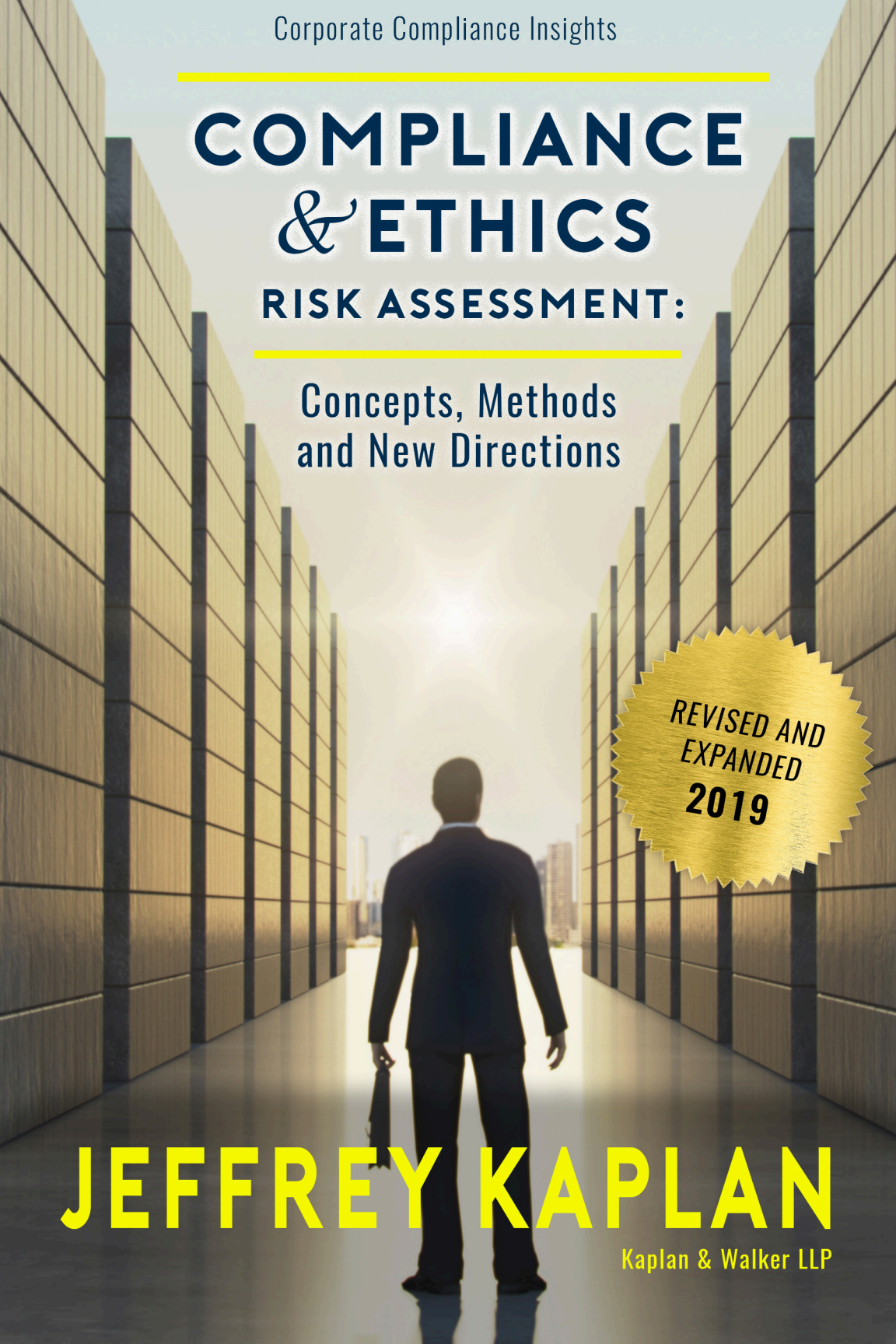
Corporate Compliance Insights

COMPLIANCE & ETHICS RISK ASSESSMENT:

Concepts, Methods and New Directions



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Compliance & Ethics Risk Assessment: Concepts, Methods and New Directions
(Expanded Edition)

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Acknowledgements

I am grateful to Sarah Hadden and Emily Ellis at CCI for their time, energy and ideas in helping to assemble this e-Book.

I am also grateful to my wife Deb Sugarman, son Ben, daughter Elizabeth and law firm partner Rebecca Walker for putting up with my tendency to see a risk around every corner.
- JMK

Introduction

This is an e-Book about compliance and ethics ("C&E") risk assessment, but it does not cover everything that every company or C&E professional needs to know about this vast, complex and important topic. Rather, it touches on an array of risk assessment ideas, methods, practices, tools and noteworthy items of C&E-related history that I think many organizations and practitioners need to know more about, and that have therefore been the focus of my columns in Corporate Compliance Insights and to a lesser extent the Conflict of Interest Blog, which I edit.

My interest in the topic goes back to the advent of the Federal Sentencing Guidelines for Organizations (the "Guidelines") in 1991 when I saw that there was a missing piece to their articulation of what was then called "an effective program to prevent and detect violations of law" (and what became, with the 2004 amendments to the Guidelines, an "effective compliance and ethics program"). That piece was risk assessment,[1] and so in 1993, when I co-edited a treatise on the Guidelines,[2] I drafted a chapter on risk assessment (called at the time a "liability inventory").[3] During the course of the 1990's wherever possible,

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[1] Of course, there were other missing pieces – but this one seemed to the most important to me.

[2] Kaplan & Murphy, Compliance Programs and the Corporate Sentencing Guidelines: Preventing Criminal and Civil Liability (Thomson Reuters 2013 ed.) (cited below as "Kaplan & Murphy"), Chapter Six.

[3] A decade later, that chapter was cited in a favorable way by an advisory group to the US Sentencing Commission, which recommended that risk assessment be added to the Guidelines – as indeed happened in the 2004 amendments. Report of the Ad Hoc Advisory Group on the Organizational Sentencing Guidelines
October 7, 2003 available at http://www.ussc.gov/Guidelines/Organizational_Guidelines/advgrprpt/advgrprpt.htm at 91, n 280.

[4] Committee of Sponsoring Organizations of the Treadway Commission - http://www.coso.org/.

I tried to include a component of risk assessment in my C&E advisory engagements.

Risk assessment was finally added to the Guidelines, in the 2004 amendments. It is now widely seen as the foundation of effective C&E programs.

Of course, largely independent of what was happening with the Guidelines (let alone my writings) the notion of broad-based risk assessment with compliance as one of several dimensions had been advanced through the COSO approach[4] to risk management with which C&E professionals are generally quite familiar. Nothing in this e-Book is meant to suggest that there are infirmities with this profoundly beneficial development. Rather, the various columns here are intended to supplement and inform C&E risk assessments of all kinds, whether COSO-based or otherwise. That is, they are offered to help companies and their advisors enhance their current risk assessments practices by developing risk-related information in a way that can be most useful to maintaining all aspects of C&E programs in an effective manner.

Risk Assessment Methodology and Scope

There is no one way to do a C&E risk assessment. However, from my experience with client organizations and what I know of the experience of others, the following general points seem worth noting.

First, assessing the likelihood of risks is vitally important to making decisions on how/where/when to deploy C&E program elements. Moreover, the process of assessing likelihood itself can be instructive to those involved, i.e., it can serve to raise awareness of C&E generally in a company.

Second, the utility of assessing the impact of C&E risks is often overrated, at least when done (as it often is) through a survey of employees - because those who are asked to assess impact may not have sufficient information to do so in a meaningful way. For example, if employees are asked in a survey to assess the potential impact of an antitrust/competition law violation and respond that such impact would likely be low, that is probably not a reliable piece of data, given that the heavy fines in this area are a matter of public record.[5]

Third, in addition to likelihood and impact, a C&E risk assessment should attempt to identify circumstances in which a violation is reasonably likely to occur. For instance, in the competition law field simply saying that a violation is likely and/or would probably be impactful does not get one very far in terms of designing effective (and targeted) mitigation. Rather, one would also want to know a) what type of violation (e.g., division of territories, price fixing, or abuse of a dominant position) should be of greatest concern; b) what products/services create the greatest competition law risks; c) what geographies are associated with the greatest risk of this sort of violation; and d) more about the circumstances in which a violation is

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[5] Note, though, that in this situation, while not reliable, the response data may still be useful – to show the need to make managers more aware of the potential impact of an antitrust violation.

reasonably likely to arise – (e.g., trade association meetings, teaming arrangements?) All of these sorts of factors I refer to collectively as the nature of the risk. They are also referred to as risk scenarios.

Of course, one would hope to ask similarly detailed questions about many other risk areas – such as corruption and confidential information. The point of all of these sorts of inquiries is to help the C&E officer develop "news you can use" – i.e., deploy program elements (such as training or monitoring) in the sort of risk-sensitive ways contemplated by the Guidelines and other C&E standards.

It is in this third dimension that I most often see risk assessments falling short of where they need to be. My hope is that some of the suggestions in this e-Book can help bridge the gap when it comes to understanding the nature (as well as likelihood and impact) of a C&E risk.

Fourth, while risk assessment can and should be a stand-alone process, there are also ways of building risk assessment into everyday business life, as discussed in one column in this first section. In my experience, many companies also have room for improvement on this front too.

Fifth, because it involves a self-critical exercise in areas that can hold considerable jeopardy for a company, C&E risk assessment is inherently difficult. One way of surmounting the reticence that employees often have to be candid about such areas as anti-corruption or competition law risks is by conducting the assessment under the organization's attorney-client privilege.

Finally, Justice Holmes famously noted that a page of history can be worth a volume of logic, and I think that is particularly true with risk assessment. So, I have tried to include a few pages of what I think are important early C&E history – such as the Bankers Trust derivatives scandal and the Hoffman- La-Roche antitrust prosecution, both from the 1990's; or the TAP case, from 2001 – in this volume.

Does Your Risk Assessment Do This?

The U.S. Sentencing Commission is currently[6] considering making changes to the risk assessment provisions of the Corporate Sentencing Guidelines – and this offers a good occasion for companies to evaluate their own risk assessment practices.

While there are many standards for such an evaluation, to my mind the best is the simplest: does the process actually produce results that will help the company have effective C & E program elements? And in self-assessing against this standard, a company might ask whether its current process helps the company do the following:

- Determine whether additional C & E policies are needed for any given part of the company (e.g., business or geographical unit) on any given topic, or the extent to which such policies need to be revised.

- Develop company-specific examples or Q & A that can help make a code of conduct less abstract.

- Determine whether any additional C & E communications (training or other) should be targeted at any particular part of the company on any given topic.

- Develop/enhance C & E audit protocols, monitoring tools and other approaches to "checking" on both an enterprise-wide and local "level."

- Identify C & E risks for which additional controls are warranted, such as pre-approvals by management or staff for specified (high-risk) activities.

- Establish additional C & E oversight/reporting responsibilities for high-risk areas.

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[6] As of early 2011. Ultimately, the Commission did not revise the risk assessment provision of the Guidelines at this time.

- Add C & E components to job descriptions, performance-evaluation criteria or business unit plans in a risk-based way.

- Determine whether incentives in any part of the Company pose an undue risk from a C & E perspective.

- Assess where and the extent to which aspects of a C & E program should apply to contractors, vendors and other third parties.

- Develop metrics for measuring the effectiveness of C & E efforts directed at individual areas of risk. (Note: for many companies metrics are still purely a matter of overall program process, e.g., number of calls to Concerns Line), and are not risk-area specific.

- Identify true ethics, as well as compliance, issues that the Program should address.

- Identify cultural C & E risks, such as lack of employee identification with the company or its mission, short-term thinking or other "moral hazard" related risks.

- Provide a stronger foundation for the Program oversight by the Board.

- Provide a basis for future/"evergreen" risk assessments.

In the columns that follow, I explore ways of using risk assessment for most of these and some other related purposes.

Third-Party Compliance and Ethics Risks: "Capacities" and "Reasons"

In the world of C&E risk assessment and mitigation third parties often present a special challenge, both because of the magnitude of the risks they pose and the difficulty of mitigating those risks.

This phenomenon is not new. In the 1980's, a number of significant defense industry procurement prosecutions arose from the actions of third-party business representatives. In the 1990's, many sales practices abuse cases in the life insurance industry centered around the actions of independent sales agents. More recently, various manufacturing companies suffered severe reputational harm from the labor practices of their suppliers. Most recently, corrupt practices by agents and distributors have been the basis for numerous FCPA prosecutions.

And, there is almost certainly more coming – probably a lot more. This is because of the seemingly inexorable trend in modern business to increasingly rely on third parties, for instance, through outsourcing or joint ventures.

How should companies try to stay ahead of the third-party risk curve? One way is to use a defined process for inventorying their third parties and analyzing the C&E risks for each.

Cataloging third parties – while potentially time consuming – is conceptually straightforward. But how can one begin to analyze the C&E risks associated with each of them?

The risk assessment concepts of capacities and reasons – meaning the capacities and reasons to engage in wrongdoing – offer a framework for such an analysis.

This is a complex subject, needless to say, but in brief, capacities tend to be specific to a given type of wrongdoing. For instance, the capacity to engage in certain types of competition law violations would include having pricing and/or bidding discretion; the capacity to violate privacy standards would de-

pend largely on one's access to private data; and the capacity to commit fraud would turn in part on the ability to make or impact representations (express or implied) about an organization's products, services, financial condition, etc.

Reasons, by contrast, tend to be broader in nature, i.e., not specific to one type of offense. An obvious example is an incentive-based reason, such where an agent's compensation is based wholly on the amount of business she generates – a reason that can be particularly risk causing in a short-term relationship. Cultural reasons can also be significant, such as where the third party's values are generally questionable or where it fails to appreciate the importance of C&E standards in particular.

Depending on the results of this inventory and assessment, one should determine the appropriate mitigation measures for each type of third party with respect to each significant risk. The results of the analysis will be driven in part by the assessment of risk – not only quantitatively (i.e., how great is the risk?) but qualitatively, too (e.g., if the reason for the risk is that the third party fails to appreciate applicable C&E standards then training or other communications measures might be called for.) However, in conducting this analysis one must be mindful of the potential downsides of becoming too deeply involved in managing a third party's business, which can also be case specific.

Finally, for some companies creating this inventory will not be a minor undertaking. But the alternative is to be at the mercy of the unknown, which in the C&E realm is never a good thing.

A Risk Assessment Spreadsheet

To illustrate some of the points made in the previous sections.

Risk area	Likelihood (1-5)	Impact (1-5)	Risk scenarios	Existing mitigation	Additional mitigation to consider adding or changing

Notes:

Risk areas mean substantive areas of risk, such as corruption.

Some risk areas should be broken down into sub-risk areas (e.g., bribery of government officials, commercial bribery).

Risk areas can be excluded if they have been the subject of other risk assessments or if they do not represent significant legal or ethical peril.

Risk scenarios are the most foreseeable ways in which relevant law could be violated – both generally and on a geographic and business line basis. (This is sometimes referred to as the nature of the risk.)

Existing mitigation includes written standards, training, communication, procedures, assigned accountability and auditing/monitoring and any other form of mitigation that varies by risk area. It would tend to exclude the help line, investigations, discipline, incentives and background checks, at least as a general matter.

"Nano Compliance"

In the great book of corporate compliance program failures, one of the most important stories is from the Bankers Trust derivatives marketing scandal of the mid-1990s. In that case, the bank – a major U.S. financial institution that was bought by Deutsche Bank shortly after the events in question here – was sued by both the government and various counterparties for deceptive practices in selling highly complex derivative instruments. (In some ways, the matter could be seen as a "prequel" to aspects of the financial meltdown of 2008.)

In connection with one of those cases, the government appointed an independent counsel to determine what the causes of the bank's compliance failure were, and interestingly he found that the bank did have policies and other compliance measures in place addressed to marketing derivatives appropriately. What the bank lacked was a key single piece for any compliance system: the designation of an individual to make sure those other measures were in fact being followed.

Given the horrific consequences to Bankers Trust of this lapse, the story calls to mind, "For want of a nail a shoe was lost," and so on up to the loss of a kingdom. It also suggests a need to "think small" – and to practice "nano compliance."

What is nano compliance? It is a local focus on the most risk-variable elements of a compliance and ethics program. By "risk-variable elements," I mean those addressed to setting standards, training and communications, auditing/monitoring and the various types of internal controls discussed in an earlier article. Other elements – e.g., investigations – can, but are less likely to, have a local dimension. And by "local," I mean not only using a geographic dimension but also analyzing risk by focusing on product and service lines or staff functions.

So, to illustrate, using the broad risk area of competition law, one would:

- Look at all of the above-listed dimensions – e.g., by geogra-

phy, product line, etc. – to determine which have non-trivial competition risks. This can include examining the intersection of two or more dimensions (e.g., competition law risks of a product line in a given geography).

- Determine what existing mitigation is for each (meaning for each dimension or intersections of dimensions) using the five risk-variable elements, e.g., what competition law training or auditing there is for the high-risk dimensions or intersections.

- Identify what other mitigation (if any) is warranted for these dimensions or intersections.

This can be a significant undertaking, as can the process of monitoring the mitigation. But, at least for some complex organizations – particularly decentralized ones – it can help prevent the kingdom from being lost.

Refresher Risk Assessments

By now, many companies have conducted foundational C&E risk assessments in response to the 2004 revisions to the Guidelines which established risk assessment as an overarching requirement of an effective C&E program. But risks obviously change over the course of time – both as a general matter, and by "mutating" in the face of newly constructed compliance-related obstacles. Companies developing C&E plans for next year may therefore wish to conduct a refresher risk assessment if they have not done so recently.

Indeed, the Guidelines speak of the need to assess risk periodically. But official C&E guidance documents are less clear on what a refresher risk assessment should entail, and so here are some considerations on this important but somewhat conceptually challenging topic.

First, one should review the foundational risk assessment and any subsequent refresher assessments to determine what circumstances have changed since those reports were prepared. Risk-related changes can, of course, be either internal (e.g., based on a new business line, a new geographical presence) or external (such as enhanced risk-causing pressures from customers or new scrutiny by enforcement agencies). Identifying which of the circumstances identified initially as relevant to risks have changed can be a good starting place for a risk assessment refresher.

Second, one should review how well identified risks in fact have been mitigated under the company's current approach. I stress this because the imperative of the Guidelines not only to assess risk but to use the results of the assessment in designing/improving all other parts of a C&E program is itself widely underappreciated. A refresher risk assessment can be a good opportunity to consider this unexciting but very important part of a compliance program.

Third, if you have not already done so, use the occasion to conduct a "deep-dive" assessment of substantive areas of high risk.

Corruption is the most obvious such area for many companies. However, competition law is – at least for some organizations – also worth focusing on. Indeed, assessing pure ethics risks can be an important part of a refresher process – both to show that a company is serious about ethics, as well as compliance, and also to help identify compliance "risks around the corner."

Fourth, the assessment can be an occasion to develop in a comprehensive way a more granular understanding of risk, not only with respect to substantive areas of law (like corruption) but also the many parts of a company (including geographical and business units). This approach is discussed in more detail in an earlier column on "Nano Compliance."

Finally, and related to the immediately preceding point, the refresher assessment might include detailed review of how a company assesses C&E risks on its "frontier," meaning with respect to organizations that are not fully under the company's control but which can still create C&E risk for it. Two columns appearing later in this e-Book on assessing joint venture risks discuss part of what this sort of effort might entail, although there is obviously much more that could be done in this regard.

Justice Department Views of Risk Assessment

When the original Federal Sentencing Guidelines for Organizations ("the Sentencing Guidelines") were issued in 1991 there was no mention in them of risk assessment as part of compliance programs. It was not until the Sentencing Guidelines were amended in 2004 that this striking omission was remedied. But even then risk assessment had not fully "arrived," as some of the early compliance program requirements in FCPA settlements failed to include a risk assessment component.

Today, of course, risk assessment is front and center in governmental compliance program expectations. This is evident in the Justice Department's recently published guidance Evaluation of Corporate Compliance Programs ("the Evaluation").

This post reviews the Evaluation's discussion of risk assessment. It also offers some practice pointers for meeting those expectations.

First, the Evaluation notes: "Prosecutors should consider whether the program is appropriately 'designed to detect the particular types of misconduct most likely to occur in a particular corporation's line of business' and 'complex regulatory environment[].' [Justice Manual] 9-28.800. For example, prosecutors should consider whether the company has analyzed and addressed the varying risks presented by, among other factors, the location of its operations, the industry sector, the competitiveness of the market, the regulatory landscape, potential clients and business partners, transactions with foreign governments, payments to foreign officials, use of third parties, gifts, travel, and entertainment expenses, and charitable and political donations."

Practice pointer: the list of risk factors – while excellent – is heavily weighted to corruption compliance. Different factors need to be applied to assessing other risks, such as protection of confidential information, conflicts of interest and consumer fraud. For instance, one of the risk factors regarding protection of confidential information is whether the company, its com-

petitors and other parties with which it deals have any information "worth stealing." And a risk factor for fraud is the extent to which successfully misrepresentation regarding a product or service is even possible, given the nature of the business in question.

The Evaluation next provides that "Prosecutors should also consider '[t]he effectiveness of the company's risk assessment and the manner in which the company's compliance program has been tailored based on that risk assessment' and whether its criteria are 'periodically updated.' See, e.g., [Justice Manual] 9-47-120(2)(c); [Sentencing Guidelines] § 8B2.1(c) ('the organization shall periodically assess the risk of criminal conduct and shall take appropriate steps to design, implement, or modify each requirement [of the compliance program] to reduce the risk of criminal conduct')."

The Evaluation further provides: "Prosecutors may credit the quality and effectiveness of a risk-based compliance program that devotes appropriate attention and resources to high-risk transactions, even if it fails to prevent an infraction in a low-risk area."

Practice Pointers: compliance officers should make their boards and senior management aware that violations of low risk areas may – given the right risk assessment process – be treated with some degree of leniency, as this is a very compelling reason to conduct a risk assessment.

Risk assessment results should be used to strengthen all aspects of a compliance program. Many companies use this information for audit prioritization and training selection but not other purposes.

The Evaluation next provides that "'Prosecutors should therefore consider, as an indicator of risk-tailoring, revisions to corporate compliance programs in light of lessons learned.' [Justice Manual] 9- 28.800." As well, it directs prosecutors to ask the following:

- "Risk Management Process – What methodology has the company used to identify, analyze, and address the particular risks it faces? What information or metrics has the company collected and used to help detect the type of misconduct in question? How have the information or metrics informed the company's compliance program?

- Risk-Tailored Resource Allocation – Does the company devote a disproportionate amount of time to policing low-risk areas instead of high-risk areas, such as questionable payments to third-party consultants, suspicious trading activity, or excessive discounts to resellers and distributors? Does the company give greater scrutiny, as warranted, to high-risk transactions (for instance, a large-dollar contract with a government agency in a high-risk country) than more modest and routine hospitality and entertainment?

- Updates and Revisions – Is the risk assessment current and subject to periodic review? Have there been any updates to policies and procedures in light of lessons learned? Do these updates account for risks discovered through misconduct or other problems with the compliance program."

Practice pointers: As part of their risk assessment governance/management document(s) companies should:

- describe the formal risk assessment process;

- have a process for capturing the informal risk assessment that occurs at virtually all companies (what might be called the "risk assessment of everyday life");

- require periodic risk updates – both as to internal sources of risk (e.g., changes to the business) and external ones (e.g., changes to the law);

- document the usage of risk assessment results to update/improve mitigation and measures;

- document any risk assessment failures, as well as lessons

learned and implemented from such failures.

Finally, risk assessments should also have a meaningful methodology. For instance, it is not enough (in my view) to simply ask interviewees about the likelihood of certain types of violations occurring. A methodology should also:

- Give the interviewees a conceptual framework for analyzing risk; and

- Identify "risk scenarios" regarding particular circumstances which should be the focus of a high degree of mitigation.

Law Departments and Risk Assessment

Much has been written on the need for C&E functions to be independent of law departments but considerably less about the critically important roles of in-house counsel in assessing and mitigating C&E-related risk. For many companies, an ideal interplay of the two disciplines can be found in a model that, among other things, articulates assessment and mitigation responsibilities for both law and C&E departments in a risk-specific way.

For instance, under this approach, on a yearly basis the law department attorney with responsibility for antitrust would be required to provide the C&E officer with an analysis – using a defined set of parameters – of antitrust risks at the company (broken down, where useful to do so, by different geographies and business segments) and of the efficacy of C&E program elements in addressing such risks. He would also offer any suggested improvements to the latter in light of the former.

The C&E officer would then review this information with the attorney and suggest possible revisions. Together with similar information for other risk areas (e.g., corruption), she would present an analysis of her findings/plans in a detailed way to senior management (or some subset thereof) in the company and in a high-level way to the board committee tasked with C&E program oversight.

Such reports can help senior managers ensure the efficacy of a C&E program and board members exercise reasonable program oversight. They can also provide internal auditors with a basis for informed program-related auditing. And, the reports can help document the company's C&E progress for possible use in the event that it ever needs to "prove" its program to the government.

Finally, and most importantly, while preserving some independence between a law department and C&E personnel, the model can help a company draw – in a best-of-both-worlds way – on the substantive expertise of the former and the C&E

program expertise (e.g., how to make training effective) of the latter. Indeed, particularly for companies with relatively high-risk profiles (whether due to the nature of their business, where they operate or other factors), both types of knowledge can be essential to C&E efficacy.

Risk Assessment: the "Demand Side" Analysis

Some C&E risk assessments are focused entirely on what might be called the "supply side," meaning on matters internal to a company giving rise to risk. But for most businesses, a full accounting of risk should also include the "demand side," meaning the risk creating impact of law enforcement priorities. Indeed, understanding the demand side may be critically important, at least in some organizations, to identifying "the risk around the corner."

At its most obvious, a demand side risk factor would be the government's perceived need to "make an example" of companies and/or individuals in a high priority area of law. The current focus on bringing FCPA prosecutions in the life sciences industry may be a reflection of this.

A less obvious but increasingly important demand side factor is that governments increasingly need money. And, in some instances, criminal prosecutions can be a non-trivial source of revenue for governments.

What does this mean from a C&E risk perspective? First, as a general matter, we are likely to continue to see "mega fines, which suggests in an across-the-board way the need for heightened attention to C&E.

Second, and more specifically, it could mean a greater focus on the types of criminal prosecutions or other proceedings that have the potential to result in large fines or other payments from companies. Chief among these is competition law/antitrust, and indeed we already seem to be in the midst of a significant expansion of competition law enforcement globally.

Competition law is also a good area for targeted risk assessment, because the risks here can vary dramatically by geography and product/service line. And – at least for some companies – it is a good area for additional mitigation such as training (particularly for senior executives), because understanding of competition law rules, and of the severity of penalties for violations, is far

from universal.

What other risks might become more significant due to this demand side phenomenon? Presumably, tax-related ones will. Indeed, in recent years the US government has sharply increased its tax enforcement efforts in various ways, and it is hard to imagine that other countries (and other jurisdictions, such as state governments) will fail to do the same (because, as Willie Sutton said of his reason for robbing banks, "That's where the money is").

Of course, few, if any, C&E officers have primary responsibility for tax compliance at their respective organizations. However, a fair – and for some companies, important –question for C&E officers to ask as part of a risk assessment is whether the organization's tax practices are consistent with its overall approach to doing business in an ethical manner.

Risk, Culture and "Soft Power"

Perhaps all C&E professionals know that a key element of risk assessment is determining culture-based risk, but not all companies use the cultural dimension of risk assessment to full advantage. This column will offer some practice pointers for doing so.

What risks? A list of cultural factors that could create or enhance risk includes the following:

- Short-term thinking
- Weak employee identification with the company, its customers, or its products/services
- Other indicia of "moral hazard" (misalignment of incentives and risks)
- Difficulty in asking questions/raising concerns (not just C&E ones)
- Marginalization of C&E issues or personnel
- A sense of unfairness or concern about lack of "organizational justice"
- Questionable managerial tone – not only at the top, but also in the "middle" and at the "edges"
- Unreasonable pressure to perform
- Rewarding bad conduct through promotions, compensation, etc.

What culture? At the most obvious level, an organization's own culture (or cultures) should be assessed. Perhaps equally obvious but less frequently done, relevant aspects of cultures in the geographies in which a company operates should be assessed for risk, too.

Finally, least obvious and quite infrequently the subject of assessment, a company should examine the risks arising from industry or professional cultures relevant to its business. This is particularly true of industries with a high degree of intercompany mobility.

Why culture? As noted above, C&E personnel universally understand the need to include a cultural dimension in risk assessment, but the importance of doing so may be less evident to others at a company. Being able to "sell" this internally may therefore be key to getting management support for the effort involved.

One way to do so is point out that a company with a strong culture C&E wise may actually need fewer of the restrictive aspects of a compliance program than a culturally imperiled organization. That is, just as the "soft power" (a phrase coined by Joseph Nye of Harvard) of diplomacy and other non-coercive sorts of influence can, in some instances, offer a more effective means to conduct foreign relations for a nation than armed intervention, so a healthy corporate culture can provide a type of soft power for C&E that may be more cost effective and otherwise desirable than the "harder" approach of having pervasive policies, procedures and monitoring.

Training Managers to be C&E "Risk Sentinels"

What does it mean for a manager to be ethical? At a minimum, of course, he or she must obey relevant laws and other standards of conduct herself, but in an age of maximum consequences for violations presumably the minimum in ethicality is only the starting point. Organizations seeking to minimize risks of this kind should also expect – and train – managers to have a heightened degree of ethical awareness, so that (among other reasons) they can be "sentinels" in spotting C&E risks.

Training managers to be effective risk sentinels has several aspects to it. One focuses on key C&E risk areas. By way of example, for confidential information one might:

- Begin the training with an attention getting hypothetical.
- Identify the principal categories of confidential information (by type and ownership).
- Describe the various legal and business imperatives for strong compliance efforts in this area.
- Review applicable company policies and procedures relating to confidential information.
- Identify pertinent "red flags."
- Examine some of the particular compliance challenges managers might face with respect to spotting confidential information issues.

A second aspect of this training is helping managers understand the general causes of risk, meaning risk causing factors that can lead to violations of all kinds. At an organizational level, these include pressures (both internal and external), compensation approaches, "organizational justice," workforce alignment with the company and its mission, openness of communication, and other cultural factors (including relevant regional and industry ones). However, the training should also address risk causing

factors that disproportionately impact individuals in positions of power[7] or the fact that people in such positions seem to have an easier time lying than do others.[8] In other words, to be a true risk sentinel a manager needs to understand the risk "within."

Finally, the training should provide guidance on how managers can help address risks. This includes, of course, some things that they can do on their own, e.g., recognizing and encouraging ethical behavior by their subordinates. But often the role of a "sentinel" is to spot a threat – not to deal with the threat herself, and as C&E risk sentinels it is vital that that managers understand the need to follow the company's C&E escalation policy when issues arise.

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[7] See sections on behavioral ethics later in this e-Book.

[8] See http://hbr.org/2010/05/defend-your-research-powerful-people-are-better-liars/ar for more information on this, and also on research tying power to risk taking.

Focusing on Managers' C&E Risks

A CEO – considerably wiser than most in these matters – once noted to me in the course of a risk assessment discussion that a compliance and ethics program should not "spread the peanut butter evenly" across the organization, meaning that a program's mitigation tools should be focused most on those who can create the most risk – the company's managers. Indeed, due to the 2010 amendments to the Guidelines concerning wrongdoing by high-level personnel, enhancing what might be called the managerial dimension of their C&E programs should be the concern of all companies. In this column I briefly examine three practical ways of doing this.

The first and most obvious of these is to provide manager-specific C&E training. Among other things, the training should address general C&E related responsibilities of managers – e.g., maintaining awareness of actions of subordinates, creating a work environment where it is relatively easy to raise ethical issues – including by responding appropriately to C&E concerns, leading by example and otherwise promoting a strong ethical culture. The training should also cover key individual areas of risk (e.g., conflicts of interest, confidential information/insider trading, use of company resources, financial reporting, corruption, competition law) to sensitize managers to their own risks of wrongdoing. One practice pointer: to get real buy in, consider presenting the training as a form of leadership development – i.e., a way of achieving a "heightened ethical awareness" that can be useful for career development, and possibly necessary for career survival.

A second, somewhat less common means is to ensure meaningful management oriented C&E components to key personnel decisions. This might include:

- C&E-based "behavioral interviewing" for management positions.

- C&E leadership-related questions and expectations in performance appraisals and performance management plans

(e.g., does the manager provide feedback to others with regard to their compliance with company standards and procedures?)

- C&E department input into succession planning.

Third and most challenging, companies should consider requiring before-the-fact C&E consultations in connection with risk-sensitive decisions by managers. Such decisions might include developing new products or services, using new production or distribution means or moving into locations of relatively high C&E risk.

Note that each of these individual strategies should not be deployed in isolation from the others. For instance, the training should build on the leadership-related C&E performance criteria. And, the risk-based consultations can include an element of "just-in-time" training (which, behavioral economics research teaches, can be a particularly effective approach to risk mitigation.)

Finally, note that this is not remotely an exhaustive list. Among other things, it does not address management-focused approaches/issues relating to risk assessment, audits, investigations, discipline for violations, employee surveys and board C&E program oversight. Hopefully, however, the discussion will be helpful to some in optimizing distribution of the "peanut butter."

Conducting Risk Assessments Under the Attorney-Client Privilege

Should risk assessments be conducted under the attorney-client privilege? There is no one-size-fits-all answer to this question, but in every instance that a company is planning a risk assessment it should at least be considered.

I say this because without the protection afforded by the privilege some employees may resist providing the sort of candid critical information that may be necessary for a program to be effective. Indeed, I recall many years ago one executive of a financial services firm being asked to take part in a risk assessment interview and responding, "Are you crazy?" But when he was told that his comments would be treated as privileged and confidential he readily went ahead with the interview (and contributed valuable information to the process).

Of course, getting potentially damaging information is absolutely key to risk assessment efficacy for high-risk areas of law. Chief among these are the corruption and competition law areas, but for many companies there will be others (e.g., privacy for organizations that possess significant amounts of private customer information).

If choosing to proceed under privilege, one must be mindful of all the formal requirements of law in this area, starting with the documentation establishing the purpose of the assessment. Typically, I suggest that the engagement letter (if an outside firm is involved) state that the attorney is providing legal advice to help the company meet C&E-related expectations and otherwise reduce legal risk. (The latter part is to cover situations where legal standards are not clear or where the attorney is likely to recommend best practice C&E approaches that go beyond legal standards.) One must also treat the information obtained in the assessment as confidential.

Finally, the attorney must in fact give legal advice for the communications in question to be privileged. However, this should not be seen as a burden, as focusing on ensuring that the priv-

ilege is maintained can itself encourage a company to pay sufficient attention to C&E-related law, which, in turn, can be useful from the perspective of ensuring program efficacy.

Areas of Risk

The heart of any risk assessment is assessing substantive areas of risk. Each will, of course, have its own assessment methodologies, based on the nature of the prohibitions/restrictions involved.

For instance, in assessing insider trading risks for a given company one would look at the following factors, among others:

- Is the company's stock volatile?
- How much material inside information (beyond what is obvious) about itself does a company have?
- How many individuals (employees and others) generally have access to the company's inside information?
- To what extent does the company have material inside information about other business organizations?
- What is the state of the company's inside-information-related controls?

However, there are also various assessment-related commonalities among the different risk areas.

In this section of the e-Book, we look at two areas of legal risk - corruption and competition law, and one area that combines both ethics and legal risk - conflicts of interest. We also offer some thoughts on gifts and entertainment. In a later section we look at how to assess and address true ethics risks.

Competition Law

Based on the frequency of very large fines, no compliance risks are, as a general matter, greater than those in the area of competition/antitrust law. Yet many companies devote far too little effort to assessing and addressing such risks.

An important guidance document[9] issued by the European Commission – Compliance matters: What companies can do better to respect EU competition rules – should help to remedy that. The document is a helpful guide to the "why" and "what" of competition law compliance programs and offers the following framework for competition law risk assessment:

"A successful company's compliance strategy would be based on a comprehensive analysis of the areas in which it is most likely to run a risk of infringing EU competition rules. These areas will depend on factors such as:

- the sector of activity; for example a history of previous infringements in the sector indicates a need for particular attention.

- (frequency/level of) the company's interaction with competitors; for example in the course of industry meetings or within trade associations, but also in day-to-day commercial dealings.

- the characteristics of the market: position of the company and its competitors, barriers to entry… If a company holds a dominant position in a market, the preventive measures to be taken will differ from those where the risk factor is more in the nature of 'cartelisation'.

"But the exposure to that risk may vary greatly according to

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[9] Available at http://bookshop.europa.eu/is-bin/INTERSHOP.enfinity/WFS/EU-Bookshop-Site/en_GB/-/EUR/ViewPublication-Start?PublicationKey=KD3211985.

the position held by each member of staff. Employees whose specific areas of responsibility cause them to be particularly exposed (for example, employees who frequently interact with competitors as part of their job or through trade associations) would be made aware of what is at stake and of the basic principles to keep in mind."

Of course, this framework is pretty obvious (as well as quite general). But there are many things in the C&E world that are not only obvious but also important – and are still ignored. Coming from the European Commission, the imperative of conducting competition law risk assessments (and, of course, of using the results of those assessments to develop and maintain strong competition law compliance programs) will now be harder to ignore.

A final point: for global companies, a competition law risk assessment should not be limited to European- and U.S.-related risks. In recent years, a significant number of other countries have initiated harsher approaches to competition law enforcement, and given how fines in this area have proven to be a non-trivial source of revenue for some governments, there is reason to believe that that trend will continue.[10]

[10] See earlier column on the "demand side" of risk assessment.

Conflicts of Interest

Several years ago the Securities and Exchange Commission identified a number of areas of potential conflicts of interest (COI) in the private equity field, in effect, strongly encouraging members of that industry to conduct COI risk assessments. But given the prevalence of COIs in the business world generally, this is a measure that other types of organizations should consider, too.

Additionally, the very nature of many COIs – in particular, those involving personal interests of powerful individuals within an organization – suggests that without a well-defined risk assessment process some conflict risks might go unaddressed. This article provides an overview of how to assess COI risks, either as a stand-alone effort or part of a more general assessment process.

First, one should be clear from the start about the purpose of the effort. It should be designed not merely to identify COI risks but also to develop the sort of information about them that can be used to design/improve all C&E program "tools." For instance, the information should be of use in drafting or revising a COI policy or FAQs on the organization's intranet; deciding whether to deploy COI certifications, and, if so, who should receive them and what their content should be; structuring/improving the COI disclosure and management approach; and making similar determinations regarding training/other communications, auditing/monitoring, board oversight and the use of technology (e.g., a COI data base).

Second – and in order to get the type of information that truly helps one tailor C&E program elements for optimum COI mitigation – one should use a methodology that, among other things, assesses the "reasons" for possible COIs.[11] Reasons, in turn, generally include "motivations" and "misunderstandings."

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[11] See earlier section on reasons and capacities in risk assessment.

"Motivations" are reasons to engage in wrongdoing purposefully – most obviously, having a personal economic interest (e.g., ownership of or other revenue participation in an entity that does business with your organization). But less tangible personal interests can form the basis motivations, too – such as reputation enhancement, and one should also consider what the relevant risks are in that respect.

"Misunderstandings" refer, first, to COI-related expectations that may truly not be understood (such as, applicable third-party standards), and, second, to standards that are known but under-appreciated (as COI rules might be in certain cultures or even industries).

Third, the methodology should also include COI "capacities," most obviously encompassing individuals in management and procurement. But there are also many other, less obvious, functions that could have COI-risk creating capacities. For instance, in some companies "corporate opportunities" will present real COI risks with respect to some employees (or agents) but not others, depending on their exposure to such opportunities; determining who is in the former group could be an important facet of COI risk assessment for such organizations.

Finally, as discussed in the Introduction, although broad-based efforts to analyze the "impact" are unnecessary with respect to many C&E risks (e.g., there is not much point in having executives vote on what they think the harm of an antitrust, bribery or employment law violation would be), with COIs an impact dimension can be important, because COI impacts tend to be less obvious than those arising from many other types of C&E risks. That is, they tend to be more business related in general and trust related in particular, and less a matter of legal penalties.

For this reason, identifying all the ways in which a COI can be harmful to trust could be useful in a number of ways, such as developing training and other communications, which tend to be more effective to the extent they are specific about harms from COIs.

Gifts and Entertainment

Virtually every conflict of interest policy contains monetary limits for individual acts of gift giving or entertainment, but not all seek to quantify how many of such acts are permitted to occur in a given time period. This issue was raised in a particularly grim way – as described in this article in MarketWatch – by a recent study which "found that both deaths from opioid overdose and opioid prescriptions rose in areas of the country where physicians received more opioid-related marketing from pharmaceutical companies, such as consulting fees and free meals,…"

Relevant to the specific issue in this post, Magdalena Cerdá, director of the Center on Opioid Epidemiology and Policy at NYU Langone Health and the senior author on the study, stated: "A lot of the discussion around the pharmaceutical industry has been around high value payments, but what seems to matter is really the number of times doctors interact with the pharmaceutical industry,… 'A physician's prescribing pattern could be influenced more by multiple inexpensive meals than a single high-value speaking fee,' she noted."

She also said: "'We think it's because the more times physicians interact with someone from the pharmaceutical industry, the easier it is to build a relationship of trust,… 'We in no way think the prescribing is some kind of nefarious intentional behavior by physicians. The fact that it is the frequent, low-level payments that have the most effect shows that it's more unintentional '…" Of course, unintentional conflicts tend to be more difficult to address than are intentional ones.

More generally, this finding seems to me to be significant in a broad-based way as it presumably applies to other commercial contexts as well. And, compliance officers in all industries should make sure that their COI policies address not just high-value gifts and entertainment but also high volumes of such.

Corruption Risks

At least conceptually, corruption-related risks should be relatively easy to assess because official expectations regarding such assessments are well articulated – most prominently in guidance documents published in 2012 by the U.S. Department of Justice and Securities and Exchange Commission, 2011 by the United Kingdom's Ministry of Justice and 2010 by the OECD. But putting those risk-assessment principles into practice can be can be daunting, particularly for large global organizations.

In undertaking anti-corruption risk assessments, it may be useful to start with what might be called general risk causing factors (i.e., factors that are relevant to not only corruption risks but other areas of C&E too). For some companies, that will include expansion of the business in developing countries, increased outsourcing and strategic partnerships and economic conditions that can lead to business pressures; of course, other companies will have their own general risk causing factors. So as not to reinvent the wheel, a practice pointer here is that those assessing a company's corruption risks should review the organization's most recent audit plan, as such a document will often have an analysis of precisely the factors in question which can be used for C&E purposes too.

Moreover, general (i.e., not corruption-specific) factors about a company can mitigate (as well as exacerbate) risk, and these should be part of an assessment as well. Among the key considerations here are the strength of a company's overall C&E culture (e.g., the extent to which C&E is seen by employees as a strategic advantage); the soundness of its overall controls; and the openness of communications in the organization. (On the other hand, culture probably mitigates corruption-related risks less than it does various other kinds, given how often bribery cases involve the "edges," rather than "top," of an organization.) Indeed, as described later in this e-Book, a risk assessment requires some degree of program assessment to accurately gauge what an organization's "net risk" is, and that is particularly true in the anti-corruption realm.

However, the gut of an anti-corruption risk assessment should be a risk-area specific analysis. Here, too, some of this aspect of assessment concerns the state of extant mitigation for the organization in question – particularly for such operationally demanding areas as controls with respect to providing things of value to "government officials" and engaging third parties; monitoring (both first and second lines of defense, as described later in this e-Book); and, perhaps less obviously, the realm of incentives. All of these, of course, go to the calculation of "net risk."

But the gross risk part of the equation is where the real challenge is for corruption, with the following being part of the focus of virtually any effort of this kind.

Geographic risks. The principal way in which geography is relevant to anti-corruption risk is through the degree to which a given country or other geographic unit is corrupt (e.g., the country's ratings on the Transparency International Corruption Perception Index). A key practice pointer is that other aspects of geography may also be relevant, such as having relatively isolated company facilities.

Product/service-related risk. There are many different risks of this kind, with the most obvious ones arising from dealings with the government as regulator (typically in manufacturing, transporting, storing or selling a certain type of product) or as customer. A key practice pointer here is that, at least in some instances, product-related risks should be examined granularly, e.g., by product line. (This can be seen as part of the "nano compliance" approach discussed earlier in this e-Book.) Another is that in looking at what constitutes "government business" one should not limit the inquiry to instances where one's direct customer is a government entity but also consider situations where the government is the end user of one's product, even if there are multiple market participants in between.

Third-party risks. This may be an area where some companies go too far (see the piece later in this e-Book on "Goldilocks compliance") but many more do not go far enough. The key,

in my view, is to apply the "capacities" and "reasons" analytic approach to third parties that is described earlier (in a broader context than just anti-corruption compliance). However, this review needs to be informed by the extensive history of third-party-related violations that one finds in FCPA case law. For instance, a classic distributor takes title, and therefore under traditional legal analysis seems to have little capacity to create corruption liability for the company whose product it sells; but, experience teaches that there are many types of distributor relationships that can in fact give rise to corruption related liability. Here, too, there is - at least for many companies – no substitute for a granular approach when it comes to risk assessment.

Private-sector corruption. Corruption is, as a general matter, both more likely and impactful in the public sphere than in the private sector, but this can mislead companies into concluding that they need to do little with respect to the latter. Therefore, it is important to include private-sector corruption in C&E risk assessments, taking into account, among other things, the C&E standards of customers and other private-sector organizations with which one's company deals, relevant geographic culture, the organizational culture of the parties in question, the controls of such organizations and pertinent industry culture. A practice pointer here is to look for situations where a private sector entity (customer or other) is not subject to the type of market discipline that generally serves to enhance compliance, i.e., where the cost of corruption is on some level an "externality" (and arguably a "moral hazard").

Mitigation Approaches

As already described[12], a key – and often underappreciated – point about risk assessment is that the results of an assessment should be used to design, operate or improve the various aspects of a C&E program. Put simply, an assessment is only as good as the utility of its results in making a C&E program effective.

In this section, I explore various aspects of risk-assessment-based mitigation, including using assessment results: auditing and monitoring, internal controls, continuous improvement and annual risk-based plans.

[12] In the Introduction and "Does your risk assessment do this?"

Keys to Success When Mitigating Identified Compliance and Ethics Risks

Compliance and ethics risk assessment in the broad sense can be thought of as having three elements to it: risk identification, analysis and mitigation. The first two of these tend to be conceptually more challenging than the third, and perhaps for this reason generally receive more attention than it does (including in this column). Yet failure to mitigate risks that have been identified and analyzed can – and does – create no small amount of harm in companies.

One key to success in this area is having a defined and well-documented risk mitigation process. Among other things, this process should set forth in sufficient detail the nature and scope of the required mitigation; the parties responsible for taking the identified measures; the expected time and cost (so that neither becomes an excuse for failing to mitigate); start and end dates; and a list of any possible impediments to the mitigation and how these can be addressed. Formal signoffs by all key affected parties can also be a helpful step to ensuring sufficient cooperation with the mitigation.

Second, companies should consider having compliance personnel conduct periodic reviews of progress against the plan with the relevant risk owners. In many instances, a quarterly review will be sufficient, but for areas of relatively high risk greater frequency should be considered.

Third, the information generated as part of the process – both in the original plan and from the reviews – should be shared with others who (even if not directly impacted by) could benefit from it. This tends to be most relevant to large, complex organizations, but can be useful for small and mid-sized companies, too.

Fourth, audits should be considered for some or all of C&E mitigation efforts once they have been completed. In some instances, other forms of checking (e.g., self-assessments) should be deployed, too.

Finally, senior management should receive reports on mitigation of risks. This serves, of course, to ensure that these efforts are viewed as a priority. It also helps keep management knowledgeable about and involved in the program, another important area where many current companies' efforts fall short of where they should be.

Annual Compliance & Ethics Risk Plans: Four Practice Pointers for Success

Does your organization apply a Sentencing Guidelines "seven-steps" approach to mitigating all significant areas of C&E risk? Many programs are built on the theory that they will do this, but far fewer actually do it to a meaningful degree.

A useful organizing tool for making an approach of this sort a reality is through the implementation of C&E risk plans, along the following lines.

First, the organization should appoint subject matter experts (SMEs) for all risk areas of significance (e.g., corruption, antitrust, IP).

While many companies do establish roles of this sort, the practice pointer here is to implement a written position description for SMEs and use this description for evaluation/compensation purposes.

Second, as part of their defined roles, SMEs should lead or participate in annual risk assessments for their respective areas. While also fairly common, the practice pointer here is here is to focus the SMEs less on estimating the likelihood and impact of a violation generally (both of which are often pretty obvious for given risks) and more on identifying specific points of vulnerability for use in enhancing mitigation measures (e.g., specific products for which collusion with competitors is relatively likely, regulatory offices in a given country where bribes are relatively likely to be extorted) – or what is referred to in this e-Book as the nature of the offense.

Third, the planning process should entail using the risk-related information to develop or enhance C&E program elements. The practice pointer here is that the actual "seven steps" framework actually is not optimal for these purposes since several of them (e.g., investigations, discipline) don't vary by risk area enough to merit inclusion for these purposes.

Instead, organizations should consider using this modified list of program elements/attributes for risk plans:

- standards and procedures (with the latter including internal controls);
- training and other communications;
- auditing, monitoring and self-assessment; and
- accountability and resources.

In addition to these "risk-variable" program elements, the annual risk plan template could also have an "other" category for those rare instances where tools beyond those listed above are needed for effective mitigation of a given area.

Finally, while the SMEs will typically have the principal role in this process, others – e.g., members of regional C&E committees – should have defined responsibilities in it, too. The practice pointer here is to articulate these duties in program governance documentation (e.g., committee charters) and to audit against them.

The Three Lines of Defense…and Two C&E "Fronts"

As the C&E program field matures, various forms of "checking" become increasingly important to ensuring program efficacy. The "three lines of defense" is a commonly used construct for identifying who does such checking (although the construct is not limited to C&E).

The first line of defense is business people monitoring their own operations. This responsibility – which, in my view, is not mandated in organizations nearly as often as it should be – serves not only as a device for checking, but also as a way of educating the business people on key risks. (A practice pointer: companies should consider reinforcing monitoring responsibilities of this sort by mentioning them in the "Managers' Duties" part of a code of conduct and perhaps including them – at least in a broad way – in managers' performance evaluations.)

The second line of defense is non-independent staff (e.g., finance, HR, EH&S or the C&E function) engaging in monitoring. This form of checking is important because in almost any large organization, the audit team cannot, as a practical matter, cover all pertinent areas of risk and so needs checking help from other experts from within a company. Moreover, the lack of true independence in this sort of checking tends, in my experience, to be more a theoretical than actual concern.

The third line of defense is true independent auditing or assessment, which is often performed by a company's internal auditors, but might also be performed by an external group – including accounting, law or consulting firms. Of course, this sort of checking tends to be the most impactful of the three types. But, as a matter of resources, there is only so much of it that any company can do. (Another practice pointer: among the areas to auditing this third line of defense is how well an organization is deploying the other two lines.)

In addition to the three lines of defense, it may also be useful to consider two C&E "fronts," meaning fields of activity for which companies should consider deploying any or all of the

lines of defense.

One of these two fronts is risk-area checking. To take a somewhat obvious example, using the risk area of corruption:

- Business people monitor gift-giving/entertainment and the use of third parties in the parts of the business for which they are responsible.

- C&E or finance also monitors such activity, but in a broader and more systematic way.

- Audit reviews various items – not just the operation of the above-described anti-corruption measures, but also various financial controls – and looks closely for possible violations in the locations/business operations of highest corruption risk.

Using a somewhat less obvious example for this "front," from the realm of competition law: business people monitor bidding activity in their unit; law (and possibly C&E) engages in some similar activity, as well as checking competition law processes (e.g., those requiring approvals before employees can engage in trade association activity); and, as with anti-corruption law, audit reviews locations/business operations of highest risk for compliance with relevant processes and for potential violations.

The second of the two "fronts" concerns what might be called generic (i.e., not risk-area-specific) program processes. To take the example of C&E training: supervisors are responsible for checking to make sure that employees in their work units have taken required training (both in-person and computer-based), C&E reviews training records to see that the required training is being delivered as planned (and also – if the information has been gathered – how employees are reacting to it) and audit conducts training related reviews (including perhaps interviewing some employees) to assess both the fact and efficacy of training.

Of course, no company can fully deploy the three lines of de-

fense with respect to all risk areas and all program processes. Indeed, no one could come close to doing this.

However, a well-designed risk assessment process will help inform this effort and guide an organization in how to use its limited checking resources in an effective manner. And a risk assessment that is not helpful in this regard should be closely reviewed with respect to fitness for purpose.

Risk Assessment and Internal Controls

Internal controls – meaning processes, structures or systematic measures to address risk – are an important but often overlooked expectation of C&E programs under the Sentencing Guidelines.

They are frequently overlooked because the mention of internal controls is more indirect than that of other program elements (such as training or auditing) in the Guidelines' seven items. That is, the Guidelines' item 1 does set forth general expectations concerning policies and procedures but it is only a Guidelines "commentary" which specifies that procedures include internal controls. Still, as a matter of C&E practice, controls can be utterly essential to effective risk mitigation.

One common type of compliance control is the requirement of pre-approval. Pre-approvals play an important role in FCPA compliance (required for retaining certain sorts of third parties or giving things of value to government officials); antitrust (mandated for attendance at trade shows or entering into business arrangements that could be considered unlawful vertical restraints); consumer protection (advertising must be pre-approved); and, perhaps most obviously, conflicts of interest (conflicts are forbidden unless disclosed and approved), including rules addressed to gifts, entertainment and travel issues beyond the FCPA realm.

Other types of controls – concerning division of responsibilities or levels of authority – play an important role in anti-fraud compliance measures.

Still another type relates to physical access to company resources. This latter sort of control can support both compliance for certain risk areas (e.g., limiting access to confidential or private information) and also the operation of a C&E program generally, such as by preventing employees from utilizing a company's information technology if they have not taken compliance training.

How do internal controls relate to risk assessment?

As described in an earlier column, a key function of risk assessment is developing information that can help a company determine which C&E tools it should deploy to address given areas of risk. And, while it may be difficult to generalize about the specific facets of risk that should trigger the use of controls (given how many types of controls there are), one can say that unless a company is actively considering internal controls for these purposes – the way it likely focuses on more commonly used program elements in conducting risk assessment – it may be missing important mitigation opportunities.

This is the case not only with respect to the traditional forms of controls described above but also possible use of newer technology-enhanced controls, for which – like nearly every choice relating to a C&E program – informed decision making should start with a meaningful understanding of a company's C&E risks.

Risks and Mitigation at "the Top"'

Many years ago, the CEO of a client company told me that he wanted to fire another corporate officer there. I asked him what basis he had for this contemplated action and he said it was that the officer had failed to take mandatory compliance training. I responded by asking if he – the CEO – had taken the training, to which he replied (without a trace of irony) that he had not.

In recent months, the unprecedented sexual misconduct allegations against (among others) high ranking officials in prominent businesses has brought unprecedented attention to the need to prevent and detect such wrongdoing using high-level solutions. For instance, writing recently in the Harvard Law School corporate governance blog , Subodh Mishra, Executive Director at Institutional Shareholder Services, Inc., identifies the following five components of an effective sexual misconduct risk management policy:

- Sexual misconduct risk is specifically enumerated and oversight assigned to a board committee.
- The board has expertise in workplace and employee issues.
- Material penalties are in place for perpetrators and abettors.
- Executive compensation structures—at a minimum—contain incentives for creating a safe and equitable workplace.
- The company models the behavior it seeks to promote.

These seem like generally sound observations, but the point of my post is not to add to the conversation on this particular area of risk but rather to suggest that ideas of this sort can and should be applied to compliance risks more broadly.

Certainly, assigning a board-level committee compliance responsibility with an emphasis on risks (such as corruption or antitrust ones) at the top, would be a sound measure general-

ly for companies to take. And the board having expertise regarding compliance issues is compelling for the same reason that having such expertise in workplace/employment issues is – though for both areas expertise can (in my view) sometimes be provided by access to an outsider adviser rather than appointment to a seat on the board.

Moreover, I certainly think that the emphasis on penalties for those engaged in misconduct is important to preventing wrongdoing of various kinds at the top, particularly the suggestion that "These policies may also be extended to any individuals that willfully concealed violations or engaged in retaliation against whistleblowers." And, on the other side of the coin, reflecting compliance success generally in executive compensation structure makes sense just as it does for promoting diversity (part of Mishra's recommendations), although doing so with the former may be more methodologically challenging than it is with the latter. Still, it can be done.

Finally, the point about modeling behavior is every bit as important to promoting compliance generally as it is to preventing harassment and discrimination in particular. For a board committee overseeing compliance at the top, this aspect of effective risk management has implications for a wide range of conduct – both substantive (e.g., how conflicts of interest are dealt with by senior managers) and procedural (such as ensuring that managers take the required training, to go back to the example at the top of this post).

Addressing the Risks of "Middle-Aged" C&E Programs

Oliver Wendell Holmes, Jr. – who served on the Supreme Court until he was ninety – once said: "From forty to fifty a man must move upward, or the natural falling off in the vigor of life will carry him rapidly downward." Do similar risks face C&E programs in their middle age?

On a most basic level, a middle-aged C&E program often lacks the vitality of its early days. The sense of urgency and purpose is often lost, and the program's standards and functions can begin to be seen as pointless bureaucracy, and be disregarded.

On a less obvious level, having lived with a program for several years can be lulling, and provide what an executive at a client recently described to me as an "it can't happen here" mentality, i.e., the program becomes a victim of its own success. Finally, a middle-aged program runs the dangers of establishing standards that the company fails to abide by, creating what could be in an enforcement setting a "worst of both worlds" scenario.

What are some ways for an organization to avoid these pitfalls?

First, a vibrant risk assessment process can show that significant C&E violations are indeed still possible at the company. C&E-related employee surveys are often useful for these purposes, too – especially ones directed to individual areas of risk, as is publicizing actual disciplinary cases (without "naming names").

Second, a strong approach to C&E-related incentives is perhaps the best way to signal to managers that a program is still mission critical to the organization's success. Training senior managers on their program-related responsibilities – to make clear the connection between individual C&E efficacy and leadership – can have the same effect.

Perhaps most useful, by documenting and explaining a program's strengths, an independent C&E program assessment can help doubters in a company understand how the program

is in fact an important asset of the organization – one which is well worth preserving and indeed enhancing. And, by identifying potential weaknesses that a prosecutor would likely spot in an investigation, an assessment can demonstrate to the complacent the possibly grave dangers to the organization of the program becoming infirm as it grows older.

"Just-in-Time" Risk Assessment

In 1994 I spoke at a meeting of a company's executives that took place shortly before the end of the company's financial quarter, and in the same session the CEO made the point that the executives needed to be vigilant against any mischief designed to dress up the quarter. This was my first exposure to "just-in-time" training/communication. And although more companies time their compliance measures in this sort of way now than did then (mostly because there are more measures to time), it is an area where many organizations can and should up their respective games.

The basic idea of just-in-time communications (also sometimes called "point of risk" communications) – as described in this post – is that compliance communications are most likely to have the desired impact if delivered shortly before exposure to the risk in question. As noted in that post, this mechanism could be used to address a wide range of risks: "anti-corruption – before interactions with government officials and third-party intermediaries; competition law – before meetings with competitors (e.g., at trade association events); insider trading/Reg FD – during key transactions, before preparing earnings reports; protection of confidential information – when receiving such information from third parties pursuant to an NDA; … accuracy of sales/marketing – in connection with developing advertising, making pitches; and employment law – while conducting performance reviews…"

To his discussion I would like to add the notion of a just-in-time risk assessment. Specifically, when conducting risk (or program) assessment interviews or surveys, compliance personnel should inquire a) for any given area or risk, whether there is a need for just-in-time training/communications; and b) if so, what the specifics of such training/communications should be.

Finally, the need to look for opportunities of this sort can be added to lists of managers' C&E duties (e.g., those set forth in the code of conduct, training for new managers, and perhaps personnel evaluations). This will not only help companies de-

velop more "just-in-time" communications but will raise the level of managers' C&E knowledge and commitment generally.

Keep Managers' C&E Duties Top of Mind to Improve Compliance

Codes of conduct almost always have a discussion (typically in the introduction) of the compliance-and-ethics (C&E) duties of all employees and a discussion of the additional duties that managers have under the code. But not all companies fully leverage this discussion throughout other parts of their C&E programs.

Managers' C&E duties tend to include leading by example and maintaining a "speak-up" environment. Somewhat less frequently one also sees mandates to serve as a "champion" of the C&E program, make sure that the employees in their unit understand how the code applies to their respective jobs and be alert to C&E risks.

These sorts of discussions can be useful – but only if they are reinforced elsewhere in the program. Examples of this sort of reinforcement include:

- Have Q&As and examples to flesh out these concepts in the code and substantive policies (e.g., in an antitrust policy, give an example of a manager failing to ensure that a subordinate who attends trade association meetings follows company policy with respect to attending such events).

- Include a discussion of managers' C&E duties in training – and not just code training, but on "substantive" topics too, such as anti-bribery.

- Through email campaigns and other types of communications, tie these duties to both risk areas of compliance and program processes (e.g., managers are responsible for making sure that all employees in their respective units take required training).

- Include managers' C&E duties in the scope of C&E auditing – such as by asking employees questions about the extent to which their respective managers fulfill those duties.

- Train investigators to look at issues of supervisory fault when investigating helpline calls and other reports of violations.

- Build consideration of such fault into disciplinary protocols.

- Publicize instances of such discipline (consistent with respecting legitimate privacy expectations).

- Perhaps most importantly, companies should consider tying the "Managers' C&E Duties" discussion into their performance evaluations – as a way of incentivizing compliance.

The challenge of promoting strong compliance by managers is not new. Indeed, the 1991 Sentencing Guidelines included a provision that companies should impose "appropriate disciplinary measures…for failing to take reasonable steps to prevent or detect criminal conduct." Moreover, the recent advent of "behavioral ethics" (as discussed elsewhere in this eBook) has helped underscore how difficult it can be for companies to establish a regime of managerial accountability.

Leveraging a provision on managers' C&E duties throughout one's program is not a quick fix for these legal and psychological challenges. But it can provide a place to start.

Risk Assessment and Program Assessment

There has long been some confusion regarding the relationship between risk assessment and program assessment, which should be not be a surprise – as there are natural overlaps between these two types of compliance assessments.

In this section of the e-Book we explore the relationship between risk and program assessment on several levels: generally, from a metrics-generation/use perspective, and in the context of post-offense review measures.

Points of Intersection Between Risk Assessment and Program Assessment

Since the 2004 amendments to the Guidelines moved risk assessments and program assessments from the realm of best practice to what can be seen as the territory of de facto requirements, there has been a fair bit of confusion regarding the distinctions between these two C&E program components.

In principle, a C&E risk assessment helps an organization understand not only what its risks are, but how to mitigate them. A program assessment, of course, tells the company how well the program is functioning. So, risk assessment can be seen as more design oriented, and a program assessment has more of an operational focus.

But in practice, the two overlap because one cannot assess risks without understanding how well a C&E program is mitigating them (i.e., the concept of "net risk") and one cannot measure program efficacy without meaningful reference to an organization's C&E risks. Moreover, some program measures will clearly serve both risk and program assessment purposes. For instance, C&E-related questions on employee surveys (e.g., whether the respondent agrees with the statement, "My manager acts with integrity") can be useful both for program assessment purposes (that is, assessing how well the program is impacting behavior) and also risk assessment ones (that is, variations in responses among business units and/or geographies can help an organization determine where its risks are, and hence where additional C&E measures – such as training or auditing – are warranted).

Further blurring these lines, some organizations conduct what are essentially stand-alone program assessments of discrete risk areas. While this would not be warranted for all risk areas of significance, it does make sense for anti-corruption compliance – at least for some organizations – and perhaps several other areas (competition law and trade compliance, among others).

A final part of this mix: a program assessment should always include review of the risk assessment function (and sometimes

it works the other way, too). Among other things, this typically entails examining the following:

- The extent to which there is a defined C&E risk assessment process with a logical methodology.

- The breadth of C&E inputs (and note that in my view, a typical ERM survey of employees by itself is only a start in this direction).

- The depth of the C&E inputs (e.g., whether personnel who provide information on risks will, either by virtue of their day-to-day work or from preparation for the interviews, be sufficiently informed for the information to be meaningful to the risk assessment process).

Finally, a key question in this area – and for many companies, a major stumbling block – is whether the results of the risk assessments are used to a sufficient degree to design and enhance the various elements of the program (and not just the obvious ones, like training and auditing). In other words, to be effective, a risk assessment should provide "news you can use" in making other parts of your program effective.

Scoping Out your Risk/Program Assessment

At the PLI Advanced Compliance & Ethics Workshop in NYC, Scott Killingsworth of the Bryan Cave law firm noted that each risk assessment should be unique. I agree, and I believe that the case for uniqueness is even more powerful for the combined program and risk assessments companies sometime undertake. Given the diversity of possibilities, where should you start in scoping out such an engagement? Another way of asking this question is "How should you conduct a needs assessment for a program/risk assessment?"

To begin, it may be worth thinking in terms of the following six fields of information which can comprise the subjects of an assessment:

1. Program assessment: tools/elements that many employees have information/views about. Examples include C&E training and the helpline.

2. Program assessment: tools/elements that relatively few employees have information/views about. Examples include monitoring approaches and pre-hiring due diligence.

3. Risk assessment: risk areas that are the primary responsibility of the C&E office and that are both broad (meaning they touch many employees) and deep (meaning they have a potentially high impact). Examples – at least in some companies – include corruption, competition law and possibly fraud.

4. Risk assessment: risk areas that are the primary responsibility of the C&E office but are not so broad and/or deep. In some companies, conflicts of interest (often broad, but not that deep) or insider trading (deep, but not typically that broad) fit into this category.

5. Risk assessment: risk areas that may be broad and deep, but that are the primary responsibility of another function at the company. In some companies, trade compliance or

employment law would fit this bill.

6. Culture assessment (which is relevant to both program and risk assessment, but for planning purposes generally should be viewed as its own effort): factors that could impact both the degree of risk and the efficacy of the program. Examples include tone at the top, accountability, openness of communication and alignment of rewards with stated C&E values.

Second, for each of the six fields, consider what the assessment need actually is for your company. For instance, for corruption (in group 3), companies that, because of the nature or locations of their business, likely have a high risk presumably will want to follow applicable law enforcement expectations (e.g., discussion in the 2012 DOJ/SEC resource guide on risk assessment and program components), and questions tracking these can and should take up a significant portion of total interview/document review time. But for risk areas that are largely the province of other functions (meaning those in group 5), one might have a narrower gauge of inquiry in the interviews/document reviews, at least if such functions have already conducted some form of targeted assessment(s) regarding these risks. And the extent of questioning/document reviews about risks in group 4 will depend on a variety factors (e.g., the extent of that part of the assessment regarding confidential information will depend partly on how important such information is to a company).

Program assessment needs also might vary in many ways. For instance, getting a wide array of feedback on training (in group 1) will make sense if you are considering overhauling your training. Additionally, a report that is going to the Board of Directors or is expected to be reviewed by the government generally should be the subject of greater overall efforts – especially in the culture part (group 6) – than an assessment that is undertaken merely as part of a regular C&E "check-up." Moreover, for the program, risk and culture assessment components, the need might vary by different lines of business or geographies within a company. Also, for some assessment topics, the extent to which one is measuring risk areas versus program tools tends

to blur. The emerging area of compliance monitoring (group 2) often falls into that category.

Finally, taking into account the results of this needs analysis, one should seek to identify which employees are likely to have relevant information for each of these six fields and then use that to develop a list of interviewees that can get you all that you need for each of the various aspects of an assessment. Assuming time and budget are not unlimited, identifying individuals who can speak to multiple topics is an obvious plus. Similarly, one should use this framework to identify and obtain pre-existing materials relevant to each group. Examples include reports of prior C&E audits/reviews; relevant sections of employee engagement surveys; training feedback; and to a lesser extent, prior results of ERM efforts.

A Risk Assessment Thought Experiment (About Metrics)

Risk assessment and program assessment are, of course, two different animals. They are referred to separately in the Guidelines – the former mentioned in section "(c)" of the definition of an effective compliance and ethics program and the latter in section "(b)(5)" of that definition.

They also serve largely different purposes. Risk assessment is mostly forward-looking – meaning an effort to understand enough about risks to implement all the other C&E program measures in an effective way. The latter is more backward-looking – meaning it is an assessment how well the measures deployed to date have fared.

But inside every risk assessment (or at least most of them) there is a program assessment struggling to be heard, and the converse is true of every program assessment. Making the most of these connections can be essential to optimizing both functions. There are several ways to do this, and in this column I want to focus on one that while (to my knowledge) is untested seems to hold a fair bit of promise.

By way of background, many risk assessments use the concept of gross and net risk, with the former representing unmitigated risk and the latter the level of risk when taking the organization's compliance measures into account. While gross and net risk can be measured both for risk likelihood and impact, the likelihood dimension is typically a more meaningful gauge of a compliance program's efficacy, since impact is more often a function of external factors (such as governmental enforcement policy or the expectations of other key third parties).

So, one way to connect risk assessment to program assessment is to measure the "spread" between gross and net risk likelihood findings over the course of time. By this I mean that if in year one for a given risk area (e.g., anti-corruption) the gross likelihood of a violation is 7 and the net likelihood is 5 and in year two the respective numbers are 7 and 4, then presumably that is some indication that the anti-corruption part of the program

is working well, i.e., a factor that should be considered as part of one's program assessment. But, if instead the numbers go from 7/5 to 7/6, then that's a negative for the program assessment.

Note that there are a number of complications for this idea – including what "level" of the company is the focus of the inquiry. Moreover, one would want to make sure that using these numbers for program assessment purposes didn't prejudice the objectivity of those doing the risk assessment.

Finally, I've never seen this done and so I don't know how well it would work in practice. But at least in theory, it would seem to be a way of quantitatively assessing in a risk-area specific way the efficacy of a company's C&E program efforts – which, I imagine, would be of interest to a host of data-hungry constituencies within many companies.

And, one way for a company to gauge if it would work for them is to take historical risk assessment numbers and see whether calculating the spreads aligns with what is otherwise known about the functioning of their program vis a vis the risk area in question.

The Risks of Corporate Carelessness: Lessons from C&E History (and the Case for Post-Offense Assessments)

"To lose one parent … may be regarded as a misfortune; to lose both looks like carelessness," wrote Oscar Wilde, and something similar can be said for corporations that fail to learn from one compliance and ethics failure only to suffer a second such event.

Consider the case of Hoffman-LaRoche, which was prosecuted in the late 1990s for an antitrust violation and was fined $14 million dollars. According to press accounts, the company did not respond sufficiently to the offense, and, not too long after, it was prosecuted again. This time the fine was $500 million – then the largest criminal penalty in the history of U.S. law.

Interestingly, the record that Hoffman-LaRoche broke had been set in a case where the organization (Daiwa Bank) was also was penalized harshly in part because the government felt it had not responded appropriately to a prior violation.

Or, consider the even more striking case of Arthur Andersen, which was indicted for obstruction of justice in connection with the Enron investigation – a charge that literally put the firm out of business and threw its many thousands of employees out of work.

Why was the Justice Department willing to take this harsh and controversial step? One reason was that Arthur Andersen had not responded sufficiently, in the government's view, to an earlier act of wrongdoing.

More recently, in connection with a much-publicized case involving questionable investment activity by one of his lieutenants, Warren Buffett has been criticized for not having learned the lessons of an earlier scandal at a company in which he had invested – Salomon Brothers. In that earlier case, the firm's senior managers failed to respond adequately after discovering an act of serious wrongdoing by another employee – a lapse which caused considerable harm to shareholders, and which seems

similar to what at least some press accounts suggest happen in the more recent matter.

To help companies be more careful in the wake of C&E failures, the Guidelines were amended in 2010 to provide (in a key commentary) that following detection of any offense an "organization should act appropriately to prevent further similar criminal conduct, including assessing the compliance and ethics program and making modifications necessary to ensure the program is effective."

Given the lessons of C&E history and the explicitness of this provision, not conducting a post-offense assessment runs a significant risk of being seen – and treated – as carelessness by the government.

Does such an assessment need to be conducted by an external party? The Guidelines are clear that this is an option, not a requirement: "[t]he steps … may include the use of an outside professional advisor to ensure adequate assessment and implementation of any modifications" (emphasis added).

Indeed, an external post-offense assessment will, in my view, most likely be warranted only a) in cases of significant wrongdoing; or b) where the analysis and/or recommendations involved in the assessment could be controversial within the organization, and hence independence is necessary for the process to be effective.

Post-offense C&E assessments have always been a sound idea. And, following the amendment to the Guidelines, they should now be considered part of the official definition of what it means to be a careful corporation.

Five Topics for Compliance and Ethics Culture Assessments

Compliance program assessments – which seem to be increasingly popular with both government enforcement personnel and companies seeking to enhance their programs as a matter of good corporate citizenship – can and generally should cover a lot of ground. And that ground ought to include the organization's ethical culture.

Of course, the notion of ethical culture itself is pretty broad, and there is no one right way for assessments of this sort to be conducted. But there are certain topics which in my view – are worth considering in virtually any given assessment.

Perhaps the most obvious of these is "tone at the top," which in an assessment itself tends to have various components, including:

- what senior managers say to underscore their expectation that employees will act lawfully and ethically;

- the related but distinct question about what senior managers do to underscore the expectation that employees will follow all dictates of the organization's C&E program, such as those concerning taking training or conducting vendor due diligence;

- inquiries designed to ascertain whether senior managers' own conduct undermines their C&E messaging; and

- similar questions regarding various levels of management besides those at the very top (such as functional or business unit leadership or those further down the organizational ladder). One best practice to consider: having those at or near the top engaged in a visible way in reminding delinquents of the need to take mandatory C&E training.

Another obvious avenue for assessment concerns an organization's speak-up culture. Perhaps the most important facet of

this sort of inquiry is assessing not only the environment regarding true C&E matters but all kinds of workplace concerns and questions, as reticence to speak up in one area may affect (or reflect) reticence in others. Of course, relevant to a company's speak-up culture is its degree of "organizational justice," and the extent to which wrongdoing is responded to in a fair and sufficiently rigorous way.

A third and somewhat less obvious aspect of culture assessment concerns rule following, and the extent to which it is genuinely expected in an organization. Here too it may be helpful to think beyond core compliance program rules to those concerning other aspects of a company's business, such as rules covered by a delegation of authority policy.

Note however, that for the ethics component of an assessment a strong rule-following culture may be less than ideal. But from a pure compliance perspective it is hard to beat a deep embrace of rules, as further discussed here.

A fourth and also less obvious area for assessment concerns industry culture. While not true of all or even most companies, in some industries such types of culture may be more of a source of risk than the organizational type. This is particularly true of industries with a significant degree of inter-company mobility.

Fifth – as is obvious from many cases of non-compliance, most recently the high-profile Wells Fargo scandal – a key aspect of culture is the extent to which pressure/incentives make it difficult for employees to do their jobs in an ethical and law-abiding way. Indeed, this may be the most important cultural attribute of all – and should be explored fully in any assessment, with aspects of this inquiry including both economic "carrots" and "sticks," as well as non-economic incentives.

Finally, I should emphasize that this piece is not intended to be a comprehensive overview of all areas to cover in a culture assessments, which is a complex and hugely important topic. But hopefully it will be helpful to those designing assessments for the first time, among others.

The Ethics Dimension

In the 2004 amendments to the Guidelines, an ethics dimension was expressly added to the government's expectations regarding compliance programs. This dimension has steadily grown more important to the government. Indeed, several years ago, a high-ranking government official noted: "A strong ethical culture flows from good governance and requires leaders to promote integrity and ethical values in decision-making across the organization. This entails asking not just 'can we do this,' but 'should we do this?'" [13] This sentiment has indeed become relatively common in pronouncements by enforcement personnel.

While the ethics dimension is often overlooked (or intentionally disregarded) in designing and implementing risk assessments, the next two columns argue that should be squarely in the focus of any business organization's attempt to assess its risks.

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[13] http://www.sec.gov/News/Speech/Detail/Speech/1370539872783#.UpDVGcSkq8R.

Back to School: Ethical Reasoning and Risk Assessment

Inspired both by the start of a new school year and Groucho Marx's timeless saying "Those are my principles, and if you don't like them… I have others," this column briefly considers how using the principal schools of ethical reasoning can help address C&E risks.

There are, of course, three predominant schools of thought in the business ethics field: utilitarianism (associated with Jeremy Bentham), which views the ethicality of actions by reference to their consequences; deontology (associated with Immanuel Kant), which is concerned more with the inherent nature of an action itself than its consequences; and virtue ethics (associated with Aristotle), which emphasizes moral character. Like Groucho, the C&E officer can be said to offer her organization a choice of different ethical reasoning approaches but – as an expert in the field (and presumably unlike Groucho) – she can also ensure that the selection is made in an informed way.

Part of what should inform that choice is risk assessment. That is, for some organizations the greatest potential ethics risks may come from failing to consider the interests of others (companies or individuals) in decisions of consequence, which suggests a need to emphasize utilitarianism. For other organizations greater risk is posed by failing to consider the rightness of possible actions, suggesting the benefit of emphasizing a deontological approach. (Of course, an organization or individual is not required to use one to the exclusion of the other – my point is purely one of emphasis.)

But perhaps of greater benefit to many C&E programs than these two schools of reasoning is deploying the third approach – one based on virtue ethics. Among other things, virtue ethics can be seen as being action oriented; stressing the importance of role modeling, responsibilities and excellence; and aiming to make ethical action a habit as much as a product of reflection.

Virtue ethics therefore has the potential to strike deeper than what is offered by the other schools. And in so doing, it may

have a better chance of reaching the various forms of ethical decision making that are outside the realm of pure reason – such as those impacted by "overconfidence" (as discussed in one of the columns on behavioral ethics) and other sub-optimal forms of thought that in recent years have been identified by behavioral economists. Companies with significant ethics – as well as compliance – risks of this nature may be good candidates for virtue ethics.

Ethics Risks: Assessment and Mitigation

A court decision several years ago in a shareholder lawsuit against Goldman Sachs[14] is yet another reminder that when it comes to liability often there is no firebreak between the "merely" unethical and the clearly unlawful. (Among the many other examples of this phenomenon are various of the conflict-of-interest-based cases brought several years ago by the New York Attorney General against investment banks and the insurance brokers.)

For C&E professionals the takeaway from this history – which is unknown to many business people – should be that assessing and addressing ethics risks may be necessary to reducing legal exposure.

Ways to assess ethics risks include:

- Examining whether a company has any relationships (with customers or others) where the need for good faith and candor might not be sufficiently understood by employees or third parties acting on its behalf. Relationships such as these – which tend to involve a high degree of trust but not necessarily a formal fiduciary duty – may be rife with ethics risk potential.

- Seeking to learn whether there are business activities where the pursuit of admirable ends might lead to wrongful means.

- Asking employees in interviews, focus groups or otherwise: What types of conduct has occasioned criticisms that the company has acted unfairly? Do they have particular concerns that the company has acted wrongfully?

Indeed, the very process of gathering information of this sort

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[14] Available at http://www.nylj.com/nylawyer/adgifs/decisions/062512crotty.pdf.

will itself send a message that "ethics counts."

Other ways to address ethics risks include:

- Offering training on methods for ethical decision making.
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- Deploying values-based communications.

- Providing, in training and communications, real-life examples of the company showing a willingness to walk away from business opportunities that, while lawful, were not ethical.

- Building ethics criteria into personnel evaluations.

- Training managers on how to recognize and encourage ethical actions by their subordinates and colleagues.

A Core Value for our Behavioral Age

Groucho Marx famously said: "Those are my principles, and if you don't like them… well, I have others." When it comes to companies committing to follow key principles to guide their behavior – what are often called "core values" – there is clearly no shortage of options. Indeed, this posting on the Threads web site offers 500 ideas for those in the market for values.

One value that I see occasionally (but not frequently) selected for "core" status is humility. Kellogg, for instance, includes humility among several other core values. Humility is not principally about ethics – Kellogg embraces an integrity value too (as is the case with a large number of companies). But I do see humility as having an important role to play in promoting compliance and ethics in business organizations, in several ways.

First, humility is a logical and arguably inevitable response to the vast body of behavioral ethics research showing "we are not as ethical as we think." Thinking and acting with humility is indeed a way of operationalizing behavioral ethics. (For a list of behavioral ethics and compliance posts click here. Also, please see this recent article in the NY Times on behavioral ethics and the notion of "servant leadership.")

Second, humility is well suited for addressing ethical challenges that are based not on the purposeful failure to be honest but on the less well-appreciated dangers of being careless. (For a post on that click here.) Recognizing the limits of one's abilities – which is part of being humble – should help underscore the need for carefulness.

Finally, humility has the potential to resonate deeply in our political, as well as business, culture. By this I mean humility can help form part of a broader mutually supporting relationship between business ethics and what might be called societal ethics.

From a professional viewpoint the benefits to the business side

are of most immediate interest to me, but as a citizen (hopefully in the broad sense) I know that the societal dimension is of greater importance. So, let me close by quoting what is one of the best (albeit largely forgotten) expressions of humility's role in societal ethics, which can be found in Learned Hand's "Spirit of Liberty" speech: "The spirit of liberty is the spirit that is not too sure that it is right [and] which seeks to understand the minds of other men and women…" Delivered in 1944 – when the US and other democracies were engaged in a truly existential battle for survival – these words have never been more compelling than they are today.

The Social Science Dimension

In the past few years the ethics-related research of behavior economists has revolutionized our understanding of the causes of much wrongdoing. As well, the long-standing notion of "moral hazard" has – by virtue of the financial crisis of 2008 – become a topic of far broader discussion than ever before.

Interestingly, despite its name, behavioral economics (from which the field of behavioral ethics emerged) is less about economics than psychology. And, despite its name, moral hazard is less about morality than economics.

In this section of the book we look at the relevance of behavioral ethics and moral hazard for C&E programs. More writings about both topics can be found in the Conflict of Interest Blog.

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[15] For more on moral hazard and C&E programs please go to http://conflictofinterestblog.com/interests/moral-hazard-bias/moral-hazard?menuid=submenu1&submenuid=submenu1.1 and for more on behavioral ethics and C&E programs please go to http://conflictofinterestblog.com/interests/moral-hazard-bias/bias?menuid=submenu1&submenuid=submenu1.1.

What Behavioral Ethics Means for C&E Programs

The spirit of liberty is the spirit which is not too sure that it is right," Judge Learned Hand once said, and the same may be true (at least in part) for the spirit of compliance and ethics (C&E). That is but one lesson that might be drawn from the emerging and important field of "behavioral ethics," which teaches that for many reasons we tend to overestimate our ability to do what is right.

In Blind Spots: Why We Fail to Do What's Right and What to Do about It (published by Princeton University Press), business school professors Max H. Bazerman of Harvard and Ann E. Tenbrunsel of Notre Dame provide an overview of behavioral ethics that is both concise but also brimming with intriguing and useful information. In my view, every C&E professional should read this book and strive to apply it's insights to their respective companies' C&E programs.

Behavioral ethics seeks to understand how "people actually behave when confronted with ethical dilemmas," and is part of a larger field of inquiry concerning imperfections in decision making of all kinds.

Drawing from research that both they and other behavioral ethicists have conducted in recent years, Bazerman and Tenbrunsel show how various psychological processes create a powerful phenomenon of "bounded ethicality" which leads even good people to engage in conduct that contradicts their own sincerely held ethical tenets.

This body of knowledge is far too vast to summarize here but the following will hopefully provide some sense of it:

- There is a strong tendency to make inaccurate predictions with respect to how one will respond to an ethical dilemma, with decisions actually being made much more by one's "want self" rather than one's "should self."

- Various processes of everyday life contribute to "ethical

fading," in which ethical dimensions are eliminated from a decision.

- Post-decision recollection biases lead to moral disengagement.

- Outcome biases permit us to ignore bad decision making if it happens to lead to desirable results, which can encourage future bad decision making.

- Vested interests make it difficult to approach situations without bias, even for those who are honest.

- Overloaded (busy) minds tend to be highly vulnerable to ethical compromise.

- There is a powerful tendency to over-discount the future – which can have serious ethical implications when it forces others to pay for one's own mistakes.

- Slippery slopes not only lead to bounded ethicality with respect to one's own behavior but also in noticing the unethical behavior of others.

- "Motivated blindness" also contributes to our not noticing others' wrongdoing

Of course, experienced C&E professionals may be familiar with anecdotal evidence regarding some – and possibly many – of these phenomena. But there is a difference between knowing something and being able to prove it, and in the C&E field that gap has often been significant and harmful when it comes to the prevalence of ethics risks in companies.

Presented as hard scientific fact, as behavioral ethics does, these risks are harder to ignore. And that, in turn, should help to underscore the need for strong C&E initiatives in companies – because it shows that companies cannot be reasonably sure that their executives and other employees will, without help, do what is right.

I should note, however, that the authors also argue that what they call "compliance systems" can in fact contribute to ethical fading, by seeming to take ethics out of the picture of decision making and for a variety of other reasons they describe (such as making conduct more attractive by forbidding it). This may – but should not, in my view – give pause to some C&E professionals.

That is, I do not believe that there is a disconnect between the vision of behavioral ethicists and that of C&E professionals because the authors also suggest several approaches for organizations to adopt to address the challenges of bounded ethicality, which, in effect, are ideas for improving C&E programs, not abandoning them. Among these are focusing consideration in goal-setting on potential ethical downsides, including ethical assessments when making decisions concerning personnel, strategy and operations; setting zero-tolerance standards for unethical behavior; and inventorying a company's "informal systems" (i.e., its culture) to understand the pressures that could cause misconduct by employees.

Indeed, read broadly, Blind Spots provides a foundation for a host of C&E program reforms. In this sense C&E programs can be seen not as an impediment to deploying behavioral ethics knowledge within organizations but rather as a "delivery device" for doing so (although I should caution that those are my words and not something said in the book itself).

For instance, companies should incorporate into their formal C&E risk assessment frameworks behavioral ethics insights about the risks of employees being very busy or isolated, of business environments with a high degree of uncertainty and of situations potentially involving unseen victims and of indirect action – all of which contribute to C&E risk.

It is also important, I believe, to operationalize within C&E programs behavioral ethics learning regarding the benefits of group decision making – which can be relevant to both structures for dealing with ethical dilemmas and responding appro-

priately to ethical failures.

Additionally, the phenomenon of motivated blindness suggests the need for greater emphasis than one would currently find at most companies on disciplining managers for C&E-related supervisory lapses.

Still other insights are relevant to mitigation of conflicts of interest – particularly research showing that disclosure alone does little to minimize the harm from conflicts (and, according to one study, can actually exacerbate such harm).

Perhaps most importantly, senior managers should themselves be trained on the key lessons of behavioral ethics – and particularly on the dangers of being too sure of one's own ethical prowess. This should lead not only to better decision-making when managers face ethical dilemmas as individuals, but also, as noted above, to greater appreciation for and support of their companies' C&E programs.

Indeed, the further we get away from the "Big Bang" that led to the creation of most modern C&E programs in the U.S. – the combination of Enron, WorldCom and other prominent scandals occurring around the same time; the passage of the Sarbanes-Oxley Act in 2002; and the revisions to the Federal Sentencing Guidelines for Organizations in 2004 – the more essential such appreciation is likely to be to the success of the C&E field.

Overconfidence, Moral Hazard, and C&E Risk

In a NY Times piece – "Often Wrong But Never in Doubt" – University of Chicago Business School Professor Richard Thaler describes a decision-making "flaw that has been documented in hundreds of studies: overconfidence." He also describes how business leaders may be particularly susceptible to this flaw. While the few studies summarized in Thaler's piece do not deal with C&E risks, concern with the general phenomenon of overconfidence should be heightened in this context due to the impact of "moral hazard" in much C&E-related decision making.

Moral hazard concerns the unhealthy impact on decision making when those who create risks do not sufficiently bear the impact of their decisions. Although – like overconfidence – it is largely addressed to other contexts (moral hazard was first used in the 19th century to describe how having insurance could create or exacerbate risk taking behavior by insureds), it is applicable to various types of C&E decisions, too. Illustrative of this is the following, now infamous, statement in an e-mail from a ratings agency employee concerning the unwarranted favorable treatment being given to certain investment instruments: "Let's hope we are all wealthy and retired by the time this house of cards falters."

The reason that moral hazard is particularly significant in the C&E context is due to the frequently great time lag between crime and punishment in the business world. In this connection, consider how many FCPA or fraud charges are not brought until many years after the misconduct at issue, often long after those who took the risks in question have moved on to other companies (or are "wealthy and retired"). Those who bear the costs are, of course, the shareholders, who were not involved in creating the risk.

The one-two punch of overconfidence and moral hazard can pose great peril for a company, i.e., those who are in the best position to mitigate risks either fail to recognize such risks or, even where the risks are understood, fail to sufficiently address

them through strong C&E measures. This is among the principal reasons why conducting formal C&E risk assessments is so important.

While risk assessments cannot fully eliminate overconfidence and moral hazard, they do make it harder for managers to fail to recognize or respond to C&E risks. This is true not only as a general matter but particularly when boards of directors – who tend to bring a different time horizon to their decision making than managers do – are apprised of the results of the risk assessment.

Identifying and Addressing Behavioral Ethics Risks

The emerging field of "behavioral ethics" examines the effects of various social, cognitive and emotional factors on ethical decision making, and, in numerous experiments, has demonstrated the limited role that traditional notions of rationality play when we are faced with ethics-related choices. The implications of behavioral ethics– which is part of a larger school of "behavioral economics" - indeed extend across a whole spectrum of contexts, from the decisions made in our private lives to matters of public policy.

While a subject of great interest in academia, so far behavioral ethics is having less of an impact on compliance and ethics programs than it should. But, at least to me, it seem only a matter of time before this new understanding of human nature begins to shape the C&E realm and indeed in the cover story from the February 2013 issue of *CSj* – a leading corporate governance magazine in Hong Kong – I explore the possible ramifications of this field for such areas as managing conflicts of interest, training/communications and holding managers accountable for the wrongdoing of their subordinates. I also examine what can be learned about behavioral-ethics-based C&E risks, sections of which are reprinted below.[16]

"One [behaviorist] experiment showed that acting indirectly – that is through a third party – can blind individuals to ethically problematic behavior more than direct action does. This suggests that companies should recognize the limits of what could be called 'inner controls' – meaning personal moral restraints – in their dealings with third parties. So, as a matter of risk assessment, an organization may have to make up the difference with enhanced compliance measures (internal controls) in dealings with suppliers, agents, distributors, joint-venture partners and others.

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[16] The full article is available at http://conflictofinterestblog.com/wp-content/uploads/2013/02/CSj-article1.pdf.

"Another experiment showed that it is easier to disregard the interests of unknown individuals in making an ethical decision than those of known ones. This finding could help explain the relative ease with which so many individuals engage in offences where the victims are not identifiable, such as insider dealing, government contracting or tax fraud. Here, too, as a matter of risk assessment, an organization may have to make up the difference left by weak 'inner controls' with enhanced compliance measures.

"Of course, and as is true of a number of [behaviorist] findings, this insight is not a complete surprise. Indeed, Ben Franklin once said, 'There is no kind of dishonesty into which otherwise good people more easily and more frequently fall than that of defrauding the government'. Still, being able to prove with real data what is otherwise known just anecdotal or intuitively may be useful to compliance professionals in getting the company to devote extra attention to a risk area.

"The same can be said for a [behaviorist] experiment showing that individuals with depleted resources tend to have greater risks of engaging in unethical conduct. When faced with this knowledge it may be difficult for management or a board to ignore a recommendation to either reduce pressure or focus extra compliance and ethics mitigation efforts on parts of an organization where employees are subject to greater-than-ordinary stress.

"A more counterintuitive finding in this field concerns what might be called the risk of good intentions. Several [behaviorist] studies have shown that being cognizant of one's ethical failings actually increases the likelihood of subsequently doing good, and that the converse is true as well. Examples of this phenomenon are that acts promoting gender equality 'license' discriminatory ones, being reminded of one's humanitarian traits causes reductions in charitable donations, and purchasing 'green' products licenses ethically questionable behavior. While unsettling, these findings suggest a need for compliance programs to pay extra attention to risks that could arise from particularly virtuous-feeling activities."

Other People's Risks

As described in a recent issue of The Economist: "Moral hazard is a problem that crops up often in economics. People behave differently if they do not face the full costs or risks of their actions: deposit insurance makes customers less careful about picking their bank, for example. Moral hazard can also be second-hand. Take medicine. A patient with private insurance may be happy to sit through extra tests, and a doctor may be happy to order them. Doctors might be more reluctant to order tests if they know that the patient would bear the full cost. A newly published paper sets out to test this secondary problem by examining a common-enough situation—taking a taxi ride in a strange city. The authors, a trio of academics at the University of Innsbruck, sent researchers on 400 taxi rides, covering 11 different routes, in Athens, Greece. In all cases, the researchers indicated they were not familiar with the city. But in half the cases, the researchers indicated that their employers would be reimbursing them for the journey. The researchers in the latter group were 17% more likely to be overcharged for their trip and paid a fare that was, on average, 7% higher."

The verdict: a clear case of "second-degree moral hazard."

Moral hazard has been a subject of various other posts here. It is like conflicts of interest and behavioral ethics – the two principal topics in this blog – in that all reflect some type of impairment in ethical decision making. But, each obviously is different from the other; indeed, there is arguably a tension between behavioral ethics and moral hazard, in that the former can be seen as a partial repudiation of the notion of homo economicus (humans as highly rational economic actors) whereas the latter suggests we have not gone far enough to understand how that semi-mythical creature really operates, as further discussed here.

All three frameworks are important in understanding risks. But, at least in compliance and ethics circles, moral hazard has gotten less attention than have its two related types of impairment, which was why I was happy to see this article.

The taxi overcharging study indeed seems to be an important contribution to the moral hazard field (although I hasten to add that I'm relying here entirely on The Economist summary of it). Just as Samuel Johnson once said that a certain individual was not only dull but the cause of dullness in others, so this study has shown that moral hazard can be the cause of unethical action by others beyond the obvious subjects. That is useful knowledge because it helps demonstrate – at least in a general way – the power of moral hazard.

Does this have any practical implications for compliance & ethics programs? Maybe it does in the area of risk assessment, but for the most part, probably not.

Thinking more broadly, however, moral hazard imperils our ability to deal with climate change, debt and various other threats where future generations will bear the consequences of present-day decision making. And, understanding moral hazard – as well as COI and behavioral ethics – can help E&C professionals and others contribute to the crucial dialogue on those challenges.

Is Being a Parent a Source of Risk?

In 1973, in speaking to colleagues on the Cook County Democratic Committee, Mayor Richard Daley of Chicago defended his having directed a million dollars of insurance business to an agency on behalf of his son John with the immortal words: "If I can't help my sons, then [my critics] can kiss my ass. I make no apologies to anyone."

I thought of this when I read about the college admission bribery scandal that emerged this past week. The scandal called to mind other cases where parents violated the law to benefit their children. A famous instance of this sort from the 1980s concerned the hiring (by a former Miss America) of a NY judge's daughter to influence the judge's decision on a pending case. In 2016, JP Morgan settled a "Princeling" case, which involved the bank's hiring the sons and daughters of important Chinese officials in return for business. And there are many other cases like these – presumably going back to our early history.

The behavioral ethics and compliance perspective focuses on structural causes of wrongdoing. There are many fruitful avenues for behavioral ethics inquiry suggested by the college admission bribery scandal. The one that most interests me is whether it is easier to commit a crime when one is doing so not to help oneself but to help one's child. (Note that I understand that there are also personal reputational benefits that parents get from having their child admitted to a prestigious university but still think that the principal beneficiaries of this corruption are the children.)

Given how powerful the drive to help one's offspring is – both as a matter of the instincts we are born with and the social norms that we adopt – the answer is almost certainly Yes, at least as a general proposition. If this turns out to be an operative fact in the admissions bribery scandal, then I hope a lesson will be that parents should refrain from doing things for their children that ethically they wouldn't do for themselves.

As the scandal unfolds I'll also be interested in learning what

was the role – or lack thereof – of risk assessment and auditing in the respective compliance programs of the universities involved. Based on the press accounts it seems as if this kind of corruption was probably fairly common. If that is so, where were the compliance programs.

Was the Grand Inquisitor Right (about Compliance)?

In Dostoevsky's short story *The Grand Inquisitor*, Jesus Christ returns to earth in Spain at the time of the Inquisition, only to be arrested by Church leaders. As explained by the Grand Inquisitor (courtesy of Wikipedia), "Jesus rejected [the Devil's] three temptations in favor of freedom, but the Inquisitor thinks that Jesus has misjudged human nature. He does not believe that the vast majority of humanity can handle the freedom which Jesus has given them. The Inquisitor thus implies that Jesus, in giving humans freedom to choose, has excluded the majority of humanity from redemption and doomed it to suffer."

In a very thoughtful and useful post last week in the *FCPA Blog*, noted C&E practitioner and scholar Carsten Tams celebrates the recent award of the Nobel prize in economics to behavioral scientist Richard Thaler. Among other things, as Tams notes, "Thaler advocates for an alternative, less coercive method for influencing behavior [than the predominant model]: a Nudge. In a book by the same title that Thaler co-authored with the eminent legal scholar Cass R. Sunstein, he defines a nudge as any aspect of a choice architecture that steers people's behavior in a predictable way, without forbidding any options or significantly changing their economic incentives. Unlike mandates or fines, nudges are specifically designed to preserve freedom of choice and avoid coercion. To qualify as a nudge, the intervention must be easy and cheap to avoid. The goal of nudges is to make desired behaviors easier, simpler, or safer for people."

I agree with Tams that behavioral ethics information and ideas offer many promising possibilities for enhancing corporate compliance programs. (See this index of prior posts on "behavioral ethics and compliance" and also this webcast from Ethical Systems.) But I also worry that when it comes to C&E programs, the Grand Inquisitor's view of human nature may be at least partly right.

I say this not as a matter of principle. On such ground I reject that view completely. Rather, my concern is one of experience,

borne of more than a quarter of a century developing, implementing and assessing C&E programs.

In that time, I can't recall learning of anything suggesting that the employees of client organizations wanted more choice when it comes to C&E-related matters. And, I have seen and heard much to the contrary, as countless interviewees have praised their employer organizations for providing clear instructions – backed up by strict enforcement measures – on how to act when faced with C&E challenges. As one C&E practitioner said about what employees at his company asked from him: "They want me to tell them what to do."

A more concrete way of looking at this is to note that while people generally cherish freedom, the freedom to make a mistake that can get them sent to prison for a long period of time is likely viewed less favorably.

I should stress that I do not generally follow – in my role as family member, friend and citizen – what might be called a Grand Inquisitor type perspective. (Presumably Dostoevsky didn't either – and the story should be read more as a provocation than a statement of principles.) It also does not define – I hope – most of my work in the C&E field.

Rather, it is offered as just one perspective for possible inclusion in the larger mix of information about human nature that – from a behavioral ethics (or other) perspective – can help guide us in developing and implementing effective C&E programs. For more on the possible limits to behavioral ethics and compliance, see this post.

Other Aspects of Risk Assessment

Ethics, behavioral science and moral hazard - discussed in the two immediately preceding sections of this e-Book - can be seen as representing new frontiers in risk assessment, in the sense that for many organizations they will present new types of information and analysis to be used in such assessments. "Nano compliance" - also discussed earlier - will be another new risk assessment frontier for many companies, and the same can be said for the approach to using metrics outlined above in the "Thought Experiment" piece.

However, there are also more traditional risk assessment frontiers for some (and perhaps many) organizations: the risks posed by C&E violations in affiliated entities, such as subsidiaries and joint ventures. Those frontiers are discussed in this section.

We also look at the importance to risk assessment of asking good questions.

Finally, we close this e-book with an appeal for moderation in assessing and mitigating risks – or what we call "Goldilocks compliance.'

Joint Ventures and Compliance Risks: the Under-Discovered Country

In the lesson-rich history of compliance failures, one of the most important cases of all time is the prosecution in 2001 of a 50/50 joint venture (JV) between two pharmaceutical companies for violations of federal fraud and abuse laws (the "TAP case").

Evidently neither of the two companies paid much attention to the compliance and ethics program of the JV. And, although neither bore legal liability for the JV's wrongdoing, the cost to each this inattention – presumably half of the total penalties of about $875 million – was higher than almost any other prosecution's total cost up until that time.

In 2012 joint ventures seem to be more common than at any time before. This is due in part to many companies expanding operations into countries where as a matter of local law (or for other reasons) they need a local partner, and in part on "asset light" strategies being pursued by some corporations.

When a company's ownership of the JV is greater than 50%, it typically extends its C&E program to the JV's operations. But this is far less common in 50/50 situations or those involving minority ownership. Still, as the TAP case shows, even where an organization has no potential legal liability for the transgression of a JV in which it has invested, it can still face dire economic consequences.

Indeed, if costly enough, a corporate compliance failure in a JV could create the rare situation where individual directors could be liable for such a failure even though their company is not – since Caremark claims are predicated on economic harm to shareholders, not legal liability per se.

For these (and other) reasons, many companies should take a more hands-on approach to the C&E programs of their JVs, particularly those operating in emerging markets. Among the measures that should be considered here are:

Most obviously, screening the contemplated JV partner. This generally involves due diligence regarding both the organization and key individuals in it, including their respective histories and (where anti-corruption concerns are significant) relationships with the government.

- Structuring the JV agreement to promote compliance. There are a number of steps that can be taken here – concerning such areas as staffing, board operation, delegation of authority, requirements of super majorities for potentially sensitive transactions, audit rights and termination provisions.

- Once the JV is operational, working on an ongoing basis with key company personnel who serve as JV board members or seconded employees in senior positions to manage compliance. This could entail a) providing a turnkey compliance program framework (e.g., charter) to the board members/seconded employees and assisting them in tailoring it to the JV's needs; b) having the JV board members/seconded employees, together with the company's C&E officer, conduct or commission periodic risk assessments and develop risk mitigations plans – which can form the basis for ongoing monitoring of the JV's compliance efforts; and c) periodically training the board members/seconded employees on key C&E issues.

Finally, I should stress that this column is not offered as a comprehensive discussion of JV compliance issues. (Among other things, there are many substantive compliance risk areas – such as IP protection, compliance with local laws and various supply chain issues – that may require particular focus in the JV context.) But hopefully it can help organizations coming to the challenging area of joint venture compliance for the first time know where to begin.

More on Joint Venture Compliance

A CCI column earlier this year briefly examined ways in which companies can analyze and mitigate C&E risks in joint ventures (meaning JVs that they do not control). Because there seems to be a lot of interest in the subject (but relatively little published about it) here are three additional thoughts, which should be read in conjunction with the earlier column.

First, assess risks on four levels. They are:

- Inherent/gross risks for the JV – based mostly on industry and geographic factors.

- Mitigated/net risks in the JV – taking into account its C&E measures and other control-related factors, e.g., trustworthy management.

- Gross risk to the investor in the JV – based largely on the amount of investment it has in the JV, but also on a) possible reputational effects; and b) if the JV has a strategic role for the investor, other business effects, such as disruptions to its supply or distribution chains.

- Net risks to the owner, based, in effect, the sum of all of the above, plus the mitigation measures the owner itself takes.

This is more complex than the typical risk assessment framework, but hopefully captures the full range of considerations a company should be mindful of in dealing with C&E risk of JVs.

Second, consider how far "down" to go. Here is a somewhat long-winded way of making the point (and is mostly an excuse for telling a great story)

As recounted in Steven Hawking's A Brief History of Time: "A well-known scientist (some say it was Bertrand Russell) once gave a public lecture on astronomy. He described how the earth orbits around the sun and how the sun, in turn, orbits around

the center of a vast collection of stars called our galaxy. At the end of the lecture, a little old lady at the back of the room got up and said: 'What you have told us is rubbish. The world is really a flat plate supported on the back of a giant tortoise.' The scientist gave a superior smile before replying, 'What is the tortoise standing on?' 'You're very clever, young man, very clever,' said the old lady. 'But it's turtles all the way down!'"

The point of this story for those developing JV compliance approaches is that – at least for some risks, such as corruption related ones – effective C&E may mean requiring the JV to have its own due diligence measures for using third parties. Of course, it will be rare that one needs to truly go "all the way down" in this respect, but at least one extra level is advisable in some circumstances.

Third, pay particular attention to incentives in crafting JV C&E responsibilities. As noted in the first article, there are lots of measures that the management of the investing company can undertake to promote C&E in a JV. Responsibilities for such measures are typically given to the C&E officer; members of the law, finance, and audit functions; and/or business personnel.

Based on my experience, however, some companies do not do enough to ensure that those with such responsibilities have sufficient motivation to do what's expected of them. Put otherwise, given their many other duties, there is a danger that those with designated with C&E duties regarding JVs could view such responsibilities as "extra-curricular activities," which take a back seat to their "day jobs."

I have two suggestions for addressing this. First, companies should consider including JV compliance as part of how employees with defined duties in this area are evaluated/compensated. Second, JV C&E measures should – at least in companies with a high-risk profiles in this regard – be subject to regular audits, as this can also be pretty motivating.

Asking a Good Question

The late Nobel Laureate in physics Isidor I. Rabi once said: "My mother made me a scientist without ever intending it. Every other Jewish mother in Brooklyn would ask her child after school: 'So? Did you learn anything today?' But not my mother. She always asked me a different question. 'Izzy,' she would say, 'did you ask a good question today?' That difference – asking good questions – made me become a scientist!"

Asking good questions can also help companies promote compliance and ethics.

In *The Road to Character*, David Brooks notes that he once met an employer who asked every job applicant: "'Describe a time when you told the truth and it hurt you.'" This is, to my mind, a good C&E-related question, as it can help identify those who practice, as well as preach, ethical behavior. It also reminds those asking the questions about the importance of C&E to the organization. A frequently used variation on this question is: "Describe an ethical challenge you've faced and how you dealt with it?"

Of course, employment interviews are not the only setting in which it is important to ask good C&E-related questions. Another is employee engagement surveys, in which one commonly sees questions about relative comfort in reporting violations and perceptions of the ethicality of the organization's management.

These are good topics for questions, and I think every company that fields an employee engagement survey should use them. But my favorite question of this sort comes from a survey conducted by the Economist, which measured respondents' perception of the need for ethical flexibility to advance one's career within an organization. What I particularly like about this question is the focus on flexibility – which may be easier for respondents to admit to than asking outright about their engaging in ethical transgressions.

Yet another setting for asking C&E questions is the compliance audit. While most of what is done in C&E audits revolves around document reviews, interviewing employees can be part of the picture as well. Among the topics that should be considered for such questioning: Does the interviewee think that the company's training is effective? In addition to producing useful information about training itself, posing this question may make it easier for employees to identify concerns about risks and actual violations. I.e., like the question above about ethical "flexibility," questions about C&E training may offer a "soft" way of approaching a "hard" topic.

Moreover, questions about training can be asked not only in audits but as part of (and typically at the end of) the training itself. One possibility here is to ask whether after the training the employee now feels that she understands how the company's compliance program applies to her job – again, a variation on the "soft" question approach.

Finding the right question can also be important in developing a C&E-component to a company's exit interview template. Options include general culture questions, such as how do you rate our company as a values and ethics driven employer – with an opportunity to say why; specific questions about key aspects of the program, such as whether the departing employee understood all the options for reporting concerns; and, of course, asking whether the employee was aware of any unreported concerns.

I should stress that this post is not intended to cover the whole world of asking C&E-related questions. Among the areas not addressed: the importance of Q&A in codes of conduct and approaches to asking questions in risk assessments.

Finally, to an extraordinary degree, boards of directors can have the power to impact a C&E program simply by asking the right questions. Here (on page 2 of the PDF) is an article which offers not actual questions but topics that boards can turn into questions in overseeing their respective companies' C&E programs.

In Search of "Goldilocks Compliance"

"It's not complicated – more is better," concludes a wonderful AT&T commercial. But for many C&E officers, it's not that simple.

In the wake of Enron/S-Ox/the Sentencing Guidelines revisions a great many companies seemingly had bottomless appetites for implementing compliance measures. That's no longer the case. With the exception of those employed by companies that are under investigation, playing catch-up with FCPA compliance expectations or in highly regulated industries, C&E officers seem increasingly under pressure to be not only effective but also highly efficient in their work, and to steer clear of "compliance overkill."

Note that this focus on efficiency should not be misinterpreted to mean that the need for effective C&E programs is any less powerful now than it was during the formative age of compliance. Indeed, the costs of non-compliance have, I believe, gone up since then – as reflected in (among other things) the fact that of the ten all-time highest corporate criminal fines in the U.S. five were imposed in 2012 alone. But perhaps precisely because harsh penalties have become the new normal, C&E programs in many companies seem to command a smaller portion of senior management mindshare than they did just a few years ago – and hence the growing imperative to avoid what are seen as unnecessary efforts in this area and to achieve "Goldilocks compliance."

There are various settings in which C&E officers should be attentive to the possibility of going overboard, including but by no means limited to the following.

- **Training**. While many companies do too little in this regard, some actually do too much – subjecting employees to training that is unwarranted from a risk perspective. (E.g., there are not many businesses where every single employee truly needs antitrust training.) Painting with an overly broad brush here can waste not only considerable amounts

time and money; it can also reflect poorly on the C&E program as a whole.

- **Background checking of third parties**. As with training, on the whole more companies need to do more – rather than less – with this essential compliance tool, but some have instituted background checking regimes that seem unmoored from any meaningful risk calculus. And – as with training – overkill here can trigger negative feelings toward C&E generally in a company.

- **Technology**. This is a particularly tricky area about which to speak generally, given the diversity of technology-related products and services now being developed in the C&E space, both by vendors and in-house resources. Similar to the case with training and background checks, on the whole, I think that there needs to be more done here, not less. But the devil is really in the details with this emerging part of the C&E world, and companies need to remember that cool does not necessarily mean necessary.

Note that C&E overkill is not only about doing too much – it can also be about saying too much. For instance, C&E officers need to be careful in discussing the relevance of C&E provisions in settlement agreements to their own companies. To use a medical analogy, what's essential for a patient who has had a heart attack is not necessarily indicated for those who merely have somewhat elevated cholesterol levels.

So how do you know when you're going from enough to too much? In some instances it is like the famous saying about obscenity, you know it when you see it. But that won't do in all cases, and for many reasons the better approach is to base determinations of this sort on your risk assessment.

Indeed, by identifying in a risk assessment anything that's not needed, a program can gain greater credibility among key decision makers in a company. This, in turn, can help the program focus on what is essential – and implement C&E measures that are "just right."

About the Author

Jeffrey M. Kaplan is a partner in the Princeton, New Jersey office of Kaplan & Walker LLP. For twenty-five years he has specialized in assisting companies in developing, implementing and reviewing corporate compliance/ethics programs. This work has included conducting risk analyses; writing/editing codes of conduct and other policy documents; counseling companies in matters regarding training; developing compliance audit protocols and reporting systems; establishing compliance/ethics offices; and assisting boards of directors in meeting their fiduciary duties under the Caremark case. He has also conducted numerous program assessments. Mr. Kaplan's compliance/ethics program practice has included work for clients in the health care, medical devices, pharmaceuticals, automotive, government contracting, insurance, manufacturing, energy, retail, paper, publishing, professional services, education, consulting, telecommunications, technology, securities, private investments, food and chemical fields, as well as non-profit organizations.

Mr. Kaplan has, on four occasions, been an independent consultant or monitor for vendors suspended by the World Bank, reporting to the Bank on their respective compliance programs, and currently serves as a monitor for the Bank in connection with the suspension of a third company; has performed a similar review for the United Nations; has served as a compliance monitor in a criminal tax case for the New York County District Attorney; has reviewed and reported to the Department of Justice and SEC on a company's compliance/ethics program in connection with the settlement of an FCPA-related investigation; and has reviewed and reported to a state attorney general on another company's compliance/ethics program in connection with a settlement of a fraud-related matter. He also conducts internal investigations on behalf of boards and companies into allegations of wrongdoing brought by whistleblowers and others. He received his B.A. (magna cum laude, Phi Beta Kappa) from Carleton College in 1976 and his J.D. (cum laude) from Harvard University in 1980. He is a former partner of Chadbourne & Parke, where he served in the Special

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For many years Mr. Kaplan was Counsel to the Ethics Officer Association (now the ECI), a professional association of more than 1000 compliance/ethics officers. He was also Program Director for the Conference Board's annual Business Ethics conference and its Council on Corporate Compliance and co-authored two research reports for the Conference Board: Ethics Programs – The Role of the Board: A Global Study and Ethics and Compliance Enforcement Decisions – the Information Gap (both with Ronald Berenbeim). In 2009, he was a recipient of a Compliance and Ethics Award from the Society for Corporate Compliance and Ethics, which that organization bestows annually on "Compliance and Ethics Champions."

Mr. Kaplan is, together with Joe Murphy, co-editor of Compliance Programs and the Corporate Sentencing Guidelines: Preventing Criminal and Civil Liability (West 1993), a leading legal treatise on designing and implementing compliance/ethics programs. He is co-author of The Prevention and Prosecution of Computer and High Technology Crime (Matthew Bender 1989) and author of an e-book on risk assessment issued by Corporate Compliance Insights. He was for many years co-publisher/executive editor of ethikos, a bimonthly magazine covering compliance/ethics best practices He is author and co-author of numerous articles about business crime and compliance/ethics programs in periodicals such as The California Management Review, The Journal of Securities and Commodities Regulation, The Prevention of Corporate Liability: Current Report, The Preventive Law Reporter, Corporate Board, Directorship, Director's Monthly, American Banker, Business Crime Commentary, the New York Law Journal and the National Law Journal, and also various book chapters on these topics.

Mr. Kaplan is a co-chair of the Practising Law Institute's annual Advanced Compliance and Ethics Workshop and for many years chaired the Continuing Legal Education program in corporate compliance sponsored by the Association of the Bar of

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