

# **ADVANCED DISCUSSION GROUP**

## **Role of the Compliance Officer in Preventing Perverse Performance Incentives**

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**18<sup>TH</sup> Annual  
Compliance  
& Ethics  
Institute**

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## **Advanced Discussion Group**

### **• Purpose:**

- To bring compliance professionals from around the globe together for a professional exchange of ideas.**
- Increase communication among the group participants.**
- Learn from each other's knowledge and experience through group discussion.**

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## How Long Have You Been in Ethics & Compliance?

1. 1 year
2. 2 years
3. 5 years
4. 5 - 10 years
5. Seasoned



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## What is your Role?

1. Chief Compliance Officer/Compliance Officer
2. Compliance Manager
3. Compliance Auditor
4. Government
5. In-house Counsel
6. Outside Counsel
7. Analyst
8. Vendor



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## WHAT ARE INCENTIVES?

- **U.S. companies spend an estimated \$38 billion on bonuses and incentives.**
- **When designed properly and intentionally, incentive programs can increase performance and drive organizational success.**
- **Incentives can drive behavior.**
  - **Highlight what is important (WHAT MANAGEMENT REALLY WANTS).**
  - **Provide positive reinforcement.**
- **When designed poorly, incentives can put a company at risk.**
  - **Pay out too much.**
  - **Reward the wrong behaviors: unintended consequences.**
  - **Game the system to meet targets.**

Source: Forbes magazine, My Say, 6/7/14 GUEST POST WRITTEN BY Chris Cancalosi, Managing Partner and Founder at [gothamCulture](#)

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## INCENTIVES IN ETHICS AND COMPLIANCE

- **The Federal Sentencing Guidelines state that the compliance and ethics program should be “promoted and enforced consistently throughout the organization through appropriate incentives to perform in accordance with the compliance and ethics program.”**
- **Management should design an incentive program to steer employees toward compliance and ethical behavior.**

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## Slide 5

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**JR1** Add periods to bullet points

Jay Rosen, 7/26/2019

JR3

**Does your organization use incentives such as bonuses or awards to drive behavior?**

- 1. Bonuses**
- 2. Awards Programs**
- 3. Commissions**
- 4. Other**
- 5. None of the Above**



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JR5

**Does your organization use specific performance objectives relating to ethics, integrity or core values in performance appraisals?**

- 1. Yes**
- 2. No**



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## Slide 7

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**JR3** Should we ask this before you describe incentives  
Jay Rosen, 7/26/2019

## Slide 8

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**JR5** Should we ask this before you describe incentives  
Jay Rosen, 7/26/2019

## PERVERSE INCENTIVES: TARGET AWARDS

- 25-50 percent of target awards suddenly kick in when a threshold level is achieved.
- To managers, that might mean millions of bonus dollars for hitting their number, or zero if they fall a dollar short – an almost vertical performance curve.
- About half of corporate scandals over the past two decades have happened with performance in a range right around an all-or-nothing threshold level.
- Result: “cutting corners” through deferred maintenance or temporary layoffs; unethical behavior such as channel stuffing or manipulation of accounting reserves; or flat-out bribery and fraud to achieve targets.
- Enron, WorldCom, Rite-Aid, and Sunbeam all utilized all-or-nothing target awards that motivated bad employee behavior.

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JR7

Do your organization’s bonus programs utilize “Target” Awards” with a steep “cliff” (all or nothing)?

1. Yes
2. No



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**JR7** Should we ask this before you describe Target Awards?

Jay Rosen, 7/26/2019



JR8

Do your organization's incentive programs focus solely on financial performance and targets?

1. Yes, solely on the financial
2. Predominately financial
3. Balanced between financial performance and ethical behavior to achieve goals
4. Don't know/We don't use incentives



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Is the CCO/CECO involved in the discussions relating to the development of incentive plans, such as bonus criteria or performance awards?

1. Yes, active participant
2. No, not involved
3. Somewhat involved...wish I had more involvement
4. Don't know



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**JR8** Should we ask this before you describe target awards?

Jay Rosen, 7/26/2019

## BEST PRACTICE: INCLUDE THE COMPLIANCE AND ETHICS OFFICER

- The SCCE April 2017 Survey
  - CECOs that review incentive plans to identify and mitigate risk prior to roll-out.
  - Management Incentive Plans:
    - 23% of CCO's review management incentive plans.
    - 52% don't review at all.
  - Employee Incentive Plans:
    - 25% of CCO's review rank & file incentive plans roll-out.
    - 46% don't review at all.

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## WHAT THE DOJ MIGHT ASK

- DoJ Fraud Section Issued Guidance on Evaluation of Corporate Compliance Programs:
  - What role has compliance played in the company's strategic and operational decisions?
  - How has the company incentivized compliance and ethical behavior?
  - Has the company considered the potential negative compliance implications of its incentives and rewards?
  - Have there been specific examples of actions taken (e.g., promotions or awards denied) as a result of compliance and ethics considerations?
- Some other questions:
  - Are compensation plans aligned with ethics, integrity, and compliance objectives via a thoroughly articulated review plan?
  - How can we balance commercial objectives and incentives with compliance, and manage tensions, when they arise, as to mitigate behavioral, operational, and financial risk?

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## INCENTIVIZING ETHICAL BEHAVIOR TO MINIMIZE MISCONDUCT

- Incorporate significant fraud, compliance, and ethics risks into internal reporting metrics.
- Ensure organizational and individual performance goals are realistic and do not foster pressure for unethical conduct.
- Reward teams and managers who achieve full compliance.
- Reward employees who display ethical leadership and openly cultivate a culture of ethics.
- Reward employees for considering potential compliance issues or offering suggestions for increased compliance.
- Recognize employees for speaking up and reporting unethical behavior.

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## THREE THINGS ETHICS, COMPLIANCE OR INTERNAL AUDIT CAN DO

1. Check your company's incentive plans for:
  - Percent of total compensation at-risk.
  - Metrics driving rewards (individual vs. group).
  - Team-based rewards can help Incentive plan leverage, especially at threshold.
  - Beware of cliffs (all-or-nothing rewards).
2. Don't settle for "what everyone else is doing":
  - Everyone else is also at risk.
3. Add Value through:
  - Awareness.
  - Boundaries (controls).
  - Ethical messages.
  - Collaboration.

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## QUESTIONS?

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