COMPLIANCE OFFICERS: MORE JOBS, MORE RESPONSIBILITY, MORE LIABILITY

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ABSTRACT

In response to a great deal of new rule making by federal agencies in the last few years, corporate compliance departments are becoming larger and more involved in businesses in an effort to eliminate regulatory violations and to reduce fines in the event of an offense. At the same time, chief compliance officers who head these departments are becoming increasingly concerned that they will be held liable for the actions of others at their companies merely because they are in charge of their companies' compliance programs. This article looks at examples of laws that give rise to compliance mandates and the costs to companies of failing in compliance, the role of the chief compliance officer in firms, theories for holding chief compliance officers liable for compliance failures, and federal actions against chief compliance officers. This article concludes that, of course, chief compliance officers should be responsible for their own affirmative illegal behavior, but they should not have supervisory liability for the infractions of others unless they truly are those persons' supervisors. To settle this liability issue, the Securities and Exchange Commission should issue clear guidelines using a "control" definition for supervisor that the U.S. Supreme Court has used in another context.

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I. INTRODUCTION

In response to a great deal of new rule making by federal agencies in the last few years, corporate compliance departments are becoming larger and more involved in line businesses in an effort to eliminate regulatory violations and to reduce fines in the event of an offense.[1] At the same time, chief compliance officers ("CCO") who head these departments are becoming increasingly concerned that they will be held liable for the actions of others at their companies merely because they are in charge of their companies' compliance programs.[2]

In fact, there is little evidence that federal regulators intend to do that,[3] but there is also no clear affirmative legal decision or rule protecting CCOs from secondary liability. What may be equally discomforting for CCOs is that many of them spend less than fifty percent of

1. Jennifer Smith, *New Legal Pitfalls Abound—Cybercrime, Labor Rules, Financial Penalties Add to General Counsels' Concerns*, WALL ST. J., Jan. 6, 2014, at B6; Daniel M. Gallagher, Comm'r, SEC, Remarks at the 2013 Nat'l Compliance Outreach Program for Broker-Dealers (Apr. 9, 2013), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1365171515226#.UvAMT_shMuc.

2. *Former SEC Compliance Chief Asks Chairwoman White to Stop Suing Compliance Officers*, MARKET COUNSEL, marketcounsel.com/2013/06/26/former-sec-compliance-chief-asks-chairwoman-white-to-stop-suing-compliance-officers/ (citing John H. Walsh, former Acting Director of the SEC's Office of Compliance Inspections and Examinations); Christian J. Mixter, ALI-ABA Mutual Fund Regulation and Compliance Conference, July 19–20, 2012, *SEC, SRO, and Private Litigation Developments Affecting Mutual Funds, 2011–2012* (noting *In the Matter of Theodore W. Urban* was a case closely watched by compliance professionals); Mark Schoeff Jr., *Crucial SEC Vote Leaves Compliance Officers in the Dark*, INVESTMENT NEWS (Jan. 27, 2012, 3:39 PM), www.investmentnews.com/article/20120127/FREE/120129924 (noting compliance professionals "are nervous about the SEC's initiative targeting compliance").

3. *See, e.g., Frequently Asked Questions About Liability of Compliance and Legal Personnel at Broker-Dealers Under Sections 15(b)(4) And 15(b)(6) of the Exchange Act*, SEC DIV. OF TRADING AND MARKETS (Sept. 30, 2013), www.sec.gov/divisions/marketreg/faq-cco-supervision-093013.htm (noting that "[t]he Exchange Act does not presume that a broker-dealer's compliance or legal personnel are supervisors solely by virtue of their compliance or legal functions") [hereinafter *Frequently Asked Questions*].

their time on compliance issues[4] in spite of the Securities and Exchange Commission's ("SEC") observations of widespread violations of various legal rules among organizations.[5] Moreover, companies are asking their CCOs to do more with fewer resources.[6]

This article looks at examples of laws that give rise to compliance mandates and the costs to companies of failing in compliance, the role of the CCO in firms, theories for holding CCOs liable for compliance failures, and federal charges against CCOs. This article concludes that, of course, CCOs should be responsible for their own affirmative illegal behavior, but they should not have supervisory liability for the infractions of others unless they truly are those persons' supervisors. If they are not in positions of power over others in their companies, then their punishment for not doing their jobs satisfactorily should be the same as that of other workers: termination or resignation, not government prosecution. To settle the liability issue, the SEC should issue clear guidelines for CCO liability using a "control" definition for supervisor that the U.S. Supreme Court has used in another context.

II. THE ROLE OF THE CCO

A. *Origin of the CCO: Federal Sentencing Guidelines*

The CCO for electronics manufacturer Jabil has defined compliance as "developing and implementing processes and procedures . . . [to address] risks that appear in the business model . . . [and] document[ing] how you are anticipating that risk by programmatic means that show the company is serious about not getting into trouble . . . ."[7] The Vice President of Compliance at Pfizer has asserted that the CCO has to be aware of risks in all facets of a business including research,

4. Melanie Waddell, *Compliance Pros' Pay, Budgets Getting Chopped*, THINKADVISOR (Aug. 29, 2013), http://www.thinkadvisor.com/2013/08/29/compliance-pros-pay-budgets-getting-chopped (citing survey by National Regulatory Services); NATIONAL REGULATORY SERVICES, NRS COMPLIANCE COMPENSATION STUDY 2011 5 (2011), *available at* http://www.nrs-inc.com/Global/White%20Papers/NRS%20Compliance%20Compensation%20Study%202011_web.pdf.

5. *See, e.g.*, Luis A. Aguilar, Comm'r, SEC, Speech at the Regulatory Compliance Ass'n: Doing the Right Thing: Compliance that Works for Investors (Apr. 18, 2013), *available at* https://www.sec.gov/News/Speech/Detail/Speech/1365171515784#.UuvncPshMuc (citing widespread violations of Investment Advisers Act of 1940) [hereinafter Aguilar].

6. Erica Teichert, *SEC Commissioner Criticizes Compliance Liability Framework*, LAW360 (Apr. 9, 2013, 7:07 PM), http://www.law360.com/articles/431479/sec-commissioner-criticizes-compliance-liability-framework (citing SEC Commissioner Daniel Gallagher). In a 2011 survey, twenty-nine percent of responding CCOs said they did not have sufficient budgets to support their programs; only twenty-seven percent thought their budgets were adequate. *The Risk Intelligent Chief Compliance Officer: Champion of Risk Intelligent Compliance*, DELOITTE (2012), http://www2.deloitte.com/ch/en/pages/governance-risk-and-compliance/articles/risk-intelligent-chief-compliance-officer.html.

7. Gregory J. Millman, *The Business of Risk: Q&A with Odell Guyton of Jabil Inc.*, WALL ST. J. (Jan. 16, 2014, 1:06 PM), http://blogs.wsj.com/riskandcompliance/2014/01/16/the-business-of-risk-qa-with-odell-guyton-of-jabil-inc/ (quoting Odell Guyton, head of global compliance at Jabil Inc. and former CCO at Microsoft Corp).

manufacturing, marketing, and the development of business strategies and innovations.[8]

Corporate compliance and ethics programs and the position of CCO were first created in a noticeable way in 1991 in response to the enactment of the Federal Sentencing Guidelines (the "Guidelines").[9] The Sentencing Reform Act of 1984[10] created the United States Sentencing Commission and authorized it to develop a system of guidelines to set penalties for federal crimes.[11] The principles underlying the Guidelines for corporations were "to recognize an organization's relative degree of culpability; and to encourage desirable organizational behavior"—a "carrot and stick" approach to control corporate crime.[12]

The Guidelines assign a "Culpability Score" to corporate offenders to determine appropriate fines for their infractions.[13] An offender starts with five "points" and then points are added or subtracted depending on various aggravating or mitigating factors.[14] If at the time of the offense the company had "an effective compliance and ethics program" in place, three points are subtracted from its Culpability Score.[15] Under the Guidelines, having an effective program requires specific high-level personnel in the organization to be responsible for the compliance and ethics program.[16] Individuals who have "day-to-day operational responsibility" have to report regularly to high-level personnel "on the effectiveness of the compliance and ethics program," and must be given "adequate resources, appropriate authority, and direct access to the governing authority."[17] In addition, the governing authority must "exercise reasonable oversight" of compliance.[18]

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8. Deloitte Insights Video, *The Chief Compliance Officer of the Future: Embracing a Risk Intelligent View*, YOUTUBE (May 16, 2012), https://www.youtube.com/watch?v=Zj8gRo36NOc.

9. Ilene H. Nagel & Winthrop M. Swenson, *The Federal Sentencing Guidelines for Corporations: Their Development, Theoretical Underpinnings, and Some Thoughts about Their Future*, 71 WASH. U. L. Q. 205, 209 (1993) (Nagel was a member of U.S. Sentencing Commission and Swenson was Deputy General Counsel of Commission); Hannah Clark, *Chief Ethics Officers: Who Needs Them?*, FORBES (Oct. 23, 2006, 12:05 PM), http://www.forbes.com/2006/10/23/leadership-ethics-hp-lead-govern-cx_hc_1023ethics.html; *History of the ECOA*, ETHICS & COMPLIANCE OFFICER ASSOC., http://www.theecoa.org/imis15/ECOAPublic/ABOUT/History_of_the_ECOA/ECOAPublic/AboutContent/History.aspx?hkey=43ce057e-1870-408c-a6b3-b2f27c5b2950.

10. The Sentencing Reform Act of 1984, 28 U.S.C. §§ 991–98; 18 U.S.C. §§ 3551–3673 (1988).

11. *See id.* §§ 991, 994.

12. Nagel & Swenson, *supra* note 9, at 228 (quoting UNITED STATES SENTENCING COMMISSION, SUPPLEMENTARY REPORT ON SENTENCING GUIDELINES FOR ORGANIZATIONS (Aug. 30, 1991)); Patti B. Saris, Remarks at the 12th Annual Compliance & Ethics Institute 4 (Oct. 7, 2013), *available at* http://www.ussc.gov/Guidelines/Organizational_Guidelines/Special_Reports/saris-remarks-annual-compliance-and-ethics-institute.pdf.

13. U.S. SENTENCING GUIDELINES MANUAL § 8C2.5 (2013).

14. *Id.*

15. *Id.* § 8C2.5(f)(1).

16. *Id.* § 8B2.1(b)(2)(B).

17. *Id.* § 8B2.1(b)(2)(C).

18. *Id.* § 8B2.1(b)(2)(A).

The offending organization can have its Culpability Score reduced by one to five more points by disclosing the offense, cooperating with an investigation, and accepting responsibility for its criminal conduct.[19] The Culpability Score corresponds to a multiplier for a base fine set in the Guidelines depending on the nature of the infractions.[20] Base fines range from $5,000 to $72,500,000 for each infraction.[21] Multipliers range from .05 for a Culpability Score of 0 or less, to 4.0 for a Culpability Score of 10 or more.[22] Thus, more corporations are becoming increasingly committed to effective compliance programs so that violations are less likely to occur and fines will be mitigated in the event of a regulatory infraction.

Unfortunately, it is common for companies to hire a CCO or to upgrade the CCO role after they have gotten into regulatory trouble rather than as part of their everyday management arrangements.[23] Regulators have asserted that they give more credit to offending companies that have incurred infractions in spite of robust compliance and ethics programs than to companies that start compliance programs after they have been investigated and prosecuted.[24] In fact, regulators are less likely to bring an action for isolated instances of misconduct against a company that has a sincere compliance program and good internal controls.[25] An Associate Director of the SEC has noted two instances when the SEC and the Department of Justice ("DOJ") decided not to prosecute companies for the illegal actions of employees.[26] They did not prosecute Morgan Stanley after an employee was convicted of criminal bribery because they were convinced that Morgan Stanley's internal controls were sufficient to ensure that other employees were not also guilty of bribery.[27] In 2013, the SEC entered into a non-prosecution agreement with Ralph Lauren Corporation ("RLC") after a subsidiary paid bribes to Argentinian government officials.[28] The SEC did not charge RLC with violations of the Foreign Corrupt Practices Act ("FCPA") because the company expeditiously reported the results of its internal investigation to the SEC, readily produced documents with summaries and translations, discovered the violations while implementing compliance initiatives at its foreign subsidiary, instituted a new company-wide compliance program, and, after conducting a worldwide risk assessment investigation, terminated its subsidiary in Argentina.[29]

19. *Id.* § 8C2.5(g).
20. *Id.* § 8C2.4.
21. *Id.* § 8C2.4(d).
22. *Id.* § 8C2.6.
23. Stephen L. Cohen, Assoc. Dir. of Enforcement, SEC, Remarks at SCCE's (Society of Corporate Compliance and Ethics) Annual Compliance & Ethics Institute (Oct. 7, 2013).
24. *Id.*
25. *Id.*
26. *Id.*
27. *Id.*
28. Press Release, SEC, SEC Announces Non-Prosecution Agreement with Ralph Lauren Corporation Involving FCPA Misconduct (Apr. 22, 2013), *available at* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171514780#.UuLrFso7yQ.
29. *Id.*

RLC's punishment was to pay the relatively low amount of approximately $1.5 million in a combination of illicitly attained profits and fines.[30]

On the other hand, at about the same time, the amounts required of other companies to settle SEC and criminal charges against them was much larger because they did not have mitigating factors in their favor.[31] The SEC and DOJ investigated Parker Drilling Company for making illegal payments to resolve customs problems with Nigerian officials in violation of the FCPA.[32] Parker had to pay $15.85 million to settle these charges, and it had to hire a CCO, who would report to the CEO and the Board's Audit Committee, and a full-time staff for the CCO.[33] Total S.A., an oil and gas company, had to pay $398 million to settle SEC and DOJ charges that it violated the FCPA by paying bribes in Iran for contracts to develop Iranian oil and gas fields.[34] Total S.A. also had to agree to hire an independent compliance consultant.[35]

The Guidelines and their implementation by the SEC and the DOJ have made CCOs quasi-government agents for ferreting out illegal company behavior. From that perspective, it is easy to see why CCOs would not be embraced as C-suite insiders. If, however, CEOs and their boards are sincere about acting within the law, not outside it or on the edge, then the CCO will be their first line of defense against violations and, in the event of infractions, sanctions imposed by federal regulators and concomitant harms to an organization's reputation.[36]

B. *Compliance Mandates for CCOs*

A myriad of federal laws require a CCO's attention to ensure that the company is behaving legally. They vary for different industries. What follows are examples of some of the rules that have significantly increased the roles of compliance departments and CCOs, and that may present risks of personal liability for CCOs.

1. Securities Exchange Act of 1934 ("SEA")[37]

The SEA regulates the secondary sales of securities and the parties involved in that business and empowers the SEC to carry out federal securities laws.[38] Section 15(b)(6) of the SEA authorizes the SEC to sanction individual brokers or dealers and their supervisors for violating Section 15(b)(4)(E) which prohibits violating any federal securities laws or failing to reasonably supervise others to prevent such viola-

30. *Managing Risk Better in 2013: Is What's Old, New Again?*, INTELLIGIZE 3 (June 2013), http://info.intelligize.com/june2013whitepaper [hereinafter INTELLIGIZE].
31. *Id.*
32. *Id.*
33. *Id.*
34. *Id.*
35. *Id.*
36. *See, e.g.*, Aguilar, *supra* note 5.
37. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–78pp (2012).
38. *Id.*

tions.[39] It is the latter that concerns CCOs. Section 15(b)(4)(E) does contain a safe harbor provision:

> [N]o person shall be deemed to have failed reasonably to supervise any other person, if—
>
> (i) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and
>
> (ii) such person has reasonably discharged the duties and obligations incumbent upon him [sic] by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with.[40]

The problem is the lack of certainty in knowing if CCOs are supervisors for SEA purposes when they advise and counsel broker-dealers and the ambiguity of "reasonable" behavior.

The SEC has said that being on a compliance staff does not make one a supervisor, nor does merely providing advice on compliance issues.[41] Some indicia of supervisory authority according to the SEC are company policies or procedures identifying a person as having supervisory responsibility over others; the power to hire, reward, or punish others; and the power to prevent the continuation of illegal behavior.[42] Unfortunately, these statements cannot reassure CCOs that they are not incurring supervisory legal liability for infractions committed by others at their companies when CCOs are acting in their advisory roles. SEC Commissioner Daniel Gallagher has said that the issue of when a CCO is a supervisor "remains disturbingly murky."[43] To do the job well, a CCO has to be able to influence workers and managers, but to avoid liability, the CCO cannot operate as their supervisor.[44] At a 2012 compliance conference held by the Investment Adviser Association, a partner at a well-known law firm, in an attempt to create a bright-line test to guide CCOs' behavior, concluded that a CCO must be able to influence, but cannot compel.[45] That formulation would not be very helpful for CCOs trying to avoid legal liability even if it were accurate, but, in fact, it is the opposite of what the SEC declared in adopting new rules under the Investment Advisers Act ("IAA") and the Investment Company Act ("ICA") in 2003.

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39. *Id.* §§ 78o(b)(6), 78o(b)(4)(E).

40. *Id.* § 78o(b)(4)(E).

41. *Frequently Asked Questions*, *supra* note 3.

42. *Id.*

43. Dan Macy, *How to Avoid Being Branded a 'Supervisor': Industry Panel Takes Fresh Look at CCO Liability*, THOMPSON INFORMATION SERV. (Apr. 24, 2012), www.thompson.com/public/newsbrief.jsp?cat=FINANCE&id=3840.

44. *Id.* (citing SEC Div. of Inv. Mgmt. Deputy Dir. Robert Plaze).

45. *Id.*

2. IAA[46] and ICA[47]

The IAA and the ICA give the SEC similar authority over investment advisors that the SEA gives it over broker-dealers.[48] Originally, the IAA and the ICA did not require investment advisers and investment companies to have written compliance procedures.[49] In 2003 the SEC promulgated new rules under these acts in response to misconduct and scandal in the mutual fund industry.[50] The rules require investment adviser companies and individual investment advisers to adopt and implement policies and procedures designed to prevent violations of federal securities laws, to review these policies and procedures and their implementation at least annually, and to designate a CCO to be responsible for administering these policies and procedures.[51]

The SEC stated that to be in compliance with the new rules, the CCO should be "competent and knowledgeable regarding the federal securities laws" and "empowered" to create and implement the required policies and procedures.[52] The SEC views the CCO as a "risk manager, a strategist, . . . an integral part of senior management . . . [and as an SEC] ally."[53] The SEC noted that the CCO "should have sufficient seniority and authority to compel others to adhere to the compliance policies and procedures."[54]

The SEC also emphasized the close relationship between the CCO and an organization's board of directors, particularly the independent directors.[55] The CCO reports directly to the board, the board must approve the CCO's compensation, and only the board can remove the CCO.[56] The SEC noted that this direct relationship with the board would allow the CCO, as a "key element" in its new rules for investor protection, to "aggressively pursue non-compliance."[57] In addition, to protect the CCO from being pressured by employees to conceal non-compliance, the new rules prohibit attempts to coerce or mislead the CCO in carrying out compliance responsibilities.[58]

Although discussing the CCO's power, in 2003 the SEC was not considering the CCO's concomitant liability at all. Language like

46. Investment Advisers Act of 1940, 15 U.S.C. § 80b (2012).

47. Investment Company Act of 1940, 15 U.S.C. § 80a (2012).

48. Ralph C. Ferrara et al., *Hardball! The SEC's New Arsenal of Enforcement Weapons*, 47 BUS. LAW. 33, 83 (1991).

49. Lawrence Cohen, *The SEC Is Picking Monitors for the Classroom*, 14 BUS. L. TODAY 57, 57 (2004).

50. Aguilar, *supra* note 5.

51. Compliance Programs of Investment Companies and Investment Advisors, 68 Fed. Reg. 74,714 (Dec. 24, 2003) (codified at 17 C.F.R. §§ 270.38a–1, 275.206(4)–7, 275.204–2, 279.1 (2014)) [hereinafter SEC Final Rule].

52. Lori A. Richards, Dir. Office of Compliance Inspections and Examinations, SEC, Speech by SEC Staff: The New Compliance Rule: An Opportunity for Change (June 28, 2004), *available at* www.sec.gov/news/speech/spch063004lar.htm.

53. *Id.*

54. SEC Final Rule, supra *note* 51, at 74,721.

55. Richards, *supra* note 52.

56. SEC Final Rule, *supra* note 51, at 74,721.

57. *Id.* at 74,722.

58. Investment Company Act of 1940, r. 38a-(1), *supra* note 47.

"empowered," "senior management," and "authority to compel others" might be assumed to describe a "supervisor." Therefore, on the one hand, these descriptions make CCOs nervous because of the additional liability they may indicate; but, on the other, the rules greatly expand the need for compliance personnel. In promulgating the new rules, the SEC estimated that the additional industry burden would be approximately a million worker hours.[59]

3. Sarbanes-Oxley Act of 2002 ("SOX")[60]

SOX was probably the biggest impetus for companies to hire and empower CCOs. Congress enacted SOX in response to another set of corporate scandals, this time involving the inaccurate reporting of corporate financial transactions.[61] The main provisions of SOX that created new compliance work require that in public companies, signing officers certify they have reviewed financial reports and attest to their accuracy,[62] issuers publish information about their internal controls and procedures for financial reporting,[63] and issuers promptly disclose material changes to their financial condition.[64] Shortly after the passage of SOX, one commentator estimated that corporate compliance costs would double in response.[65] An example of an international company with $3 billion in revenue estimated initial additional costs at $4 million to $9 million with recurring annual costs of $3 million.[66] A survey of internal auditors in 2004 concluded that most companies did not have the skills and resources to implement SOX mandates, and they were behind schedule in meeting date requirements.[67]

A strong incentive for companies to implement SOX mandates was the tying of officer certification violations to legal sanctions for officers: a maximum penalty of $1 million, a maximum prison term of ten years, or both, and willful violators face a maximum fine of $5 million, a maximum of twenty years in prison, or both.[68] The pressure to comply with SOX caused an immediate reaction calling for amending or repealing

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59. SEC Final Rule, *supra* note 51, at 74,716.

60. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in sections of 11, 15, 18, 28, and 29 U.S.C. (2002)).

61. *See, e.g.*, Allison Fass, *One Year Later, The Impact of Sarbanes-Oxley*, FORBES (July 22, 2003, 7:00 AM), http://www.forbes.com/2003/07/22/cz_af_0722sarbanes.html (noting scandals at Enron, Arthur Andersen, Tyco, Global Crossing, WorldCom). For an overview of SOX, see Patrick W. Fitzgerald et al., *Towards Understanding Sarbanes-Oxley and Business and Financial Ethics Requirements in a Post-Enron World*, 60 CONSUMER FIN. L.Q. REP. 64, 76–84 (2006); J. Brent Wilkins, Comment, *The Sarbanes-Oxley Act of 2002: The Ripple Effects of Restoring Shareholder Confidence*, 29 S. ILL. U. L.J. 339 (2005).

62. 15 U.S.C. § 7241 (2012).

63. *Id.* § 7262.

64. *Id.* § 78m; *see*, Deborah J. Friedman & Michelle H. Shepston, *The Implications of Sarbanes-Oxley: Bringing a Different Perspective to the Acquisition Due Diligence Process*, 51 ROCKY MTN. MIN. L. INST. 23–1 (2005) (overview of SOX requirements).

65. Fass, *supra* note 61.

66. Fitzgerald et al., *supra* note 61, at 79.

67. Jefferson Wells Int'l & The Inst. of Internal Auditors, Sarbanes-Oxley Implementation Survey 3, 5 (May 2004) (on file with journal).

68. 18 U.S.C. § 1350 (2012).

it, and asserting its negative effects on businesses and investors.[69] Nevertheless, SOX resulted in many companies hiring "an internal cop," the start of a CCO being a routine part of corporate management.[70]

Before SOX, business emphasis in response to scandals had been on ethics,[71] and managers in this area were generally human resources workers with little internal or external visibility.[72] After SOX, forced by the SEC to hire compliance officers in response to violations, companies were more likely to hire high-profile people with more power and access to CEOs and corporate boards.[73] For example, KPMG, the accounting firm, hired a former SEC Chair; Computer Associates, the software company, hired a former vice-president at United Technologies; and Morgan Stanley hired a former attorney in the New York Attorney General's office.[74] While there was talk about the unprecedented power of these people in their new roles,[75] it was not accompanied by concern for the liability they were undertaking. It was a measure of the seriousness of companies to be compliant and ethical to note that their CCOs had the power to take corrective actions including the ability to fire employees.[76]

4. Foreign Corrupt Practices Act ("FCPA")

In their required disclosures in SEC filings, companies made more than 2,000 references to the FCPA in a six-month period between 2012 and 2013.[77] In 2012, the SEC took 734 enforcement actions based on FCPA violations, a twenty-eight percent increase over 2006.[78] There is no doubt that assessing and prioritizing bribery risk is a big concern of CCOs.[79]

Congress enacted the FCPA in 1977 in reaction to yet another scandal: this one concerning U.S. companies bribing foreign officials.[80] Its purpose was to protect honest businesses and the credibility of mar-

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69. *See, e.g.*, Cory L. Braddock, Comment, *Penny Wise, Pound Foolish: Why Investors Would Be Foolish to Pay a Penny or a Pound for the Protections Provided by Sarbanes-Oxley*, 2006 BYU L. REV. 175, 202 (2006); Ryan Hinson, Note & Comment, *Paralyzed Inaction or Conscious Disregard: An Assessment of the SEC's Efforts to Reduce the Reporting Requirements for Small Publicly Traded Companies*, 28 WHITTIER L. REV. 1335, 1341–43 (2007); Paul Rose, *Balancing Public Market Benefits and Burdens for Smaller Companies Post Sarbanes-Oxley*, 41 WILLAMETTE L. REV. 707, 707 (2005).

70. Joseph Weber, *The New Ethics Enforcers*, BUS. WK., Feb. 12, 2006, at 76, *available at* http://www.businessweek.com/stories/2006-02-12/the-new-ethics-enforcers.

71. *See, e.g., id.* (citing Enron's 62-page code of ethics "to protect the outfit's 'reputation for fairness and honesty'").

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*

77. INTELLIGIZE, *supra* note 30, at 3.

78. *Id.*

79. Jimmy Lin, *3 Expert Opinions on FCPA Compliance and Compliance Risks*, NETWORK (Nov. 8, 2013), http://www.tnwinc.com/6066/fcpa-compliance-houston-2/.

80. DOJ & SEC, A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT 2 (2012) [hereinafter FCPA Resource Guide].

kets in the eyes of the public.[81] It applies to all companies that have to file reports with the SEC, all businesses that have their principal place of business in the United States or are organized under U.S. laws, and anyone involved in bribery while in the United States.[82] It prohibits payments intended to influence foreign officials to assist "in obtaining or retaining business."[83] In addition to its anti-bribery provisions, the FCPA also contains accounting provisions for companies that have to file with the SEC.[84] It requires companies to keep accurate, detailed books and records and to maintain a system of internal accounting controls.[85] A purpose of the accounting requirements is to keep companies from mischaracterizing bribes in their books and records.[86]

The DOJ and SEC have emphasized the importance of an effective compliance program in preventing and discovering FCPA misconduct.[87] They have publicized one case in which a U.S. financial institution was involved in a real estate joint venture with special purpose vehicles ("SPV") created by a district government department in China.[88] The U.S. financial institution had a well-staffed and robust compliance program that included regular training for all employees and extensive due diligence, but nevertheless, it failed to learn that the Chinese official responsible for the transaction had a significant personal stake in one of the SPVs.[89] Because the financial institution acted in good faith in implementing its compliance program, the DOJ and SEC did not take enforcement action against it.[90]

Heavy penalties under the FCPA are a big incentive to maintain active compliance programs. Businesses can be fined up to $2 million for each violation of the anti-bribery provisions.[91] Officers and directors can be fined up to $250,000 for each violation and imprisoned for up to five years.[92] Businesses can be fined up to $25 million for violating the accounting provisions, and individuals are subject to fines of up to $5 million and imprisonment for up to twenty years.[93]

81. *Id.*

82. Foreign Corrupt Practices Act, 15 U.S.C. § 78dd (2012).

83. *Id.*

84. *Id.* § 78m(b)(2).

85. *Id.*

86. FCPA Resource Guide, *supra* note 80, at 39.

87. *Id.* at 56.

88. *Id.* at 61.

89. *Id.*

90. *Id.* The DOJ prosecuted the institution's executive who pleaded guilty and settled with the SEC. *Id.*

91. 15 U.S.C. §§ 78dd, 78ff (2012).

92. *Id.*; 18 U.S.C. § 3571(b)(3), (e) (2012).

93. 15 U.S.C. § 78ff.

5. Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")[94]

In 2010 Congress enacted Dodd-Frank in response to a national financial crisis and recession "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail,' to protect the American taxpayer by ending bailouts, [and] to protect consumers from abusive financial services practices . . . ."[95] Agencies regulating the entire financial industry have spent the last four years drafting more than two hundred new rules to implement the law, and they have about another two hundred to go.[96] The House Financial Services Committee estimated it would take twenty-four million worker hours annually for businesses to satisfy Dodd-Frank rules.[97]

Among the new regulations is the requirement that swap dealers, major swap participants, and futures commission merchants designate a CCO who must submit an annual report to the Commodity Futures Trading Commission ("CFTC") assessing the company's compliance activities.[98] In promulgating rules under Dodd-Frank, the CFTC made some important decisions in defining the role of CCOs. In deference to commenters' concerns about the scope of a CCO's duties, the CFTC decided not to require that a CCO have full responsibility and authority or "'enforce policies and procedures, but rather a CCO need only "develop . . . policies and procedures . . . to ensure compliance with . . . regulations."[99] Thus, the final rules list the CCO's duties as administering policies and procedures to ensure compliance; resolving conflicts of interest in consultation with the CEO or Board of Directors; establishing procedures for remediating violations; and preparing an annual report for the CEO or Board.[100] By 2012, unlike ten years earlier, the CCO is no longer described as having power or authority to compel others. Nevertheless, the CCO has become a more important part of the management team in many companies, with larger staffs, higher salaries, and more respect, albeit achieving this success in a more nuanced way.

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94. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 124 Stat. 1376 (2010) (codified as amended in scattered sections of 7, 12, 15, 18, and 31 U.S.C.).

95. *Id.* at Preamble.

96. Abha Bhattarai & Catherine Ho, *Four Years Into Dodd-Frank, Local Banks Say This is the Year They'll Feel the Most Impact*, WASH. POST (Feb. 7, 2014), http://www.washingtonpost.com/business/capitalbusiness/four-years-into-dodd-frank-local-banks-say-this-is-the-year-theyll-feel-the-most-impact/2014/02/07/12c7ca48-877e-11e3-a5bd-844629433ba3_story.html.

97. Gallagher, *supra* note 1.

98. Commodity Exchange Act, 7 U.S.C. §§ 4d(d), 4s(k) (2010).

99. 17 C.F.R § 3.3(a) (2012).

100. 17 C.F.R § 3.3(d), (e) (2012).

C. *The CCO's Job Today*

Increased regulation and heavy fines for regulatory violations have made the role of CCO more important and prestigious, and have increased demand for experienced people.[101] In considering the lagging job market in the United States, commentators have described the compliance field as "booming."[102] Because more businesses are operating internationally with a concomitant increase in regulations and risks, even industries that are subject to less domestic regulation, such as manufacturing and technology, are developing more comprehensive compliance programs.[103] The serious emergence of cybercrime risks has also added to the portfolio of CCOs.[104] A recent study of executives in nineteen industries indicated that ninety-eight percent of financial companies have CCOs, eighty-two percent of technology companies, and eighty percent of manufacturing companies.[105] CEOs and others are more likely now to view CCOs as businesspeople, not merely naysayers,[106] who have to be involved in decisions about risk in order to make compliance programs work.[107]

Companies, especially banks, are greatly increasing the size of compliance departments.[108] HSBC Holdings PLC, for example, added 1,600 workers to its compliance department in 2013.[109] JPMorgan

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101. James A. Fanto, *Advising Compliance in Financial Firms: A New Mission for the Legal Academy*, 8 BROOK. J. CORP. FIN. & COM. L. 1, 2 (2013). In a 2013 survey of compliance professionals in more than twenty industries, thirty-eight percent of respondents said that compliance staffing increased over the past year. SAI GLOBAL & BAKER & MCKENZIE, 2013 GLOBAL COMPLIANCE AND ETHICS BENCHMARKING SURVEY 5 (2013), *available at* http://compliance.saiglobal.com/assets/whitepapers/SAI-GLOBAL-whitepaper-2013-global-ce-benchmarking-survey.pdf. At America's Job Exchange in 2010 there were listings for 221 compliance jobs; in the second half of 2011 there were 9,148 jobs with "compliance" in the title. Alex Konrad, *The One Job Banks and Hedge Funds Can't Fill*, FORTUNE (Mar. 13, 2012, 9:00 AM), http://fortune.com/2012/03/13/the-one-job-banks-and-hedge-funds-cant-fill/.

102. Gregory J. Millman & Samuel Rubenfeld, *Compliance Officer: Dream Career?*, WALL ST. J. (Jan. 15, 2014, 8:13 PM), http://online.wsj.com/news/articles/SB10001424052702303330204579250722114538750; *see also* Aruna Viswanatha, *Wall Street's Hot Trade: Compliance Officers*, REUTERS (Oct. 9, 2013, 4:35 PM), http://in.reuters.com/article/2013/10/09/us-usa-banks-compliance-idINBRE9980EE20131009 (noting a "red-hot market" for CCOs); Fanto, *supra* note 100, at 16–17 (noting perception of compliance job opportunities in difficult job market).

103. PRICEWATERHOUSECOOPERS, DEEPER INSIGHT FOR GREATER STRATEGIC VALUE STATE OF COMPLIANCE: 2013 SURVEY 8 (June 2013), http://www.pwc.com/us/en/risk-management/assets/soc-survey-2013-final.pdf.

104. Donna Boehme, *2013's 10 Big Moments for Chief Compliance Officers*, CORP. COUNSEL (Dec. 20, 2013), http://compliancestrategists.com/csblog/wp-content/uploads/2014/03/2013s-10-Big-Moments-for-Chief-Compliance-Officers.pdf.

105. PRICEWATERHOUSECOOPERS, *supra* note 102, at 8.

106. DELOITTE, *supra* note 6.

107. Nicholas Elliott, *The Morning Risk Report: "There's Too Much Compliance,"* WALL ST. J.: RISK & COMPLIANCE J. (Apr. 5, 2013, 6:57 AM), http://blogs.wsj.com/riskandcompliance/3013/04/05/the-morning-risk-report-theres-too-much-compliance.

108. Millman & Rubenfeld, *supra* note 101; Smith, *supra* note 1, at B6.

109. Millman & Rubenfeld, *supra* note 101. In 2012, HSBC agreed to pay $1.92 billion to settle money-laundering cases with state and federal regulators. Ben Protess & Jessica Silver-Greenberg, *HSBC to Pay $1.92 Billion to Settle Charges of Money Laundering*,

Chase announced that in 2013 it was spending an additional $4 billion on compliance and after adding 7,000 compliance workers in 2013, it was going to add 3,000 more in 2014.[110] Wal-Mart announced that it spent $282 million on compliance for the year ending January 31, 2014.[111] After being investigated by the DOJ and the SEC for allegedly violating the FCPA by giving envelopes of cash to Mexican officials who issue permits, Wal-Mart said it hired a dedicated FCPA compliance director in Mexico.[112]

There is evidence that more companies are setting up compliance departments and hiring CCOs, and there is some evidence that these actions represent more ethical corporate cultures rather than mere window dressing.[113] In Asia, where there has not been a corporate culture that emphasizes ethics and legal compliance, the recent financial crises have created high demand for compliance personnel, particularly in global financial companies.[114]

On the other hand, a Deloitte investigation in 2013 revealed that about half of the companies surveyed had fewer than five compliance employees and compliance budgets of less than $1 million.[115] A 2012 survey of forty-eight CCOs at Fortune 1000 companies reported that almost half of the respondents said they did not have sufficient resources to manage their compliance programs effectively, and more than half said their companies' appraisal and incentive programs do

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N.Y. TIMES (Dec. 10, 2012, 4:10 PM), http://dealbook.nytimes.com/2012/12/10/hsbc-said-to-near-1-9-billion-settlement-over-money-laundering/.

110. Dan Fitzpatrick, *J.P. Morgan's Chief Compliance Officer Leaves Firm*, WALL ST. J., *available at* http://online.wsj.com/news/articles/SB10001424052702304834704579405170312160540 (last updated Feb 25, 2014); Rachel L. Ensign, *The Morning Risk Report: Companies Trying Harder to Get Compliance Right*, WALL ST. J.: RISK & COMPLIANCE J. (Jan. 17, 2014, 7:00 AM), http://blogs.wsj.com/riskandcompliance/2014/01/17/the-morning-risk-report-companies-trying-harder-to-get-compliance-right/ [hereinafter *Companies Trying Harder*]. In 2013 regulatory agencies assessed penalties totaling $20 billion against JPMorgan Chase. Peter Eavis, *Steep Penalties Taken in Stride by JPMorgan Chase*, N.Y. TIMES DEALBOOK (Jan. 7, 2014, 9:09 PM), http://dealbook.nytimes.com/2014/01/07/steep-penalties-taken-in-stride-by-jpmorgan-chase/?_php=true&_type=blogs&_r=0.

111. Samuel Rubenfeld, *Wal-Mart Forecasts More than $200M in FCPA Costs*, WALL ST. J.: RISK & COMPLIANCE J. (Feb. 21, 2014, 10:22 AM), http://blogs.wsj.com/riskandcompliance/2014/02/21/wal-mart-forecasts-more-than-200-million-in-fcpa-costs/.

112. *Id.*

113. Samuel Rubenfeld, *Employees' Ethical Behavior Is Best in 20 Years*, WALL ST. J.: RISK & COMPLIANCE J. (Feb. 4, 2014, 6:00 AM), http://blogs.wsj.com/riskandcompliance/2014/02/04/employees-ethical-behavior-is-best-in-20-years/ (noting a 2013 survey finding fewer workers observed corporate misconduct or felt pressure to violate standards and concluding that a probable cause was commitment to strong ethics and compliance programs).

114. Michelle Price, *Compliance Staff on Top During Asia Bonus Season*, FIN. NEWS (Feb. 4, 2014), http://www.efinancialnews.com/story/2014-02-04/asia-banker-bonuses-compliance-regulation?mod=home-mostemailedmod=home-mostemailed&ea9c8a2de0ee111045601ab04d673622.

115. Gregory J. Millman & Ben DiPietro, *More Compliance Chiefs Get Direct Line to Boss*, WALL ST. J. (Jan. 15, 2014, 8:16 PM), http://online.wsj.com/articles/SB10001424052702303330204579250723925965180.

not support their compliance and integrity objectives.[116] This variation suggests the ambiguity in compliance departments and the role of the CCO. Recent resignations of CCOs at companies like JPMorgan Chase, HSBC Holdings PLC, and Barclays have led corporate consultants to opine on the stress and difficulties CCOs endure because of regulatory pressure to implement stronger compliance programs while companies are reluctant to give them sufficient support to do their jobs properly.[117] Furthermore, CCOs in global companies have the additional problem of general acceptance in emerging countries of practices considered illegal in the United States.[118]

When companies settle with the SEC or the DOJ for regulatory violations they may have to agree to having their CCOs report directly to their CEOs and boards.[119] In a 2013 survey across industries fifty-three percent of respondents said they reported directly to the board and half of the remainder said they reported directly to the CEO.[120] Nevertheless, some CCOs complain that CEOs do not want to hear advice from CCOs and compliance programs are not taken seriously.[121] Such problems require CCOs to approach their jobs and their colleagues emphasizing that a strong compliance program is good for a business's bottom line. Among the factors that indicate a successful compliance program as well as a successful business are the identification of risks and controls, the optimization of personnel and other resources, the creation of high quality data and information, and the alignment of operating strategy with line department activities.[122] The result of carrying out these activities effectively can be protection of a company's reputation and brand, improvement in personnel performance, lowering of costs associated with compliance failures, and undertaking risk more confidently.[123] Across industries there is evidence that the pri-

116. CONSERO GROUP LLC, 2012 CHIEF COMPLIANCE OFFICER DATA SURVEY 7 (Nov. 26, 2012), *available at* http://consero.com/2012-chief-compliance-officer-data-survey/.

117. Gregory J. Millman, *The Morning Risk Report: Mammas Don't Let Your Babies Grow Up to Be CCOs*, WALL ST. J.: RISK & COMPLIANCE J. (Feb. 27, 2014, 6:12 AM), http://blogs.wsj.com/riskandcompliance/2014/02/27/the-morning-risk-report-mammas-dont-let-your-babies-grow-up-to-be-ccos/.

118. Millman & DiPietro, *supra* note 114. For example, an Ernst & Young survey in 2012 found that twelve percent of executives in Brazil were willing to use bribery to gain business. *Id.*

119. *Id.* Such was the case in Johnson & Johnson's settlement with the DOJ in 2013. *Id.*

120. Society of Corporate Compliance and Ethics ("SCCE") & Health Care Compliance Association ("HCCA"), *The Relationship Between the Board of Directors and the Compliance and Ethics Officer* 2–3 (Jan. 2014), https://www.ibe.org.uk/userassets/surveys/board&ecorelationshipscce.pdf. The numbers are higher for the health care industry alone. *Id.*

121. Millman & DiPietro, *supra* note 114. Some experts complain that CCOs are mere "window dressing" or "just a mask for the company to hide behind." Clark, *supra* note 9.

122. Robert Biskup, *The Benefits of Integrating Governance, Risk and Compliance*, WALL ST. J.: RISK & COMPLIANCE J. (Mar. 6, 2014, 12:01 AM), http://deloitte.wsj.com/riskandcompliance/2014/03/06/the-benefits-of-integrating-governance-risk-and-compliance/.

123. *Id.*

mary goal of compliance programs today is protecting a company's brand and reputation.[124] Responding to pressure from outside regulators is only the third most cited purpose for compliance programs.[125] It is integration of compliance with a company's general goals that will enhance both and make the CCO more effective and more satisfied.

D. *Part of Legal Department or Separate Compliance Department?*

Traditionally, the CCO was part of the Chief Legal Officer's ("CLO")[126] office, and sometimes one person held both titles.[127] In the last ten years or so, regulatory agencies have been encouraging the separation of the two roles.[128] This change has set up some skirmishing between the compliance industry, many of whose members are lawyers, and law departments, with differences of opinion showing up in discussions by theorists as well.[129]

A lawyer in charge of a large law firm's health care practice has noted the importance of coordinating legal advice with compliance advice and, therefore, asserted the advantages in having a CCO report to the CLO as long as the CCO was reporting to directors as well.[130] He opined that a CCO may not have the experience or expertise of a CLO.[131] One theorist has also questioned the sufficiency of expertise in a stand-alone compliance department and has suggested that C-level managers may ostracize CCOs who don't have the influence of CLOs.[132] She has characterized "departmentalization" as possibly just a "trapping" of a compliance program rather than a change that will actually contribute to a more effective compliance program.[133] She characterizes the stand-alone compliance department as a "more command-and-control based approach" rather than the more effective "integrity-based or self-regulation approach,"[134] but why one would expect that having a legal department in charge of compliance or requiring a CCO to report to a CLO would be more likely to lead to the latter is unclear. An American Bar Association Task Force has also recommended that

124. SAI GLOBAL & BAKER & MCKENZIE, *supra* note 100, at 7.

125. *Id.*

126. This article will use the CLO title although in some corporations the person serving that function is called the General Counsel.

127. Michele DeStefano, *Creating a Culture of Compliance: Why Departmentalization May Not Be the Answer*, 10 HASTINGS BUS. L.J. 71, 73 (2014); Jaclyn Jaeger, *The Importance of Splitting Legal and Compliance*, COMPLIANCE WEEK (Oct. 18, 2011), *available at* http://www.complianceweek.com/news/news-bulletin/the-importance-of-splitting-legal-and-compliance.

128. Jaeger, *supra* note 127.

129. Jaclyn Jaeger, *Why Compliance Reporting to GC Still Exists*, COMPLIANCE WK. (Feb. 25, 2014), *available at* http://www.complianceweek.com/news/news-bulletin/why-compliance-reporting-to-gc-still-exists.

130. Roy Snell, *Greg Luce Talks About the Relationship Between Legal Counsel and Compliance*, 9 J. HEALTH CARE COMPLIANCE 31 (2007).

131. *Id.*

132. DeStefano, *supra* note 127, at 155.

133. *Id.* at 157.

134. *Id.* at 165–67.

the CLO have primary responsibility for overseeing a corporate compliance program.[135]

Taking the opposing view, the Office of the Inspector General of the U.S. Department of Health and Human Services has favored free-standing compliance departments for hospitals to encourage independence, objectivity, and a system of checks and balances in carrying out an effective compliance program.[136] The Securities Industry and Financial Markets Association ("SIFMA") has also urged financial companies to have independent compliance departments that are not unduly pressured by any other departments.[137] One commentator has suggested that CLOs and their legal departments may not be suited to creating and implementing a program emphasizing the integrity-based approach because their training is in avoiding and solving legal problems.[138] They may ignore broad cultural problems in a company in favor of concentrating on narrow legal solutions.[139]

Senator Chuck Grassley, when he was chairman of the Senate Finance Committee, led an investigation of Tenet Healthcare Corporation for perpetrating a wide variety of frauds.[140] He called Tenet "among the worst corporate wrongdoers" and specifically mentioned the woman who was both Tenet's general counsel and CCO.[141] He noted that as general counsel she "zealously defended Tenet against claims of ethical and legal non-compliance . . . while as chief compliance officer, she supposedly ensured compliance by Tenet's officers, directors and employees."[142] He concluded that "[i]t doesn't take a pig farmer from Iowa to smell the stench of conflict in that arrangement."[143]

A 2013 survey of executives from nineteen industries and from companies with revenue from $200 million to $100 billion indicated that seventy-nine percent of the U.S. companies surveyed had a CCO and of those, forty-one percent were based in legal departments.[144] The same survey indicated that in the last three years there has been a gradual reduction in the number of CCOs who report to the CLO in favor of reporting to CEOs.[145]

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135. U.S. DEP'T OF HEALTH & HUMAN SERV., OFFICE OF INSPECTOR GEN. & AM. HEALTH LAWYERS ASS'N, AN INTEGRATED APPROACH TO CORPORATE COMPLIANCE 1 (July 1, 2004), *available at* https://oig.hhs.gov/fraud/docs/complianceguidance/Tab%204E%20Appendx-Final.pdf.

136. *Id.*

137. SEC. INDUS. AND FIN. MKT. ASS'N, THE EVOLVING ROLE OF COMPLIANCE 29 (2013).

138. Linda K. Treviño et al., *Managing Ethics and Legal Compliance: What Works and What Hurts,* 41 CAL. MGMT. REV. 131, 146 (1999).

139. *Id.*

140. Press Release, Sen. Chuck Grassley, Grassley Investigates Tenet Healthcare's Use of Federal Tax Dollars (Sept. 7, 2003), *available at* http://www.grassley.senate.gov/news/news-releases/grassley-investigates-tenet-healthcares-use-federal-tax-dollars.

141. *Id.*

142. *Id.*

143. *Id.*

144. PRICEWATERHOUSECOOPERS, *supra* note 103, at 9.

145. *Id.* at 10, 12.

The purpose of this article is not to advocate for one or the other of these organizational models, but merely to provide background for the consideration of a CCO's liability as a supervisor. So far, there is not any clear evidence indicating that one or the other model of a compliance program achieves greater success than the other. Prosecutions of CCOs also do not suggest that there is more or less protection from secondary liability for CCOs in charge of their own departments or CCOs who perform other organizational roles in addition to their compliance roles. However, because there will be overlapping activities between compliance and legal, it is important that companies establish protocols to indicate which kind of activity is being undertaken to ensure that all regulations are being followed and privileges are being maintained.[146]

E. *Indicia of an Effective Compliance Program*

A recent study of compliance programs suggests that a values-based approach, rather than a compliance-based approach, gives a company the most return for its allocation of resources.[147] A fifteen-year-old study came to the same conclusion.[148] Generally, compliance-based programs are viewed as governing behavior required by law, whereas values-based programs focus on discretionary behavior, are founded on pre-existing organizational functions, and achieve compliance by encouraging ethical decision-making.[149] One commentator notes that a values-based approach should be more effective because it encourages self-governance as employees act according to shared values rather than in response to the avoidance of punishment.[150]

In 2012 the DOJ and the SEC issued a joint resource guide to the FCPA which contains a discussion of the indicia of an effective compliance program,[151] and it can be used to evaluate a compliance and ethics program for any purpose. The goal for all businesses should be to have programs that are specifically tailored to their own needs and risks so that they can "prevent violations, detect those that do occur, and remediate them promptly and appropriately."[152] A first step for all compliance programs is to have senior management clearly articulate, adhere to, and disseminate company standards so that they set a tone of

146. U.S. DEP'T OF HEALTH & HUMAN SERV., *supra* note 135, at 9.

147. LRN CORP., 2013 ETHICS & COMPLIANCE LEADERSHIP SURVEY REPORT 7 (2013).

148. Treviño et al., *supra* note 138, at 149.

149. *See, e.g.*, SECRETARIAT, TREASURY BOARD OF CANADA, REPORT ON GOVERNANCE STRUCTURES FOR VALUES AND ETHICS, *available at* https://www.tbs-sct.gc.ca/rp/sgs01-eng.asp (last modified Jan. 17, 2011) (noting that a compliance approach focuses primarily on preventing, detecting, and punishing violations of the law, while a values-based approach aims to define organizational values and encourage employee commitment to ethical aspirations); *see also* Treviño et al., *supra* note 138, at 135.

150. Lynn Sharp Paine, *Managing for Organizational Integrity*, 72 HARV. BUS. REV. 106, 111 (1994).

151. U.S. DEP'T OF JUSTICE & U.S. SEC. & EXCH. COMM'N, A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACTS 57-63 (Nov. 14, 2012) *available at* http://www.justice.gov/criminal/fraud/fcpa/guide.pdf.

152. *Id.* at 57.

compliance and ethics throughout the organization.[153] The importance of the "tone at the top" has become a cliché, but it is only effective if it creates the proper "mood in the middle" and "buzz at the bottom" so that the whole company is invested in the compliance and ethics standards.[154]

The standards will generally exist within a company code of conduct and a set of compliance policies and procedures that are clear, concise, specific to the company's business and risks, and accessible to all employees and outside contractors.[155] The amount of due diligence, the frequency of internal audits, and the kind and amount of training for employees depend upon the size of a company and the particular risks it faces.[156] Last but not least, a company has to consider enforcement and incentives. A company should have clear, fair, and reliable disciplinary procedures to encourage compliant and ethical behavior.[157]

Companies have shown an increased interest in providing incentives for compliant and ethical behavior.[158] Incentives could include having promotions, evaluations, incentive pay, and other rewards dependent upon employees' support for and leadership in the company compliance program.[159] A large national hospital system, for example, has implemented a series of metrics to evaluate whether employees are achieving specific compliance and ethics goals.[160] There are twenty-five to thirty metrics each year.[161] Every goal has to be objectively measurable and each is worth a set number of points in the program.[162] A department's good score on the compliance metrics is a requirement for all executive bonuses.[163] Hospital presidents, although skeptical of the program at first, have become supporters because they recognize it protects them by indicating that they are taking action to do what the law and ethics require them to do.[164]

153. *Id.*

154. Saris, *supra* note 12, at 20.

155. U.S. DEP'T OF JUSTICE & U.S. SEC. & EXCH. COMM'N, *supra* note 151, at 57–58.

156. *Id.* at 59.

157. *Id.*

158. *Id.*

159. Joe Murphy, *What Is an Antitrust Compliance Program?*, 4 SOCIETY OF CORPORATE COMPLIANCE AND ETHICS, *available at* http://www.compliance-network.com/wp-content/uploads/2013/02/4th-edition-What-is-an-antitrust-compliance-program.pdf.

160. Gregory J. Millman, *Q&A: Daniel Roach, Vice President Compliance and Audit, Dignity Health*, WALL ST. J.: RISK & COMPLIANCE J. (Oct. 24, 2013, 10:11 AM), http://blogs.wsj.com/riskandcompliance/2013/10/24/qa-daniel-roach-vice-president-compliance-and-audit-dignity-health/.

161. *Id.*

162. *Id.*

163. *Id.*

164. *Id.*

III. Cases and Theories for Liability

A. *Support for CCOs: Prohibition Against Misleading CCOs*

A recent case supporting CCOs in carrying out their duties was the first one brought by the SEC under ICA Rule 38a-1(c) that prohibits securities brokers and dealers from misleading CCOs in performing their duties.[165] Carl Johns managed portfolios for and was an officer of registered investment companies.[166] To hide personal securities transactions, he altered brokerage statements, trade confirmations, and pretrade approvals, and lied to the CCO about them.[167] The SEC found Johns guilty, *inter alia*, of violating the Rule, barred him from working in the securities field for five years before being able to apply for reentry and fined him about $350,000 for disgorgement, interest, and penalties.[168] The compliance industry was encouraged that this case would make it easier for CCOs to do their jobs.[169]

B. *Support for CCOs: Requiring CCO to Have Professional Knowledge*

In 2011 the SEC created its Compliance Program Initiative to oversee financial firms that had been warned about compliance deficiencies but did not correct them.[170] In *Modern Portfolio Management, Inc.* ("MPM")[171] the SEC conducted an examination of MPM and found violations of the IAA including making misleading statements in its marketing materials, failing to implement written policies and procedures to prevent violations of the IAA, and failing to perform annual compliance reviews.[172] When MPM did not remedy these violations over a period of years, the SEC brought an action against the company and its principals.[173] The SEC noted that MPM had designated as CCO an employee without relevant compliance knowledge, experience, or training.[174] When the CCO left, one of the principals took over as

165. *In re* Carl D. Johns, Investment Adviser Act Release No. 3655, Investment Company Act Release No. 30675, Administrative Proceeding Release No. 3-15440, 2013 WL 4521169 (Aug. 27, 2013), http://www.sec.gov/litigation/admin/2013/ia-3655.pdf; Press Release, U.S. Sec. & Exch. Comm'n, SEC Sanctions Colorado-Based Portfolio Manager for Forging Documents and Misleading Chief Compliance Officer (Aug. 27, 2013), *available at* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539791420#.Uv0JQvshMuc; ICA, Rule 38a-(1), *supra* note 58.

166. *In re* Carl D. Johns, *supra* note 165, at 2.

167. *Id.* at 3.

168. *Id.* at 5.

169. Samuel Rubenfeld, *SEC Stands Up for Compliance Officers in Colorado Case*, Wall St. J.: Risk & Compliance J. (Aug. 29, 2013, 3:49 PM), http://blogs.wsj.com/riskandcompliance/2013/08/29/sec-stands-up-for-compliance-officers-in-colorado-case/.

170. Press Release, U.S. Sec. & Exch. Comm'n, SEC Sanctions Three Firms Under Compliance Program Initiative (Oct. 23, 2013), *available at* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540008287#.Uv5aWfshMuc.

171. *In re* Modern Portfolio Management, Inc., Investment Adviser Act Release No. 3702, Administrative Proceeding Release No. 3-15583, 2013 WL 5741332 (Oct. 23, 2013), *available at* http://www.sec.gov/litigation/admin/2013/ia-3702.pdf.

172. *Id.* at 2, 5–6.

173. *Id.* at 2.

174. *Id.* at 3.

CCO although he too had no compliance experience.[175] The SEC, in addition to fining MPM and its principals and censuring the principals, required MPM to hire a compliance consultant for three years and to designate someone in the company, other than either of the principals, to be the CCO.[176] This case should be encouraging to CCOs because it indicates that merely paying lip service to compliance requirements will not satisfy SEC investigators. A knowledgeable CCO is almost a requirement to indicate a meaningful compliance program that satisfies SEC rules.

C. *Liability of CCOs: Failure to Supervise*

It is, however, the cases in which CCOs have been charged with malfeasance that create the greatest interest and concern for the industry. Of these, the issues of when a CCO is a supervisor and whether the CCO carried out supervisory responsibilities reasonably have been the most contentious issues for more than twenty years.[177] Because the cases are so fact specific, it is difficult for CCOs to determine clear guidelines for getting company employees to act within regulatory and ethics code rules without becoming their supervisors so that CCO liability does not hinge on the reasonableness of CCO behavior, a standard that is even less clear.[178] In a good example of the confusion on these issues, SEC commissioners have determined that a CCO discharged supervisory responsibilities in a reasonable manner without ever determining that the CCO was a supervisor.[179]

1. *Gutfreund* and *Urban*

Recently, the most notable case was the proceeding the SEC brought against Theodore W. Urban which the SEC ultimately dismissed in 2012.[180] In spite of the eventual dismissal, it is a very frightening case for CCOs. Urban, who had been head of the Legal and Compliance Department at a financial firm, lost his professional reputation and employment opportunities and incurred significant expense because of this proceeding.[181] In the case against Urban, the SEC and its expert witness relied heavily on the leading case, *In re John H. Gutfreund*.[182]

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175. *Id.* at 5.

176. *Id.* at 7–8.

177. *See, e.g.*, Richard Y. Roberts, Remarks at Securities Law Comm'n of Fed. Bar Ass'n, Failure to Supervise Liability for Legal and Compliance Personnel (Dec. 7, 1992).

178. *Id.* at 6.

179. *Id.* at 8–10 (discussing Arthur James Huff, No. 34-29017 (Mar. 28, 1991)).

180. *In re* Theodore W. Urban, Order Dismissing Proceeding, Securities Exchange Act Release No. 66259, Investment Adviser Act Release No. 3366, Administrative Proceeding Release No. 3-13655, 2012 WL 261254 (Jan. 26, 2012), *available at* http://www.sec.gov/litigation/admin/2012/34-66259.pdf.

181. *In re* Theodore W. Urban, Initial Decision, Securities Exchange Act Release No. 402, Administrative Proceeding Release No. 3-13655, 2010 WL 3500928 1, 57 (ALJ Sept. 8, 2010), *available at* https://www.sec.gov/litigation/aljdec/2010/id402bpm.pdf.

182. *In re* John H. Gutfreund, Securities Exchange Act Release No. 34–31554, Administrative Proceeding Release No. 3-7930, 1992 WL 362753 (Dec. 3, 1992), *available*

Both the *Gutfreund* and the *Urban* cases were about CCOs' failure to supervise subordinates who committed illegal acts.[183] What was so distressing about the *Urban* case was that the SEC applied the law from *Gutfreund* when the facts of the two cases were significantly different. In *Gutfreund*, the Chairman and CEO of Salomon Brothers as well as the President and Vice Chairman were informed by the CLO, who supervised both the Legal and Compliance Departments, that a subordinate had violated federal securities laws, but none of them took any action.[184] For almost two years, the subordinate continued to make false bids for U.S. Treasury securities on behalf of Salomon.[185] The SEC found the CEO, the President, and the Vice Chairman guilty of violating section 15(b)(4)(E) of the SEA for failing to reasonably supervise their subordinate who they knew was violating federal securities law.[186] Then the SEC discussed the role of the CLO.[187]

The SEC concluded that the CLO was not a direct supervisor of the subordinate committing the illegal acts at the time he first learned of them, so the SEC did not charge him in this proceeding; however, the SEC took the opportunity to explain when a legal advisor becomes a supervisor for purposes of the SEA.[188] The SEC noted that the CLO did notify senior management about the illegal acts and urged them to report to the government, but he did not take any other actions to prevent and detect future violations.[189] The SEC said that CLOs or CCOs do not become supervisors merely based on their job titles; being a supervisor depends on having the "requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue."[190] Someone in the position of the CLO at Salomon cannot be "a mere bystander," but must take "affirmative steps . . . to address the misconduct."[191] If management still fails to act, then one in that position must take "additional steps . . . [which] may include disclosure of the matter to the entity's board of directors, resignation from the firm, or disclosure to regulatory authorities."[192] That is the language that the SEC relied on in proceeding against Theodore Urban.[193]

Urban headed the compliance, human resources, and internal audit departments at FBW, a financial firm.[194] The problem he faced

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at http://ocw.mit.edu/courses/sloan-school-of-management/15-649-the-law-of-mergers-and-acquisitions-spring-2003/study-materials/class13gutfreund.pdf.

183. *Id.* § IV(A)(4).

184. *Id.*

185. *Id.* § IV(A)(13).

186. *Id.* §§ IV(B)(1) & (2).

187. *Id.* § IV(C).

188. *Id.*

189. *Id.*

190. *Id.*

191. *Id.*

192. *Id.*

193. *In re* Theodore W. Urban, Initial Decision, Securities Exchange Act Release No. 402, Administrative Proceeding Release No. 3-13655, 2010 WL 3500928 1, 46–47 (ALJ Sept. 8, 2010), *available at* https://www.sec.gov/litigation/aljdec/2010/id402bpm.pdf.

194. *Id.* at 2.

was a company broker who falsified accounts and made unsuitable trades for accounts which had very high turnover and commission-to-equity ratios.[195] Urban recommended the broker's termination, but the broker's direct supervisor, board member, and "most powerful person at the firm" vehemently objected.[196] The broker was prosecuted, convicted, and served a year in prison.[197] The SEC's expert testified that in his opinion Urban was the broker's supervisor and had supervisory responsibility because of the senior level position he held and his knowledge of the broker's activities.[198] According to the expert, "a person who gets involved in a compliance problem becomes a supervisor" as set out in *Gutfreund*.[199] The SEC asserted that CCOs are supervisors if they play a "significant, even if shared, role in the firm's supervisory structure [even if their] authority [is] subject to countermand at a higher level."[200] The SEC's position was that Urban didn't respond "vigorously" enough when he discovered the broker's illegal activities.[201]

The Chief Administrative Law Judge ("CALJ") hearing the case was convinced that Urban was honest and tried to do the right thing.[202] She distinguished the facts in *Gutfreund* from those in Urban's case: *Gutfreund* involved known criminal conduct whereas in Urban's case the guilty broker was well-respected and his conduct was only suspect to a few people; the CLO in *Gutfreund* acted as a bystander whereas Urban "took actions, and . . . shared information;" Urban's senior managers lied to him, kept information from him, and told him they were carrying out their responsibilities vis-a-vis the broker, although they were not.[203] The CALJ agreed with the SEC that under a strict interpretation of *Gutfreund*, Urban was the broker's supervisor because he along with many others at FBW had "a requisite degree of responsibility, ability, or authority to affect [the broker's] conduct."[204] Nevertheless, she concluded that Urban did not fail to supervise the broker under SEA section 15(b)(4)(E)(i) because he acted "reasonably" in carrying out his responsibilities.[205] The SEC appealed the ruling: three SEC commissioners recused themselves, the remaining two were split, and therefore, the SEC dismissed the case.[206]

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195. *Id.* at 8–9.
196. *Id.* at 3, 25–26.
197. *Id.* at 39.
198. *Id.* at 40.
199. *Id.* at 40, 42.
200. *Id.* at 46.
201. *Id.* at 47.
202. *Id.* at 48.
203. *Id.* at 49–50.
204. *Id.* at 51–52.
205. *Id.* at 55–56.
206. *In re* Theodore W. Urban, Order Dismissing Proceeding, Securities Exchange Act Release No. 66259, Investment Adviser Act Release No. 3366, Administrative Proceeding Release No. 3-13655, 2012 WL 261254 (Jan. 26, 2012), *available at* http://www.sec.gov/litigation/admin/2012/34-66259.pdf. When there isn't agreement among a majority of commissioners on the merits of a case, the initial decision is void. Commission Rule of Practice, 17 C.F.R. § 201.411(f) (2006).

2. Theories for Supervisory Liability

The prominence of this case and the lack of a decision on its merits has caused a great deal of uncertainty and discomfort among compliance professionals.[207] Of course the negligence standard of reasonable behavior works well enough across wide swaths of the law, but in the context of assessing the behavior of CCOs, it may not accomplish the purpose of the SEA. It is desirable for CCOs to act forcefully in encouraging their firms and its employees to obey the law and behave ethically, but the looming liability for supervising others might discourage CCOs from taking the most vigorous actions to accomplish that goal for fear of appearing to be a supervisor and then being liable under a very subjective reasonableness standard.[208] In the midst of trying to eliminate illegal behavior without the benefit of hindsight, it can be difficult to determine when reasonably carrying out a CCO's responsibilities does not veer into the territory of being a supervisor.

One of Urban's expert witnesses suggested that instead of using a negligence standard for determining CCO liability under the SEA, a supervisor should be defined as "a person who knows, or reasonably should know, that he or she has been given the authority and responsibility for exercising control over one or more activities" of another person.[209] The CALJ rejected this suggestion,[210] but it is worthy of consideration to provide clarity, particularly if "control" means the ability to sanction.[211] Some SEC commissioners have asserted that control is not necessary at all for supervisory liability: the responsibility or authority merely "to affect the conduct" of another employee is sufficient for supervisory liability.[212]

Late last year, the SEC's Division of Trading and Markets ("DTM") issued responses to questions about CCO liability.[213] The DTM suggested that a question one might ask to determine whether a CCO is a supervisor is whether "the person ha[d] the power to affect another's

207. *See, e.g.*, Schoeff, *supra* note 2.

208. Deborah A. DeMott, *The Crucial but (Potentially) Precarious Position of the Chief Compliance Officer*, 8 BROOK. J. CORP. FIN. & COM. L. 56, 77 (2013).

209. *In re* Theodore W. Urban, Securities Exchange Act Release No. 402, Administrative Proceeding Release No. 3-13655, 2010 WL 3500928 1, 42 (ALJ Sept. 8, 2010), *available at* https://www.sec.gov/litigation/aljdec/2010/id402bpm.pdf.). About twenty years earlier former SEC Commissioners Lochner and Schapiro offered a similar definition: a "supervisor" has been given the authority and responsibility for exercising control over one or more activities of another person so that the "supervisor" "could take effective action to prevent a violation of [SEC] rules." *In re* Arthur James Huff, Securities Exchange Act Release No. 34–29017, Administrative Proceeding Release No. 3-6700, 1991 WL 296561 (Mar. 28, 1991) (concurring opinion).

210. *In re* Theodore W. Urban, 2010 WL 3500928, at 42 n.75.

211. Roberts, *supra* note 177, at 11 (noting Lochner/Schapiro formula that person's power to control, i.e., ability to sanction, determines existence of supervisory relationship).

212. *Id.* at 18.

213. Frequently Asked Questions about Liability of Compliance and Legal Personnel at Broker-Dealers under Sections 15(b)(4) and 15(b)(6) of the Exchange Act, SEC DIV. OF TRADING AND MARKETS (Sept. 30, 2013), *available at* www.sec.gov/divisions/marketreg/faq-cco-supervision-093013.htm.

conduct," and the examples given were whether the person "ha[d] the ability to hire, reward or punish."[214] The DTM said another determining question is whether the CCO had the authority to stop the violations even if the CCO did not "have the power to fire, demote or reduce . . . pay."[215] These definitions and explanations only add to the ambiguity of the CCO's position and could discourage meaningful discourse between CCOs and other employees.

A change in the definition of "supervisor" that would make CCOs better protected and feel more secure in carrying out their responsibilities, is defining "supervisor" in the context of securities law as the U. S. Supreme Court recently defined "supervisor" for the purpose of vicarious liability under Title VII of the Civil Rights Act of 1964.[216] In *Vance v. Ball State University*,[217] the Court had to decide whether a fellow employee who was being accused of creating a racially hostile work environment was a supervisor or merely a co-worker.[218] Under Title VII the liability of the employer depends on the status of the employee/harasser.[219] The Court heard this case to settle a conflict among the Circuit Courts of Appeals.[220] The Second and Fourth Circuits held that a supervisor had "the ability to exercise significant direction over another's daily work."[221] The First, Seventh, and Eighth Circuits held that to be a supervisor one must have "the power to hire, fire, demote, promote, transfer, or discipline."[222] Justice Alito, writing for the majority, held that an employer may be vicariously liable for an employee's unlawful harassment only when the employer has empowered that employee to take tangible employment actions against the victim, i.e., to effect a "significant change in employment status, such as hiring, firing, failing to promote, reassignment with significantly different responsibilities, or a decision causing a significant change in benefits."[223]

Justice Alito noted the wide variety of definitions of the term "supervisor" both in general usage and in legal contexts.[224] He called the Second and Fourth Circuits' definition "nebulous,"[225] "murky,"[226] and a "study in ambiguity,"[227] whereas the definition he upheld "can be

214. *Id.*
215. *Id.*
216. 42 U.S.C. § 2000e; Vance v. Ball State Univ., 133 S. Ct. 2434, 2443 (2013).
217. 133 S. Ct. 2434 (2013).
218. *Id.* at 2439.
219. *Id.*
220. *Id.* at 2443.
221. *Id.* (citing Mack v. Otis Elevator Co., 326 F.3d 116, 126–27 (2d Cir. 2003); Whitten v. Fred's, Inc., 601 F.3d 231, 245–47 (4th Cir. 2010)).
222. *Id.* (citing Vance v. Ball State Univ., 646 F.3d 461, 470 (7th Cir. 2011); Noviello v. Boston, 398 F.3d 76, 96 (1st Cir. 2005); Weyers v. Lear Operations Corp., 359 F.3d 1049, 1057 (8th Cir. 2004)).
223. *Id.*
224. *Id.* at 2444–45.
225. *Id.*
226. *Id.* at 2449.
227. *Id.*

readily applied."[228] The four dissenting justices noted that the Court "adopted a standard, rather than a clear rule . . . [because] no crisp definition of supervisor could supply the unwavering line the Court desires."[229]

A definition of "supervisor" has been problematic in other situations as well. The National Labor Relations Act ("NLRA") defines a "supervisor" as:

> [A]ny individual having authority, in the interest of the employer, to hire, transfer, suspend, lay off, recall, promote, discharge, assign, reward, or discipline other employees, or responsibly direct them, or to adjust their grievances, or to effectively recommend such action, if in connection with the foregoing the exercise of such authority is not of a merely routine or clerical nature, but requires the use of independent judgment.[230]

Cases have been litigated that turned on applying that definition to determine whether certain employees were supervisors or not.[231] The U.S. Court of Appeals for the Sixth Circuit has said that "[t]here are no bright lines controlling the determination of whether a particular position comes within the definition of 'supervisor' under the NLRA."[232] So, the NLRA definition would not be helpful in the CCO situation; it would maintain the ambiguity. It is likely that part of a CCO's job would be to "direct" employees or to "effectively recommend" actions regarding them. It would not be useful to have those actions result in CCO liability if employees then violated the law in spite of the CCO's best efforts to implement appropriate compliance procedures and to report violations.

The U.S. Court of Appeals for the Ninth Circuit has noted that the Clean Air Act uses the term "supervisor" but does not define the degree of authority necessary to be a supervisor.[233] The court said it has held that the governing criterion for defining "supervisor" under the Clean Air Act is "'substantial control'"[234] which does not mean "ultimate, maximal, or preeminent control," but does mean "having the ability to direct the manner in which work is performed and the authority to correct problems."[235] That definition could also sweep an active CCO into its liability sphere.

Although the reasons for preferring one definition or another for the term "supervisor" are different in the Title VII, the labor law, the

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228. *Id.*

229. *Id.* at 2463 (Ginsburg, J., dissenting).

230. 29 U.S.C. § 152(11) (2013).

231. *See, e.g.*, Kaczynski v. Draper Printing, 848 F. Supp. 1060, 1062–63 (D. Mass. 1994) (determining whether employee was supervisor as defined by NLRA and, therefore, not part of union bargaining unit); *In re* Employees of Bermudian Springs School District, 69 Pa. D. & C.2d 765 (Pa. Com. Pl. 1975) (construing "supervisor" as defined in the Pa. Public Employee Relations Act which is same definition as in NLRA).

232. AFTRA v. Storer Broadcasting Co., 745 F.2d 392, 399 (6th Cir. 1984).

233. United States v. Pearson, 274 F.3d 1225, 1230–31 (9th Cir. 2001).

234. *Id.* (citing United States v. Walsh, 8 F.3d 659, 662–63 (9th Cir. 1993)).

235. *Id.*

environmental law, and the securities law contexts, acknowledging the ambiguities in the term and the different possibilities for defining it are important in arriving at the best definition in the context of holding CCOs in any industry liable for the actions of others. In the latter situation, the goal is to have CCOs be experienced enough to assess company compliance risk properly; diligent enough to provide policies and procedures to ensure company compliance, supported enough in words and deeds by line supervisors, top managers, and directors to achieve company-wide compliance, and confident enough that doing their job appropriately will not be construed as acting as a supervisor, subjecting them to liability for the misdeeds of others.[236] There is no useful reason to use an expansive definition of "supervisor" in the context of CCO liability. It would reward inaction. The SEC should adopt Justice Alito's definition of "supervisor" in *Vance* for CCOs, setting an example for other regulatory agencies.

3. An Unfortunate Example of Supervisory Liability

In *Manuel Lopez-Tarre*,[237] Lopez-Tarre, CCO for FTC Capital Markets, Inc., was responsible for supervising the customer account activity of the owner of the company.[238] Tasks included in his area of responsibility were reviewing correspondence, including electronic correspondence, of the owner, Clamens, and another employee, Lopez.[239] The SEC issued a judgment against Clamens and Lopez for violating securities fraud laws when they made tens of millions of dollars of unauthorized trades in their customer Citgo's account.[240] The SEC also charged Lopez-Tarre with failing to reasonably supervise Clamens and Lopez by reviewing their correspondence and, therefore, failing to prevent and detect their violations.[241] He agreed to being barred from associating with financial organizations in a supervisory capacity for one year.[242]

It is clear that Lopez-Tarre did not do his job so he should have been charged with failing to implement compliance procedures or with aiding and abetting securities law violations. His failure to carry out his primary responsibilities allowed the violations to persist. He did not

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236. This discussion of supervisory liability does not apply to CCOs' being supervisors of personnel in their own compliance departments where their supervisory responsibilities are clear and the same as managers of any other department. *See, e.g.*, *In re* Dennis S. Kaminski, Securities Exchange Act Release No. 65347, Administrative Proceeding Release No. 3-14054, 2011 WL 4336702 (Sept. 16, 2011) (finding Kaminski as CCO of MSC ran understaffed, poorly paid, inadequately supervised department, failed to communicate with senior management and, therefore, was suspended for eighteen months and fined $50,000).

237. *In re* Manuel Lopez-Tarre, Securities Exchange Act Release No. 65391, Administrative Proceeding Release No. 3-14562, 2011 WL 4431616 (Sept. 23, 2011), *available at* http://www.sec.gov/litigation/admin/2011/34-65391.pdf.

238. *Id.* at 4.

239. *Id.*

240. *Id.* at 3.

241. *Id.* at 6.

242. *Id.*

have the power to hire, fire, demote, promote, transfer, or discipline Clamens or Lopez, so using his failure as a supervisor to justify sanctions against him was not necessary to satisfactorily resolve this case, and calling his wrongdoing supervisory failure just contributes to wariness among CCOs in pursuing their responsibilities.

D. *Liability of CCOs: Failing to Implement and Review Compliance Procedures*

Responsibilities of CCOs that are not controversial, but have led to cases brought against them by the SEC, require registered investment advisors to implement and regularly review "written policies and procedures reasonably designed to prevent violations of the [IAA] and its rules" and to maintain, enforce, and distribute a written code of ethics.[243] The importance of these cases is to suggest that all regulated companies, no matter how small, must consider compliance a fundamental part of their business operations and invest the resources necessary to maintain a functioning compliance program.[244] It is not sufficient to merely designate someone as CCO and purchase an off-the-shelf compliance manual.[245] If that CCO does not do the implementation and review the job specifically and adequately, he or she is going to be responsible for the failure. The case of *Asset Advisors*[246] is instructive.

Carl Gill founded Asset Advisors ("AA") and registered with the SEC as an investment adviser.[247] AA had $27 million in assets under management, six employees only one of whom (Gill) provided investment advice to clients.[248] Although Gill had no experience or training in compliance, he served as CCO because there was no one else to do it.[249] It was during an SEC routine on-site exam that Gill learned about requirements for a written compliance program and a written code of ethics.[250] AA then adopted a code of ethics and created a compliance

243. IAA §§ 206(4)-7, 204A-1 (2012).

244. *See, e.g.*, *In re* Feltl & Co., Inc., Securities Exchange Act Release No. 65838, Investment Advisers Act Release No. 3325, Investment Company Act Release No. 29875, Administrative Proceeding Release No. 3-14645, 2011 WL 5911238 (Nov. 28, 2011) (dually-registered broker-dealer and investment advisor failed to adopt and implement written compliance policies and procedures and code of ethics that specifically applied to its advisor business resulting in failures to get required client consent, to disclose fees, to charge proper commissions).

245. *See, e.g.*, *In re* OMNI Investment Advisors, Inc., Securities Exchange Act Release No. 65837, Investment Advisers Act Release No. 3323, Investment Company Act Release No. 29873, Administrative Proceeding Release No. 3-14643, 2011 WL 5970787 (Nov. 28, 2011) (registered investment advisor listed owner as CCO although he was in Brazil on three-year religious mission and had no compliance program other than compliance manual not specifically tailored to OMNI's business).

246. *In re* Asset Advisors, LLC, Investment Advisers Act Release 3324, Investment Company Act Release No. 29874, Administrative Proceeding Release No. 3-14644, 2011 WL 5970790 (Nov. 28, 2011).

247. *Id.* at 2.

248. *Id.*

249. *Id.* at 3–4.

250. *Id.* at 3.

manual but did nothing to make those documents particularly relevant to the business at hand or to implement relevant procedures.[251] After four years of non-compliance, Gill in an agreement with the SEC, undertook to withdraw AA's registration as an investment advisor, close operations and dissolve itself in addition to paying a penalty of $20,000.[252]

The Banking Secrecy Act ("BSA")[253] also mandates financial institutions, including small check cashing businesses, to designate a compliance officer who must develop policies, procedures, and controls to guard against money laundering.[254] In addition, the compliance officer must regularly file currency transaction reports with the Department of Treasury.[255] Last year, the compliance officer for a Los Angeles check cashing store pleaded guilty to DOJ charges for failing to have an effective anti-money laundering program.[256] He failed to create the required records, verify customer identification, and file currency transaction reports.[257] He was sentenced to eight months in prison.[258]

E. *Liability of CCOs: Aiding and Abetting Securities Law Violations*

Similarly, if CCOs establish compliance policies and procedures that are not reasonably designed to address the actual existing risks at their companies, or they establish appropriate compliance policies and procedures but fail to implement them, they will be liable for aiding, abetting, and causing their companies' violations. In *Buckingham Research Group, Inc.*,[259] for example, Lloyd Karp was the CCO for Buckingham Research Group, Inc. ("BRG"), an equity research firm servicing hedge funds and other institutional customers.[260] Buckingham Capital Management, Inc. ("BCM") had a subsidiary registered investment adviser located in adjoining office space with little physical separation; thus, there was a significant risk of information flow between the two entities resulting in the potential misuse of BRG's research information by BCM.[261] BRG created written policies and procedures to detect and prevent misuse, but in practice did not follow them.[262] Karp, as the CCO, was responsible for establishing and administering all com-

251. *Id.* at 3–5.

252. *Id.* at 5–6.

253. 31 U.S.C. § 5301 (2013).

254. 31 U.S.C. § 5318(h)(1) (2014).

255. 31 U.S.C. § 5311 (2014).

256. Press Release, DOJ, Los Angeles Check Cashing Store, Its Head Manager and Compliance Officer Sentenced for Violating Anti-Money Laundering Laws, 2013 WL 142511 (Jan. 14, 2013).

257. *Id.*

258. *Id.*

259. *In re* Buckingham Research Group, Inc., Securities Exchange Act Release No. 63323, Investment Advisers Act Release No. 3109, Administrative Proceeding Release No. 3-14125, WL 4648468 (Nov. 17, 2010).

260. *Id.* at 2.

261. *Id.* at 3.

262. *Id.* at 3–4, 6.

pany compliance policies.[263] When he did not act to address the risk of misuse of material, nonpublic information, the SEC found that he "willfully aided and abetted and caused the firms' violations."[264] The SEC censured him and fined him $35,000.[265]

IV. CONCLUSIONS

As CCOs become more involved in general business activities, they become more threatened by the risk of supervisory accountability for the regulatory violations of company employees to whom they have provided advice.[266] Unfortunately, that threat can limit the effectiveness of a company's compliance and ethics program and its CCO.[267] Regulatory agencies are beginning to recognize this problem they themselves encouraged when they first started requiring comprehensive compliance programs. In a report last year, SIFMA specifically told top executives that they "should not assign supervisory or managerial responsibilities to Compliance . . . even in limited ways or on a temporary basis."[268] Now it is time for these agencies to define "supervisor" so that there is no ambiguity in its meaning for CCOs.

A functional difficulty for CCOs lies in straddling the line between being team players for their companies and being quasi-employees of regulating agencies.[269] In the best interests of the company from both regulatory and reputational viewpoints, the board and other C-suite managers should view the CCO as an equal C-suite businessperson who contributes to the company's well-being by monitoring and limiting risk, rather than as a thorn in its side. The position should be dedicated to managing the company's compliance and ethics responsibilities through investigation, monitoring, education, and prescription, but not through control of employees. If CCOs are supported in word and deed by top management and directors, then their advice will be sufficient to encourage all company employees to follow the law and company ethics rules, and they will not need supervisory powers to get their jobs done.

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263. *Id.* at 6.

264. *Id. See also In re* Ronald S. Rollins, Securities Exchange Act Release No. 70058, Investment Advisers Act Release No. 3635, Investment Company Act Release No. 30633, Administrative Proceeding Release No. 3-15392, 2013 WL 3874860 (July 29, 2013) (aiding and abetting fraud of another); *In re* Wunderlich Securities, Inc., Securities Exchange Act Release No. 64558, Investment Advisers Act Release No. 3211, Administrative Proceeding Release No. 3-14403, 2011, WL 2098195 (May 27, 2011) (aiding and abetting failure to adopt and implement written policies and procedures and written code of ethics).

265. *Id.* at 10–11.

266. SEC. INDUS. AND FIN. MKT. ASS'N, *supra* note 137, at 5.

267. *Id.*

268. *Id.* at 29.

269. Mary Jo White, SEC Chair, Remarks at National Society of Compliance Professionals National Membership Meeting, Oct. 22, 2013 (noting that "at the SEC, we rely on you" and "we see you as a critical line of defense against violations of the securities laws and regulations . . . .").