Michael D. Greenberg, J.D., Ph.D.

Michael Greenberg is a Behavioral Scientist with the RAND Corporation, and Director for the RAND Center for Corporate Ethics and Governance (CCEG). He is a lawyer and a clinical psychologist by training. He received his Ph.D. in psychology from Duke University, and following an internship at Dartmouth-Hitchcock Medical Center in New Hampshire, he subsequently entered law school and received his J.D. from Harvard. Dr. Greenberg worked as an attorney at Ropes & Gray, a large Boston law firm, prior to joining RAND, the nation's oldest non-partisan, non-profit think tank. In leading the RAND Center for Corporate Ethics and Governance, Dr. Greenberg oversees a RAND Corporation effort to contribute to public policy discourse on related topics, both through the conduct of objective empirical research and through convening groups of stakeholders in path-breaking conference events.

Dr. Greenberg's work at RAND has included empirical research projects on topics spanning civil justice, healthcare, regulation, and national security issues. Dr. Greenberg has led or co-led projects at RAND in all of these areas, and examples of his work include studies on medical malpractice litigation and hospital-based patient safety; on mass litigation and insurance; and on maritime terrorism risk and liability. In the area of corporate ethics and governance, his recent and immediately forthcoming activities include hosting conferences on the perspectives of ethics and compliance officers on institutional prevention of corporate misdeeds, and on the role and challenges for corporate boards in performing ethics and compliance oversight. His recent publications on corporate governance related topics include Greenberg, Kang, & Brown (2009), *Corporate Governance in China: A Tale of Rapid Change,* CORPORATE FINANCE REVIEW, 13(5), 5-11); Greenberg (2009), *The Fault Lies Not in Our Stars, But in Ourselves: Energizing Compliance and Ethics in U.S. Firms*, CORPORATE FINANCE REVIEW,14(5), 5-10; and Greenberg (2009), *Perspectives of Chief Ethics and Compliance Officers on the Detection and Prevention of Corporate Misdeeds*. Santa Monica, CA: RAND, CF-258-RC .

In addition to his work at RAND, Dr. Greenberg holds adjunct appointments at the University of Pittsburgh School of Law, the University of Pittsburgh School of Medicine, and the Heinz College of Public Policy at Carnegie Mellon University.

21 March 2010

United States Sentencing Commission
One Columbus Circle, N.E.
Suite 2-500
Washington, D.C. 20002-8002
Attention: Public Affairs

RE: *Proposed Revisions to Chapter Eight*
Submission from Michael Greenberg and Donna Boehme

To the Honorable Members of the United States Sentencing Commission:

We very much appreciate the opportunity to submit comments to the Commission on proposed amendments to the organizational guidelines.

We bring both scholarly perspective and extensive practical experience in corporate ethics and compliance work to our comments. Michael Greenberg is the Director of the RAND Corporation Center for Corporate Ethics and Governance, a non-partisan research group with the mission of improving corporate ethics and related public policy through objective, empirical research and analysis. Donna Boehme is a member of the advisory board for the RAND Center for Corporate Ethics and Governance. She is also an ethics and compliance professional with more than 20 years of experience in designing and managing C&E programs for large corporations. She serves as the principal of Compliance Strategists LLC; as special advisor to Compliance Systems Legal Group; and she was previously the Chief Ethics and Compliance Officer for both BP plc and BOC Group.

We would like to commend the Commission for considering amendments to the organizational guidelines. As the Commission knows, the provisions establishing the culpability score criteria, and especially those pertaining to an effective C&E program, are extremely important to public policy, to C&E practitioners on the ground, and to companies both in the United States and abroad. Section 8B2.1 is also vital, because it sets a defining standard for the business community in understanding what an "effective" C&E program needs to look like.

In light of the above, we are writing to respond to the invitation for comment on a possible amendment to §8C2.5(f)(3) of the Guidelines, on culpability scoring and mitigation for an effective compliance program. We are responding specifically to the Commission's "Issue for Comment":

> Issue for Comment:
>
> *Should the Commission amend §8C2.5(f)(3) (Culpability Score) to allow an organization to receive the three level mitigation for an effective compliance program even when high-level personnel are involved in the offense if (A) the individual(s) with operational responsibility for compliance in the organization have direct reporting authority to the board level (e.g. an audit committee of the board); (B) the compliance program was successful in detecting the offense prior to discovery or reasonable likelihood of discovery outside of the organization; and (C) the organization promptly reported the violation to the appropriate authorities?*

In sum, we think that this is a reasonable and appropriate change to make in the Guidelines, with the aim of achieving stronger and more effective C&E programs within companies. We would

like to offer some brief observations on this issue, based on our general experience, and specifically on our take-aways from leading a March 2009 RAND Corporation conference on The Perspectives of Chief Ethics and Compliance Officers on the Detection and Prevention of Corporate Misdeeds: What the Policy Community Should Know. As noted below, many of the findings from this conference are directly relevant to the "Issue for Comment" currently being considered by the Commission.

The purpose of this conference was to draw on the insights of chief ethics and compliance officers (CECOs) — senior corporate officials charged with responsibility for running compliance and ethics programs, and persons with a unique "insider" perspective on the challenges involved in implementing them. The conference also included stakeholders with other viewpoints, including current and former legislative and executive branch officials, academics, and leaders from several nonprofit compliance and ethics associations. In convening this group for discussion, the objective was to provide expert input to the policy community about the current state of ethics and compliance initiatives within corporations today — particularly as policymakers contemplate new avenues for regulatory oversight of corporations in the future. For reference, we have enclosed a copy of the published proceedings from the RAND conference with this letter. The same proceedings are available at http://www.rand.org/pubs/conf_proceedings/CF258/.

In our discussions last year, one of the major points of consensus expressed was that an empowered CECO is a key ingredient for driving an effective C&E program. In turn, we were told that one of the defining criteria for CECO empowerment involves direct reporting authority to the board level – consonant with the 2004 amendments to the Guidelines, which stipulated direct access to the board for the person with day-to-day operational responsibility for administering the C&E program.[1] This kind of reporting relationship goes beyond simply ensuring that the board receives periodic reports on C&E matters. More important, this relationship helps to define the essence of what the managerial role of the CECO (and by extension, the C&E program) is supposed to be.

By directly reporting to the board, the CECO role becomes more independent, and considerably more sheltered from executive influence, than it otherwise would be. As Donna Boehme noted in an invited white paper for the RAND conference, the absence of these factors is one of the primary reasons why so many corporate compliance and ethics programs have failed, and the key difference between a "paper program" and one that effectively prevents and detects wrongdoing, as contemplated by the FSG: *"A well implemented compliance and ethics program doesn't spring from the void ex nihilo - it requires a strong leader to engage others in the organization, including powerful senior managers, to surface and resolve issues, and to make the vision a reality."*[2]

Direct reporting by the CECO to the board also underlines the notion that a chief function of the CECO is to enable the board to fulfill its own legal mandates for C&E oversight. As Keith Darcy (the Executive Director of ECOA) observed in his remarks at the conference, *"The CECO acts as an agent of the board in meeting its fiduciary obligations for oversight of corporate ethics… The*

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[1] See also comment to the Sentencing Commission from Joseph E. Murphy, March 22, 2010, addressing this point.

[2] Donna C. Boehme (2009), *"From Enron to Madoff: Why Many Compliance and Ethics Programs are Positioned for Failure."* Ms. Boehme's white paper appears in The Perspectives of Chief Ethics and Compliance Officers on the Detection and Prevention of Corporate Misdeeds: What the Policy Community Should Know, RAND Corporation (2009), Santa Monica, CA, at 27.

CECO must be a part of the company's power structure to be effective as an agent of the directors."[3]

Several conference participants made another, related point: Namely, that the optimal characteristics of the CECO position within management are defined by the functions that we want the CECO to perform. So for example, if we want the CECO to contribute an ethics and compliance perspective to top level strategic decision-making in the company, it follows that the CECO needs to be involved in meetings of the C-suite. *Similarly, if we truly want the CECO to detect misbehavior among top executives, and to empower the board to respond to such misbehavior proactively, it follows that a direct reporting relationship between CECO and the board is indicated.*

In light of these kinds of observations, the proposed amendment to §8C2.5(f)(3) of the Guidelines makes a good deal of sense. Ultimately, one of the chief aims of the Guidelines is to incentivize lawful behavior, and good management practice, on the part of companies. Obviously, a prime objective is to deter misconduct among high-level company personnel in the first place. But given the likelihood that such misconduct occasionally will occur, it follows that we ideally would want CECOs and C&E programs that are equipped to deal with that misconduct when it happens, and to engage their boards in appropriate remedial activity.

The proposed amendments to §8C2.5(f)(3) seem well-calibrated to this end. They send a clear message that the reporting relationship between CECO and board is a mitigating factor when organizational crime occurs; that setting up C&E management structures to help detect and neutralize high-level misconduct is a good institutional thing to do; and that even as the Guidelines articulate standards of punishment for organizational misconduct, they also reward good organizational behavior and management structures through leniency. These themes echo many of the comments and suggestions that we heard in the 2009 RAND conference, with regard to empowering CECOs and making corporate compliance and ethics programs more effective.

Given the foregoing, we believe that the Commission's proposed amendments on culpability scoring at §8C2.5(f)(3) are both reasonable and appropriate. Thank you again for the opportunity to provide these comments to the Commission.

Very truly yours,

Michael D. Greenberg, Director
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[3] Remark quoted from Keith Darcy (2009), *"Ethics and the Role of the Board as Governing Authority."* Mr. Darcy's white paper appears in The Perspectives of Chief Ethics and Compliance Officers on the Detection and Prevention of Corporate Misdeeds: What the Policy Community Should Know, RAND Corporation (2009), Santa Monica, CA, at 33.

From Enron to Madoff: Why Many Corporate Compliance and Ethics Programs Are Positioned for Failure

Donna Boehme, Compliance Strategists, LLC

Remarks presented on March 5, 2009

Introduction: "Where Was the Ethics Officer"?[1]

With the wreckage of the first generation of Enron-type corporate scandals in the rear view mirror, and the chaos of Madoff and the subprime meltdown now all around us, commentators are asking "Where were the ethics officers?" and "Are corporate compliance and ethics programs just window dressing?" These are fair questions, given that in the 18 years since the 1991 promulgation of the U.S. Organizational Sentencing Guidelines (which set out the roadmap for companies to detect and prevent wrongdoing),[2] several studies have indicated that little progress has been made,[3] and recent events in the corporate world suggest that effective mechanisms to prevent corporate misconduct are lacking. This paper sets out a response to these two questions from some leading practitioners in the field of corporate compliance and ethics. This paper also suggests a path forward, moving beyond the sometimes unrealistic assumption of policymakers, boards and management that integrity and compliance can be achieved simply by establishing basic elements such as a formal code of conduct, an "ethics officer," a training program, monitoring, and/or an employee helpline, and then expecting that good results will necessarily follow. In short, we believe that it is time for companies to get serious about corporate culture, accountability, compliance and ethics, and that the key initial step in achieving this involves the creation of a C-level, empowered compliance and ethics officer: someone with the experience, positioning, mandate and clout to actually make things happen in the organization.

The "Kumbaya" Approach to Ethics and Compliance

On paper, many companies have established a wide range of compliance and ethics programs since 1991.[4] Moreover, companies were subsequently required to add

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[1] For convenience, the term "ethics officer" is intended to encompass the role of the chief compliance and ethics officer, in its many variations.

[2] The guidelines, including the 2004 amendment, are available at http://www.ussc.gov/guidelin.htm. The amendment became effective on November 1, 2004.

[3] The Ethics Resource Center's 2007 National Business Ethics Survey, based upon interviews with 2,000 employees at a broad range of public and private U.S. companies, found "little if any meaningful reduction in the enterprise-wide risk of unethical behavior at U.S. companies." ERC Press Release, November 28, 2007, available at http://www.ethics.org/about-erc/press-releases.asp?aid=1146.

[4] The U.S. Sentencing Guidelines, requiring organizations to establish an "effective program" to prevent and detect violations of law, were initially promulgated in 1991 and further amended in 2004. See footnote 2.

to their compliance infrastructure by Sarbanes-Oxley in 2004, and by other government efforts to impose elements of compliance programs. Today, most major corporations have at least some compliance and ethics infrastructure, including formal codes of conduct and confidential employee hotlines, and the new management role of "chief ethics and compliance officer" (CECO) is rising in demand. Most companies in highly regulated industries, such as financial services, health care, and defense, also have developed detailed compliance procedures. But there is a critical distinction between compliance and ethics programs that have all the designated features on paper, and those that have real "teeth" and the potential for success. The former might be described as adopting a "Kumbaya"[5] approach — an optimistic but rather naive expectation that once a code is published, a hotline activated, a rousing speech and memorandum from the CEO is delivered, and an "ethics officer" appointed, then all the employees and managers will join hands in a "Kumbaya" moment, and the program will somehow magically work as envisioned. This kind of program may look good at first, but without continuing, empowered leadership on compliance and ethics issues, together with tangible management commitment to making hard choices, such a program is unlikely to succeed in preventing, detecting, and addressing real world problems. We would note that Enron had a 64-page code of ethics and an employee hotline in place prior to the exposure of the scandals that ultimately brought that company down. Similarly, today's newspaper headlines are full of allegations of corporate fraud and crime, at companies with relatively hollow, check-the-box compliance and ethics programs.

Leading Integrity: The Critical Role of the Chief Ethics and Compliance Officer

We believe an effective approach to integrity and corporate ethics starts with a senior-level chief ethics and compliance officer (CECO) who understands the compliance and ethics field, is empowered and experienced, and who has the independence, clout, a "seat at the table" where key senior management decisions are made, and resources to lead and oversee a company's ethics and compliance program — even when that program appears at odds with other key business goals of the company. A well-implemented compliance and ethics program doesn't spring from the void ex nihilo — it requires a strong leader to engage others in the organization, including powerful senior managers, to surface and resolve issues and challenges, and to make a culture of transparency, accountability and responsibility a reality.

But accomplishing this is easier said than done. To a great extent, the evolving role of the CECO was initially viewed by companies as a lower-level management or even administrative role, often positioned within the legal department or another

[5] Kumbaya, a 1930s Southern spiritual that some trace to the former slaves living in the sea islands of South Carolina and Georgia, is sometimes used to describe a "naively optimistic view of the world and human nature" — see http://en.wikipedia.org/wiki/Kumbaya.

function such as finance, audit or even HR, and with little empowerment, mandate or independence to fulfill the important accountabilities of the role. When compliance programs have been mandated by government rules and regulations, programs have tended to devolve into hyper-technical efforts devoid of senior-level participation and commitment.

In a serious compliance and ethics role, the CECO is often required to challenge the established way of doing things, or to introduce new concepts such as stricter controls on senior managers, increased transparency, and consistent standards of discipline. Imagine a CECO being called into the office of a powerful Andy Fastow-type CFO and being ordered to drop a confidential investigation, change a report to the Board, or otherwise compromise the responsibilities of the role. This is corporate ethics' "dirty little secret": In many companies today, the CECO is still poorly positioned, and lacking in the empowerment and independence needed for successful discharge of the critical role he or she is expected to play.[6] It is important to note that the "expectations" of having an effective CECO and ethics and compliance program come, not only from the organization itself, but also from regulators, from policymakers and other stakeholders, and from the general public.

This view is expressly endorsed by a startlingly candid white paper published last year on the topic, entitled "Leading Corporate Integrity: Defining the Role of the Chief Ethics and Compliance Officer" — a collaboration of five leading nonprofit organizations supporting the profession.[7] Echoing the sentiment that "most CECOs do not believe they have been given sufficient authority and resources to achieve their mission," the white paper comments that "many executives and boards have not yet realized the potential of their CECOs" and that "a CECO that serves as window dressing likely does more harm than good, especially in times of difficulty." The CECO's line of reporting is the "single biggest influence on his or her credibility within the organization" and should be a direct reporting relationship to either the CEO or the board, with "direct, unfiltered access to the Board." The CECO must be "independent to raise matters of concern without fear of reprisal or a conflict of interest." Further, a reporting line to the general counsel, one of the most common structures in companies today, is not viewed as effective positioning — since the aim of reducing external litigation risk is not always well-aligned with the aim of promoting ethics and

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[6] As reported by the *Financial Times* on June 29, 2007, "Siemens Anti-Graft Chief Quits," Daniel Noa, a former German prosecutor with "impeccable credentials" appointed to the post as part of Siemens' response to the corruption scandal in 2007, quit the role involuntarily after only six months on the job. The paper quoted one source: "He was alone and lacked support. He came up against a lot of people who didn't want him to succeed in his job." Media reports cite a changed reporting relationship that "undermined" Noa, "infighting" and "lack of support."

[7] See Ethics Resource Center (2007), *Leading Corporate Integrity: Defining the Role of the Chief Ethics and Compliance Officer (CECO)*. This report is available for download at http://www.ethics.org/CECO/.

compliance within the organization. Thus for companies serious about integrity, merely establishing a new ethics management position is not sufficient as a foundation for a strong compliance and ethics program. Rather, close attention must also be paid to empowerment, mandate, a seat at the table, independence, and reporting relationships of the CECO. Without proper positioning, a CECO (and ultimately, the compliance and ethics program that he or she administers) is likely to be ineffective and in serious danger of failure.

That brings us back to the two questions we posed in the introduction, with regard to the most recent wave of corporate scandals: Question: "Where was the ethics officer?" Answer: "Present, but most likely lacking empowerment, positioning and independence (and probably not even a true 'officer' of the corporation)." Question: "Are corporate compliance and ethics programs just window-dressing?" Answer: "In many companies, probably yes."

Policymakers Need to Support Effective Programs

Congress and regulators can also do more to support effective CECOs, and (by extension) effective corporate compliance and ethics programs. For instance, the New York Stock Exchange (NYSE) listing rules have been hailed for requiring all listed companies to have a code of ethical conduct. This is certainly an important starting point in establishing a good compliance and ethics program, but by itself, a formal code of conduct can become an empty gesture unless that code is implemented effectively. Similarly, the Sarbanes-Oxley reforms of 2002 responded to a stream of corporate accounting and fraud scandals by mandating new ethics hotlines, codes of conduct, and stronger internal controls and reporting efforts, but here again, these steps are only part of the overall compliance and ethics approach needed to support a culture of integrity at a corporation. Two key ideas have been missing from related government regulations. First, any single element of a corporate compliance and ethics program, taken in isolation, is unlikely to be effective by itself. Thus, formal codes of conduct, employee hotlines, and internal controls ideally should all be implemented as parts of an overall, holistic compliance and ethics program. Second, such programs should ideally be led and overseen by a senior-level, empowered chief compliance officer, with the clout and independence to make things happen in the organization. Without both of these elements, an NYSE-style paper requirement for a formal code of conduct (for example) is unlikely to succeed in achieving its aims. In sum, more is needed from government and policymakers to make more plainly stated the expectations for an effective CECO and a strong corporate compliance and ethics program — ultimately, prerequisites for protecting the interests of the organization itself, and for maintaining accountability to other stakeholders and to the public interest. In a companion paper in this document (titled "What Government Can Do to Prevent Corporate Crime"), our colleague

provides some specific suggestions on how policymakers can help to support more effective ethics and compliance programs and stronger CECOs.

How Can Companies Put Integrity Back In Business?

Perhaps the underlying question here is, how do we move beyond corporate compliance and ethics programs that look good on paper, but that are ineffective at achieving real world results? More generally, CEOs of successful companies know that little is accomplished in business without first having a plan, resources, and an accountable, effective leader in place to implement the plan. A company's program for compliance and ethics is no different from any other aspect of business enterprise. Where the stated goal is to change the culture of an entire organization, to identify and address key compliance and ethics risks, and to encourage good business judgments among all managers and employees, a serious approach and commitment of resources is needed. We've already described the first step of creating an empowered, independent CECO position, filling it with someone who is knowledgeable about compliance and ethics, and giving that person a seat at the senior management table. The rest of the formula, which the CECO will drive, has to do with implementing and integrating a range of compliance and ethics initiatives, supported by management at all levels of the organization. Without diminishing the key role of formal codes of conduct and help lines, establishing those features is a relatively easy part of a company's compliance and ethics effort. The more difficult aspects of the effort involve incorporating the company's code of conduct and policies into the DNA of its business operations, and all of the resulting tough choices management needs to make along the way in doing so. This is where many compliance and ethics efforts fall short, whether by lack of management resolve, loss of focus, or lack of leadership by a strong CECO in driving the program on a daily basis. Here are some examples of features we view as essential indicia of a serious compliance and ethics program (i.e., one with "teeth"):

- Executive and management compensation linked to compliance and ethics leadership
- Consistent enforcement of the company's code of conduct and policies, especially at senior levels
- Confidential, professional management of the help line, including investigations
- Vigorous enforcement of non-retaliation policies
- Effective and ongoing compliance and ethics risk-assessment
- Integration of clear, measurable compliance and ethics goals into the annual plan

- Direct access and periodic unfiltered reporting by the CECO to a compliance-savvy board
- Strong compliance and ethics infrastructure throughout all parts of the business
- Real compliance audits designed to uncover lawbreaking
- Practical and powerful action (not merely words) by the CEO and management team to promote compliance and ethics
- Shared learning within the company based on actual disciplinary cases.

Conclusion and Way Forward

With committed management support, together with empowerment, independence, a seat at the table, resources and appropriate reporting structure for its CECO, a company can forge beyond window-dressing in its compliance and ethics effort. This is an essential first step toward establishing a corporate culture of transparency, openness and integrity, in which ethical and compliance problems are more likely to be detected earlier rather than later — so that the company can seek to prevent fires, rather than put them out after the fact. Unless we want to keep asking "Where was the ethics officer?", it's time for companies — and policymakers — to reject a check-the-box approach to compliance and ethics programs, and get much more serious about putting integrity back into the heart of business.

Ethics and the Role of the Board as Governing Authority

Keith Darcy, Ethics and Compliance Officer Association

Remarks presented on March 5, 2009

Introduction: Can the Board Truly Oversee Compliance and Ethics?

The role of corporate directors in overseeing the activities of management has changed dramatically over the past several years. The days of director complacency are long gone. Shareholder activism has fostered greater scrutiny on director oversight responsibilities, with more emphasis placed on fostering corporate ethics, compliance and culture. At the same time, legal and regulatory developments have greatly increased expectations of directors in their oversight role.

The shift toward greater legal burdens for directors arguably began with the Caremark decision[1] in 1996, which elaborated on directors' oversight responsibilities in connection with fiduciary duty, and opened directors to personal liability in the event that they fail in fulfilling those responsibilities. In 2002, the Sarbanes-Oxley Act (SOX)[2] was passed, following the headline-grabbing scandals at Enron, Tyco, Xerox, Rite-Aid, Adelphia, HealthSouth, Arthur Andersen, Hollinger and WorldCom. Among other things, SOX clarified the board's accountability to ensure that adequate internal controls are in place within their companies. More recently, the 2004 amendments to the Federal Sentencing Guidelines expressly contemplate a board's obligation not only to exercise "reasonable oversight" but to "be knowledgeable" about its company's compliance and ethics activities.

Notwithstanding these and other changes in law and regulation affecting corporate directors, in the years since SOX there has been a series of further scandals and settlements involving Wall Street analysts, mutual funds, as well as the insurance, healthcare and pharmaceutical industries. Beyond the scandals in these specific industries, many other corporate directors have been taken to task for their role in scores of options back-dating schemes. And in early 2009, the directors of many large financial institutions are being criticized and subjected to intense regulatory and shareholder scrutiny, in connection with alleged failures in corporate management that may have contributed to the economic collapse. For example, the newly appointed Chair of the Securities and Exchange Commission, Mary Schapiro, has announced she will examine the role of directors during the economic meltdown, including their backgrounds, skills and how they managed issues like financial risk and executive compensation.[3] The juxtaposition of increasing legal responsibility of boards, together with their colorful track record in scandals in recent years, leads us to a pose a fundamental question: Can

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[1] In re Caremark International Inc. Derivative Litigation, 698 A.2d 959 (Del. Ch. 1996)

[2] Sarbanes-Oxley Act of 2002 (Pub.L. 107-204, 116 Stat. 745, enacted July 30, 2002)

[3] "SEC to Examine Boards' Role in Financial Crisis," *Washington Post*, February 20, 2009.

corporate boards, given the breadth and depth of their responsibilities, truly oversee ethics and compliance in the companies they serve?

We would suggest that the appropriate answer is "yes." Directors are essentially "guardians" of a firm, charged with overseeing management to ensure that the firm's business is conducted with sound strategy and prudence. More than just maximizing return on investment, good governance demands that directors do everything in their power to protect shareholders' assets. Increasingly, too, various external stakeholders outside the company are raising questions about how a company conducts its social responsibilities. Consonant with these varied perspectives and responsibilities, directors' attention to the ethics and compliance function within their companies is an integral aspect of carrying out their fiduciary duty. This paper highlights the critical role of the board in overseeing the management of ethics within the company, and suggests some ways in which directors can most effectively discharge this critical duty of care.

Management Support for the Board in Addressing Ethics and Compliance

As a starting point, it is well understood that a corporate board cannot oversee the affairs of its company in a vacuum. Certain key executives have basic responsibilities to inform and assist the board in the discharge of their oversight duties, including the CEO, CFO, director of human resources and internal auditor. In the critical area of compliance and ethics, an essential supporter to the board is the chief ethics and compliance officer (CECO), who acts as an agent for the board in meeting its regulatory and extra-regulatory responsibilities. The role of the CECO in supporting the board is implicitly recognized in the U.S. Organizational Sentencing Guidelines,[4] which set up the roadmap for effective corporate compliance and ethics programs, and include, among other requirements:

- That the "governing authority" of a company must be knowledgeable and reasonably oversee the company's ethics and compliance program;
- That there must be a "high-level" person charged with oversight for the ethics and compliance program;
- That this individual must have adequate resources and appropriate authority to execute his/her responsibilities; and
- That the firm must take reasonable steps to communicate appropriate behaviors, and conduct effective training in compliance and ethics: including training aimed at the "governing authority."

[4] The Organizational Sentencing Guidelines (OSG) were originally promulgated by the U.S. Sentencing Commission in 1991, and then substantially amended in 2004. For a short summary describing the history and impact of the OSG, see discussion at http://en.wikipedia.org/wiki/Compliance_and_ethics_program.

Beyond the responsibilities set out for directors under the OSG, SOX also introduced new standards of accountability for directors of U.S. public companies (and foreign companies listed on U.S. stock exchanges). For example, under Section 406 of SOX, public companies must either explain why they have no code of conduct or else institute a code of ethics for senior financial officers to promote "honest and ethical conduct, including the handling of actual or apparent conflicts-of-interest between personal and professional relationships...fair, accurate and timely disclosure...and compliance with laws and regulations." In addition, Section 806 of SOX provides whistleblower protection "prohibiting discrimination in the terms of employment by public corporations, or any officer, employee, contractor, sub-contractor or agent of such corporation..." against insiders who blow the whistle internally on certain types of corporate misconduct. Finally under SOX, internal controls are now the direct responsibility of directors, and the failure to establish adequate institutional safeguards against misconduct carries significant personal risks and liability to the directors.

Given the many internal and external issues potentially impacting a company's reputation, how does a director protect shareholders' assets? More to the point: How do directors minimize a company's ethical liabilities and maximize its ethical assets?

Again, the logical starting point is in the person of a company's chief ethics and compliance officer: The CECO acts as an agent of the board in meeting its fiduciary obligations for oversight of corporate ethics. As pointed out by colleagues in two companion papers included in this report, a CECO must be a "chief," an executive-level officer reporting to the board of directors and involved in the strategic and policy decisions of the firm. Events of the recent past indicate that top executives like the CEO, CFO, general counsel and other senior officers frequently show up in the reports of the Federal Fraud Task Force. It is unlikely that a lower-level employee would have the clout to intervene at that level of management, let alone be privy to decisions being made in the "C suite." The CECO must be part of the company's power structure to be effective as an agent of the directors.

Independence of the CECO is also critical to ensuring that the ethics and compliance function is carried out effectively. Direct line reporting by the CECO to the board is a basic step toward ensuring that independence. In at least some companies, the board has direct oversight in hiring, firing, determining benefits and compensation for, and the responsibilities of, the CECO. Independence can be further assured by providing the CECO an employment contract, ample severance, indemnification, and full D&O insurance coverage. Where the CECO does not have a direct report to the board, a senior empowered position, direct access and the ability to make periodic, unfiltered reports to the board are important indicia of independence. Board-backed independence can ensure the CECO has the appropriate authority to carry out her

mandate, and by extension, to support the board in fulfilling its responsibility for ethics and compliance oversight.

Considerations for the Board in Fulfilling Its Fiduciary Role

A board that is effective in overseeing ethics and compliance within its firm is armed with two key weapons: first, knowledge, and second, an empowered CECO. Some related aspects of fiduciary duty that directors should consider include the following:

- Board members must understand the risks they undertake in their role as fiduciaries, and how these risks can be mitigated or resolved.
- They must know and perform diligently their fiduciary responsibilities to oversee and be knowledgeable about the company's compliance and ethics program.
- Directors must make time on the board agenda for periodic progress reports from the CECO.
- Boards should receive briefings on the highest compliance and ethics risks for the company, and what the company is doing to address these risks. Periodic, if not continuous, risk assessment is essential.
- Directors should tell management and the CECO the important matters they want to hear about, and management should be responsive to the request — without exceptions, excuses, or filtering.
- Board members should make sure that the CECO is independent, empowered, connected and professional. They should insist that the CECO be a senior, empowered member of management, with a proven track record in compliance and ethics, and with direct, unfiltered access to the board.
- Directors should ask the CECO during every closed executive session — or even over coffee or at lunch — "What are you personally worried about or think we should know?"
- Directors should require that any CECO termination be approved by the board before management does anything, and be available for an exit interview.
- Directors should ask the CEO and the rest of the senior management team to tell them in person what specific things they do to promote ethics and compliance and support the CECO — in other words, demonstrate "how they walk the walk."
- Board members should periodically require a benchmark assessment regarding how the company's ethics and compliance program compares with that of other leading peer companies — is the company the leader, middle of the pack, or lagging behind?

Conclusion

Clearly, one of the most lethal threats to any organization is misconduct within its own ranks or in how it engages with the public. Ideally, we need to embed a system of values, ethics and compliance into the cultures of our organizations. The absence of these foundational values, especially in these frightening times, can only contribute to anomie, cynicism, despair, and in the end, continuing corruption within capitalist institutions. The CEO and senior management have primary responsibility for setting the tone, values and standards of behavior for the company. But as our colleague in a companion paper in this document has pointed out ("From Enron to Madoff: Why Many Corporate Compliance and Ethics Programs Are Positioned for Failure"), a compliance and ethics program cannot implement itself. It is the CECO who serves as the pivotal figure and architect in leading a program that supports a culture of integrity throughout the organization. In addition to the "tone from the top" set by management and the engagement of the business at all levels, the CECO requires the strong support and involvement of the board of directors to achieve this purpose. And in turn, the directors can significantly enhance the discharge of their legal responsibilities for corporate compliance and ethics with the support of an effective agent in the person of the CECO.