

The Importance of Splitting Legal and Compliance

By **Jaclyn Jaeger**

In the aftermath of changes to the U.S. Sentencing Guidelines last year, and in the face of an unforgiving regulatory environment at both state and federal levels, companies increasingly see the sense of the compliance officer and general counsel jobs.

Historically, the general counsel in many companies also served as the company's chief compliance officer, since compliance was viewed as a legal and regulatory concern. That habit is still common today, but views have changed substantially over the past few years, says Matthew Tanzer, chief compliance counsel for Tyco International.

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—Rob Biskup,
Head of Financial Investigations, Corp.
Compliance Practice,
Deloitte

Now the preference, especially among large companies in highly regulated industries, is to separate that top job—and even the entire functions—due to a growing awareness that compliance today “often encompass matters far removed from legal or regulatory compliance,” such as business ethics, company values, and integrity, Tanzer says.

Companies have been pushed along in this direction by changes in the U.S. Sentencing Guidelines last year, which explicitly call for chief compliance officers to report directly to the board. Under the U.S. Sentencing Guidelines, the person with operational responsibility for the compliance and ethics program must have “direct reporting obligations to the governing authority or an appropriate

sub-group,” such as an audit committee, if the company hopes to win the most cooperation credit possible during a federal investigation.

In other words, federal authorities “don't want the roles combined, nor do they want the compliance office reporting to legal,” says Rob Biskup, leader of Deloitte's financial investigations and corporate compliance practice.

Such prodding is starting to materialize in a change of reporting roles. A survey by Compliance Week and PwC earlier this year found that 32 percent of chief compliance officers now report to the CEO. “You see a strong push to have the compliance function in a very visible setting,” Biskup adds, “with the compliance officer having regular interaction

with the board.”

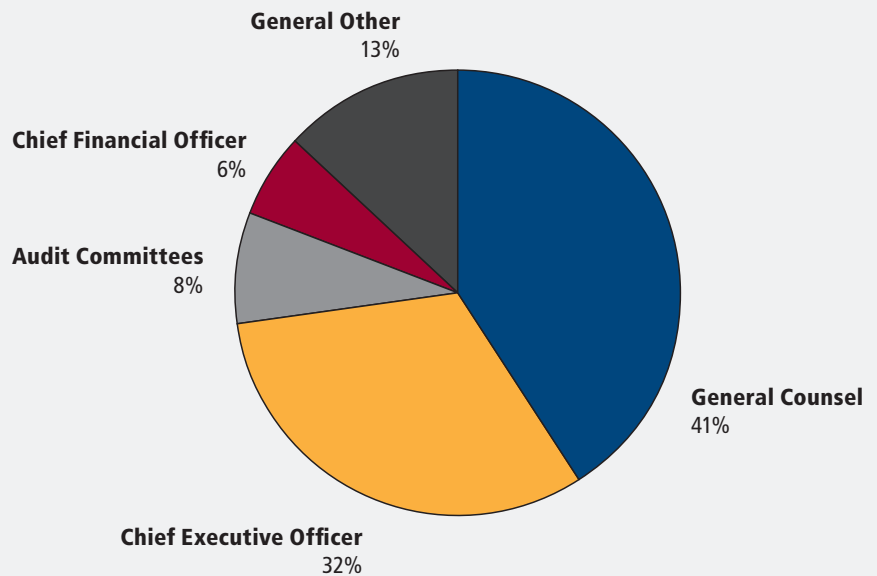
Still, just 8 percent of respondents said that the CCO at their company reports to the board, and 41 percent say the CCO reports to the general counsel, implying that the functions are still combined or closely related at these companies.

That could be changing. Corporate integrity agreements between federal agencies and several companies call for separation of the CCO and general counsel roles. For example, in August 2009 a corporate integrity agreement between Pfizer and the Department of Health and Human Services stated that, “compliance and legal functions should be separate, and the CCO should not report to the general counsel.” That separation, HHS guidance says, “helps to ensure indepen-

TO WHOM DOES THE CCO REPORT?

The chart below from the CW/PwC State of Compliance study shows who the CCO reports to at most companies.

The CCO reports to the following individual(s):



Source: CW and PwC: *The State of Compliance 2011 Study*.

dent and objective legal reviews” and fosters “a system of checks and balances ... to more effectively achieve the goals of the compliance program.”

Similarly, a corporate integrity agreement between the Justice Department and Eli Lilly in 2009 stated that the chief compliance officer “shall not be, or be subordinate to, the general counsel or chief financial officer.”

“As a result of the broadening role of the CCO and the increased pressure for an independent governance voice within corporations, it probably is preferable for most companies to have the GC and CCO roles be separated,” Tanzer says. “However, this is not mandatory and every company needs to evaluate its own management structure and culture to determine what will work best.”

Yet the separation of the roles might not work for everyone. “The structure you adopt for your organization has to fit your organization,” says Richard Crist, chief ethics, compliance, and privacy officer for Allstate. In smaller companies that typically have far fewer resources, for example, he says it may not always be practical to have two full-time employees devoted to each of those jobs.

That doesn’t mean small companies are completely off the hook. “If you have a small company that runs into significant compliance problems, the government will still recommend, and may even require in a corporate integrity agreement, that the jobs be split,” says Josh Buchman, a partner in the law firm McDermott, Will & Emery.

Forced Split

The government is far less lenient, however, with large companies. It takes the view that dividing the compliance and legal functions helps to nurture a strong compliance program. While both the general counsel and chief compliance officer have responsibility “to protect both the reputation and the legal risk profile of the organization,” Buchman says, “the government perceives the two positions as being fundamentally different.”

For the most part, many compliance and legal executives agree. “If you’re in a larger organization, and you’re in a highly regulated industry, those roles, specifically the GC and chief compliance officer, are clearly separate and distinct,” Crist says.

At Allstate, Crist reports to the general counsel, who has responsibility for legal compliance. “My role is much more focused in the sense that it is specifically regulatory compliance,” in addition to ethics, privacy, and internal investigations, he says.

If general counsels today were to assume all of the compliance officers’ expanded roles, that responsibility would overwhelm one person, compliance officers say. “At a minimum, it may detract from the GC’s primary responsibilities of managing and counseling the company on legal risks,” Tanzer says.

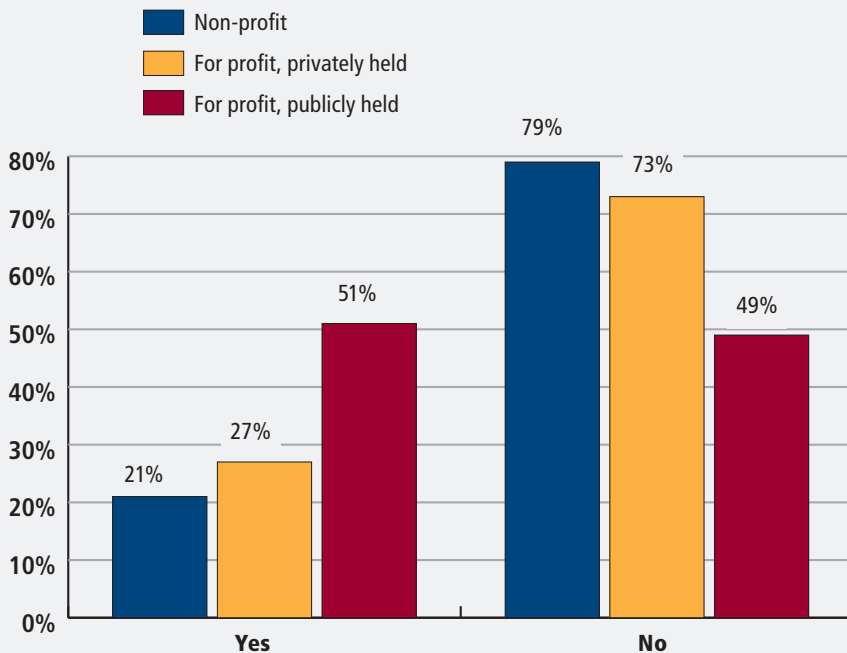
Concerns about attorney-client privilege are another reason why the government believes the roles should be split, Buchman says. If the compliance officer is also the general counsel or some other company lawyer, “all the compliance-related activity is going to be presumptively cloaked in the attorney-client privilege, so the government can’t thoroughly investigate the issue,” he says.

But the idea that attorney-client privilege does not extend to a separate compliance officer isn’t quite true. Buchman says a compliance officer can indeed have privileged conversations with the general counsel (or even outside counsel) when the roles are split. “As a matter of fact, I think that’s a good idea, because those legal considerations are an important part of a compliance officer’s job, knowing what is and isn’t legal and what does and

WHERE IS COMPLIANCE HOUSED?

The chart below from the Society of Corporate Compliance & Ethics shows the results of a recent poll in which respondents were asked if compliance was part of the general counsel office.

Just because the compliance function was located in the GC’s office did not necessarily mean the [Chief Ethics & Compliance Officer] was also the GC. Only about one quarter of those who reported that compliance was located in the GC’s office also reported that the CE/CO was the GC (26 percent) as well.



Source: SCCE Survey: The Evolving Role of the Chief Compliance and Ethics Officer (2010).

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doesn't pose compliance risks," Buchman says. "But I don't think it's necessary for them to be the same person for the compliance officer to get adequate legal guidance in doing his job."

What's important is that the two roles learn how to work effectively with one another. "From our perspective, the roles are completely unique and would require two different people to occupy the roles," Crist says. "Yet, it's really important that they integrate very effectively." Most companies, even if the roles are separate, still ensure that compliance and legal work closely together. Just 5 percent of respondents to

the Compliance Week-PwC survey said that the chief compliance officer doesn't report to or coordinate with the legal department.

At Allstate, for example, in the rare circumstance that the general counsel and chief compliance officer have opposing views on an issue, the company has developed a charter for the compliance function that gives Crist direct access to the CEO and audit committee.

In such situations, Crist says to make sure the company's structures and processes allow the organization to have the benefit of both points of view. "You have to make sure that the compliance officer has that access not only to his or her im-

mediate manager but to the board and the highest levels of management within the organization," he says.

"The most important factor, putting aside the reporting lines, is that the effectiveness and the success of the CCO is going to be directly linked to the seniority of the individual, their influence, their visibility, their stature in the organization, and their independence—both in appearance and in fact," says Biskup.

Furthermore, each individual role—legal and compliance—"has to respect the responsibilities and priorities of the other," Buchman says. "If that isn't there, your chances of some sort of corporate dysfunction go way up." ■