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Culture, Compliance, and the C-Suite

How Executives, Boards, and Policymakers Can Better Safeguard Against Misconduct at the Top

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Summary

Despite the widely acknowledged leadership insight that "tone at the top" of corporations is important, C-suite-level[2] compliance failures and episodes of executive misconduct abound. Recent studies and press releases have spotlighted that (1) a high proportion of occurrences of corporate fraud feature some level of involvement by the senior executive team, (2) criminal prosecutions against executives and high-value deferred-prosecution agreements involving their firms both appear to be on the rise, and (3) the reputational harm to a corporation can be substantial when an instance of senior executive misconduct does occur. These observations suggest that the conventional wisdom of relying on the board to appoint the right CEO and then simply hoping that "tone at the top" will therefore ensue may no longer be an adequate approach to supporting compliance in the C-suite. In some respects, the C-suite setting itself may put its denizens at heightened risk for ethical lapses and missteps because that environment arguably combines strong performance pressures and demands for rapid decisionmaking with a range of other social and cognitive vulnerabilities to bias. For business leaders and policymakers, a basic question then follows: Are there practical ways to strengthen the C-suite as an institution and to better support executives in their commitment to high ethical standards, compliance with the law, and transparency toward shareholders and employees?

A serious inquiry into the challenges involved in C-suite-level compliance touches on many strands of management and governance practice within organizations. Among these strands are the role and capability of corporate boards, whose fiduciary duty encompasses the monitoring of C-suite-level compliance and ethics (C&E) risks; the responsibility and empowerment of the chief ethics and compliance officer (CECO), who has day-to-day authority for helming the C&E program (including at the C-suite level); and the influence of government enforcement efforts in helping to drive compliance activity more broadly. To the extent that compliance practice and ethical standards within too many C-suites are falling short, the question then becomes how to modify or leverage these various strands, in supporting better C-suite practice and ethical tone in the future.

It was in this context that RAND convened a symposium on May 2, 2013, titled "Culture, Compliance and the C-Suite: How Executives, Boards and Policy-Makers Can Better Safeguard Against Misconduct at the Top." The objective was to stimulate a broad conversation about the challenges posed by executive misconduct within the C-suite, on the risk factors that contribute

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[2] *C-suite* typically refers to the level of management involving the top executives within any given company. The titles of many such executives begin with the word "chief," so the C-suite is typically made up of the chief executive officer (CEO), chief financial officer, chief operations officer, and others with similar titles and levels of responsibility.

to such misconduct, and on practical steps that could be taken to strengthen compliance and ethical tone at the C-suite level and the unique roles of directors, top executives, CECOs, and government regulators and policymakers in pursuing those steps.

The symposium brought together a group of 20 senior thought leaders from the ranks of public company directors and executives, CECOs, and stakeholders from the government, academic, and nonprofit sectors. Discussions focused on practical steps that could be taken to strengthen compliance and ethical tone at the C-suite level and the unique roles of directors, top executives, CECOs, and government policy in pursuing that end. Prior to the symposium, several of the invited participants were asked to prepare and present formal remarks on corporate culture, compliance, and the C-suite. Their white papers, distributed in advance of the event, represent varied perspectives on law enforcement, organizational behavior, and compliance activity, all relating to instances of C-suite misconduct. The speakers presented their remarks during the first session of the symposium. The second and third sessions engaged the symposium participants in interactive discussions, launching from the foundational remarks initially offered by the white-paper authors.

Several major themes emerged from the symposium discussions. The first was that misconduct in the C-suite often reflects a basic compliance gap in corporate management. That gap manifests itself in multiple ways: between what top executives say is important and what they actually model through their behavior; between "tone at the top" as a vague expression of values and the embodiment of those values through an effective, management-driven C&E program; and between a legalistic, check-the-box approach to compliance in the C-suite and a deeper commitment to ethical culture as a basic element embedded in the operating fabric of the corporation. A second major theme focused on the role of corporate boards in addressing C-suite-level compliance risk. There is a broad range of board-level interventions that could be undertaken to improve C&E oversight within the C-suite. Examples of these interventions include enhanced board training; adding new board members with professional experience as CECOs, undertaking board-instigated assessments of C-suite compliance risk and ethical culture, and improving board practice in vetting new CEO candidates to reduce related compliance risks. A third broad symposium theme highlighted the importance of an empowered, independent CECO in contributing to C-suite-level compliance and ethical culture and related implications for restructuring the CECO role. In particular, it was observed that the seniority, positioning, and power of the CECO need to be fundamentally congruent with the functional responsibilities that that person is expected to carry out. To the extent that the CECO is tasked with training and engaging the C-suite, serving as an independent voice in the C-suite, and evaluating C-suite compliance culture and risks, while contributing a C&E perspective to top-level strategic and operational decisions within the company, the CECO will require sufficient access and authority in order to carry out those various tasks successfully.

Invited Remarks from Panelists

The first session of the symposium began with a keynote address from Judge Ruben Castillo of the U.S. District Court for the Northern District of Illinois, speaking on the topic of new technology as an aggravating factor to the challenges posed by C-suite-level compliance. Judge Castillo's remarks were followed by remarks from three invited white-paper authors, who respectively focused on trends in criminal prosecution, C-suite ethical culture, and application of corporate compliance strategy to the C-suite. The speakers were Stanley R. Soya, a partner with the law firm Pepper Hamilton LLP; Scott Killingsworth, a partner with the law firm Bryan Cave LLP; and Michael Volkov, CEO and owner of the Volkov Law Group LLC. Their remarks were based on invited white papers titled "Prosecution of Frauds and Crimes in the C-Suite: What Can We Learn from These Cases and Trends?" (Soya); "'C' Is for Crucible: Behavioral Ethics, Culture, and the Board's Role in C-Suite Compliance" (Killingsworth); and "Compliance in the C-Suite" (Volkov). The three invited white papers were distributed to symposium participants in advance of the May 2 meeting to set the context and facilitate a dynamic discussion.

What Are the Fundamental Compliance and Ethics Challenges Facing the C-Suite, and What Oversight Role Should the Board Play?

The second session of the symposium addressed the basic compliance and ethics challenges facing members of the C-suite. It was observed that the initial selection of top executive candidates with a track record of superior achievement and ambition, when combined with short-term performance pressures, the subsequent autonomy of the executives, and their need to make executive decisions collectively in small groups, tends to make people in top executive positions inherently more vulnerable to C&E misadventures. As one symposium participant observed, "If you wanted to design an incubator for generating misconduct, it would look a lot like the C-suite." Several other participants noted that the C-suite typically "operates with very little oversight," that "motivated blindness" and cognitive bias are not uncommon, and that, too often, "there is no lid on the cookie jar." Other symposium participants, however, offered more moderate views. One person suggested that "misconduct in the C-suite is a complex proposition" with many contributing factors that give rise to it. Another emphasized that the substantial majority of senior executives are noteworthy for their integrity and high standards of conduct, notwithstanding the pressures of the C-suite. Several symposium participants put more emphasis on the prevalence and consequences of executive misconduct. One person noted that "there is a flawed assumption that those in the C-suite will tend to do the right thing." Another pointed out that, even if the majority of executives are highly conscientious, that provides small comfort when "even a single act [of malfeasance] at the senior level can be catastrophic [to a company]."

Much of the discussion in this session focused on the appropriate oversight role for the board in connection with compliance and misconduct in the C-suite. Some participants noted that basic

C&E problems and instances of misconduct also occur at the board level, as well as within the C-suite, and that an important priority for boards is simply to self-police their members' behavior more effectively. Others argued that boards have a responsibility to "be at the forefront of the culture they expect [from the C-suite]" and that boards "need to inject a greater sense of responsibility into the C-suite." There were mixed opinions among the symposium participants about how well boards are currently doing in terms of C-suite oversight and how much it is reasonable to expect them to do when it comes to policing the C-suite on C&E issues. One participant said that he had "seen good boards and bad boards, [though] a lot more bad ones." Another observed that, in context of the high rate of malfeasance involving C-suite executives, "boards have not served very well as gatekeepers." Finally, there was also some discussion in the symposium session addressing the tie between the boardroom and broader organizational culture and the varied ways in which incentives and norms established by the board of directors can feed into the culture of the C-suite and ultimately into the organization as a whole.

Session participants generally agreed on several key points:

- Crime and misbehavior in the C-suite represent an important problem not sufficiently addressed by the current focus on "tone at the top."
- Deficiencies in C-suite ethical culture, including groupthink and motivated blindness, are an antecedent to many instances of misbehavior.
- Misconduct in the C-suite reflects a basic gap in compliance.
- Compliance needs to be embedded throughout management, but achieving this requires a strong compliance leadership position within management.
- For boards, key stumbling blocks in carrying out effective C-suite monitoring include lack of C&E insight and expertise.

How to Overcome the Barriers to High Standards of Integrity in the C-Suite, and What Should Boards, Management, and Policymakers Do Next?

Participants in the final session of the symposium focused more deeply on identifying potential solutions to the problems of compliance and misconduct in the C-suite and on tangible next steps that might be taken by boards, executives, regulators, and policymakers. Some strands of the discussion focused primarily on the governance role of the board of directors, while other strands touched more strongly on the C&E function and the role of the CECO. There was broad consensus that both boards and CECOs have meaningful parts to play in seeking to improve the compliance climate of the C-suite: the former (in part) through more effective, proactive exercise of their oversight responsibility, and the latter (at a minimum) by helping to inform and empower the former and by serving as an independent voice in the C-suite. A separate strand of the symposium discussion focused on the Federal Sentencing Guidelines, enforcement activity, and the prospects for new policy aimed directly at influencing compliance and ethical culture in the C-suite. In context, it was observed that high-profile enforcement efforts and criminal prosecutions that target senior executives are already sending a compliance signal to members of

the C-suite. The question then becomes, what other options should policymakers be considering? Finally, another theme in the discussion touched on the larger corporate governance framework within which C-suite compliance and ethical-culture problems are manifesting themselves. One of the symposium participants notably remarked that "based on the theory that animates the corporate law, none of these problems [with criminal misconduct in the C-suite] ought to exist." It was pointed out that various of the traditional governance functions and responsibilities of the board (including with regard to CEO hiring and compensation) could be remodulated to try to better detect and prevent misconduct in the C-suite. However, it was also observed that some of the relevant governance levers (e.g., executive compensation) may also be associated with broader structural problems in the corporate form, which go beyond the issues of C-suite compliance to fully address.

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

- Both structural and nonstructural factors are important targets for contributing to C-suite integrity.
- Training, incentives, monitoring, and risk and culture assessment are all C&E practices that can be elevated up to the C-suite level.
- The CECO role should be elevated and empowered to better support C&E at the C-suite level.
- Board priorities for preventing and detecting misconduct in the C-suite can draw on a range of structural and cultural reforms.
- Policy and enforcement efforts will continue to shift the landscape of compliance in the C-suite.