ROY SNELL

Just How Independent Should the CECO Be (from Legal)?

Industry Expert Discusses Why Lines Must Be Drawn When It Comes to Reporting Relationships

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Snell: Is the compliance officer's independence compromised by reporting to the general counsel?

Boehme: Yes, for so many reasons. A reporting line to the general counsel is usually the worst possible structure for the compliance and ethics officer and, by extension, the overall program. Sen. Charles Grassley's famous quote about a general counsel managing a compliance program (in the Tenet Healthcare Medicare fraud settlement) was: "It doesn't take a pig farmer from Iowa to smell the stench of this conflict."[1] Whether a highly regulated or nonregulated industry, the principle of an independent voice in the C-suite and to the board for matters as significant and far-reaching as compliance, ethics, and culture is an idea whose time has come.

Snell: What does the United States Sentencing Guidelines (USSG) say about the reporting relationship question?

Boehme: The 2010 federal sentencing guidelines amendments specifically supported direct chief ethics and compliance officer (CECO) access to the board through

"direct reporting obligations." This was significant because, despite furious "the sky is falling" lobbying by the in-house counsel community, the Commission recognized and validated the critical role of the CECO's reporting relationship to the board, without filtering by legal or any other powerful forces within the company.

Snell: Are there any other government documents or regulations that suggest that the CECO be independent?

Boehme: We are seeing growing recognition that CECO independence is a key indicator of whether the compliance program will be more than just a piece of paper. In addition to the federal sentencing guidelines, the Organization for Economic Cooperation and Development (OECD) Good Practice Guidance (recognized in 38 nations for anticorruption programs) says that the CECO should have an "adequate level of autonomy from management."

CECO independence is also a fully developed concept in certain highly regulated industries such as health care, where it is set out in Office of Inspector General (OIG) guidance documents and recent settlement agreements, and in the mutual fund industry, where the CECO has been required to report to the board since 2004. Currently, the U.S. Commodity Futures Trading Commission (CFTC) has proposed rules under Dodd-Frank that require commodities futures dealers to appoint a CECO that reports directly to the board or senior officer of the firm.

Snell: The Pfizer corporate integrity agreement dealt with this issue. Can you tell us what that was about and why they did it?

Boehme: A key part of Pfizer's $2.3 billion settlement was the requirement that the CECO report directly to the chief executive officer (CEO) and not be, or be subordinate to, the general counsel or chief financial officer — a clear separation of the legal and compliance functions. This was an express recognition that having the CECO report to the general counsel had created conflicts of interest and filtering of CECO reports to the board. One of the OIG officials said at the time: "The lawyers tell you whether you can do something, and compliance tells you whether you should…We think upper management should hear both arguments." I couldn't agree more.

Snell: Are there any other examples of companies who have run into trouble because it was felt the CECO was not independent?

Boehme: Anecdotally, there are a lot of stories about this in the field, even without making it into the *Wall Street Journal* headlines. There are a number of settlements that have imposed the Pfizer rule.

Snell: Why do you think the general counsel is so adamant that the CECO report to them?

Boehme: The flippant answer is: those in power never give it up willingly. Also, a basic lack of understanding about the role and mandate of compliance, and how it should interact with legal, leads to knee jerk reaction of "anything to do with legal matters must report to legal." But, if that were the case, audit would also report to legal and so would human resources. Just as those two functions have a separate and critical mandate that intersects with legal, so does compliance.

Snell: If the general counsel and the CECO were one in the same person, would that limit the ability of the general counsel to vigorously defend the company?

Boehme: Yes, because the last time I looked, the general counsel was a full-time job. I was once on a panel where one of the other panelists, a well-respected general counsel, asserted that there was "no need" for a chief compliance officer because the "collective wisdom" of the CEO, chief financial officer (CFO), and

general counsel made the existence of a CECO unnecessary. That's like saying — we don't need an internal auditor because the C-suite is smart enough to detect problems without one. Comments like this reflect a basic ignorance, or at least a lack of appreciation, for the breadth and significance of the CECO's role, if a company is serious about compliance. There is an entire RAND symposium report on this issue, which can be accessed at www.rand.org/pubs/conf_proceedings/CF258.html.

Snell: The external audit profession recently lost some of its independence. The government responded by making recommendations in Sarbanes Oxley that they be rotated, et cetera. Do you think that the government will respond to companies who do not take CECO independence seriously by writing more regulations?

Boehme: We have already seen the government take action in some highly regulated industries. There have been U.S. Securities and Exchange Commission (SEC) regulations mandating that the CECO report directly to the board in the mutual fund business since 2004. More recently, under Dodd-Frank, the CFTC has proposed regulations requiring that commodities dealers appoint a qualified compliance officer reporting directly to the firm's board or senior officer. And in health care, not only is there clear OIG guidance, but the issue of CECO independence has become a staple of most high-profile settlement agreements.

We haven't seen this kind of movement in nonregulated industries, and I think such mandated reporting rules are unlikely, but the recent federal sentencing guidelines supporting direct CECO access to the board ("direct reporting obligations") is definite progress along these lines.

Snell: Is the work of the CECO duplicative of the general counsel?

Boehme: Not if the company understands the significance of the role and is serious about a compliance program. I haven't met the general counsel yet who understands the four corners of how to design, develop, implement, and oversee a fully functioning compliance and ethics program in a manner that is fully integrated into company operations. That's if they had time to do it. In truth, there is little to no overlap between the roles, but there are many areas where the general counsel and the CECO can and should collaborate. If company management thinks the roles are duplicative, that is a sure fire sign to me that they don't have a serious program.

Snell: Is it enough to have the CECO reporting to the board even if the general counsel conducts the CECO performance evaluation and has hire/fire determination?

Boehme: Follow the money. If you want to know who the boss is, look to pay and rations decisions. It is a very tricky dance to have the CECO report to the general counsel, and I have rarely seen it work optimally. Many commentators in this field believe that the board should approve of any hiring and firing of the CECO, and I am in that camp. At the end of the day, if the CECO does not report to the CEO, I would rather see her reporting to the CFO or another senior corporate officer, not the general counsel.

Snell: Why do you think the general counsel did not prevent this whole situation from coming up in the first place by effectively finding and fixing regulatory and ethical issues?

Boehme: If the general counsel is the same as a CECO and can do that job, then we wouldn't have the need for the rapidly growing profession we see today! The simple fact is that the general counsel has a critical mandate of advising and defending the corporation — a full-time job — and much of the role is reactive to the specific issues or problems of the day.

The compliance profession falls in an entirely different dimension — it is the job of the CECO to develop, implement, and oversee a system of risk management that detects and prevents wrongdoing and supports a culture of integrity. Compliance is mostly proactive, not reactive. The legal profession never embraced this new proactive role, which as it developed required very different key competencies, skills, and mindset than usually found in a general counsel.

Snell: Should the CECO have a severance package?

Boehme: I believe that is the way of the future for leading companies that are serious about compliance and ethics. The dirty little secret of the compliance profession is that many CECOs are actually positioned for failure (see the RAND report on this topic). They are given this huge mandate and little empowerment or resources to do the job. A severance package, in addition to senior positioning and direct unfiltered access and reporting to the board, goes a long way to addressing this problem.

Snell: Some argue that the CECO can report to the general counsel, but when a compliance issue comes up, they build a firewall between the two during the resolution of the compliance issue. If there is a significant disagreement between the CECO and the general counsel, can a CECO, whose annual review is being conducted by the general counsel and operating under a "firewall," effectively argue his or her points?

Boehme: Firewalls only work when there is a wall. I don't see how you can create a firewall between a CECO and his general counsel boss when the general counsel is making decisions on performance reviews, promotions, bonus — and probably the CECO budget to boot. (In the banking world, regulators decided that the "virtual firewall" didn't work between research and investment banking as long as the reporting lines were merged.)

I know there are situations in which CECOs say the general counsel respects their judgment and is generally "hands off," and I don't deny that there are arrangements out there where the CECO does have clout, empowerment, and independence while reporting to the general counsel. But, at the end of the day, those arrangements are still entirely dependent on the goodwill and worldview of an individual general counsel. All the stars must be aligned for this kind of arrangement to work at all, and even then, when one of those stars explodes (such as the general counsel retires, an issue arises that negatively impacts legal or the general counsel, or a close colleague of the general counsel is implicated), so does the "firewall." I believe it is better to set up the CECO for success, as foolproof as possible, and one important step is to structure the role correctly from the beginning.

Snell: The government published a list of the three most likely positions to be involved in fraud — CEO, CFO, and general counsel. Does that have an impact on the reporting relationship issues?

Boehme: Absolutely. (By the way, I recall that the Compliance and Ethics Leadership Council also did a study on this with the same results). There's rarely a problem when the mailroom guy needs to be investigated or disciplined. But, as these surveys show, the major acts of misconduct often involve the more senior levels of management. It's almost ludicrous to imagine that a CECO without position, seniority, and empowerment can successfully oversee an investigation involving, for instance, someone in the C-suite. I've seen CECOs in this kind of situation ordered to close or change the course of investigations, reveal confidential identities, or simply go away.

I've also heard from many CECOs who have had their board reports unilaterally changed. Both of these scenarios create

great risk that serious matters of misconduct at the senior levels will never reach the governing authority, thereby undermining one of the fundamental purposes of the compliance program.

Snell: You once published a quote of a general counsel who wanted to have compliance report to them so that they could control compliance. Can you give that to us again and tell us what relevancy it has with the general counsel/CECO reporting relationship discussion?

Boehme: Here's the quote, and it comes from a law firm memo to its clients (mostly general counsels) about the impact of the recent federal sentencing guidelines amendment on "direct reporting obligations":

> The new requirement may not allow the senior officer (*e.g.*, the general counsel) to act as a filter in deciding which conduct warrants reporting (and when) to the audit committee.[2]

The quote is emblematic of the in-house counsel lobby which has consistently opposed measures to increase the CECO's independence and direct access to the board. It illustrates one of the key problems that negatively impacts the ability of many CECOs to be effective in the role: the outdated notion that the general counsel is the all-seeing, all-knowing arbiter of what is worthy of board attention, and therefore, any interface between the CECO and the board must be "filtered."

This is exactly the mindset that has landed Pfizer, Tenet, Bayer, and others in hot water in the past and the reason prosecutors and regulators are increasingly acknowledging the critical role of the CECO to make independent reports and judgments. In reality, compliance is a *different* profession from legal, with a separate mandate of great significance to the firm. Legal is not the same as compliance and ethics — and neither is compliance and ethics a subset of legal. The two should collaborate closely, but there are demonstrated and valid reasons for an amicable divorce of these two roles.

Endnotes:

1. hcca-info.org/Content/NavigationMenu/ComplianceResources/ExternalLinks/prg092503b.pdf.
2. www.gibsondunn.com/publications/pages/USSentencingCommissionAmendsRequirementsForEffectiveComplianceEthicsProgram.aspx.

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