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CONFERENCE PROCEEDINGS

Perspectives of Chief Ethics and Compliance Officers on the Detection and Prevention of Corporate Misdeeds

What the Policy Community Should Know

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Center for Corporate Ethics and Governance

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SUMMARY

The worldwide economic collapse of 2008 has aroused the interest of U.S. policymakers in the mechanisms of corporate governance, compliance, and ethics, and their collective role in preventing and mitigating excesses and scandals in the corporate sector. Earlier rounds of corporate scandal gave rise to the Sarbanes-Oxley Act of 2002 (SOX) and to the Federal Sentencing Guidelines for Organizations in 1991, which reflected attempts to drive better corporate oversight and compliance through a combination of government mandates, incentives, and standard-setting. It remains to be seen whether the current financial meltdown in the U.S. mortgage and banking sectors will ultimately be attributable, in significant part, to failures in governance, compliance, and ethics. But regardless, 2009 is a year in which legislators and regulators are closely scrutinizing existing policy in these areas, with an eye toward addressing any lapses, loopholes, or inadequacies in the regulatory framework.

It is in this context that RAND convened a March 5, 2009, conference entitled “Perspectives of Chief Ethics and Compliance Officers on the Detection and Prevention of Corporate Misdeeds: What the Policy Community Should Know.” The purpose of the conference was to draw on the perspectives and insights of chief ethics and compliance officers (CECOs) – senior corporate officials charged with responsibility for running compliance and ethics programs, and persons with a unique “insider” perspective on the challenges and opportunities involved in implementing them. The conference also included stakeholders with other, complementary viewpoints, including current and former legislative and executive branch officials, academics, and leaders from several nonprofit compliance and ethics associations. In convening this group for discussions about corporate ethics and compliance, the aim was to provide expert input to the policy community about the current state of ethics and compliance initiatives within corporations today – particularly as policymakers contemplate new avenues for regulatory oversight of corporations in the future.

Several major ideas emerged from the conference discussions. First was the observation that chief ethics and compliance officers occupy a unique position in corporate management, and in principle, they can be at least as important to successful ethics and compliance performance as are any of a host of programmatic initiatives like compliance hotlines, ethical codes of conduct, or formal training. In practice, the effectiveness of a CECO is likely to depend on how his or her specific role is defined, whether he or she has direct access to the board and to C-suite decisionmakers, and whether he or she oversees an ethics and compliance function that is independent of other corporate groups, such as legal or human resources. A second general theme arising from the conference was the importance of organizational culture, as a vital part of what a CECO is supposed to oversee. *Culture* refers to an intangible set of shared understandings about how a corporation operates and what its chief values are. To the extent that trust, honesty, and fairness become embodied in a company’s brand promise and in the shared understanding of its workers, then that in turn can be a powerful prophylactic in

avoiding misconduct. A third theme discussed extensively during the conference was the importance of open communication, internal whistleblowers, and employee reporting as major defenses against fraud and misconduct. Creating a culture of open communication, together with appropriate safeguards to encourage workers to come forward and protect them against retaliation, are additional important responsibilities for a CECO.

INVITED REMARKS FROM THREE PANELISTS

The initial session of the conference was dedicated to invited remarks from three panelists, all of them current or former CECOs or practitioners. The first panelist discussed a series of reasons for why many corporate compliance programs are “set up to fail” – arguably because those programs represent check-the-box efforts to meet legal requirements, without effective and committed leadership in implementing and managing them on a day-to-day basis within companies. The second panelist focused on the role of boards in oversight for compliance and ethics. He described the common law and regulatory requirements that establish directors’ responsibilities in this arena, and then reflected on how directors can best fulfill their duties. This panelist suggested that here, again, the CECO can play a key role, as a designated management proxy who can provide the board with the information and access it needs in order to meet its own responsibilities for oversight. The third panelist presented a lengthy list of measures that government might consider undertaking to promote better ethics and compliance performance in corporations. Some of those steps could serve to empower ethics and compliance officers to be more effective within their organizations, while others involve a range of collaborative activities, training efforts, and/or incentives to corporations to implement better ethics and compliance programs.

CORPORATE COMPLIANCE, GOVERNANCE AND REGULATION – THE CECO PERSPECTIVE AND ROLE

The second session of the conference involved a moderated discussion on a broad range of issues connected with corporate governance, compliance, and regulation. The session opened with some reflections on the regulation of corporate governance and compliance, on the impact of SOX, and on the tension between stronger regulatory controls for corporations and the performance pressures for management to adopt a short-sighted, “meet-the-numbers” operating posture. Some but not all of the discussions touched on the central role of CECOs as drivers of the corporate compliance function, and as potential agents for boards of directors in carrying out the governance responsibilities of the latter. The reality that many corporate compliance programs fall short in achieving their aims was a major theme of conversation, with a serial focus on several of the different reasons why this appears to be so. When asked for potential top priorities for government intervention to improve corporate compliance and ethics efforts, one participant suggested that government place greater emphasis on acknowledging and rewarding positive ethics and compliance performance, as a complement to its ongoing

enforcement and prosecution efforts against offenders. As another initial step, the participant also suggested that the government designate specific agency officials as formal leads and points of contact for the private sector on corporate ethics and compliance issues.

Major points of agreement in this discussion session included the following:

- CECOs have a very different role and perspective in their companies from that of chief counsel.
- CECOs have the potential to play a pivotal role in companies, but their effectiveness depends on independence, seniority, “seat at the table,” and empowerment.
- Directors have significant responsibility for compliance oversight, but many are relatively unprepared, inexperienced, and/or ineffective in that role.
- Legal requirements and regulatory mechanisms can be important elements in driving corporate governance and compliance efforts, but mandates can sometimes also have perverse effects.
- Ethical culture is a prime responsibility for CECOs and a major factor in achieving good organizational compliance and ethics, but it is difficult to establish by external mandate.

CORPORATE CULTURE AND ETHICS – CONSIDERATIONS FOR BOARDS AND POLICYMAKERS

The final discussion session of the conference focused more deeply on the topics of corporate culture and ethics, their relationship to formal ethics and compliance initiatives, and considerations for boards and policymakers in trying to promote a strong ethical culture within organizations. Much of the discussion during this session focused on whistleblowing and the importance of an “open-communication” culture that encourages employees to raise concerns and report instances of malfeasance or misconduct to management. Whistleblowing presents a challenging set of practical and cultural issues for corporations to manage. On the practical side, these issues include implementing controls and mechanisms to support and protect workers who come forward as whistleblowers, while on the cultural side, the issues extend to creating an environment of trust and non-retaliation in which people feel comfortable with coming forward to disclose, even when this involves reporting misconduct committed by peers or superiors. Complementing the conference discussion about whistleblowing, this session also touched on a range of other issues connected with organizational culture and ethics, such as the formal definition of *corporate culture*, the return-on-investment argument in support of ethics and compliance activity, and the challenges involved in pressing the corporate community to take ethics and compliance – and the development of ethical culture within organizations – more seriously.

Several of the major points of discussion and agreement during the session included the following:

- Whistleblowing and open employee communication are critical resources for detecting fraud within companies.
- Anti-retaliation mechanisms are focal to efforts to protect whistleblowers, and by extension, to encourage them to come forward.
- Anti-retaliation ties directly to organizational culture and to norms about trust, honesty, and open communication.
- “Corporate culture” corresponds to a series of intangibles, including expectations of and about workers, ways of doing business, internal and external reputation, and other factors not captured by written policy.
- A return-on-investment argument for compliance and ethics (and for ethical culture) has been challenging to make, with the result that compliance and ethics may often be viewed by management as a cost center, rather than a revenue center.
- CEO endorsement of ethics as an overriding priority in an organization (or an industry) can sometimes help to drive top-down changes in culture and values.