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Conflicts of Interest: Why You Can't Serve Two Masters

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Agenda

- Why conflicts of interest matter for organizations
- Key conflicts of interest for board members, compliance professionals and other employees
- Case studies, best practices and effective mitigation strategies

Conflicts of Interest Never End

- *SEC Takes Deep Dive on Conflicts of Interest*
- *Glaxo Says It Will Stop Paying Doctors to Promote Drugs*
- *World Bank President Paul Wolfowitz Forced Out Over Promotion and Pay Increase for His Girlfriend*
- *Former Boeing Exec Pleads Guilty; Admits Conflict of Interest Charges*
- *The FDA's Conflict of Interest Problem: Doctors on Advisory Panel Owned Stock and Received Lecture Fees from Drug Companies*
- *USOC President Under Fire for Conflict of Interest Charges*
- *Student Loan Giant Sallie Mae Settles Conflict of Interest Probe*
- *UN Oil-for-Food Inquiry Finds Conflicts of Interest*

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Why You Can't Serve Two Masters

Peter B. Madoff, former Chief Compliance Officer,
Bernard L. Madoff Investment Securities LLC



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NYSE Definition

- “A conflict of interest occurs when an individual’s private interest interferes in any way—or even appears to interfere—with the interests of the corporation as a whole. A conflict situation can arise when an employee, officer, or director takes action or has interests that may make it difficult to perform his or her company work objectively and effectively.”

– Section 303A of the NYSE Corporate Governance Rules

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Why Conflicts of Interest Matter

- A conflict of interest increases risk of bias or poor judgment because of an obligation or commitment to two or more competing interests
- A perceived conflict can tarnish public image and erode community trust
- Government regulators expect companies to assess their exposure to the risks of conflicts of interest

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Human Nature of Conflicts of Interest

- One should avoid conflicts of interest, or situations that can give rise to the appearance of a conflict of interest
 - But if you don't think you have one, you can't or won't avoid it
 - We are often a poor judge of our own conflicts and not motivated to resolve or disclose them
- A wide range of activities are prone to potential conflict situations
 - Multiple roles are increasingly common for individuals and organizations
 - Conflict situations are likely with accomplished and well-connected individuals (company leaders)

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Comments from the SEC on COIs

“The types of conflicts that I find most challenging are situations where people who profess to be ethical and clear-thinking are led astray by cultural pressure (poor tone at the top), misaligned financial incentives, herd behavior (everyone is doing it), or just personal weakness – vanity, self-delusion or poor judgment. The best antidote for this type of conflict is a strong ethics program for the organization, as well as a strong internalized sense of ethics by everyone in an organization....”

- Carlo V. di Florio, Director, SEC Office of Inspections and Examination, 10/22/12

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Fiduciary Responsibility: Duties of Loyalty and Care

- *Duty of Loyalty* is the obligation to give primacy to the interests of the company rather than personal concerns – to avoid self dealing at the corporation's expense
- *Duty of Care* is to act in good faith, in a manner which is reasonably believed to be in the best interests of the company, with the care a reasonably prudent person would use in similar circumstances.

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Divided Loyalties, Arrogance & Greed Result in Prison

Martha Stewart



Samuel Waksal



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Common Conflicts Of Interest

Use of Company Information for Private Gain

General Financial Interests (hidden ownership, bid-rigging, procurement fraud)

Moonlighting (employment and future job offers)

Service on a Board of Directors

Family and Romantic Relationships –Nepotism

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Common Conflicts Of Interest

Spouses, Domestic Partners, Immediate Family Members or Relatives as Suppliers, Vendors, Customers

Implied Pressure on Employees to Use a Manager's Relative

Vendor Relationships - Kickbacks and Rebates

Gifts from Vendors, Customers or Others

Improper Use of Company Assets

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Kickbacks, Defined As:

The giving or receiving of any “thing of value” to influence a business decision without the employer’s knowledge and consent

Kickbacks can take many forms:

- Cash
- Gifts and gratuities
- Travel and entertainment
- Cars
- Loans at less than market interest
- Debt forgiveness
- Payment of personal expenses
- Medical treatment
- Other payments and incentives

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Conflicts of Interest for Board Members

- Self-dealing and related party transactions
- Outside interests and businesses
- Insider trading
- M&A transactions
- Affiliations with shareholders
- Director compensation
- Personal relationships with company employees
- Duty of confidentiality
- Board member skills and expertise

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Case Study: A Board Member's Independence & Potential Conflict of Interest

CA, Inc. (renamed CA Technologies, Inc. & now acquired by Broadcom)

- Audit Committee investigation of fraudulent accounting allegation
- Fundamental Business Rules
 - “Integrity and Respect are the foundational values of CA.”
 - “Values provide perspective in the best of times and the worst.”
 - “The fundamental business rules for all CA employees are: Don’t Lie, Don’t Cheat, Don’t Steal.”
- “A conflict of interest is anything that might cause an individual’s private interest to interfere in any way—or even appear to interfere—with the interests of CA. A conflict situation can arise when an employee’s actions or interests make it difficult to perform company work objectively and effectively. It is anything that might deprive CA of an employee’s undivided loyalty as he/she does business on its behalf.”

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“Ex-Best Buy CEO Had Inappropriate Relationship With Employee”

Former CEO Brian Dunn



*Report
Of The
Audit Committee of the Board
of Directors of Best Buy
To The
Board of Directors of Best Buy
Regarding
Investigation of Alleged
Misconduct By Former Chief
Executive Officer
May 12, 2012*

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BEST PRACTICES & EFFECTIVE MITIGATION STRATEGIES

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Performing a Risk Assessment

- Goals
 - Integrate into existing risk assessment processes
 - Identify key risk areas
 - Gather sufficient information for making sound policy decisions
 - Assist in designing effective compliance policies and processes
- Risk assessment to determine who should complete a disclosure statement
 - Regulatory considerations
 - Organizational requirements/objectives
 - Higher level employees are generally at a higher risk
 - Indicators identified from helpline/hotline calls
 - Consider third party risk

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Code of Conduct

- A detailed conflict of interest policy should be incorporated in a code of business conduct
 - Explain the issue of conflicts of interest and how the policy applies to all employees including executives and directors
 - Discuss why conflicts create legal and reputational risk and must be avoided
 - Detail that even the appearances of a conflict of interest can be problematic
 - Disclosure requirements
- Best-in-class codes contain situational examples (scenarios) of ethical challenges and questions and answers around conflict issues to further reinforce compliance

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Gifts: Standards and Policy

- Defining acceptable gifts and entertainment
 - Dollar values, thresholds
 - Nominal, customary, inexpensive, reasonable and appropriate
 - Infrequent, annual limits
- Requiring approval
 - In excess of set limit or for all gifts
 - Gifts to government officials (FCPA)
- Gift disclosure and recordkeeping
 - Approval versus reporting
 - All gifts or those over a defined value

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Corporate Board Conflict of Interest Policy (Elements)

- Policy statement
- Roles and responsibilities
- Definitions
- Relevant laws and regulations
- Policy requirements and expectations for compliance
- Types of conflicts of interest
- Training and awareness
- Prohibited conduct and consequences for policy violations
- Disclosing conflicts of interest
- Conflict management and resolution
- Waivers and documentation
- Periodic risk assessments
- Attestation and disclosure

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Training and Communication

- Evangelize the code of conduct and a culture of compliance
- Ongoing company-wide conflicts of interest awareness and prevention communication
 - Interactive, scenario-based training including conflicts of interest examples
 - Encourage employees to ask questions and seek guidance before they engage in possible conflicts of interest
 - Communicate existence of hotline for reporting including whistleblower and non-retaliation policies
- Training at new employee orientation, new manager training, management and executive seminars, new director onboarding, annual and ongoing director training

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People Should Ask Themselves:

- “Would I be concerned if other people found out about it?”
- “How would it look if it was in the newspaper?” (*The Wall Street Journal Rule*)
- “How would I feel if it involved someone else?”
- “What is the right thing to do?”
- “Could I lose my job or worse?”

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Promoting Tone at the Top & Message in the Middle

- Have the directors/executives/managers completed the required training and ethics courses?
- Have the directors/executives/managers handled compliance matters appropriately when they have occurred in their organization?
- Have the directors/executives/managers communicated the importance of knowing and following the code of conduct and company policies and procedures throughout their organization?
- Have the directors/executives/managers set the appropriate “tone at the top/message in the middle” and is it communicated and practiced?

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Hotlines: Build It Right and They Will Call

- Well-communicated and easily accessible
- Available in many forms (telephone, e-mail, mail, and fax)
- Operated 24/7 with live operators
- Available to callers in every country the organization operates
- Language capability
- Use a third-party vendor of hotline services

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Certifications and Disclosures

- Certifications
 - Used by organizations for select (mostly high-level) or all employees
 - Provide employees opportunity to report potential conflicts
 - Typically require employees to certify that they have read and are familiar with the conflicts of interest policy (and code of conduct)
 - Certify they are not aware of any violations of the policy
- Questionnaires
 - Request employees to supply information and respond to more detailed questions, not just certify
 - Large organizations utilize Web and electronic systems to manage the process and data

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Attestation

- The conflict of interest attestation section that the employee signs upon completion of the disclosure form should include the following statements:
 - I have read the organization's code of conduct and the conflicts of interest policy
 - I understand and acknowledge the policy's requirements
 - I agree to comply with the conflict of interest policy and the overall ethical code
 - I agree to immediately report any potential conflicts of interest whether mine or that of another employee or vendor
 - I am not currently aware of any conflict of interest on my part or that of any other employee or third party
 - To my knowledge, I attest that the answers provided in this disclosure form are true and accurate

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Auditing the Conflict of Interest Program

- Auditing the process is important to determine the value of the program, findings, measurements, successes or failures of the program and opportunities for improvement
- Data evaluation will tell you the most common types of conflicts and whether targeted training in that area is needed
- You may find that you will have different types of conflicts in various parts of the business and/or in various geographies where the company operates
- You will also find out who did not complete the required certifications and why it was not addressed previously

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Compliance Benchmarking

- Benchmark your conflict of interests policies and procedures, as well as your overall compliance program, against other companies for a comparative analysis of:
 - Policies
 - Risk assessments
 - Training and communication
 - Investigations
 - Incentives and discipline
 - Program modification
 - Overall best practices
- Facilitate a compliance summit with several companies participating or just one-on-one meetings

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Effective Management of Conflicts of Interest

- We'll always face conflicts of interests but leading compliance program practices can make a difference in detection, prevention and mitigation.
- Companies should not wait for ethical issues and misconduct to occur before evaluating and enhancing corporate policies and procedures.
- Best-in-class organizations are constantly looking at opportunities to provide their employees with the most current guidance on new and emerging ethical issues.
- “When it comes to compliance, you have to live, eat, breathe and drink it. It has to be embedded in a firm’s DNA.” – Harvey Pitt, former SEC Chairman

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THANK YOU!

QUESTIONS?

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