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an interview by Adam Turteltaub

In the Spotlight: Loretta Lynch

Adam Turteltaub (adam.turteltaub@corporatecompliance.org), SCCE Vice President for Membership, conducted this interview with **Loretta Lynch** (loretta.lynch@usdoj.gov), U.S. Attorney for the Eastern District of New York, in June.

AT: Loretta, this is your second stint at the U.S. Attorney's Office. During the intervening time, you were in private practice at a major firm in New York. How does the time doing white collar criminal defense work inform your work as a prosecutor?

Turteltaub

Lynch

LL: My time in private practice was invaluable in providing the corporate perspective on enforcement matters. I was able to see the pressures that influence a company's response to government actions, pressures one doesn't always readily see from the government side. At the same time, I tried to provide the government's perspective to companies, and help them focus on the substance of a government request rather than what can often be collateral consequences. Now that I'm back in government, familiarity with the corporate perspective is extremely useful in analyzing presentations and ultimately determining if a company is truly committed to resolving an issue.

AT: What did you learn about compliance programs, good and bad, in your practice?

LL: The most important thing I learned about compliance programs is also the most basic thing—the tone at the top truly sets the parameters for whether one has an effective or ineffective compliance program. And by effective, I don't mean a program in a company where there is never any wrongdoing, because that company does not exist. If there is one message I'd like to leave with corporate America, it is that the government actually does understand that things can and will go wrong, even where there is a strong compliance program. Every company develops issues. It's how you deal with them that defines your corporate culture and informs me if you are serious about fixing the problem and preventing it from recurring going forward.

AT: One of the things that strikes me about your career in the U.S. Attorney's Office is that fighting corruption has been an ongoing focus. And, it's notable to point out that we're not just talking about the Foreign Corrupt Practices Act (FCPA), but also corruption here in the U.S. Are there common threads that you see among government corruption cases everywhere?

LL: Corruption, whether here in Brooklyn or on the other side of the globe, has real and far-reaching consequences. The common thread is that someone in power loses their connection to the constituency they are supposed to serve, whether citizens or shareholders. When government officials engage in self-dealing, when they abdicate their responsibility, when they succumb to greed, the average citizen pays for it dearly and on many levels. Constituents everywhere end up spending more for services—infrastructure, healthcare, education—and sometimes have to go without these vital services, when government officials line their own pockets with public funds. Law-abiding companies here in the U.S. and abroad are placed at a competitive disadvantage when business is won or lost based on bribes, not the quality of a company's products and services.

And because corruption involves, at its heart, the breaking of a trust relationship, its ramifications often go far beyond the financial. Corruption infects society as a whole, increasing the level of cynicism and distrust that constituents have about their elected officials and government processes. In this way, corruption also impacts those government officials who are truly trying to do the right thing. They get tarred with the same brush. We all deserve honest and effective representation, and my office is committed to investigating and prosecuting those who trade on the trust we place in them to enrich themselves, who let greed get in the way of helping the people that they represent.

AT: What should businesses be aware of domestically? Looking at the Transparency International Index, the U.S. falls on the cleaner side of the scale, but we're not as clean as we might think. Are companies vigilant enough about the domestic risk?

LL: In this global economy, foreign corruption is a significant risk for many companies. But as your question correctly points out, for some companies, the most significant risks may well be right here in the U.S. Companies are sometimes complacent about domestic risk. There can be a perception that "our employees grew up with us" and would not put the company at risk. This view, however, ignores the changing nature of risk, and each company's obligation to give their employees the tools to both recognize issues and protect themselves and the company from being drawn into compromising situations.

To be effective, your compliance program has to be tailored to the industry you are in, and to the part of the world in which you operate. Management needs to sit down and literally say, what could go wrong in our company? How do we prevent it? How do we find out about it? And how do we handle it? You need to understand the risks that flow from the nature of your business and where you do that business. Your company may be susceptible to organized crime infiltration, employee and workplace fraud, or immigration violations. Potential anti-trust, import-export, supply chain, and cyber security issues may present significant risks for your organization. In industries that are heavily regulated, like healthcare or the financial sector, you may need to spend a lot of your time focusing on domestic regulatory risks and getting compliance policies in place to ensure employees are complying with applicable regulations.

AT: The Morgan Stanley FCPA case was a very high-profile declination by main Justice and your U.S. Attorney's Office. They don't come that often, and it's very rare to see compliance efforts cited so widely as the reason why. Can you give a brief description of the case for those who are not familiar with it?

LL: Absolutely. In April of 2012, my office and the Department of Justice's (DOJ) fraud section prosecuted Garth Peterson, the former Managing Director in charge of the Morgan Stanley's real estate group in Shanghai, China. Peterson had engaged in a conspiracy to sell an ownership interest in a Shanghai building owned by Morgan Stanley to a local government official who had provided assistance to Peterson in securing business for Morgan Stanley in China. During the conspiracy, Peterson repeatedly and falsely told Morgan Stanley that the corporation buying the ownership interest in the building was owned by the Shanghai government when, in fact, it was owned by Peterson and the local government official, among others. By lying and providing false information to Morgan Stanley, Peterson was circumventing the company's internal controls, which were created and intended to prevent FCPA violations. Peterson was charged with one count

of conspiring to circumvent Morgan Stanley's internal controls, and after pleading guilty, he was ultimately was sentenced to a period of incarceration. We declined to take any action against Morgan Stanley in that case.

AT: Again, what's notable is that it was the first major FCPA case I can recall in which there was a public declination, and just as importantly, the compliance program was cited so publicly as a major part of the reason why. In fact, it's hard to remember many cases of any type in which the compliance program's effectiveness was cited so publicly, which suggests to me that even people without FCPA risks should take note. What made this case so different?

What set Morgan Stanley apart was that, after considering all the available facts and circumstances, the government concluded that Morgan Stanley was a company that had done all that it could.

LL: You're right. This was an unusual case. Morgan Stanley self-reported Peterson's conduct, and cooperated fully and extensively with the government's investigation. But that's not what made the case different. What set Morgan Stanley apart was that, after considering all the available facts and circumstances, the government concluded that Morgan Stanley was a company that had done all that it could. It had a compliance program specifically tailored to its business risks, with commitment to compliance from the very top of the company, that itself did not tolerate wrongdoing. The bank acted to fire Peterson before any of the facts became public. We concluded that Peterson was the quintessential "rogue employee" who schemed to affirmatively sidestep compliance because he knew his behavior would not be countenanced. Every company says its bad actors are "rogues," and that they do not promote corruption, but at Morgan Stanley we could see it. There was a stark contrast between the bank's corporate culture and Peterson's actions.

This presented a fundamentally different situation from companies that say they don't tolerate wrongdoing, yet push employees to meet goals and quotas overseas with little to no guidance on the risks and consequences. It was fundamentally different from companies who distance themselves from their agents and consultants overseas, and then argue that they have to "go along" to avoid being disadvantaged in overseas markets. And it was fundamentally different from companies that say "That's not who we are," yet have nothing on record that informs me otherwise.

What we saw was that Morgan Stanley conducted extensive due diligence with respect to the sale that Peterson orchestrated. We saw that Peterson had circumvented a compliance program that was an active component of the company's business—Peterson himself was trained on FCPA compliance seven times and reminded about FCPA compliance at least 35 times. Compliance at Morgan Stanley was also proactive, with the bank routinely adjusting and updating its compliance program to address new issues and problems as they arose. It was not simply a program that was put in place 10 years ago, set apart from the business, and left unchanged over time, without regard

to changes in the company's business or the increasing complexity of transactions. When we looked at Morgan Stanley, we also saw a bank that invested resources, that had internal controls in place to ensure accountability, that regularly monitored transactions, and that randomly audited employees, transactions, and business units.

This case stands out because it also touched on a common complaint in the FCPA world, and that is the supposed lack of transparency regarding the government's consideration of a company's compliance efforts in making charging decisions. The lengthy description of Morgan Stanley's compliance program in the Peterson charging document was a deliberate response to that criticism. The Peterson case was even cited for that purpose in the FCPA Resource Guide prepared by DOJ and the Securities and Exchange Commission (SEC) in November 2012.

Morgan Stanley was able to demonstrate that Peterson truly was a "rogue," that he had betrayed them, and he had rejected their culture of compliance.

AT: What should compliance professionals take away as key learning from that case?

LL: There are actually two "takeaways" in this case. The first is that the government will aggressively pursue those who engage in criminal conduct involving corporate corruption. The second is that companies that employ robust and effective compliance programs are not only better able to detect and identify potential compliance issues that may negatively affect the company's business and reputation, but also those unusual instances where an employee is intent on circumventing a company's internal controls. An added benefit for a company that employs a robust compliance program is that the company will be in a better position to address concerns raised by regulators or the government, if the company's conduct ever comes under scrutiny. Morgan Stanley was able to demonstrate that Peterson truly was a "rogue," that he had betrayed them, and he had rejected their culture of compliance.

AT: More recently we had the declination in the Ralph Lauren case. In that case, Ralph Lauren discovered questionable payments by a third party working on their behalf in Argentina. You were the US attorney on that case as well. What were some of the factors that led to the decision not to prosecute?

LL: Actually we did not decline prosecution in that case. Rather, we entered into a non-prosecution agreement with Ralph Lauren. The agreement is for a two-year term and requires the implementation of various corporate reforms. Ralph Lauren also paid an $882,000 penalty to the DOJ and disgorged $700,000 in ill-gotten gains and interest to the SEC. There were several reasons for that outcome.

Ralph Lauren discovered criminal conduct involving violations of the FCPA while it was in the midst of trying to improve its internal controls and compliance worldwide. Our investigation revealed that, over the course of five years, the manager of Ralph Lauren's subsidiary in Argentina had made roughly $580,000 in corrupt payments to customs officials for unwarranted benefits, like obtaining entry for its products into the country without the necessary paperwork or without any inspection at all. The bribes were funneled

through a customs broker who, at the manager's direction, created fictitious invoices that were paid by Ralph Lauren in order to cover up the scheme.

Several factors compelled our decision to enter into a non-prosecution agreement with Ralph Lauren. First, there was the detection of the wrongdoing by the corporation itself, as part of an effort to improve global compliance standards. Following the discovery of the corruption, the company also undertook an exceedingly thorough internal investigation of the misconduct and cooperated fully with our investigation. They made foreign witnesses available for government interviews; they provided real-time translation of foreign documents.

It was also very significant that Ralph Lauren implemented a host of extensive, remedial measures, including the termination of employees engaged in the wrongdoing, and improvements in internal controls and compliance programs. Finally, we took into account that they swiftly and voluntarily disclosed the conduct to the government and the SEC. The company first self-reported the misconduct to the government within two weeks of discovering it. They basically did everything that a company that finds itself in that unfortunate situation can possibly do.

Ralph Lauren discovered criminal conduct involving violations of the FCPA while it was in the midst of trying to improve its internal controls and compliance worldwide.

AT: This was the first time the SEC publicly stated it would not proceed. What got their attention and led to the decision?

LL: I cannot speak for the SEC, but we do typically have parallel investigations of FCPA violations, and I believe that they were swayed by the same factors that we were. Although Ralph Lauren did not have an anti-corruption program and did not provide any anti-corruption training or oversight during the five-year span of the conspiracy, all of the government agencies investigating the case were impressed with their resulting commitment to compliance in this area globally, as well as their self-disclosure and full cooperation.

AT: HSBC's money laundering settlement also holds some lessons for compliance programs. The bank agreed to a $1.9 billion settlement, which is obviously a lot of money. However, what was lost by many are some of the steps they took in the compliance arena that helped prevent the penalties from being much more severe. What were some of the actions that they took that had the most resonance with you as the prosecutor?

LL: You are right; much attention was given to the $1.9 billion that HSBC paid in fines and forfeiture—and understandably so. It was the largest forfeiture ever by a financial institution in connection with a compliance failure. There were, however, other truly groundbreaking aspects of that settlement, most of which did get overshadowed by the amount of money involved. First and foremost, HSBC stood before a court of law and admitted its criminal conduct. They also gave the government every remedy we could have gained, and arguably even more, had we indicted the bank and taken it to trial to prove that guilt. As part of the deferred

prosecution agreement, HSBC committed to a far-reaching overhaul of its compliance practices around the world. Given the systemic, global compliance failures uncovered during the investigation, I think it is fair to say that extraordinary remediation saved HSBC from indictment.

HSBC did not simply replace its senior management and then come to us with a report that it had fixed its compliance problems. To be sure, the bank did replace its senior management, and even clawed back bonuses from the CEO, CCO, and other senior compliance officials. But what resonated with the government was the fact that HSBC made sweeping, sometimes unprecedented, changes that were designed to foster and maintain a deeply engrained, lasting culture of compliance at the bank. HSBC took a hard look at the root causes of their compliance failures, and what came out of that review was a significant restructuring of their organization. The revamped structure allows compliance issues and information to be shared horizontally, across a very large, global institution. The new structure, which includes a stand-alone Compliance department and new reporting lines, enhanced the prominence and independence of the compliance function. HSBC's head of global compliance is now one of the bank's top 50 executives worldwide.

It was also important to us to see that HSBC provided its revamped compliance function with enough resources to be effective. You can make all the structural changes you want in an organization, but if you don't properly staff and fund it, you won't realize the intended improvements. At HSBC, anti-money laundering (AML) compliance staffing was increased ten-fold, compliance officers were retrained, and investments were made in better-automated monitoring systems.

HSBC's efforts to more closely align the organization's commitment to compliance with the interests of its employees also resonated with us. Going forward, the bank's bonus structure for senior executives will be closely tied to performance regarding compliance standards and values. In making this change, HSBC sent a strong message to its employees. It told them that, if you don't share in the bank's commitment to compliance, you will be hit where it hurts—in your wallet, in your bank account. This aligns the employees' interests with the interests of the bank in a very real, tangible way.

I think the remedial measure that stood out to most to me, because it is seemingly unprecedented, was HSBC's agreement to subscribe to a single global standard for compliance. This means that HSBC will apply the highest or most effective compliance requirements for operations worldwide, regardless of the laws and regulations that apply where a particular office or affiliate is located. In other words, if the U.K. has the toughest anti-corruption laws in the world, HSBC will apply them worldwide. If the AML requirements in the United States are the most stringent, they will apply globally. What this said to us was that HSBC was really striving to be the "gold standard" for compliance.

AT: One of the things that was notable is that HSBC split the compliance officer from the General Counsel's Office. There's been a lot of push within the Compliance community to move out of Legal. Judging by the HSBC settlement, it seems that you as a prosecutor would agree that the jobs should be separate. What do you see as the virtue of separating the roles?

LL: Separating the Legal and Compliance functions within HSBC was part of a deliberate, carefully crafted effort to give Compliance more prominence, more autonomy and more authority within the bank. It also was intended to make senior management more directly accountable for compliance values and

standards. In companies where the CCO has a position equal in stature to the GC, with a separate reporting line to the CEO or the board or audit committee, it not only ensures the independence of the Compliance function, but it also conveys to employees that the company values, and is committed to, compliance. This structure also typically provides a direct line of communication, without potential interference from senior management, straight to the top of the house, if and when compliance issues must be escalated.

That being said, it is not my position that separating the CCO and GC roles will make sense in every organization. It made sense for HSBC, which was, at the time, the fourth largest bank in the world, a bank that had global operations in what is arguably the most heavily regulated industry in the world. There may be situations where it makes sense to have the Compliance department housed within the Legal division, reporting up to the GC, or a GC that also fulfills the duties of a CCO. On the other hand, there will be cases where a combined GC-CCO position is cost effective in the short term, but results in costly, long-term consequences, because the individual wearing both hats doesn't have enough time or sufficient ability to do both jobs well.

I just don't think that a one-size-fits-all approach works when it comes to compliance.

The optimal structure of the Legal and Compliance functions within an organization may depend on any number of factors—organizational size, industry, regulatory environment, staffing constraints and individual capabilities, to name a few. No matter how a company structures the roles of the GC and CCO, I think it is critical to the success and effectiveness of a compliance program to ensure cooperation and coordination between the Compliance and Legal functions.

That being said, when an investigation reveals that significant, systemic failures and flaws exist within a company's Compliance function, the government will question—as should the company—whether the organizational structure in place contributed to that failure. I will also add that, in my experience, successful compliance programs—regardless of whether the GC and CCO roles are split—are found within companies that have and maintain a culture of compliance. It will matter not that the GC and CCO are subsumed in a single role, or that they are separate and distinct positions, if the company does not demonstrate to its employees in tangible and intangible ways that compliance matters—that everyone, from the top down, must value integrity, and that issues of legal, financial, and ethical rules will be handled in a rigorous and transparent manner. Without that culture, even companies with separate legal and compliance leaders will face an uphill battle.

One of the things that was notable is that HSBC split the compliance officer from the General Counsel's Office.

AT: As I recall, part of the settlement also includes a change so that Compliance reports directly to the board. Is that something you would advocate for compliance professionals and the companies they work for to take note of?

LL: Again, I don't think "one size fits all." I do believe, however, that an organizational structure that gives the CCO unfettered access

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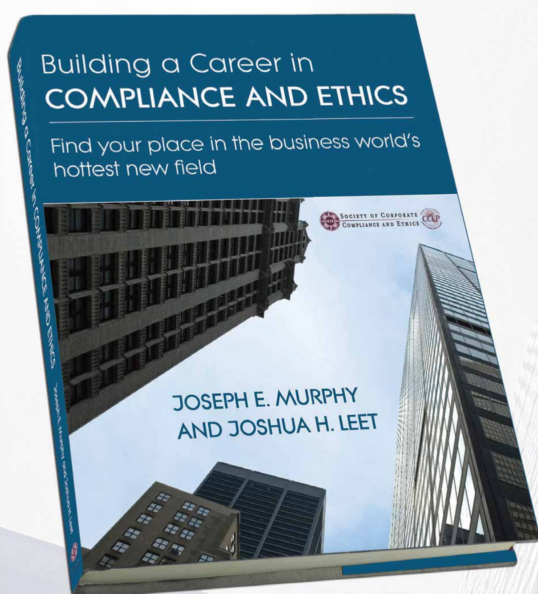

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to the board or audit committee goes a long way towards ensuring that compliance issues are appropriately escalated, without undue influence from senior management. You want your CCO to have a seat at the table—to be able to speak truth to power when necessary. You want an autonomous CCO who is heard, a CCO who is empowered to candidly report information to the board or audit committee. It may be that, in order to fulfill that wish list, some organizations will need to put in place a structure where the CCO operates separate and apart from the GC, and has a direct reporting line to the CEO or the board or audit committee. On the other hand, some organizations may be able to accomplish that without installing a direct reporting line.

AT: Finally, are we seeing the start of a new era in which compliance programs are going to be looked at more closely by prosecutors? And, just as importantly, will good programs earn organizations public credit for their efforts?

LL: Absolutely. Compliance is the lens through which we view your company. A robust compliance program demonstrates to us that the company "gets it." Making your compliance program a top priority is an investment a company can't afford not to make. To put it more bluntly, by the time you have a problem that has drawn the government's attention, under our principles and guidelines that govern corporate prosecutions, the existence of a robust compliance program can save you, as in the Morgan Stanley case. While Ralph Lauren and HSBC were able to implement compliance programs that allowed them to escape indictment, they should nevertheless be viewed as guidance to other companies, not a guarantee. You're still far better off making compliance part of the fabric of your company and the face you present to the world. ✳