Creating Effective Ethics & Compliance Metrics and Incentives

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Overview

- The compliance and ethics challenge
- Roles and responsibilities: board, management and the ethics/compliance officer
- Aligning incentives
- Metric and incentive discussion
Ethics and Compliance Challenge

**Ethics:**
- Perception: Most people are ethical
- Realty
  - Cheating
    - High school
    - College
    - MBA
  - Resumes
  - Workplace

- Laws and rules can be complicated
- Not their area of expertise
- More than enough work already
- Intense pressure
  - One of our biggest challenges as ethics and compliance officers is to give management specific direction and tasks
### What do they need to do? - Boards

- Define scope of the program
- Approve key policies & procedures
- Require periodic, substantive reporting by management/ethics & compliance officer
- Align incentives

**Tip:** Add expertise to board or appropriate committee

### What do they need to do? - Management

- Actively support program
- Execute ethics & compliance program
- Insist on compliance
- Be a role model

**Tip:** It’s management’s job to implement the program and ensure compliance. The role of the compliance officer is to ensure management has the tools & resources.
Roles & Responsibility Compliance Officer

• Design (and redesign) program with input from management (operations), employees, peers and experts
• Develop policies and procedures
  – Structural → OSGs
  – Substantive → high risk areas
• Develop/acquire educational programs applicable to targeted job functions

Tip: Identify, address, measure and report your top 5-10 risks/metrics.

Roles & Responsibility Compliance Officer (Cont.)

• Give management clear direction, explicit targets
• Simplify complex, clarify ambiguous
• Respond to environmental changes
• Monitor and report on execution
• Have the difficult conversations
## Behavioral Challenge

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<td>$ Focused management</td>
<td>Cognitive dissonance</td>
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<td>Unbalanced incentives</td>
<td>Weak internal controls</td>
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How can we meaningfully impact management and other employee behavior?

## Behavioral Challenge

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<td>What motivates executives, managers, employees?</td>
<td>Compensation vs. Non-financial / Other</td>
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<td>Performance Appraisals – Getting a seat at the table</td>
<td>Promotions</td>
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<td>Positive Reinforcement</td>
<td>Disciplinary Actions – Perceptions</td>
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**Tip:** Embed ethics and compliance in the regular business decisions, actions and processes.
Ethics and Compliance Challenge

• How to combat?
  – “It’s the law!”
  • U.S. FEDERAL SENTENCING GUIDELINES, §8B2.1(b)(6)
  • Deferred Prosecution Agreements
    – Computer Associates – “CA will [ . . . ] amend CA’s senior executive compensation plans to add an enhanced component to CA’s performance-based programs tied to the establishment and maintenance of high ethical and compliance standards throughout CA.”
    – Mellon Bank – “Performance evaluation criteria and compensation should also be linked to specific steps taken by [substantial authority] personnel to support the compliance and ethics program (e.g., briefing “direct reports” on the code’s application and the importance of raising compliance and ethics issues; ensuring that “direct reports” have completed required training).”
  – Financial Industries – Proposed rule which would limit incentives in which “the regulators determine were encouraged by inappropriate risk taking.”
  – Collaborate with HR

Non-Financial Incentives

• Humana Military Healthcare Services “Exemplar Award”
  – Annual Award
  – “Exemplifies the principles of business ethics and compliance during the year.”
  – Chosen by Senior Management Team
  – Receives:
    • Letter of Recognition signed by CEO, Chief, HR, and Compliance
    • Physical engraved reward
    • Recognition at town hall meetings
    • $1,000

“...ribbons characterize a service member’s career and command respect because others recognize the significance of the awards. The value of this example for the commercial sector is that incentives do not have to be monetary, and they do not have to be complicated. Rather, to be effective, they must be so deeply embedded in an organization’s culture that employees strive to attain them. Also, the incentive must align with what the organization values.”
## Non-Financial Incentives

- Behavior-Based Performance Reviews – Translates values into behaviors, maps behaviors to jobs / roles in goal-setting, measures progress versus goal, and impacts career planning and training opportunities; Ex: Tyco
- Lockheed Martin
  - Chairman’s Award for Ethical Conduct chosen by CEO and COO from pool of candidates nominated by their colleagues – Receive from CEO at Senior Management Meeting

"The main point, says Pink, is that our basic assumptions about money and motivation are "often wrong." We assume that if we reward behavior it will be repeated and if we punish behavior it will stop. That's just not always true, says Pink."

## Financial Incentives

### Positives
- Proven motivator
- Focus management’s attention
- Emphasizes most important
- Rewards hard work & innovation
Financial Incentives

Negatives

- Promote greed
- Promote “tunnel vision” or obsessive focus on target
- Encourage manipulation
- Improperly structured rewards/incentives may promote bad behavior.

Trust is not an internal control!
### Financial Incentives

- **Annual Bonuses** – Inclusion of “integrity” and business objectives in performance reviews via Performance Assessment Matrix; ex: Novartis
  
  > “Based upon the number that you received it could impact stock options...A ‘one’ was a negative rating – it could negatively impact variable compensation up to 50%. 2.2 was an average performer...3.3 would equal up to 150% of variable compensation.” – Former Novartis, Associate Director, Leadership Training

- **Merit Increases / Variable Compensation** – Includes “Compliance and Ethics Focus” into a list of 9 other Competencies in performance reviews via scale of “Does not meet, Partially meets, or Fully meets expectations;” ex: Chemical Company

### Incentives: Ethics & Compliance Metrics

- **Specific**
  - Structural – orientation, education screening, reporting, investigation, remediation
  - Substantive (high risk areas)

- **Objectively measureable**

- **Fair, reasonable**

- **Meaningful impact**

  **Tip:** Target leaders of key business units.

See attached sample of ethics/compliance objectives.
Incentives: Transparency

- Transparency changes behavior
  - Taps competitiveness and self-preservation instinct
- Require “public” reporting to peers, management and board
- Must be objective, fair, reasonable and targeted to organization risks

Incentives: Transparency

- Publicize the negatives / consequences…we have heard of this.
  - Ethics Bulletins
  - Best Buy Blog
- Equally as important to publicize the positives
  - Emails with CC to C-Suite, Business Presidents, etc.
  - “Ethical Leadership Bulletins”
  - Promotions – Ethics & Compliance track records, leadership, etc.
### Aligning Incentives

- Are ethical and compliant business practices fundamental to who we are?
- Prove it:
  - Specific, measurable objectives
  - Aligned incentives
  - Internal transparency
  - Climate monitoring

### Personal Effectiveness

- Leverage authority
- Practice difficult/crucial conversations
- Think before you speak
- Attack the problem, not the person
- Listen carefully

Admit mistakes – the two most disarming words in the English language are _____________. 
Notes

2. “Building Incentives in Your Compliance and Ethics Program” Joe Murphy
5. Compliance and Ethics Leadership Council; Embedding Compliance Series; March, 2005
7. “The role of incentives in compliance and ethics program effectiveness” Compliance and Ethics Professional April, 2011 By Amy E. Hutchens, JD, CCEP; and Kelly Lippert, CCEP

Resources


The Seven Signs of Ethical Collapse: How to Spot Moral Meltdowns in Companies . . . Before It’s Too Late, Marianne M. Jennings, J.D., St. Martin's Press 2006

Crucial Conversations: Tools for Talking When Stakes are High, Kerry Patterson et. al., McGraw-Hill, 2002

QUESTIONS?