

GOVERNANCE BEST PRACTICES FOR EFFECTIVE COMPLIANCE PROGRAMS

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Why governance?

- Governance, what's the big deal?
 - *“Corporate governance typically gets attention only under one condition: when there is an obvious lack of it.... But it's the little things - the stuff that doesn't make the headlines - that often define the difference between good and bad governance.”*
 - Lawrence Rout, Editor, *Wall Street Journal* 1/14/08
- This topic may be as boring as you fear, and at the same time, more important than you could ever imagine
- Presentation goal is to provide an overview of corporate governance which will enable you to influence adoption of best practices supporting an effective compliance program

Corporate Governance Overview

- What is corporate governance?
 - The rules, processes and practices by which companies are directed and controlled
 - Governance involves balancing stakeholder interests, including shareholders, management, customers, suppliers, financiers, government and the community
- Governance reform typically reactive rather than proactive:
 - Institutional investor demands / scandal / financial crisis
- Good corporate governance:
 - Sets the tone throughout an organization, reflecting not only legal requirements for compliance, but also consideration of culture, ethics, controls, efficiency and optics
 - Provides foundation for success of compliance and ethics program

Sources of Governance Authority

- State Law (where the entity is incorporated or formed)
- Articles of Incorporation
- Board of Directors
- Director Fiduciary Obligations
- Stock Exchanges (if applicable)
- Bylaws
- Resolutions and Consents
- Delegations of Authority
- Committee Charters
- Code of Conduct
- Corporate Policies

“Corporate governance is a broad concept that much ... legal literature has given a narrow definition... . But corporate governance may refer more broadly to any system of incentives and constraints operating within a firm ... designed to constrain bad acts on the part of corporations and their managers.”

TOM BAKER & SEAN J. GRIFFITH, ENSURING CORPORATE MISCONDUCT: HOW LIABILITY INSURANCE UNDERMINES SHAREHOLDER LITIGATION 9 (2011)

Sources of Governance Authority

○ Articles of Incorporation:

- Governed by state law
- Establish existence of corporation
- Articles and amendments must be filed with state (and Securities and Exchange Commission (“SEC”), if applicable) – publicly available
- Grant corporation, officers, directors, and stockholders powers and privileges:
 - Outline any exceptions to primacy of board in management of corporate affairs (subject to state governing law). Otherwise, board has sole authority to act for corporation and all other authority is derived from board action
 - Articles (and bylaws) may contain additional stockholder approval requirements (though Articles win in case of conflicts)

Sources of Governance Authority

- Board of Directors:
 - Ultimate decision-maker and provides oversight of management
 - Oversees company business and affairs, acting in the best interests of the corporation
 - Director fiduciary obligations:
 - Established by law of company's state of incorporation
 - Board acts by adopting resolutions or otherwise approving matters noted in meeting minutes or written consents
 - Board's authority is governed by state statute, case law, the articles of incorporation and bylaws
 - Board delegates:
 - Certain oversight responsibilities to Board committees
 - Day-to-day management to the chief executive officer and other officers

Sources of Governance Authority

○ Bylaws:

- Governed by state law and subordinate to articles of incorporation
- “[W]ell-established ... that a proper function of bylaws is not to mandate how the board should decide specific substantive business decisions, but rather to define the process ... by which those decisions are made.”
CA, Inc. v. AFSCME Employees Pension Plan, No. 329, 2008, at 12.
- Bylaws cannot require board to act in a fashion that would limit the exercise of their fiduciary duties (but articles of incorporation may)
- No need to file with state, but bylaws and any amendments must be filed with SEC (if applicable) and are publicly available
- Establishes authority of board to oversee the corporation:
 - Number, election, term of office, removal, resignation, vacancies
 - Notice for regular and special meetings, quorums
 - Election of Chairman of the Board
 - Use of committees
- Election and authority of senior officers:
 - Processes for election / appointment of officers
 - Officer’s authority to act on behalf of the corporation
 - Delegation (or not) to subordinate officers

Sources of Governance Authority

- Resolutions:
 - Written statement of action taken by board
 - Included in or attached to minutes; part of permanent corporate record
 - When used?
 - Precise wording is necessary or advisable
 - Evidence of board or committee action for third party
 - Significant corporate action

- Committee Charters:
 - Standing committees usually have charters
 - Charters delegate Board responsibilities and authorities to committees:
 - May permit sub-delegation to subcommittees or committee chair
 - May also define reporting responsibilities of officers (e.g., compliance officer reports to audit and compliance committee)

- Code of Business Conduct and Ethics / Corporate Policies:
 - Statement of principles and/or guidelines for company or employee activities and behaviors

Sources of Governance Authority

- Stock Exchanges:

- Establish baseline governance standards for listed companies (e.g., NYSE 303A.00 Corporate Governance Standards) such as:
 - Annual meetings
 - Majority independent directors
 - Requirements for committees and member composition
 - Code of Business Conduct and Ethics

Governance Minimum Requirements

- The [United States Sentencing Commission, Guidelines Manual, §8B2.1](#) (USSG) sets the *minimum* requirements for Board compliance responsibilities:
 - (b)(2)(A) - The organization's governing authority shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program.
 - Commentary applicable to this section states "individual(s) with day-to-day operational responsibility for the program typically should, no less than annually, give the governing authority or an appropriate subgroup thereof information on the implementation and effectiveness of the compliance and ethics program."
- Corporation's bylaws and committee charters are tools to implement requirements which go beyond the minimum

Governance Best Practices for Compliance Programs

- Going beyond the minimum requirements to ensure effectiveness:
 - Bylaws should establish a committee with oversight for the compliance program with a board approved charter which requires:
 - Charter to be reviewed and updated on a regular basis (e.g., biennially)
 - Chairperson to be an independent director with appropriate background and experience related to compliance
 - Majority of the committee members to be independent
 - Quorum with majority of independent members for conducting business
 - Committee to approve compliance officer's job description
 - Committee to approve hiring of compliance officer
 - Committee to provide feedback on compliance officer's performance rating
 - Termination of the compliance officer be approved by committee and require a majority vote of the independent members
 - Committee to meet with the compliance officer in executive session on a regular basis (preferably at each meeting)
 - Compliance officer have express permission for direct communications with the Chairperson outside of regularly scheduled meetings
 - Committee to have a minimum number of meetings per year

Governance Best Practices for Compliance Programs

- Going beyond the minimum requirements to ensure effectiveness:
 - Bylaws should establish a committee with oversight for the compliance program with a board approved charter which requires (continued):
 - Review of adequacy and effectiveness of the compliance program
 - Review and approval of annual compliance plan
 - Approval of charter of the executive compliance committee
 - Compliance officer to have authority and discretionary resources to retain independent legal counsel and consultants without prior authorization of any organizational official
 - Compliance officer to have a role in development of company policy
 - Annual review and approval of the Code of Business Conduct and any updates
 - Assessment of the chief executive officer's support of the compliance program

Homework

- Request and read your company's:
 - Bylaws (or operating agreement if an LLC):
 - How are board members selected?
 - Are there specific requirements for independent directors?
 - What are the requirements for an audit and compliance committee (or equivalent)?
 - What authority is held by the board? What authority is delegated?
 - How are conflict of interests addressed?
 - Committee charters:
 - What authority is delegated to the committees?
 - What number of directors constitutes a quorum?
 - What specific activities is the committee required to conduct?
 - Resolutions related to the compliance program
 - Minutes from audit and compliance committee meetings
- Review Corporate Integrity Agreements on the [OIG website](#)

Questions?