"C" Is for Crucible: Behavioral Ethics, Culture, and the Board's Role in C-suite Compliance

Scott Killingsworth, Partner
Bryan Cave LLP

Introduction

The C-suite is a unique environment peopled with extraordinary individuals and endowed with the potential to achieve enormous good – or, as recent history has vividly shown, to inflict devastating harm. Given that senior executives operate largely beyond the reach of traditional compliance program controls, a board that aspires to true stewardship must embrace a special responsibility to support and monitor ethics and compliance in the C-suite.

Operating unchecked, the forces at large in the C-suite would challenge the ability of even the most conscientious and rational executives to make consistently irreproachable decisions. The problem of C-suite ethics has a deeper dimension, though, than the mere impact of strong pressures upon rational decision-makers. Recent behavioral research brings the unwelcome news that the subversive effects of these pressures are amplified by systematic, predictable human failings that can prompt us to slip our moral moorings and overlook when others do so. But we also know that organizational culture can dramatically affect both ethical conduct and reporting of misconduct, by establishing workplace norms, harnessing social identity and group loyalty and increasing the salience of ethical values.¹ How can these learnings inform the board’s interaction with, and monitoring of, the C-suite? And how can the board help forge a stronger connection between the C-Suite and the organization’s compliance and ethics program?

The Crucible

Several powerful forces converge in the C-suite to test the mettle of executives and the board that supervises them. First, to quote Willie Sutton,² “that's where the money is”: the stakes are very high both for the organization and, crucially, for the individuals as well – as to pay, status, career prospects, and employment itself. The high stakes for the

¹ For a review of the effects of cultural factors on workplace compliance and on speaking up about misconduct, see Scott Killingsworth, Modeling the Message: Communicating Compliance through Organizational Values and Culture, GEORGETOWN JOURNAL OF LEGAL ETHICS, Vol. XV, No. 4 (Fall 2012), 961, available at http://ssrn.com/abstract=2161076.

² Actually, Sutton disavowed his famous quip, attributing it to an enterprising reporter in search of colorful copy. In our context, a genuine quotation from Sutton may be both relevant and cautionary: “Why did I rob banks? Because I enjoyed it. I loved it. I was more alive when I was inside a bank robbing it, than at any other time in my life.” See http://www.snopes.com/quotes/sutton.asp.
organization may tempt even faithful executives to cut corners for the benefit of the company and its stakeholders. Separately, at the personal level, the prospect of gaining, or the risk of losing, large performance-based incentives can mean outsized temptations to do what it takes to obtain the desired results.

Another marker of the C-suite and its occupants is power: control over business strategy, tactics, and execution, and over employees and their careers. One facet of power is the ability to operate with great freedom and little supervision: subject to very few effective “hard” controls, senior executives wield operational command over many compliance-sensitive activities, if not over the compliance function itself. Power also facilitates suppression of dissent, further eroding controls. With power also comes enormous pressure to perform, particularly in public companies where performance is measured hourly by stock price. Senior executives are accountable to the board, to shareholders and creditors, to the news media and to the public, any one of which can topple them under the right circumstances.

Things happen fast in this crucible, with urgency driven not only by business necessity but also by the inexorable demands of the quarterly reporting cycle. Quick decisions about complex problems are required, often involving forced choices between competing values. (What if skirting a costly environmental requirement will save hundreds of jobs?)

The final unique feature of the C-suite is its occupants. People arrive there through a process of natural selection which only the most able, motivated and determined survive. We can expect high intelligence, strong ambition, domain mastery, and advanced skills in leadership and persuasion. We can also expect, most of the time, a hard-earned reputation for integrity. But the winnowing process also selects, in some cases, for a much stronger-than-usual attraction to perquisites found in unique abundance in the C-suite: money, power, autonomy, recognition, attention, and status, an attraction that may be strong enough to overpower allegiance to ethical or legal rules. And the C-suite has no magical ability to exclude the most dangerous personality types – psychopaths,

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5 Of course there are significant accounting and systems controls but many of these are vulnerable to collusion at the C-suite level.

4 Few compliance officers are unaware of the cautionary tale of Paul Moore, fired by the CEO of HBOS shortly after having warned the board’s audit committee about the bank’s unbalanced sales culture.

5 According to the Ethics Resource Center’s 2012 National Business Ethics Survey of Fortune 500 companies, public-company employees are significantly more likely to feel pressure to compromise standards than those in privately-held companies – and public-company employees who follow the stock price daily are more than twice as likely to feel pressure as private company employees.

6 We might pause to consider the relevance of Nobel Laureate Daniel Kahneman’s observation that “people who are simultaneously challenged by a demanding cognitive task and a temptation are more likely to yield to the temptation.” Daniel Kahneman, THINKING, FAST AND SLOW, Farrar, Straus and Giroux 2011, p. 41.
extreme narcissists, and others who lack conscience but often possess charisma, intelligence, motivation, and advanced manipulative skills.

There is no reason to believe that senior executives, individually or as a group, are innately less ethical than the general population. But experience and headlines tell us that reaching the top is no guarantee of moral invulnerability, and that is all a board needs to know. Where high stakes, strong temptations, vast power, extreme pressure, a fast pace, complex problems and ambitious people come together with few external restraints, could anything major go wrong? A high-impact risk exists and must be addressed.

How the Crucible Amplifies Ethical Infirmities: Behavioral Ethics

The worst executives can intentionally cause great damage in pursuit of their self-centered agendas, but even the best are subject to predictable human infirmities. This should particularly worry us in the superheated environment of the C-suite. Over the past two decades, researchers in “behavioral ethics” have shown that an individual’s morality is much more malleable under situational and social forces than formerly supposed, and that most of the unethical behavior in organizations is committed by individuals who value morality and consider themselves ethical, yet regularly fail to resist temptation, or even to recognize that their decisions have a moral dimension. As we have seen, the C-suite is rife with potent situational and social forces; a few examples of their operation below the plane of conscious thought will be useful.

Conflicts of Interest. One of the core teachings of behavioral ethics research is that it is not just difficult, but impossible, to be truly objective about a decision when you have a significant interest in the outcome. Good-faith judgments about what is good for the company (or shareholders, or employees) may be infected by an unconscious self-serving bias, and justified by post-hoc rationalization, if the executive’s personal interests

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7 We should recall that most senior executives never get into serious trouble and probably never deserve to. In risk management terms, the statistical likelihood of serious executive misconduct in a given company is quite small, though it is hardly an unforeseeable “black swan;” the potential impact, however, is huge.
10 Where the financial interests of the company and of the executive are aligned, and cheating will produce a good result or avoid a bad one, the rationalization is particularly seductive through a kind of conflation of Charles E. Wilson’s apocryphal “What’s good for General Motors is good for the country” with Charles DeGaulle’s “L’état, c’est moi.”
weigh heavier on one side of the scales than on the other.11 In a C-suite where large incentive compensation for most or all of the executives may hinge sensitively on short-term corporate earnings reports, there is clear potential for these conflicts of interest to influence decisions involving ethics, legal compliance and risk.12 This potential has been confirmed in studies that show a significant correlation between unusually large incentive compensation for CEOs and the risk of credit default, large credit-rating downgrades, accounting restatements, and fraud.13

Motivated Blindness and Framing. Rationalization of misconduct is especially tempting where the ethical or legal issues are unclear, uncertain, deferred, or simply not in the frame of reference – and the frame of reference has a way of shrinking. We are subject to “motivated blindness,” a tendency to acquire tunnel vision if it will help us ignore inconvenient facts. This may occur if we inadvertently frame a multidimensional decision as “purely business,”14 a hazard that behavioral ethics pioneer Max Bazerman illustrates with the Ford Pinto episode, where Ford used a “formal cost-benefit analysis – putting dollar amounts on …lives – and determined that it would be cheaper to pay off lawsuits than to make the repair.”15 We can also be blinded if we have a substantial stake in not noticing something: Bazerman recalls how long it took Major League Baseball, the players’ union, and his team’s management to pay attention to the changes in Barry Bonds as his hitting improved.16 And being simply too focused on one particular goal can crowd out all competing input – a phenomenon that is often invoked

11 As Upton Sinclair put it, “It is difficult to get a man to understand something, when his salary depends on his not understanding it.” I, CANDIDATE FOR GOVERNOR, AND HOW I GOT LICKED, (1939), repr., University of California Press, 1994, p. 109.
12 The issue of proper alignment between executive compensation and organizational goals is subject to considerable debate and is beyond the scope of this paper; for our purposes the key point is that conflicts do exist and are relatively ineradicable in the presence of large incentive compensation. See Lynn A. Stout, Killing Conscience: The Unintended Consequences of ‘Pay for Performance,’ working paper, 2012.
13 See Kenneth Bertsch and Chris Mann, CEO Compensation and Credit Risk, Moody’s Special Comment, July 2005 (as to credit defaults and ratings downgrades); Merle Erikson, Michelle Hanlon, and Edward Maydew, Is there a Link between Executive Compensation and Accounting Fraud?, working paper, University of Michigan, 2004 (as to restatements and accounting fraud). To be fair, CEOs, for all their power, do not act in a vacuum. We should not presume that the directors who oversee these CEOs and approve their strategic moves are immune to similar temptations, in an age where options and restricted stock have become an increasing percentage of board compensation. The outsized CEO incentives in these studies were, after all, granted by corporate boards, and it would be interesting to know what kind of compensation plans those directors had voted for themselves.
14 One attribute of “business” framing is that decision-making is typically governed by cost-benefit analysis – another way of saying that tradeoffs are to be expected, and usually negotiable. This approach yields considerable ethical flexibility. In ethical framing, or analysis of illegality, problems may be difficult but the answers are not negotiable.
15 Max H. Bazerman and Ann E. Tenbrunsel, Ethical Breakdowns, HARVARD BUSINESS REVIEW, April 2011, p. 58.
16 Id.
by overly-narrow performance metrics\textsuperscript{17} and that has been unforgettably demonstrated with a simple basketball exercise that one must see to believe.\textsuperscript{18}

\textit{Time Pressure}. A form of motivated blindness can also take over when we are in a hurry. In a well-known study, seminary students at Princeton were sent across campus to give a short talk on the story of the Good Samaritan. Along the way they had to pass by a groaning man collapsed in a doorway. Under unhurried conditions 63\% of the students stopped to give aid, but if the experimenter sent the students off with no time to spare, only 45\% helped the man, and if the experimenter instructed them to get to their destination as fast as possible, only about 10\% helped.\textsuperscript{19} If this happens to seminarians on their way to preach about helpfulness, what does it suggest about the likelihood that business executives, rushing to meet a launch date, will pause to consider whether the product may present safety, ethical or legal issues? Deepwater Horizon comes to mind.

\textit{Irrationality in Loss Avoidance}. We are much more likely to act unethically, and to take risks in general, to avoid losses than to obtain equivalent gains, and this holds true even where an identical situation is simply \textit{described}, or \textit{framed}, in terms that emphasize the possibility of either loss or gain.\textsuperscript{20} Here the notion of failing to "hit the numbers," or of "losing" a bonus one has come to expect, or of failing to close a sale that one has considered likely, has obvious relevance: risk-taking increases and ethical standards may sag. Taking more risk, of course, doesn’t always turn out as hoped; and when this leads to greater losses, even greater risk taking may result – a cycle known as "escalating commitment" that seldom ends well. This is the story of Barings Bank, of the London Whale, and of countless embezzlers who originally planned to repay their employers before the missing funds could be discovered.

\textit{Overconfidence}. Another recurring theme in behavioral ethics and cognitive psychology is overconfidence. Most of us have it to some degree, from the incompetent\textsuperscript{21} to the accomplished, and given their personal histories of success C-suite officers have more than most. Overconfidence leads us to take on more risk than we intend to, and in certain situations, to think that we won’t get caught. One especially vicious cycle is that

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\item[\textsuperscript{17}] This risk was elegantly portrayed in the following dialogue from the Scott Adams “Dilbert” comic strip of November 28, 2012. Boss: “Your compensation will be based on achieving these goals.” Dilbert: “Awesome. It’s like written permission to ignore everything else you ask me to do.”
\item[\textsuperscript{18}] See the video at \url{http://www.youtube.com/watch?v=vJG698U2Mvo}. See also Christopher Chabris and Daniel Simons, \textit{The Invisible Gorilla}, HarperCollins Publishers, 2011.
\end{itemize}
overconfidence can be fueled by early success in high-risk initiatives, leading
decisionmakers to recalibrate their risk assessment, discount the risk already taken, and
“double down” on risky business going forward. The space shuttle Challenger disaster
and the collapse of U.K. banking giant HBOS are tragic products of this beguiling form
of self-deception.  
Worse, since we tend to attribute our successes to our personal
characteristics, we may not only downgrade our risk assessment, we may
simultaneously raise our opinion of our own ability to judge risk and to predict the
future.

Power. Power by itself has been shown to breed overconfidence and to increase risk
taking. In the corporate arena there is specific evidence that companies with high-
powered CEOs take more risk than those with less-powerful CEOs. Approaching the
issue from another angle, researchers have shown that companies with very powerful
CEOs show significantly above-average variation in performance – higher highs and

22 Space shuttles had repeatedly suffered, without consequence, partial O-ring burn-throughs of the kind
that later caused the Challenger explosion. This experience led NASA management to conclude that the
burn-throughs, though unexpected and poorly understood, must not pose a significant risk – when any
dispassionate analysis would have predicted that if the burn-throughs continued, sooner or later one would
cause an explosion. See Nobel Laureate Richard Feynman’s APPENDIX TO THE REPORT OF THE
PRESIDENTIAL COMMISSION ON THE SPACE SHUTTLE CHALLENGER ACCIDENT (1986), admonishing that
contary to NASA’s way of thinking, “When playing Russian roulette the fact that the first shot got off
safely is little comfort for the next.” With respect to HBOS, see PARLIAMENTARY COMMISSION ON
BANKING STANDARDS, 'AN ACCIDENT WAITING TO HAPPEN': THE FAILURE OF HBOS, April 4, 2013: “The
growth of HBOS’s Corporate Division was not the result of superior performance but of its high-risk
strategy.” As HBOS moved increasingly into credit derivatives and foreign markets, “HBOS was
excessively confident that its understanding of UK residential mortgages and related securitizations gave it
the ability to understand and evaluate the risks in a wide range of asset-backed instruments.” (at 46-47)

23 That we tend to attribute our successes to ability while blaming failures on external situational causes is
one of the implications of attribution theory, first developed by Fritz Heider in the 1950s and later
elaborated on by Weiner and others. See, e.g., Fritz Heider, The Psychology of Interpersonal Relations,
Wiley (1958); Edward E. Jones, David E. Kannouse, Harold H. Kelley, Richard E. Nisbett, Stuart Valins,
and Bernard Weiner, Eds. Attribution: Perceiving the Causes of Behavior, Morristown, NJ: General

24 For example, according to the Parliamentary Commission, the HBOS “culture was brash, underpinned by
a belief that the growing market share was due to a special set of skills which HBOS possessed and which
its competitors lacked.” Id.

25 Niro Sivanathan and Adam D. Galinsky, Power and Overconfidence (2007), IACM 2007 Meetings
Paper.

26 See Jeffrey Pfeffer, POWER: WHY SOME PEOPLE HAVE IT – AND OTHERS DON’T, HarperCollins
Publishers 2010, p. 200: “Studies on the effects of power on the power holder consistently find that power
produces overconfidence and risk taking…”

27 Krista B. Lewellyn and Maureen I. Muller-Kahle, CEO Power and Risk Taking: Evidence from the
Subprime Lending Industry, CORPORATE GOVERNANCE: AN INTERNATIONAL REVIEW, Vol. 20, No. 3, 289-
307 (2012).
lower lows – again, consistent with increased levels of risk (and reward).²⁸

There is ample reason to believe that the elevated risk tolerance associated with power applies to ethical or legal risks just as it does to business risks. In an experimental setting, participants endowed with power not only committed more moral or legal infractions, they judged their own infractions less harshly than they judged the same conduct by others: they felt they were entitled to their transgressions while others were not.²⁹

Does power corrupt? It seems more justified to say that power amplifies native tendencies: the core principle seems to be that power lowers inhibitions. Undesirable behavior becomes more likely as inhibition is reduced, and even behaviors desirable in moderation, like risk taking, can become undesirable when limits are lifted.³⁰

Group Dynamics. The C-suite is a group, a small and sometimes insular one where members see a lot more of one another than of other employees. Like any group it will develop its own distinct identity, behavioral norms and culture, for better or worse. The risk of groupthink – collegiality and teamwork devolving to uncritical thinking or an absence of dissent – cannot be discounted, particularly on the turf of a dominant CEO.³¹

These themes of in-group identification, conformity and deference to authority have unsettling ramifications for compliance. Experiments have shown that misconduct by an authority figure such as a CEO strongly primes independent episodes of misbehavior by others,³² and the “copycat” misconduct can be of any type: the lesson taught by example is not theft, or bribery, or misrepresentation: it’s disregard of rules. This principle can apply within the executive corps between more and less powerful executives, and then “trickle down” throughout the organization via a process Enron seems to have perfected.

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²⁹ Joris Lammers, Diederek A. Stapel and Adam D. Galinsky, Power Increases Hypocrisy: Moralizing in Reasoning, Immorality in Behavior, PSYCHOLOGICAL SCIENCE Vol. 21, No. 5, pp. 737-734. One is reminded that “rank hath its privileges,” and that “privilege” translates to “private law.”
³¹ It is hard to say no to any boss, domineering or not, and the “authority bias” compellingly demonstrated by Milgram’s electric shock experiments reminds us that deference to authority can quite easily override ethical qualms. See Stanley Milgram, Behavioral Study of Obedience, 67 J. ABNORMAL AND SOCIAL PSYCHOL. 371-378 (Oct. 1963).

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and even named.33

A similar effect operates laterally between those of equal power within a group, even one that is not particularly close-knit. In one study, Francesca Gino and Adam Galinsky discovered that feelings of closeness drawn from group membership, or even a perception of minor commonalities such as birthdays, leads people to rationalize and justify misconduct committed by those they identify with, and worse, to emulate the misbehavior.34 In another study of in-group effects, Gino and others showed that college students will more readily cheat if they see another student in the same class cheating— but the effect disappears if the cheater appears to be from another school.35

If these experimental studies seem academic, consider CEO Connectedness and Corporate Frauds, a retrospective study of securities fraud in nearly 3,000 public companies over a 10 year period.36 The study measured fraud incidence as a function of how many of the other top four C-suite executives were appointed during the current CEO’s tenure, a rough index of “connectedness” within the suite based on the assumption that CEOs likely played a role in the selection of others appointed during their term. More connected executive teams may be more susceptible to unhealthy in-group influences, and perhaps more to the point they can collude and cover for one another. The study’s bottom line was that in firms where all four of the other executives were appointed during the current CEO’s term, the fraud incidence was 34% higher than in firms where none were appointed during that term, with fairly linear results in between these two extremes. Detection was also significantly slower. C-suite closeness probably doesn’t cause fraud, but, aided by the kinds of psychological forces discussed above, it certainly seems to enable and prolong it.

This is a fitting time to remind ourselves that this combustible mixture of C-suite pressures and temptations with intractable human frailties doesn’t actually explode very often. That tells us a lot about the integrity of the “average” senior executive.

33 See Lynne L. Dallas, A Preliminary Inquiry into the Responsibility of Corporations and their Directors and Officers for Corporate Climate: The Psychology of Enron’s Demise, Public Law and Legal Theory Research Paper 44, St. John’s University Law Review Symposium (2002), quoting a member of Enron’s Risk Assessment and Management Group about the “Enronizing” of new employees: “[i]f your boss was fudging, and you have never worked anywhere else, you just assume that everybody fudges earnings…It was easy to get into ‘well, everybody else is doing it, so maybe it isn’t so bad’” (at 66).
34 Francesca Gino and Adam Galinsky, When Psychological Closeness Creates Distance from One’s Moral Compass, paper presented at the 23rd Annual International Association of Conflict Management Conference, Boston, Massachusetts, June 24-27, 2010.
But failures do happen and the damage to the organization can be vast, for two distinct reasons. First, serious C-suite misconduct can directly cause major financial and reputational damage, as the rare but spectacular corporate collapses of the past decade show. Second, and much more common and insidious, the C-suite is the font of corporate culture and whether through the direct and intentional exercise of power or through instructive example, it tends to leverage its own culture, ethics, and behavioral expectations throughout the organization. We now consider how a board can address these risks.

**What Not to Do**

The challenges directors face in working effectively with senior management are legendary. The task requires constant balancing among conflicting goals such as monitoring versus mutual trust, objectivity versus collegiality, collaboration versus independence, and support and motivation versus discipline and deterrence. The answer to C-suite compliance risk is not to double down on controls, confrontation, and suspicion. The board cannot, and should not, manage the corporation nor can it, or should it, directly supervise senior executives in the execution of their duties. And projecting expectations of misconduct upon executives – very few of whom deserve it – will produce, at best, dysfunction and at worst, a self-fulfilling prophecy.

In the face of a distrustful board, executives can be expected to react defensively and to involve the board only in decisions where its participation is clearly required; and teamwork and effectiveness will suffer. Executives may also react by exerting tighter control over the already-limited information the board receives, even beyond the intrinsic motivation to portray their own performance favorably, thus actually impairing the board’s monitoring capability.

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37 See text accompanying notes 29-34 above for examples of how toxic leadership by example can influence follower behavior.

38 The customary shorthand for the appropriate engagement level of directors is “nose in, fingers out.”

39 Needless to say, tighter monitoring is hardly the long-term answer for any executive who has actually earned the board’s distrust: they should be encouraged to find a more suitable position elsewhere.


41 This key vulnerability in the board's monitoring function – the fact that much of the board's information on the C-suite's performance is provided and to some extent controlled by the C-suite, and most of the Board's information on the integrity, character, and ethics of the C-suite is similarly based on direct interaction with the C-suite – points us towards some alternate approaches. See below under “Culture And Expectations Of The C-suite” and “Culture and the ‘Information and Reporting System’.”
In its role as the ultimate guardian of ethical culture, the board can be far more effective by taking positive actions than by adversarially positioning itself as the C-suite’s “compliance cop.” The greatest impact will be achieved if the board focuses on selecting executive leaders with unblemished records of integrity, working supportively with the CCO and other internal-control officers, maintaining continuity of “tone at the top” as executives come and go, and promoting ethical leadership within the C-suite and ethical culture throughout the organization.

Leadership Selection

Good leadership selection, especially not hiring the wrong people, is critical for compliance. It is not always easy to distinguish between the confidence, ambition, dedication and persuasive power that makes for a successful executive and the aggression, ambition, intensity and manipulative power that characterizes a narcissist or psychopath. Still, it helps to be clear about what you're trying to avoid.

The august Group of Thirty offers this advice about CEOs who think of themselves as “stars”: “A very good CEO is preferable to a “star” CEO.” Very good CEOs “care much more about doing the right thing than about being right,” while “star” CEOs “may conflate the [company’s] success with their own personal goals,” “advance their own ideas in preference to listening to the good ideas of others, and they may start to believe their own press.” Essentially, they are warning against the temptation to hire charismatic CEOs who are high in narcissism, and who in their unending pursuit of admiration, affirmation and applause, have been shown to regularly take greater risks, make more acquisitions, pay higher premiums for them, and produce more extreme results (good or bad) on several measures of corporate performance than those lower in narcissism.

To similar effect, in his book Good to Great, Jim Collins pointed out that the successful companies he studied had in common that they were led predominately by 41 “humble CEOs,” or servant-leaders, who were continually described with words like “quiet,

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43 Group of Thirty, TOWARD EFFECTIVE GOVERNANCE OF FINANCIAL INSTITUTIONS, 2012, p.20. It is worth noting that this 81-page report by some of the world's most senior and hard-nosed financial executives and scholars uses the word "culture" 126 times, and "values" 86 times.
44 Id. at 38.
45 See Arjit Chatterjee and Donald C. Hambrick, It's All About Me: Narcissistic CEOs And Their Effects on Company Strategy and Performance, ADMINISTRATIVE SCIENCE QUARTERLY 52:351-386 (2007). This paper helpfully provides a number of indicia of narcissism that a board could use in vetting management candidates.
humble, modest, reserved, shy, gracious, mild-mannered, self-effacing, understated, did not believe his own clippings, and so on.”47 Similarly, compliance strategist Donna Boehme has observed that “the most enduring, most powerful ethical cultures have at their core some simple, well-worn CEO stories” of humility.48

Below the CEO level, the Group of Thirty also recommends direct board involvement in the selection of other C-suite officers, and that “[a]t a minimum, the board must confirm the appointments of corporate officers for whom independence from line of business management is critical. These typically include the internal auditor, the chief financial officer, the chief risk officer, the chief compliance officer, and the chief legal officer.”49 Besides offering prophylaxis against undue “connectedness” in the C-suite, this step would underscore the expectation of independence of these officers.

**Working with the Chief Compliance Officer**

The board should develop a close and supportive relationship with the Chief Compliance Officer, ensure her independence,50 and communicate directly with her on a regular basis. An integral part of the CCO’s job is understanding the board’s and the C-suite's attitude towards modeling and supporting ethics and compliance within the organization. In a healthy company the CCO should always be in a position to “speak truth to power” in the C-suite itself, but to whatever extent this is not the case, it is all the more essential that she be able to speak frankly, and privately, with the board.

For our purposes, a crucial point with respect to the CCO is that unless the CCO regularly reports directly to the board, the company cannot receive leniency under the Federal Sentencing Guidelines in connection with senior executive misconduct, no matter how excellent the company's compliance program may be in other respects.51 Notably, the Guidelines also emphasize that the CCO must have “adequate resources” and “appropriate authority.”

Similar considerations apply with respect to other officers whose jobs involve a monitoring element and require independence, as mentioned earlier. In fact, the Group of

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47 It is noteworthy that the increased misconduct and hypocrisy found in the Lammers study, *supra* note 29, appears only if the subject also feels entitled to his power: humility trumps hypocrisy.  
48 See Donna Boehme, *5 Ethical Culture Lessons for CEOs from Pope Francis*, CORPORATE COUNSEL, April 4, 2013.  
51 United States Sentencing Commission, *Guidelines Manual 8C2.5(f)(3)(C) (2010).* This has led no less an authority than the NACD to recommend, in understated fashion, that boards “should at least consider having their chief ethics/compliance officer report to the audit committee and/or board of directors,” National Association of Corporate Directors, *C-Suite Expectations: Understanding C-Suite Roles Beyond the Core*, 2013, at 16.
Thirty’s discussion of the Chief Risk Officer (CRO) role applies equally well to the role
of the CCO, as well as those of Internal Audit, the General Counsel and the CFO. After
observing that, in many of the financial institutions that failed during the recent financial
crisis, the CRO “struggled to properly influence their firm’s risk-taking activities” and
“lacked sufficient independence from and credibility with the firm’s top management and
business units,” the report concluded that CROs need the following conditions to be
successful:

They need courage and conviction, and they should be willing to walk away from
their job if their judgment on major issues is ignored. They should have the right
statute in the organization. They should be a member of the senior management
team and should report to the CEO. They should have high visibility in the
boardroom and should have unfettered access to the chairman of the risk
committee and the full board where necessary.

Given a real “seat at the table” in senior management and regular interaction with the
board, all of these officers can assist the board’s C-suite monitoring function by
providing current information on the climate in the C-suite, on particular issues of
compliance and reputational risk, and on “pink flags” or emerging concerns. The board
should also pay attention to the relationships between these “control” officers and the rest
of the C-suite; distance, antagonism, or portrayal of these officers as the “department of
sales prevention” are danger signs. The rest of the C-suite should appreciate that the
faster the car, the more it needs a good set of brakes.

Modeling the Message

The final responsibility for corporate culture remains with the board – duties may be
delegable but responsibility is not. Our final sections examine three different ways the
board can harness organizational culture as a means of effectively monitoring and
governing the C-suite: by modeling and articulating the culture the board wishes to
instantiate (and thereby sending a powerful implicit message to management); by
explicitly engaging the C-suite with cultural and ethical-leadership responsibilities; and
by taking advantage of a positive culture’s potential as a compliance “information and
reporting system” for the board.

There is no longer doubt that organizational culture drives improved compliance results
through a variety of mechanisms, including most broadly the establishment and
pervasive reinforcement of behavioral norms, demonstrating the legitimacy of the

52 TOWARD EFFECTIVE GOVERNANCE OF FINANCIAL INSTITUTIONS, supra note 43, at 48.
53 Id.
54 See, generally, Killingsworth, Modeling the Message, supra note 1.
company’s ethical leadership and rules,\textsuperscript{55} harnessing group loyalty and engagement\textsuperscript{56} and activation of employees’ existing ethical values.\textsuperscript{57} Culture counteracts the undertow of temptation and rationalization by helping people recognize the ethical dimensions of workplace issues, encouraging upright behavior and providing tools for dealing with ethical conflicts. The results are dramatic: the Ethics Resource Center found that the incidence of misconduct at companies in the lower quartile of an ethical culture measure was triple the incidence at companies in the top quartile,\textsuperscript{58} and using its own index of ethical culture, the Corporate Executive Board found the same 3-to-1 ratio between the bottom and top quartiles for violations in high-risk compliance areas such as conflicts of interest and accounting irregularities.\textsuperscript{59}

If the C-suite is the font of organizational culture, the board is its wellspring. Consider the interaction between these two assertions:

\begin{quote}
If each level in a corporate hierarchy emulates the one above it, then a corporation can never be better than its board – Alice Peterson\textsuperscript{60}

You’re only as good as the leaders you have underneath you. You might think that because you’re projecting our values, then the rest of the company is experiencing the values. What you realize is that the direct supervisors become the most important influence on people in the company. – Victoria Ransom\textsuperscript{61}
\end{quote}

To instill an ethical culture, the board and the C-suite each depend on one another: the board must inspire the C-suite and the C-suite must propagate that inspiration down through the organization.

Directors often overlook the intensity with which their behavior is scrutinized by senior


\textsuperscript{57} See Dan Ariely, \textit{PREDICTABLY IRRATIONAL} 195-216 (2008)

\textsuperscript{58} Ethics Resource Center, 2011 National Business Ethics Survey, p.20.


\textsuperscript{60} Remarks at the Practising Law Institute Corporate Compliance and Ethics program, Chicago, Illinois, May 6, 2012.

\textsuperscript{61} Quoted in Adam Bryant, \textit{If the Supervisors Respect Values, So Will Everyone Else}, \textit{THE NEW YORK TIMES}, January 26, 2013.
management. The conflict of interest inherent in a board's setting its own compensation, perquisites, meeting sites, and expense reimbursement policies is lost on no one, and the decisions made in that domain, and the process by which they are made, are received as powerful messages about the board's values and integrity. Moreover, some officers may feel that some directors are just as vulnerable to the pernicious influences of power, money, urgency, in-group preference, and motivated blindness as are ordinary mortals, and may interpret directors' behavior through this lens. If the company can be no better than the C-suite’s perception of its board, the board must embrace without reservation its obligation to model ethical behavior.

With regard to its own members’ behavior, as well as that in the C-suite, the board must consistently “repair the broken windows” of even small legal and ethical breaches that come to their attention. The literature is replete with evidence that tolerating visible infractions breeds further infractions of all kinds, and leads step-by-step to continued decline in overall compliance. Deal with small problems conspicuously now, and you may not have to deal with big problems later. Of course, the response must be proportional to the infraction, but the point is that there must be a response, lest a climate of delinquency and disorder gain a foothold in the organization, at the top of a slippery slope.

In addition to ensuring that misconduct is dealt with, from a communications and modeling perspective the board should be reluctant to “let a good mistake go to waste.” The value of addressing a single violation can be multiplied if the company can get the word out about the nature of the violation and the steps taken to address it. This reinforces not only the organization's behavioral norms but also its genuine commitment to organizational justice. Nothing is more important to ethical culture than employees’ belief that if misconduct is discovered, appropriate action will follow – especially where high performers or those in senior positions are involved. How important is it? In a large-scale study, the Corporate Executive Board identified seven key drivers of employee perceptions that their organization has a culture of integrity. At the top of the list, and three times as important as the other six factors combined, was organizational justice: the perception that the company responds quickly and consistently to proven

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62 The principle discussed in connection with note 26, that persons in power may be more forgiving of their own transgressions while simultaneously harsher in judging the actions of others, may have special cautionary relevance to board/C-suite interactions.
64 See note 26 and accompanying text.
65 For an excellent example of how this can be done effectively in a large company without identifying the participants, see the blog by Kathleen Edmond, Best Buy’s chief ethics officer, at www.kathleenedmond.com.
unethical behavior and that unethical behavior is not tolerated in their department.66

Finally, the board can also exercise leadership with respect to other cognitive traps that can lead to compliance breakdowns, such as motivated blindness, business-only framing, and tunnel vision in strategic decision-making. The board is uniquely positioned to be the voice for a broader analysis of strategic problems, one that systematically takes into account how other constituencies, such as regulators, customers, or the press, might frame a problem under consideration. And through its role in setting executive compensation, goals, incentives and the associated timelines, the board can mitigate the corrosive psychological forces at work in the crucible.

**Culture and Expectations of the C-Suite**

The board should also challenge senior leadership to take ownership of the organization's ethical culture and to be accountable for results. Setting these expectations has a dual function: to benefit the overall organization by engaging the C-suite in supporting ethical culture through modeling, communications, discipline, etc., while simultaneously raising the salience of ethical behavior in the minds of the executives themselves. A clear, explicit expectation from the board that the senior executive's duties include serving, and being accountable, as a positive role model for the rank and file can do much to focus the mind on topics that might otherwise be consigned to the back burner.

At a minimum, compliance failures should be included in executive performance reviews. Senior executives can also be invited to account for their objective actions in promoting compliance and ethical culture, such as completing required training and encouraging their staffs to do so; contributing to compliance-related newsletters and other communications; attending compliance-related functions; including “compliance moments” in presentations; making resources available for employee training; assisting with internal investigations; assisting with the design of compliance controls in their area of responsibility, etc.67 What gets measured gets done.

On a broader scale, C-suite executives can, individually or as a group, be rewarded for measurable improvements in the company's compliance in a variety of ways. Metrics of commonly recurring issues such as employment discrimination suits, safety citations, etc. can go into an evaluation.

Other facets of executive ethical leadership can best be measured through the eyes of

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66 Corporate Executive Board, Ethical Leadership, supra note 59.
67 In C-SUITE EXPECTATIONS, supra note 51, the NACD suggests asking the CEO directly about “how the CEO is engaged in ongoing evaluation of the ethics program” and requesting examples of “how the CEO is building ethics requirements into his/her staff’s objectives” and of “how the CEO is modeling ethical behaviors” (at p. 17).
others, for example through 360° evaluations by peers, direct and indirect reports, and the
board, or via employee surveys – both emerging best practices employed by leading
companies.\textsuperscript{68} Validated survey tools can reliably measure employees' perception of key
ethical-culture variables, such as organizational justice, comfort speaking up about
violations, comfort seeking advice about compliance issues, tone at the top, clarity of
behavioral expectations, trust in colleagues, and the like. These cultural assessments can
identify organizational weak spots and compliance danger zones, across the company as a
whole or within particular locations or functions, and can serve as roadmaps for remedial
action. The board can send no stronger message about the importance and priority it
assigns to ethical culture than to tie part of executive compensation to improvements on
these key measures.

**Culture and the “Information and Reporting System”**

The board's fundamental obligation with respect to compliance is to establish, and
monitor, an “information and reporting system” designed to provide sufficient timely,
accurate information to support informed judgments about the corporation's
compliance.\textsuperscript{69} With respect to C-suite compliance, the information and reporting system
includes the CCO, Internal Audit, the General Counsel and other control officers,
external auditors, and the board's direct experience with senior executives. All of these
represent different windows into the executive suite, and each window is limited in its
own way. But few things happen in a corporation completely unwitnessed.

The final piece of a fully-developed information and reporting system is, quite simply,
everyone else in the company. The effectiveness of this component depends on how
comfortable employees feel in speaking to their supervisor, to a compliance officer, to in-
house counsel or to an internal auditor about compliance concerns and questions; how
much they trust the anonymity of the hotline service and the integrity of the investigative
process that follows a report; whether they believe that the company will take appropriate
action when misconduct is discovered, especially if the culprit is a high achiever,
occupies a senior position, or has friends in management; and whether they believe that
good-faith whistleblowers will be protected from retaliation.\textsuperscript{70}

In a high-functioning culture, these factors operate to make rank-and-file employees the
eyes and ears, the early warning system, and sometimes the conscience, of the company.

\textsuperscript{68} See Joseph E. Murphy, \textit{SOCIETY OF CORPORATE COMPLIANCE AND ETHICS, USING INCENTIVES IN YOUR
COMPLIANCE AND ETHICS PROGRAM} (2011)


\textsuperscript{70} See generally, Michael D. Greenberg, \textit{FOR WHOM THE WHISTLE BLOWS: ADVANCING CORPORATE
COMPLIANCE AND INTEGRITY EFFORTS IN THE ERA OF DODD-FRANK, RAND CENTER FOR CORPORATE
ETHICS AND GOVERNANCE, CONFERENCE PROCEEDINGS REPORT} (2011); Ethics Resource Center, \textit{INSIDE
THE MIND OF A WHISTLEBLOWER, SUPPLEMENTAL REPORT OF THE 2011 NATIONAL BUSINESS ETHICS
SURVEY} (2012).
A culture of “speaking up” can uncover existing or incipient violations via up-the-chain reporting and anonymous hotlines, and can identify organizational red flags and renegade microcultures via surveys or focus groups. It can also be good for earnings. As mentioned earlier, these crucial perceptions of the company’s integrity and the resulting willingness of employees to speak up can be measured and, through ethical leadership at the senior executive and supervisor level, fair treatment of employees, communications, and training, can be improved.

By investing in a robust ethics and compliance program led by an empowered CCO and committing to the long-term development of a consistent and uncompromising ethical culture, a board can ensure that its most effective “information and reporting system” – its people – will be there when most needed.

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71 See id, reporting that in companies with a weak ethical culture and a weak compliance program, approximately half the employees who witness misconduct do nothing to report it, while in companies with both strong culture and a strong program, only 3% fail to report misconduct they have observed. In another Ethics Resource Center study that measured reporting-up purely as a function of culture (as opposed to culture plus compliance program), employees in a stronger culture were one-third more likely to report observed misconduct than those in a weaker culture. Ethics Resource Center, The Importance of Ethical Culture: Increasing Trust and Driving Down Risks, Supplemental Research Brief of the 2009 National Business Ethics Survey. More generally, see also discussion in Michael D. Greenberg, Corporate Culture and Ethical Leadership Under the Federal Sentencing Guidelines: What Should Boards, Management and Policymakers Do Now? RAND Center for Corporate Ethics and Governance, Conference Proceedings Report (2012).

72 See Ethical Leadership, supra note 59, which found a significant positive and linear relationship between employee comfort in speaking up and 10-year total shareholder return.