public arising from the prosecution;
- 8. the adequacy of the prosecution of individuals responsible for the corporation's malfeasance; and
- 9. the adequacy of remedies such as civil or regulatory enforcement actions.

Department of Justice Guidelines for Prosecuting Corporations and Other Business Organizations



- To qualify for immunity, amnesty, or reduced sanctions, the DOJ encourages corporations as part of their CP to:
 1. Conduct internal investigations
 2. Timely and voluntarily disclose relevant facts to authorities

Department of Justice Guidelines for Prosecuting Corporations and Other Business Organizations



- Main factors that prosecutors should consider in evaluating effectiveness of CP and support of management
 1. Adequate design of the CP
 2. Earnest application of the CP in good faith
 3. Effectiveness of the CP

Department of Justice Guidelines for Prosecuting Corporations and Other Business Organizations

- Sub-factors
 1. Comprehensiveness of the compliance program
 2. History, extent, pervasiveness, seriousness, duration, and frequency of criminal misconduct
 3. Number and level of the corporate employees involved
 4. Remedial actions, including disciplinary action against past violators uncovered by the compliance program
 5. Revisions to the compliance program in light of lessons learned
 6. Effective corporate governance mechanisms (i.e. independent review by directors, audit functions, reasonable information and reporting system to provide management and directors with timely and accurate information for compliance purposes)

Department of Justice FCPA Opinion Release 04-02



- While binding on the DOJ and requesting party, provides instructive advice and guidance
- Instant scenario involved investment group seeking to acquire companies and assets from another company that was previously convicted of FCPA violations.
- Investment group was required to adopt a rigorous compliance code

Department of Justice FCPA Opinion Release 04-02



- Components of the code included:
 1. Clearly articulated corporate policy against violations of the FCPA and foreign anti-bribery laws
 2. Establishing compliance standards and procedures to be followed by all directors, officers, employees, and all business partners
 3. Assigning to at least one senior corporate official the responsibility, implementation and oversight of the compliance program

Department of Justice FCPA Opinion Release 04-02



4. Direct reporting by senior official in charge of compliance program to Board of Directors
5. Effective communication of compliance program to all shareholders' representatives, directors, officers, employees, agents, and business parties through regular training and annual certifications of compliance
6. Establishing a reporting system, including a helpline, for suspected violations of the compliance code and criminal conduct

Department of Justice FCPA Opinion Release 04-02

7. Appropriate disciplinary procedures
8. Clearly articulated corporate procedures for business relationships with reputable and qualified business partners and for preventing the granting of substantial discretionary authority to individuals whom corporation knows, or should know through due diligence, to have a propensity to engage in illegal or improper activities
9. Extensive pre-retention due diligence requirements and post-retention oversight for agents and business partners, as well as maintenance of due diligence records

Department of Justice FCPA Opinion Release 04-02



10. Committee of senior corporate officials reviewing and recording retention, contracting, and payment of agents
11. Agreements, contracts, and renewals to contain anti-corruption standards, allowance for internal and independent audits of books and records of agents and business partners, and provision for termination
12. Maintenance of a system of internal accounting controls
13. Independent audits by outside counsel and auditors

Enhanced Compliance Programs

- Recent cases (2012)
 - ▣ United States of America vs. Pfizer H.C.P. Corporation, 12 CR 169 (D.C. 2012); United States of America vs. Data Systems & Solutions LLC, 12 CR 262 (E.D. Va 2012); United States of America vs. Bizjet International Sales & Support, Inc. 12 CR 61 (N.D. Okla. 2012); The Nordam Group Inc. (July 6, 2012); Tyco International, Ltd. (Sept 20, 2012).
- Involves companies who have taken steps to augment and agreed to DOJ's prescriptions for CPs
- Main benefit is release from requirement to appoint an independent compliance monitor, thus reducing expense and intrusion

Enhanced Compliance Programs



□ Examples

1. Appointment of a senior corporate executive with significant experience with FCPA compliance to serve as Chief Compliance and Risk Officer
2. Enacting a global anti-bribery and anti-corruption policy and international anti-bribery and anti-corruption policy tailored for market, region, and function as appropriate
3. Establishing an international investigations group responsible for global compliance issues and remedial measures

Enhanced Compliance Programs

4. Enacting heightened risk assessment reviews including "proactive reviews" targeting high-risk markets; including on-site visits by an FCPA review team comprised of qualified individuals; involvement of auditors in those visits, review of representative contracts and high-risk transactions, and creation of remedial action plans
5. Requiring annual certifications from senior managers confirming FCPA compliance
6. Requiring strong, explicit, and visible support from directors and senior management for anti-corruption laws and code of conduct

Securities and Exchange Commission

Seaboard Report

- Case involved former controller of a company's subsidiary and contribution to inaccurate books and records
- The SEC declined to take action against the parent company due to its remedial actions
- 1. company's internal auditors conducted a preliminary review and reported their findings to management who hired an outside law firm to conduct an independent inquiry
- 2. Swift action to terminate controller and other responsible employees
- 3. Publicly disclosed information and restated earnings
- 4. Full cooperation with investigators and waived legal privileges
- 5. Augmented financial reporting processes

Securities and Exchange Commission Seaboard Report

- The SEC also provided thirteen general principles that it said it would take into consideration in crediting the behavior of an organization, including:

Factor 2

- How did the misconduct arise?
- Is it the result of pressure placed on employees to achieve specific results, or a tone of lawlessness set by those in control of the company?
- What compliance procedures were in place to prevent the misconduct now uncovered?
- Why did those procedures fail to stop or inhibit the wrongful conduct?

Securities and Exchange Commission Seaboard Report



Factor 6

- How was the misconduct detected and who uncovered it?

Factor 9

- What processes did the company follow to resolve many of these issues and ferret out necessary information?
- Were the Audit Committee and the Board of Directors fully informed? If so, when?

Securities and Exchange Commission Seaboard Report



Factor 12

- What assurances are there that the conduct is unlikely to recur?
- Did the company adopt and ensure enforcement of new and more effective internal controls and procedures designed to prevent a recurrence of the misconduct?
- Did the company provide our staff with sufficient information for it to evaluate the company's measures to correct the situation and ensure that the conduct does not recur?

Caremark Case



- Delaware Chancery Court case where shareholders brought a derivative lawsuit against Caremark International Inc., alleging that the board of directors breached their fiduciary duty of care by failing to monitor their employees who participated in a kickback scheme
- Court's judgment recognized that boards of directors had such a duty to monitor their employees, and one such avenue, was the establishment of some type of compliance program.

Caremark Case



“[I]t is important that the board exercise a good faith judgment that the corporation's information and reporting system is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner as a matter of ordinary operations, so that it may satisfy its responsibility. [O]nly a sustained or systematic failure of the board to exercise oversight -- such as an utter failure to attempt to assure a reasonable information and reporting system exists -- will establish the lack of good faith that is a necessary condition to liability.”

Stone vs. Ritter

- Delaware Supreme Court case that reaffirmed and restated Caremark holding
- Liability for failure to monitor employees occur when:
 1. the directors utterly fail to implement any reporting or information system or controls; or
 2. having implemented such a system or controls, consciously fail to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.

Stone vs. Ritter



- In this case, a bank suffered compliance failures but was absolved of Caremark liability
- After discovery of violations, bank was required to engage an independent consultant to review its CP
- Consultant's report found that bank "dedicated considerable resources and systems to ensure compliance"

Stone vs. Ritter

- Components of the CP included:
 1. Support by numerous employees
 2. Appointment of an Officer responsible for training, communications, reporting, and presenting policy and program changes to the Board of Directors and management
 3. Long standing presence of a well-staffed Compliance Department, including a compliance manager and compliance reporting manager
 4. Presence of a Corporate Security Department responsible for detection and reporting of suspicious fraudulent activity led by experienced director
 5. Presence of a Suspicious Activity Oversight Committee responsible for active oversight of the compliance program

Siemens – Evolution of Compliance



- Company and various subsidiaries engaged in widespread bribery in multiple countries
- Illegal payments totaling approximately \$1.4 billion using a variety of techniques
- Weak to non-existent commitment to compliance and ethics

Siemens – Evolution of Compliance

Before

- ❑ Part-time corporate officer for compliance
- ❑ Inadequate compliance staff
- ❑ Lackadaisical tone at the top
- ❑ Lack of investigations, disciplinary actions, due diligence

After

- ❑ Top management with strong corporate governance and compliance backgrounds
- ❑ Increased support for compliance functions
- ❑ Emphasis on training and communication
- ❑ Ombudsman program, compliance helpdesk
- ❑ Enhanced internal controls, due diligence, and monitoring

Garth Peterson and Morgan Stanley – The Practical Benefit of a Compliance Program

- Peterson, a managing director of Morgan Stanley, falsely represented facts to company in order to enrich him and his co-conspirators; eventually prosecuted and pled guilty to FCPA violations
- First time that the Department of Justice explicitly declined to bring any enforcement against a company for the acts of its agent
- The high quality of Morgan Stanley's compliance program was specifically emphasized and praised

Garth Peterson and Morgan Stanley – The Practical Benefit of a Compliance Program



- **Substantial compliance staff and resources**
 - Between 2002-2008, Morgan Stanley hired 500 compliance officers, including those responsible for evaluating region-specific risks. Compliance staff had direct line of reporting to management.

- **Stringent payment-approval process and anti-corruption policy**
 - Multiple layers of authorization and review
 - Annual employee certification to code of conduct

Garth Peterson and Morgan Stanley – The Practical Benefit of a Compliance Program

□ **Emphasis on Training**

- Frequent and through various methods
- Trainings conducted by high-level personnel

□ **Compliance Hotline**

- 24-hour, 7 days a week, staffed in every major language

□ **Constant evaluation and improvement**

- Risk based auditing, internal audits, desk reviews, meetings between compliance staff and other employees, up-to-date on regulatory developments, annual formal review with independent legal counsel

Effective Compliance and Ethics Programs Elements

- Dedicated Personnel (CECO etc.)
- Clear Standards (e.g., *Code of Ethics*)
- Effective Communications (e.g., policies)
- Use of technology
- Continuous Training
- Helpline/Ombudsperson
- Investigations/Discipline/Incentives
- Auditing and Continuous Monitoring
- Risk Management
- Performance Indicators and Progress Assessment
- Towards a Culture of Integrity and Accountability
- Address Internal and External Relationships

Recommendations for Building Effective Compliance and Ethics Programs



- **Assessment, consolidation, and automation/use of technology**
 - Formal assessment of systems, processes, gaps, weaknesses
 - Responsibility of a single dedicated team – focus on consistency and flexibility
 - Consider use of technology and automation to increase organization of information

Recommendations for Building Effective Compliance and Ethics Programs

- **Active and involved role of leadership and management**
 - Board of directors, senior management, legal staff, human resources, and public affairs executives
 - Role of managers arguably more important than CP
 - Tone at the top influences all levels of organization

Recommendations for Building Effective Compliance and Ethics Programs

- **Presence of a written compliance policy**
 - Although basic and ubiquitous, serves important symbolic action
 - Focus on readability, tone, relevance, and realism
 - Provide examples, explanations, justifications
 - Wide dissemination through various mediums
 - Require employee certification

Recommendations for Building Effective Compliance and Ethics Programs

- **Effective, regular, and widespread communication and training**
 - Focus on all levels of employees
 - Incorporate various techniques – video-conferencing, live speakers, web-based training
 - Consider specific needs of departments and units
 - Induction training of new employees
 - Goal is to familiarize employees with compliance and to build awareness and sensitivity

Recommendations for Building Effective Compliance and Ethics Programs

- **Effective whistleblowing and avenues of reporting misconduct**
 - Anonymous and confidential
 - 24-hour telephone/email hotlines
 - Staffed in multiple languages
 - Decision between outsourcing or handled by company insider
 - Scrutinize and monitor audit committee

Recommendations for Building Effective Compliance and Ethics Programs

- **Enforcement of standards and monitoring**
 - Periodic background checks and when employee is promoted to leadership roles
 - Disciplinary actions and follow-through are integral to show commitment by management
 - Consider rewards as motivational factors – i.e. through performance reviews

Recommendations for Building Effective Compliance and Ethics Programs

- **Oversight and auditing of compliance and ethics programs**
 - Auditing of the compliance program demonstrated to induce better compliance
 - Interviews, desk reviews
 - Focus on independence and qualifications of auditors and investigators
 - Balance out with cost of third-party monitoring

Recommendations for Building Effective Compliance and Ethics Programs

□ **Role of Chief Compliance and Ethics Officer (CECO)**

- Well-defined role with sufficient funding and staffing
- Independence, autonomy, and sufficient standing in organization
- Direct reporting lines to CEO and upper management
- Performance goals set by upper management
- Decisions on CECO employment by upper management

Thank you so much

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