

PBI's  
 "A Day on Health Law"

**Codes of Conduct: Do They Really Prevent Unethical/Illegal Conduct?**

David R. Hoffman, JD, FCPP  
 October 23, 2018

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**Federal Sentencing Guidelines  
 § 8B2.1**

- (a) To have an effective **compliance and ethics program**, for purposes of subsection (f) of §8C2.5 (Culpability Score) and subsection (b)(1) of §8D1.4 (Recommended Conditions of Probation — Organizations), an organization shall—
  - (1) exercise due diligence to prevent and detect criminal conduct; and
  - (2) **otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.**

Such compliance and ethics program shall be reasonably designed, implemented, and enforced so that the program is generally effective in preventing and detecting criminal conduct. The failure to prevent or detect the instant offense does not necessarily mean that the program is not generally effective in preventing and detecting criminal conduct.

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**Sentencing Guidelines**

(b) Due diligence and the promotion of an organizational culture that encourages ethical conduct and a commitment to compliance with the law within the meaning of subsection (a) minimally require the following:

- (1) The organization shall establish standards and procedures to prevent and detect criminal conduct.
- (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.
- (B) High-level personnel of the organization shall ensure that the organization has an effective compliance and ethics program, as described in this guideline. Specific individual(s) within high-level personnel shall be assigned overall responsibility for the compliance and ethics program.

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### Who is “High-level?”

“High-level personnel of the organization” means individuals who have substantial control over the organization or who have a substantial role in the making of policy within the organization. The term includes: a director; an executive officer; an individual in charge of a major business or functional unit of the organization, such as sales, administration, or finance; and an individual with a substantial ownership interest.

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### “Too Much Information”

- Tension between compliance and General Counsel
- What should CEO, Board Members know?
- What about Yates memo and cooperation?

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### “Evaluation of Corporate Compliance Programs”

- “Filip Factors”—existence and effectiveness of the corporation’s pre-existing compliance program” and remedial efforts “to implement an effective corporate compliance program or to improve an existing one.”
- How many times are the words “ethics/ethical” used in the “Evaluation of Corporate Compliance Programs document?”

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## Answer

- **TWICE!**
  - Under "Incentives and Disciplinary Measures"
  - "Have there been specific examples of actions taken (e.g., promotions or awards denied) as a result of compliance and ethics considerations?"
  - Under "Third Party Management"
    - "How has the company incentivized compliance and ethical behavior by **third parties**?"

WHAT ABOUT ETHICS EDUCATIONAL SESSIONS THROUGHOUT THE ENTIRE ORGANIZATION?

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## Ethics v. Rules-Based Programs

- What is the difference?
- Which is better?
- Why?

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## My Perspective

Ethics as the foundation for a compliance program is better suited than a rules-based compliance program

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### Codes of Conduct/Ethics

- What should they say?
- Question really is...what should the Code say about us?
- Set of Principles that guide present and future behavior....describes values; inspire trust; motivate; encourage compliance
- NOT just a mechanism to terminate an employee who might violate the Code's Principles and, perhaps, break the law

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### Lehman Brothers Code

- Investment Bank--Failed in 2008
- Code said:
  - “We must always do business in a manner that protects and promotes the interest of our clients.”
  - “Ethical business practices entail a clear understanding of right and wrong, and a motivation on the part of our directors and employees to act at all times in a manner of which they can be proud.”
  - What do you think?

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### Lehman Code

- “Employees and directors have a duty to the firm to advance its legitimate interests whenever the opportunity arises.
- Later, “compete aggressively in furthering the interests of the firm” and
- “Gifts of a material nature are forbidden if they might influence the recipient (emphasis added).
- What do you think?

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### “Culture”

- Dick Fuld, former CEO, “adhered to a Code of honor” and “famously demanded loyalty”  
*Bloomberg*, September 13, 2013
- “[Fuld] began by admiring the culture of the firm, noting that employees, whom he called “risk managers,” owned more than 30 percent of the \$40 billion company.”  
*Breaking Silence, Richard Fuld Speaks on Love, Putin and ‘Rocky’*, David Gelles, May 28, 2015
- Culture in reality: Communication stifled; top down decision-making without questioning?
- Was there a concern about ethical practices emanating from the top at all? Does employee ownership lead to greater or lesser ethical conduct?

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### Wells Fargo

- Wells Fargo employees allegedly set up 2 million deposit, credit card and debit accounts without consumers’ knowledge
- Violated Dodd-Frank and Consumer Protection Act
- Fired over 5300 employees
- Code of Conduct and Compliance Program— of course!

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### Wells Fargo

- 2004 internal Wells Fargo investigation titled “gaming” warned that bankers felt they couldn’t “make sales goals without gaming the system.”
- Report was sent to chief auditor, HR and others...“incentive to cheat” that was “based on the fear of losing their jobs” if they didn’t make their targets.
  - Wells Fargo Claws back \$75 million from former CEO and top exec, Matt Egan, CNN, April 10, 2017

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### Wells Fargo Re-Payments

- \$185 million in fines and penalties on the account scam
- Additional \$142 million to settle class action claims
- \$108 million to the Federal government—allegedly charged military veterans illegal fees to refinance mortgages, costing taxpayers money when those mortgages defaulted
- \$80 million on the car insurance nonsense

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### Did Some Employees Know Right from Wrong?

- Yes. At least a 6 employees were fired after they called the confidential ethics hotline.
- 2-day ethics workshop in mid-2014
- Message:  
Don't create fake bank accounts in the name of unsuspecting clients!  
REPORT IT!

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### So Bad Stuff Stopped, Right?

- Wrong!
- NO CHANGE IN SALES GOALS—ROOT CAUSE OF THE ISSUE
- Sales goals part of employees' duties and annual bonus calculation
- Bad decisions by unethical workers or really bad structure led by really bad leaders/managers?
- Fear factor....loss of job trumps ethics

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### Whistleblower(s)

- Labor Department ordered Wells Fargo to pay \$5.4 million and rehire a whistleblower who was fired in 2010 after calling the bank's ethics hotline to report suspected fraud.
- Manager previously had positive job performance appraisals, reported separate instances of suspected bank, mail and wire fraud by 2 bankers under his supervision
- Recently settled another whistleblower matter for \$577,000
- Litigation progressing on other whistleblower matters as well

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### More Fraudulent Accounts Found in 2017

- Charged customers who took out car loans for auto insurance they did not need or want
- Guaranteed auto/asset protection (GAP)—protects a lender against the fact that car loses value the moment you drive it off the lot
- If pay off early, get refund; if possessed, increased what consumer owed
- 800,000 customers affected—274,000 people pushed into delinquency and 25,000 cars wrongly repossessed

NY Times, August 2017

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### Wells Fargo-May 2018

- Wells Fargo pays \$480 million to settle claims that the bank misled shareholders about its fake-accounts scandal.
- A class-action securities fraud lawsuit brought by investors alleged that Wells Fargo made misstatements and omissions in its disclosures about its notorious sales practices.

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### Wells Fargo-August 2018

- Wells Fargo agreed to pay a \$2.09 billion fine for issuing mortgage loans it knew contained incorrect income information
- The government alleged that between 2005 and 2007, Wells Fargo knew many of its home loans were based on misstated income details and misrepresented their quality.
- Investors, including federally-insured financial institutions, ultimately lost billions of dollars from investing in mortgage-backed securities that contained Wells Fargo loans, according to the Justice Department.  
– MyFinance, CNNMoney, August 1, 2018

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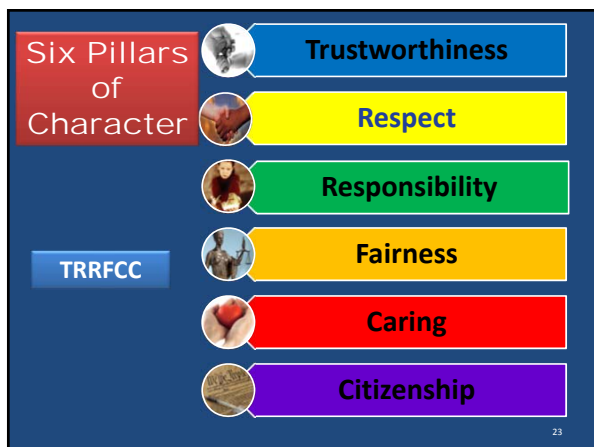
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### Code Elements Beyond The "Vision Thing"

- Make it readable
- Give concrete examples
- Set the correct tone
- Make it relevant
- Senior management "buy-in"
- Reporting requirements clear
- Appropriate enforcement

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## Compliance and Ethics Requires Top Down Approach

- Remember that High-level personnel are responsible for program
- Recent study titled "Hierarchical rank and principled dissent: How holding higher rank suppresses objection to ethical practices"

Jessica Kennedy, Cameron Anderson,  
*Organizational Behavior and Human Decision Processes* (2017)

- Study Results
- How should we approach compliance and ethics?

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## The End

### QUESTIONS?

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