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Keith Darcy: How Boards Can Raise the Bar on Ethics and Compliance

A symbiotic relationship between ethics and compliance can help companies deliver shareholder value and mitigate risks. Keith Darcy, independent senior advisor to Deloitte & Touche LLP's Governance, Regulatory & Risk Strategies enterprise compliance practice, discusses how boards can guide an organization's ethics and compliance efforts in light of heightened regulatory scrutiny and emerging threats. Mr. Darcy is the former executive director of the Ethics & Compliance Officer Association, and has been the CEO and served on boards of various financial services institutions.

Q: How have boards' attitudes toward oversight of organizations' ethics and compliance risks changed in recent years?

Keith Darcy: Boards definitely take their responsibilities for overseeing ethics and compliance risks much more seriously than they have in the past. Over the past two decades, fiduciary obligations have been clearly defined by new regulations, such as the Sarbanes-Oxley Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act, as well as by legislation, case law and the U.S. Federal Sentencing Guidelines. Together, they have vastly expanded expectations of the board and produced a declining tolerance for failures to meet fiduciary obligations. Increasingly, boards recognize that ethics and compliance risks are among the top threats organizations face. In response, effective boards take a comprehensive view of ethics,

compliance, as well as reputation risks. That said, risks today are increasing at a time when many companies continue to face austerity measures. Taken together, this is a challenging and potentially dangerous environment. Boards must ensure that their organizations provide appropriate authority and adequate resources to the chief ethics and compliance officer. In an age of austerity, boards likely will need to focus more on addressing resource constraints.

Q: How can boards gain insights into the ethics and compliance risks amid time and resource constraints and other challenges?

Keith Darcy: The goal is to aggregate the organization's ethics, compliance and reputation risks so they can be vetted at the board level; otherwise risks can fall into functional silos or get buried under multiple management levels. Historically, some companies separated their risk management functions, and while that's not inappropriate, the totality of those risks may not rise to the board level. As a board member that would concern me because to be effective, boards want to learn about an organization's risks from a single or collective source, which in turn fosters a comprehensive approach to mitigation. Taking such an approach, however, brings up another question: Should boards create a risk management committee? There is recognition that the responsibilities of the audit committee, which often handles risk management oversight, are quite extensive and at times overwhelming, so I am beginning to see some boards consider separating out their risk management functions. There probably are no more than 10% of public corporations that have a separate committee, but I expect we'll see this slowly increase in the years ahead.

For the time being, though, the number of separate board-level risk committees is low. A recent analysis by Deloitte LLP of disclosures in proxy statements filed between January 1 and May 31, 2013 by companies comprising the S&P 200, showed that 6% of 170 companies in the sample disclosed having a separate board risk committee. Meanwhile 24% of those companies had a separate risk committee at the management level.

Q. With only so much time and resources, how can boards provide enough attention to an organization's ethics, as well as compliance, efforts?

Keith Darcy: Compliance is nonnegotiable. You must comply with the laws, regulations and company policies that may go beyond legal requirements. But by themselves, they don't win the day. Rather, it's critical that boards and management establish a culture of integrity and strong ethics. In fact, the law expects organizations to take extra measures to develop a culture of integrity. This recognizes both the limitations of compliance as a check-the-box paper program, as well as the powerful influence culture has on the behavior in organizations. So, too, strong cultures can create a sense of loyalty among stakeholders. Increasingly boards understand their role in recognizing culture as an effective framework that allows boards to address compliance, ethics and integrity risks.

Q. It's often said that corporate culture starts with the tone at the top, but what are the tangible elements of creating a culture of integrity?

Keith Darcy: Creating a culture of integrity begins with tone at the top, but it has to include the mood in the middle and the buzz at the bottom. Culture is what people see as recognized and rewarded. For employees, the face of culture might be their supervisor. The voices of culture are the legendary stories told throughout an organization that reinforce the fundamental values that it stands for. As important and essential as compliance is, in the struggle between culture and compliance, culture always wins. That's how powerful it is. I have long said to boards and top executives that if companies aren't managing culture, culture is managing them. Organizations can protect themselves by communicating their values on a consistent basis. Unfortunately, from my past experience, I've found that management and boards tend to under communicate values by a factor of 10.

Having a culture of integrity and real corporate responsibility mean living your values; it's not about a program or a press release. Successful companies align a corporate culture to a brand "promise," which is not brand management. Say 67% of consumers recognize your company logo, it's the job of the brand manager to get the number to 68%, and for doing that the manager might receive an incentive bonus. That's brand management. A brand "*promise*" is the expectation that a company will deliver the same experience to its stakeholders across the board time and time again. When a company achieves that level of trust, stakeholders come to believe there is a "promise" inherent in the product or service, which builds "reputational" capital. In time of stress, stakeholders may cut an organization some slack when the organization needs it most.

Q. What emerging risks should boards be tracking?

Keith Darcy: From where I sit, digital risks are the number one set of emerging risks today, including cyberthreats and the expanding use of social media and mobile technologies. Given the rapid changes in technology, it's challenging for fiduciaries and risk managers to know what they don't know. At the same time, technology managers, as good as they are, may not have the skills of a risk manager, and may not consider how the potential for reputation risks, for example, could affect the organization. I believe boards must explore the potential gaps.

One risk that could sneak up on organizations, especially in this age of transparency, is conflicts of interest. From a U.S. perspective, once a conflict is exposed, the issue typically raises flags. In other regions, where the majority of businesses are family-owned, conflicts of interest are often viewed differently. Doing business with family or within close-knit groups—and the embedded sense of trust—can outweigh the importance of investigations into conflicts. But as transparency takes hold globally, more conflict-of-interest issues will likely be raised, which boards may have to address.

Bribery and corruption is another big risk for boards to consider. There have been more prosecutions in the last three years for Foreign Corrupt Practices Act (FCPA) violations than there were collectively in the previous 30 years. Globally, the U.K. Bribery Act is more expansive than the FCPA, the G20 has an ongoing agenda item related to anticorruption collaboration among countries, and there are enforcement actions being promoted by the UN and OECD. These are seeds for change. While bribery and corruption will never disappear, the added scrutiny from the global community and significant new cross-border cooperation between regulators and prosecutors may refocus the attention of boards to be more vigilant.

Q. Looking ahead, what should boards be considering as they seek to improve oversight of ethics and compliance?

Keith Darcy: Boards should consider whether they have the appropriate experiences among the governing authority members to appropriately address tomorrow's risks. The biggest question is around digital risk. Does the board have directors with technology backgrounds and experience? In many cases, the answer is "no," which should prompt the board to ask a series of follow-up questions: Can we leverage advisors or other experts to supplement our knowledge? Or do we need a board member with those specific skillsets? Does the organization have the right skills internally, and if not, can the organization afford to bring in new talent or is it more effective to create relationships with external providers given the pace of quickly changing risks? Given the extraordinary velocity of change in technology, this deserves serious board attention.

Boards—and management—also should be taking into consideration the future talent pool and how important corporate culture is to younger members of the workforce: "Generation Y." These individuals who are entering the workforce are dramatically different from those of us who have come before them. These future leaders want to work for a company that stands for something. As consumers, investors and employees, they are politically savvy, are driven by a sense of purpose, crave authenticity and will be drawn to socially responsible organizations. If companies want to create a secure workforce, it's important for us to better understand this next generation. The average 32-year-old has had nine job experiences, a so-called portfolio career. Organizations can't afford that much turnover. So boards and management should consider building an organization that creates long-term relationships with the next generation, and an important building block is having a culture of integrity.

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