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ON BOARD

Protecting the Compliance Officer: A Balanced Approach

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The compliance industry is in a justifiable uproar, and that's something to which the board, and its audit committee, should pay close attention. *The Wall Street Journal* is the latest and most prominent media outlet to chronicle the rising concerns of compliance officers—across industry lines—about personal liability. These concerns are grounded in recent enforcement actions of the Securities and Exchange Commission, comments from senior SEC officials and other regulatory initiatives.

While the actual risk of personal exposure appears very low, the risk of harm to compliance program integrity is not. The governing board's obligations under the seminal *Caremark* decision to create and maintain a corporate reporting/compliance program should prompt directors to be sensitive to, and take steps to address, legitimate compliance officer anxieties. But those steps should be measured and balanced, and reflective of the increasing legal exposure of *all* members of the management team.

Certainly, the primary source of compliance industry concern is the series of enforcement actions initiated by the SEC against compliance officers working in the investment adviser sector. In



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a speech last November, SEC Enforcement Director Andrew Ceresney acknowledged that these actions “have caused concern in the compliance community,” and pledged continued SEC support for the compliance officer function. Yet, the SEC continues to pursue enforcement actions against compliance officers involving conduct the SEC believes to be egregious. Indeed, the SEC’s Enforcement Division has identified three categories of conduct that could expose compliance officers to scrutiny and potential liability. But that’s not the only problem area.

A more recent source of concern arises from proposed New York State financial services industry regulations that would allow state officials to pursue criminal liability against compliance officers for false certification of certain types of regulatory reports. Then there is the ongoing appeal of the 2014 decision of an SEC administrative law judge that the chief compliance officer for the Allen Stanford companies should be fined more than \$850,000 for certain alleged derelictions of duty (e.g., allegedly ignoring red flags of corporate misconduct). Compliance thought

leaders might fairly ask whether these types of actions could spread into other industries.

From a governance perspective, it matters not that these chief compliance officer (CCO) enforcement actions appear to be narrowly focused in particular industry sectors. Rather, what matters is the potential these actions may have to more broadly destabilize the role and function of the compliance officer. The job is hard enough as it is. Should compliance officers feel (fairly or unfairly) that they are exposed to regulatory sanction for simply errors of omission or commission, the job will become even more challenging. Interest in compliance positions—especially in heavily regulated industries—may decline. Companies will be frustrated in their attempt to maintain effective compliance programs if they are unable to attract and maintain qualified, experienced compliance officers.

This concern arises at the same time as regulatory agencies (e.g., the U.S. Department of Justice) are increasing their emphasis on the elements of an effective compliance plan, including whether a company's compliance staff have the appropriate background for the specific circumstances of the company and its business model. *Talk about bad timing...*

This is a concern the board should tackle head-on with a series of measures that seek to address core aspects of natural CCO concern. This could include expanded elements of insurance/indemnification/advancement coverage; increased access to legal counsel (internal and external) for advice on positional matters of controversy; the highest possible hierarchical position within the organization; and a commitment that compensation, job

performance and retention decisions relating to the CCO would require audit committee ratification.

The board and its audit committee may be forced to become more involved in the recruitment and retention of compliance officers. In particular, the board may wish to focus more deliberately on compliance officer-targeted executive search arrangements, in anticipation of increasing challenges in recruiting experienced, qualified senior level compliance consultants. Hiring—and retaining—underqualified persons for significant unstaffed and open compliance officer positions will never be a good decision.

Special care should be taken in situations where qualified candidates simply cannot be readily found for senior compliance officer positions. In those situations, the board should consult with its legal advisors on possible short term scenarios while increasing its search efforts. Such short term “patches” could include temporarily assigning senior compliance officer duties to the general counsel (which could, of course, create its own level of controversy), or contracting with outside compliance consulting firms for temporary senior staffing assistance. These kinds of “patches” are far from ideal, however.

These concerns notwithstanding, the board's reaction should be measured and balanced. Compliance officers should not be placed in a more protected position than are other corporate gatekeepers. For it is a simple fact of the current environment that corporate gatekeepers of *all* stripes are now at much greater risk of personal liability exposure than ever before. These are gatekeepers who share the same (if not greater) duties and obligations as compliance officers to protect

the organization and preserve its ethics and reputation. While compliance officers provide a critical role in upholding the organization's legal/ethical safety net, that role is not exclusive to them.

This “spike” in compliance officer anxiety is the latest example of the chilling effect settling on all corporate gatekeepers from the increased enforcement focus on individual officers and executives. It is critical that the board adopt a comprehensive approach aimed at supporting those gatekeepers in the performance of their duties, and preventing the harm that could come from self-protective actions. In implementing that approach, however, the board should be careful not to treat some types of gatekeepers (e.g., compliance officers) as more deserving of protection than others.

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