Compliance Readiness Essentials – Program, Investigation And Defense

Participating in this Roundtable are:

**Jack Holleran**, who is a leader in Ernst & Young's Corporate Compliance Advisory Services practice. He advises clients on identifying and prioritizing compliance risks, implementing and enhancing compliance programs, assuring that compliance programs are integrated and effective and measuring their effectiveness. Prior to joining Ernst & Young, he was the Chief Compliance Officer at Philip Morris USA. As a former compliance officer, Mr. Holleran's practice is focused on helping companies design compliance risk management infrastructures including programs, processes and controls in a way that is very much in line with their compliance risk profile.

**Steven Kaufhold**, who is a partner in the San Francisco office of Akin Gump Strauss Hauer & Feld LLP. He focuses on securities litigation, including shareholder class actions and derivative claims. Since the enactment of the Private Securities Litigation Reform Act (PSLRA) of 1995, he has represented dozens of public companies, officers and directors in securities cases. He has represented directors, officers or companies in eight separate "options backdating" investigations and/or cases. Mr. Kaufhold also handles complex business litigation and investigations for clients.

**Stephen A. Mansfield**, who was responsible for the investigation and what further information might be developed by the investigation that would mitigate such exposures?

**Kaufhold**: The two primary focal points of such an investigation would be the contemporaneous written documents relating to the subject of the investigation and interviews with company employees and others with information relating to the subject matter. Once these two key areas have been explored, an investigator would likely be in a position to consider whether a breakdown of controls has occurred and, if so, whether such a breakdown results from a decentralized structure or some other circumstance or factor.

**Editor**: Mr. Mansfield, what would an investigator do about developing information that might lead to the conclusion that the breakdown of controls was attributable to a decentralized approach?

**Mansfield**: The most serious exposure would follow from evidence that the breakdown occurred as part of an intentional plan or known practice to boost revenues within an organization. But not every breakdown occurs for such a purpose. Communication failures and poor
organization cannot occur through negligence and poor management without drawing an inference that fraud occurred.

Editor: Mr. Holleran, there seem to be fewer complaints from clients about the burdens and costs of compliance. Is this attributable to changes in the regulations or are there other factors?

Holleran: The discipline of compliance risk management has evolved quite a bit over the past 15 years, and many organizations have made significant progress in integrating compliance risk management practices into everyday business decision-making. The more compliance risk management is integrated into business processes, the less noticeable it is, and the more it is seen as part of the way business is done. That said, our clients continue to search for meaningful ways to measure the internal rate of return on their compliance investments and to find measurements and metrics that demonstrate the effectiveness of their compliance program. This is an inherently difficult exercise—successful compliance program was once described to me as “constant vigilance, and nothing happens.” It is impossible to measure your effectiveness in preventing non-compliance, but there are measures and metrics that, when evaluated over time, can help organizations get more efficient in the way they allocate their compliance resources.

Editor: Mr. Kaufhold, would your investigation focus on metrics that might show a dedicated effort on the part of a company to improve its compliance program?

Kaufhold: Yes. The structure and efficacy of a company’s compliance program would be a key fact against a finding of element in proving that something has gone wrong. Second, from a business standpoint, it is important to know whether a compliance program is serving the purpose it has been designed for in order to protect the company from business risks and losses separable and apart from any legal issues. Finally, a lack of response or investigation focus on metrics that are agreed upon, the organization should establish the following core processes:

- Intake (the sources from which allegations are received)
- Categorize (the process for determining which allegations are more serious)
- Processing (including escalation with the organization)
- Plan (determining who will conduct the investigation)
- Investigate (actually investigating the allegation)
- Resolve (including feedback to the complainant and disciplinary action if the allegation in substantiated)
- Improve (driving continuous improvement into both the compliance program and the investigations process)

The Chief Compliance Officer often plays a lead role in assured that these processes are established and executed with quality. The CCO also may play a role in determining who is best situated to conduct an investigation, including when it’s appropriate to bring in outside counsel or forensic accountants.

Editor: Mr. Holleran, how do you go about investigating the effectiveness of handling allegations of non-compliance?

Holleran: Allegations of non-compliance are typically handled in a thoughtful and confidential manner. And, the investigation needs to be conducted in an appropriate way. As a result, having an effective investigations process is to a cornerstone of an effective compliance program. Investigations typically involve multiple stakeholders, including Compliance, HR, Legal, Internal Audit, and perhaps Security and Finance. It is important that the organization establish an investigative role that is responsible for addressing the existence of a good faith compliance program would be a likely part of most any company's compliance policy or that it might want to take a fresh look at its antitrust compliance policy or that training be conducted for employees who interact with competition laws and processes.

So the two steps are to conduct the investigation with the right people with the right skill-sets, often including law firms or forensic accounting firms or other third parties. But then once the investigation is closed, it is important to drive continuous improvement both into the compliance program where it can be enhanced but also into the investigation’s process to make sure that the investigation is working efficiently and fairly for all concerned.

Editor: Mr. Kaufhold, how you would you investigate your investigation have revealed failures by internal audit to pick up the subprime breakdown?

Kaufhold: That’s a difficult question to answer. My sense is that when all is said and done, many companies will conclude that the subprime breakdown clued a number of extremely bright and hardworking folks in both internal audit and other corporate functions.

Editor: Mr. Mansfield, what would the failure of internal audit to pick up the subprime breakdown be a factor in increasing exposures to criminal or civil penalties?

Mansfield: It’s very difficult to answer this question definitively. So much depends on the nature, scope and practice with respect to the internal audit in terms of how it will be evaluated later.

Editor: Mr. Holleran, if you find there is a compliance breach on the part of the client, what is your next step?

Holleran: I think there are really two steps which need to proceed in sequence. The first step is to make sure that the investigation is working efficiently and fairly for all concerned. The second step is to make sure that the investigation needs to be conducted in a way that it drives towards ultimate resolution, that is, either the allegation is substantiated, in which case appropriate action needs to be taken including disciplinary action, or if the allegation is not substantiated, closure needs to be achieved both for the person who raises the allegation as well as for the person, or persons, about whom the allegation is made. So it is important that the process drive towards closure. It is also important that there is a second step that ought to take place, which is that companies look at the investigation from the point of allegation to the point of disposition and see what the process is telling them about the overall compliance program. For example, if you see a continued series of allegations of non-compliance that elevate to the level of an antitrust practice, this might give an organization an indication that it might want to take a fresh look at its antitrust compliance policy or that training be conducted for employees who interact with competition laws and processes.
Editor: Mr. Holleran, how should a compliance program be communicated to employees?

Holleran: We have seen a number of successful program communication efforts of an overall compliance program. One of the best is town hall meetings in which the senior executive responsible for the compliance program convenes employees, pulls together an agenda of preexisting departmental meetings and spends face-time in front of a group of employees talking about the program from a business perspective and why compliance makes good business sense. This helps to install a sense of individual ownership and accountability in employees for complying with the laws and regulations that apply to their individual job, making sure they do the right thing day-in and day-out. I think that is probably the most important type of communication because it puts a face on a human dimension to a compliance program that web training and website communications and email often do not. Those types of communications are very important, and I think particularly so today with the use of email, the use of pop-up screens on company intranets, the use of home pages, and all sorts of electronic types of communication. Another tool is compliance reminders: the compliance question of the week; the compliance column that shows up weekly on the compliance webpage on an organization’s internal website – all those types of communications are very important as part of an overall communications strategy. But what should not be lost is the very tangible asset of spending time talking to employees, not only about the program but listening to employees about what their concerns are, what enhancements they would like to see to the compliance program or questions they might have about how it operates.

Editor: Mr. Kaufhold, do your investigations record the tone at the top where senior executives demonstrate their commitment to compliance?

Kaufhold: Yes. Both company directors and regulators have an interest in the tone at the top of an organization and many will tell you that the attitude of senior executives and culture of a company are more important and effective indicators of compliance than all of the processes in the world.

Editor: Mr. Mansfield, would the failure of senior management to caution brokers and sales people about high-pressure selling tactics in connection with the subprime breakdown be a factor in increasing exposures to criminal or civil penalties?

Mansfield: Possibly. It depends on what is meant by “high pressure selling tactics.” Enthusiasm and passion are the essence of sales. On the other hand, mis-representation and omission of material facts are the hallmarks of fraud. These are fact-specific determinations.

Editor: Mr. Holleran, are there compliance issues with respect to agents and suppliers, including those overseas?

Holleran: It is a problem that organizations face both domestically and internationally, which is that your ability to influence diminishes the farther you get away from the core of your employee base. So your ability to influence third parties who are employed by vendors or suppliers or other agents is limited – you have some ability but less directly than with your own employees. It is a problem companies face certainly for those who operate within the U.S. and the problem becomes even more complex outside of our nation’s shores because you run into language issues, into cultural issues, into issues of local law and regulation or custom or practice. That is why I think the Foreign Corrupt Practices Act and similar types of anti-corruption and anti-bribery laws have become such an important area of enforcement for agencies like the Department of Justice and the SEC.

Editor: Mr. Kaufhold, would your investigations record the tone at the top where senior executives demonstrate their commitment to compliance?

Kaufhold: Yes. Both company directors and regulators have an interest in the tone at the top of an organization and many will tell you that the attitude of senior executives and culture of a company are more important and effective indicators of compliance than all of the processes in the world.

Editor: Mr. Mansfield, would the failure of senior management to caution brokers and sales people about high-pressure selling tactics in connection with the subprime breakdown be a factor in increasing exposures to criminal or civil penalties?

Mansfield: Possibly. It depends on what is meant by “high pressure selling tactics.” Enthusiasm and passion are the essence of sales. On the other hand, mis-representation and omission of material facts are the hallmarks of fraud. These are fact-specific determinations.

Editor: Mr. Holleran, are there compliance issues with respect to agents and suppliers, including those overseas?

Holleran: It is a problem that organizations face both domestically and internationally, which is that your ability to influence diminishes the farther you get away from the core of your employee base. So your ability to influence third parties who are employed by vendors or suppliers or other agents is limited – you have some ability but less directly than with your own employees. It is a problem companies face certainly for those who operate within the U.S. and the problem becomes even more complex outside of our nation’s shores because you run into language issues, into cultural issues, into issues of local law and regulation or custom or practice. That is why I think the Foreign Corrupt Practices Act and similar types of anti-corruption and anti-bribery laws have become such an important area of enforcement for agencies like the Department of Justice and the SEC.

Editor: Mr. Kaufhold, would your investigations record the tone at the top where senior executives demonstrate their commitment to compliance?

Kaufhold: Yes. Both company directors and regulators have an interest in the tone at the top of an organization and many will tell you that the attitude of senior executives and culture of a company are more important and effective indicators of compliance than all of the processes in the world.

Editor: Mr. Mansfield, would the failure of senior management to caution brokers and sales people about high-pressure selling tactics in connection with the subprime breakdown be a factor in increasing exposures to criminal or civil penalties?

Mansfield: Possibly. It depends on what is meant by “high pressure selling tactics.” Enthusiasm and passion are the essence of sales. On the other hand, mis-representation and omission of material facts are the hallmarks of fraud. These are fact-specific determinations.

Editor: Mr. Holleran, are there compliance issues with respect to agents and suppliers, including those overseas?

Holleran: It is a problem that organizations face both domestically and internationally, which is that your ability to influence diminishes the farther you get away from the core of your employee base. So your ability to influence third parties who are employed by vendors or suppliers or other agents is limited – you have some ability but less directly than with your own employees. It is a problem companies face certainly for those who operate within the U.S. and the problem becomes even more complex outside of our nation’s shores because you run into language issues, into cultural issues, into issues of local law and regulation or custom or practice. That is why I think the Foreign Corrupt Practices Act and similar types of anti-corruption and anti-bribery laws have become such an important area of enforcement for agencies like the Department of Justice and the SEC.

Editor: Mr. Kaufhold, would your investigations record the tone at the top where senior executives demonstrate their commitment to compliance?

Kaufhold: Yes. Both company directors and regulators have an interest in the tone at the top of an organization and many will tell you that the attitude of senior executives and culture of a company are more important and effective indicators of compliance than all of the processes in the world.

Editor: Mr. Mansfield, would the failure of senior management to caution brokers and sales people about high-pressure selling tactics in connection with the subprime breakdown be a factor in increasing exposures to criminal or civil penalties?

Mansfield: Possibly. It depends on what is meant by “high pressure selling tactics.” Enthusiasm and passion are the essence of sales. On the other hand, mis-representation and omission of material facts are the hallmarks of fraud. These are fact-specific determinations.