HIDDEN IN PLAIN SIGHT

How uncovering conflicts of interest can save your business and your career

convercent

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INTRODUCTION

Life as a chief ethics and compliance officer (CECO) or general counsel can seem like a never-ending parade of questions and worry.

You've invested heavily—both in time and resources—in devising risk and compliance policies, training employees, and deploying the latest (allegedly), greatest technologies to keep your company on track and your job intact.

Yet, it still happened. An account rep accepted a gift he shouldn't have. A senior manager failed to disclose her financial stake in another organization. And the boss's kid just got a summer internship with a vendor with whom your company has recently signed a business contract.

Dealing with conflicts of interest (COI) and other disclosures is the bane of many a CECO's existence. Despite your best efforts, some of these violations happen on your watch. But it's not your fault.

Ninety-eight percent of senior corporate leaders say they are committed to ethics and compliance to steer their organizations, yet only 67% have a process in place to identify owners of specific compliance and ethics-related risks.[1]

You're flying blind and operating under near-impossible conditions. This guide will give you the information you need to understand the full scope of disclosure management and formulate strategies and processes for dramatically improving the speed and accuracy of your disclosure operations.

CHAPTER 1
DISCLOSURES 101

We all feel like we have a good handle on what is or what isn't a COI, but what about other disclosures? Let's dispense right away with the ambiguity and get down to disclosure basics and set some baseline definitions.

Types of Disclosures

Generally speaking, organizations must manage three primary types of disclosures:

» **Conflict of interest**
Any situation in which a person or organization is involved in multiple interests—financial or otherwise—one of which could possibly corrupt the motivation or decision-making of that individual or organization.

» **Gifts, travel and entertainment (GTE)**
Personal gifts from outside entities that may include:
- The acceptance from a vendor or outside entity of meals (regardless of their value)
- Attendance at recreational, cultural, sporting or other events that would generally have a cost
- Any form of travel, transportation or lodging that would generally have a cost

» **Industry-specific disclosures and compliance standards**
Regular internal control activities such as SOX 302 (quarterly exercise for public companies) or FCPA/Anti-bribery and Corruption annual questionnaires require the capture of information from internal stakeholders to be compiled, tracked, and reported out.

Other types of disclosures may be necessary depending on your type of business or established company policies. Most of those, however, will fall under one of the three main categories.

Why Should You Even Care About Disclosures?

Such a simple question, but not such a simple answer. Sure, the crux of your job is to protect your company's reputation, integrity, and bottom line. Yet many organizations do the bare minimum when it comes to disclosure management, sending out questionnaires to select executives about high-level conflicts of interest such as board membership just once per year to say they've met their obligations.

However, your company comprises more than just the C-suite and other executives. Employees at all levels have the potential for getting your company into hot water with conflicts of interest—whether intentional or inadvertent.

Of course, collecting disclosures from every employee on an ongoing basis means creating and distributing different disclosure questionnaires for every type of disclosure and every level of employee. Few professionals have the time, energy or desire to manually input that information or to manage answers and analyze the data. Doing so would result in complete paralysis of the risk management efforts.

Still, going the extra mile to systematically collect information others can't or won't is essential to creating a culture of ethics, accountability and compliance. After all, the more data your ethics and compliance program captures and correlates, the better prepared you and other control partners will be to:

- Identify previously hidden risks
- Proactively address ethics and compliance challenges
- State with confidence that you've done everything in your power to "do the right thing" as an organization

> "Conflicts of interest can be thought of as the viruses that threaten the organization's well-being.
>
> - Securities Exchange Commission

The High Cost of Poor COI Control

Conflicts of interest are pervasive in virtually every industry, market and sector.

Some instances are accidental (the employee simply didn't know) and in others it's a willful pursuit of personal enrichment because some people are just greedy, company be darned.

In either case, failing to properly identify, account and remedy conflicts of interest can be costly to your organization on multiple levels.

Reputational Risk

Your business's reputation is one of its most valuable assets and an essential tool for attracting new customers, partners, donations (for non-profits) and referrals, and even maintaining stock prices.

But conflicts of interest can jeopardize all your organization has worked for, as they can damage your reputation—the company's and your own—causing even your staunchest allies and most loyal customers to wonder whether decisions are made in the best interests of your business or whether members of your team have the necessary expertise for their role.

Practically speaking, failing to manage conflicts of interest can have a negative impact on:

- Fundraising and donations
- Recruitment and retention of staff and volunteers
- Public trust and confidence in your organization

Financial Risk

Beyond the risks to your company's name and reputation (and your own, as well), there's a very real, and potentially very large, financial risk in not sufficiently addressing COI.

Responding to negative publicity can be very expensive, as your organization will need to devote time, energy and resources into public outreach, press releases, and marketing initiatives that otherwise would have been allocated to your primary business to defend its reputation.

But decreased revenues from missed opportunities are just the tip of the financial iceberg. Revenues can also be negatively impacted by poor ethics driven by conflicts of interest throughout the organization, as some firms have lost more than 40% of their market value on news of misconduct, much of it attributed to a damaged reputation.[2]

To make matters worse, consider also that most companies allocate upward of $1.5 million annually for compliance programs (for all their compliance needs, not just COI management), only to have it and their efforts wiped away by fines and penalties in the millions of dollars for bad behavior.

Specifically, potential settlements for violations of the Foreign Corruption Practices Act (FCPA) have a median direct cost of $17 million per incident, while other charges of fraud and employee misconduct add anywhere from $1 million to $8 million per incident.[3] Punitive damages for ethical misconduct averaged more than $23.5 million for nearly 600 firms misrepresenting financial disclosures over more than two decades[4]—with many of those actions relating directly back to the personal vested interests of board members and other company executives.

CHAPTER 2

COI UP CLOSE AND PERSONAL

For many of us, conflicts of interest on a grand (and damaging) scale feel like something that just happens elsewhere. Sure, smaller, more benign COIs may exist in our organizations, but they don't really have an impact on our overall business health.

Or do they?

The reality is that, of course, the potential for severely damaging conflicts of interest exist in your business, too. Yet, it's important to realize that even less egregious conflicts of interest like associates accepting tickets to a sports game or sales execs receiving upgraded travel accommodations from a prospective vendor slowly erode your business's character, chip away at its integrity, and rot the organization's moral and ethical core from the inside out.

It's imperative as an ethics and compliance leader to understand the myriad ways conflicts creep into your business. It's the only way to properly plan for them, manage them, and mitigate the potential damage to your company.

Conflict of Interest Use Cases

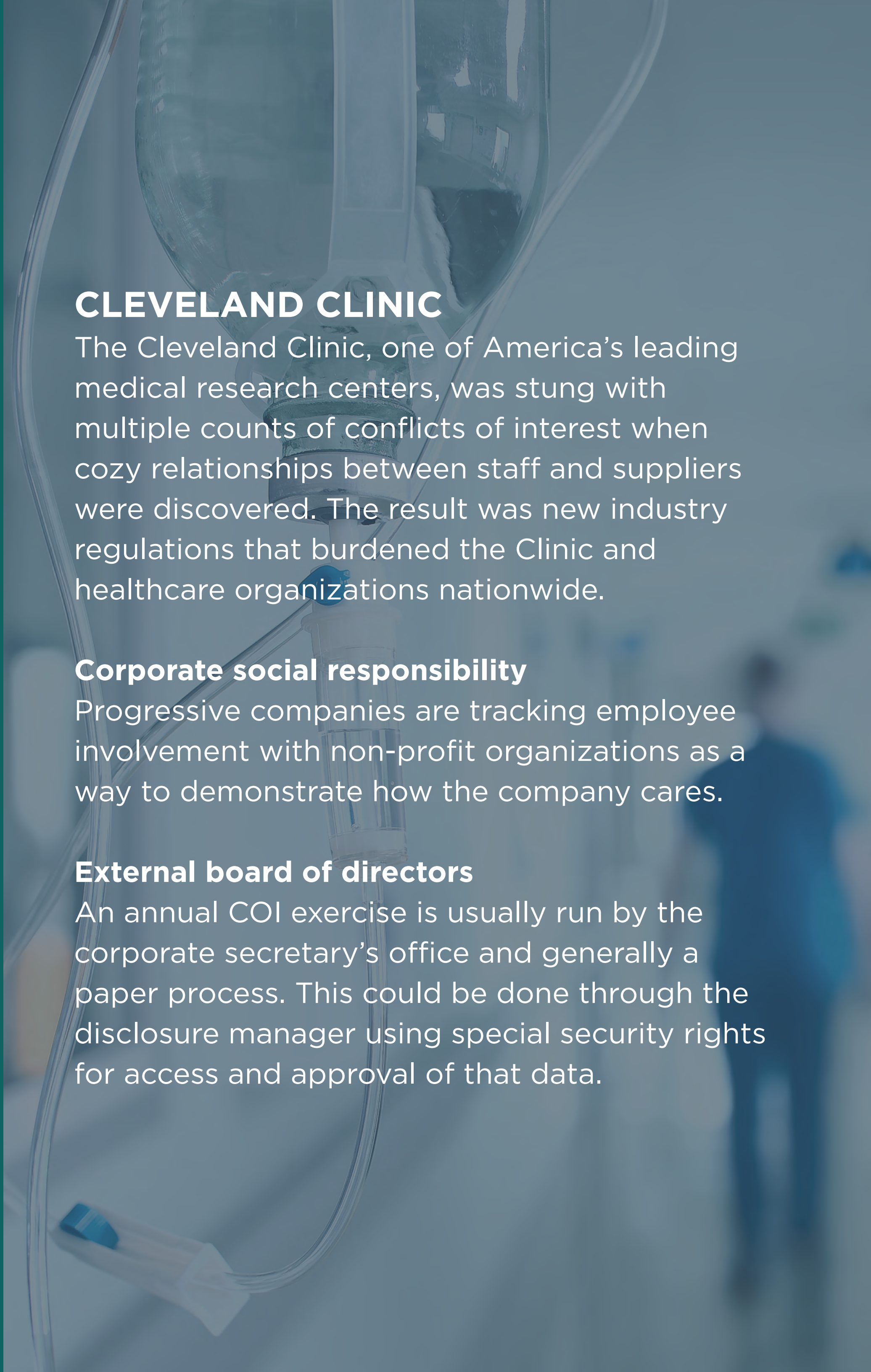
Anti-bribery and corruption

Ascertaining whether certain "high risk" employees made any offers, payments or promises to pay or authorizations to pay any money, by or on behalf of the company to any employees, agents, representatives or officials of any organization—a private company, a government-owned (or even partially owned) company, a political party or any other entity, organization or individual.

- If those target employees made a payment to a government official or clerk for the purpose of expediting or ensuring the performance of a routine, non-discretionary government function
- If high-risk employees provided any gifts or hospitality (such as the payment of hotel, transportation, meal and entertainment expenses), or provided anything of value to a government official
- If there were payments or provisions to third-party workers that are not consistent with the amount of work performed

COMMON COI SCENARIOS

- » Employment of relatives
- » Intellectual property that the employee creates during employment
- » Membership on outside board of directors, advisory council, trade association, or government sponsored association
- » 5% (or more) financial interest in a company that competes or does business with your company
- » Being a party to a transaction of your company
- » Decisions benefitting the employee or their immediate family
- » Outside employment
- » Political activity



CLEVELAND CLINIC

The Cleveland Clinic, one of America's leading medical research centers, was stung with multiple counts of conflicts of interest when cozy relationships between staff and suppliers were discovered. The result was new industry regulations that burdened the Clinic and healthcare organizations nationwide.

Corporate social responsibility
Progressive companies are tracking employee involvement with non-profit organizations as a way to demonstrate how the company cares.

External board of directors
An annual COI exercise is usually run by the corporate secretary's office and generally a paper process. This could be done through the disclosure manager using special security rights for access and approval of that data.

EBAY

In 2014, an eBay investor created an uproar over the fact that multiple members of eBay's board had business relationships with eBay's competitors. If they had had an effective COI disclosure process, this could have been avoided. When the scandal reached news outlets, it put the spinoff of PayPal in jeopardy and called into question the board's independence.

Conventional Conflicts of Interest

Usually falling under the quid pro quo or 'tit for tat' category, conflicts of interest are often driven by long-standing personal relationships. These conflicts can take many forms, ranging from nepotism to disclosures of intellectual property to unsanctioned or inappropriate political activities. In these instances, if you leave it up to the employee to determine if it's a conflict or not, chances are good they're not going to claim it as one. So it's in your (and their) best interest to create appropriate guidance (conditions) for them to continue that activity without putting the company at risk.

DIAGEO

The UK-based spirits company spent approximately $64,184 on rice cakes and other gifts for the South Korean military over four years; the gifts ranged in value from $100 to $300 per recipient. The company paid more than $16 million to settle FCPA charges with the SEC for, in part, its gift-giving practice as the SEC concluded that the company incorrectly recorded the expenses in its books, which made the issue a 'books and records' offense, with all the attendant consequences. The approximately $64,000 of badly managed gifts cost Diageo $16 million.

BLACKROCK ADVISORS

The Securities and Exchange Commission charged BlackRock Advisors LLC with breaching its fiduciary duty by failing to disclose a conflict of interest created by the outside business activity of a top-performing portfolio manager. As a result, BlackRock agreed to settle the charges and pay a $12 million penalty. The firm also must engage an independent compliance consultant to conduct an internal review.

AON

AON, one of the largest insurance firms in the world, administered training funds that were supposed to be used to educate Costa Rican and other insurance officials on industry issues by providing travel to seminars and conferences. A judgment against the company found that many of the invoices and records did not provide the business purposes or otherwise show that the trips were related to legitimate business activities, leading to the conclusion that the company had neither the necessary controls and processes in place nor the desire to rectify that situation. As a result, AON settled for a total of $16.2 million in criminal penalties and other costs.

CHAPTER 3

BEST PRACTICES FOR WHAT TO DO ABOUT COI

There's an old saying that "a goal without a plan is just a wish." In few scenarios do those words ring truer than in ethics and compliance management.

We put in place generic ethics and compliance policies and conduct occasional training to get the word out, hoping that our employees out of the goodness of their hearts and a sense of loyalty to the company will self-police and help stamp out actions that jeopardize the health of the company.

But that's not how it works. In fact, as the most commonly observed type of misconduct, just over 40% of workers who observe conflicts of interest report what they see.[5] Part of it may be fear of retaliation, but more commonly it's because the conduct doesn't register with them that it's inappropriate. In either case, you run the very real risk of incidents going unreported, undocumented and unnoticed until something goes devastatingly wrong.

BEST PRACTICES
FOR MANAGING COI

The key to creating a culture of ethics and accountability is systematizing how you approach it. Aligning people and processes and supporting them with technologies enables better collection and organization of disclosure data. In this way, you can understand, address, anticipate and manage the conflicts that create risk and misconduct within your organization and make strategic business decisions with ease and confidence.

01 Gather your people

No one is immune to potential conflicts of interest and understanding all potential vulnerabilities is essential to formulating a comprehensive strategy and program to mitigate COI.

Take an inventory of the various stakeholders in your business—employees, external directors, partners, suppliers, even job candidates—and identify potential areas of conflict for each group. From there, map a communications plan for each group to educate them on the various COI management initiatives underway, incorporating them into the process, and providing a closed feedback loop for them to make recommendations, ask questions, or report misconduct anonymously.

02 Establish a culture of trust

Operationalizing COI risk management is an essential strategy for building a culture of accountability and minimizing business risk now and into the future. But creating a culture of accountability first depends on building one of trust.

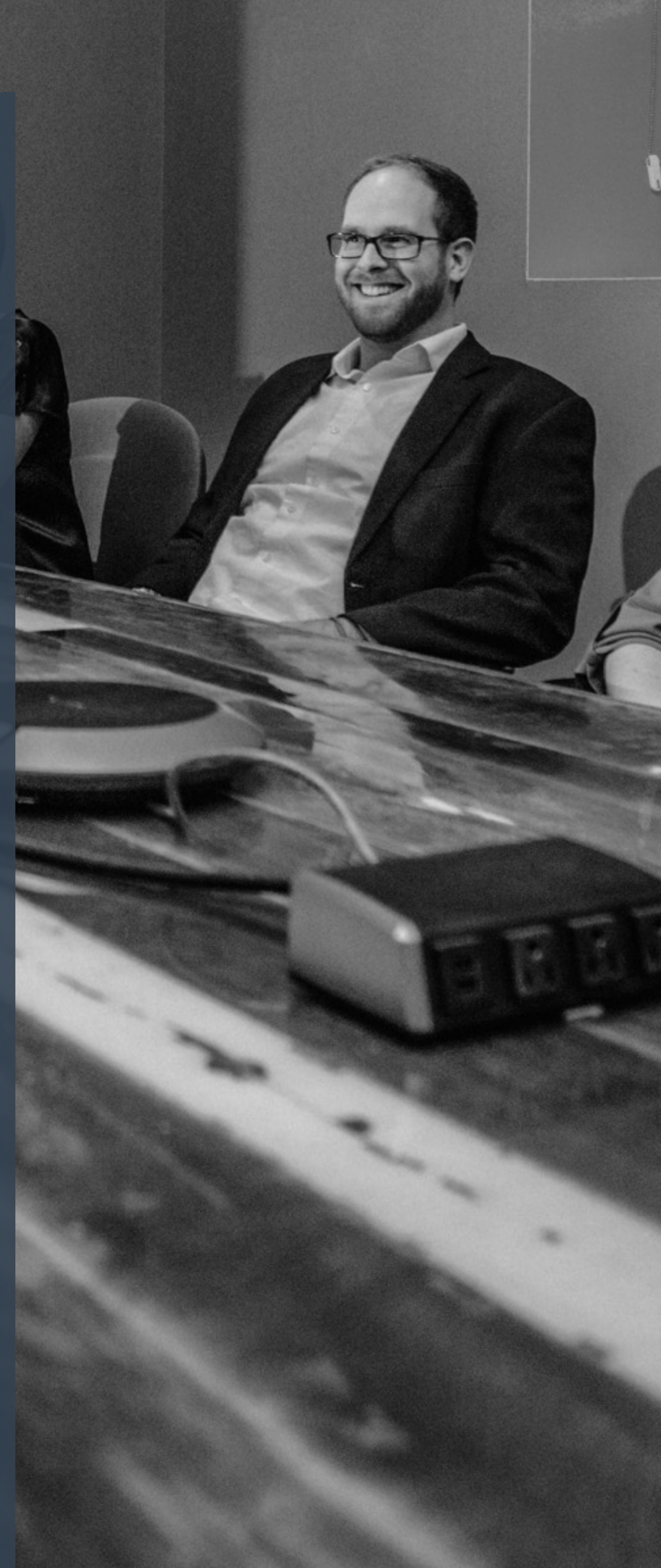
Establishing a culture of trust requires creating an environment in which employees feel like they can report conflicts without the specter of sanctions or retaliation hanging over their heads. In most cases, this means employing a mandatory non-retaliation policy and adhering to a fair process doctrine, the ethics and compliance equivalent of due process. When employees, executives and other parties know they'll be treated fairly during the course of an investigation, they'll be more accepting of the result—even if it goes against them.

03 Lay out formal processes

Every regulator and agency is now focused on COI. Without formal processes in place, they'll assume the Board (and you) is failing in their fiduciary responsibilities. When regulators look at your overall compliance program they are going to see if it is risk-based, which would include a comprehensive, defensible Conflicts of Interest program that is able to keep pace with evolving workplaces and employee complexities.

More importantly, trying to keep everything straight on your end without a formal structure in place is a recipe for disaster and failure. Instead, you should create workflows that underscore the potential impacts of COI on your business and collect information about employee dealings continuously, starting from Day 1. Your process may include:

- A pre-hire COI exercise helpful for senior executives
- COI module during employee onboarding or orientation
- An annual questionnaire sent to every employee, at all levels and in all functions across your business
- Periodic ad hoc disclosures for potential conflicts that come up during the year to fill in gaps that annual disclosure forms may miss
- A strategy for addressing reported conflicts with individuals and a specific remediation guide for handling reported conflicts
- Analytics that offer an in-depth view into disclosures and how you're managing them



04 Manage, mitigate, and automate with technology

The best laid plans are nothing without tools to help facilitate them. Try as you might, managing an entire ethics and compliance program (with COI at the center) manually is a near impossibility.

Using tools like spreadsheets to manually document or map employee and vendor relationships might save a few bucks, but it can be a nightmare when it comes to aggregating and updating massive volumes of information from various sources. Worse, it's an unsecure environment, meaning that anyone can edit the document at any time without an audit trail for verifying the data is correct or protecting it from unauthorized access.

From an enterprise perspective, using spreadsheets and other manually driven forms of COI disclosure management only include information reported directly to or from the ethics and compliance team. Data from other business functions—HR, security, and employee relations—that have specific value in helping identify overarching trends across the organization is invisible because it can't be shared efficiently across teams.

Instead, employ a third-party COI disclosure system that automates manual tasks, so that you can focus the skills and capabilities of your team to higher-value risk mitigation work to prevent misconduct and preserve the culture. This is a proactive measure for seeking out potential risks to your organization so that the risk can be mitigated BEFORE the misconduct occurs.

Purpose-built COI management solutions are evergreen systems that enable employees to review previous disclosures, retire old ones, and input new ones. This way, the organization can accurately track and mitigate conflicts on an ongoing basis—all with minimal effort from your already-stretched-thin ethics and compliance team.

KEY CONSIDERATIONS FOR A COI DISCLOSURE SYSTEM

- Enables online attestation of COI and other ethics policies
- Automates campaign workflows to ensure all employees are educated and trained on relevant policies
- Offers role-based disclosure forms and training content
- Proactively distributes COI disclosure forms at specified intervals or events
- Provides anonymous tip lines or helplines to encourage reporting of suspected misconduct
- Creates convenient one-click data visualizations and reports to identify hot spots and dark spots and benchmark with your industry peers

Investing in a COI Solution: Justification to Management

While you may be ready to bring a COI disclosure system into your ethics and compliance program, you still need buy-in from the top. Here's how to start the conversation with executive management regarding ROI on a COI solution:

- » **Financial:** The potential for financial and brand impact from conflicts of interest creates significant corporate vulnerability; leveraging a COI solution to mitigate that risk is 'insurance' that costs a fraction of what disclosure violations can cost your organization
- » **Administrative:** A COI disclosure solution makes it easier for employees to be forthcoming in their disclosures, fosters more relevant disclosures, and enables more effective disclosure management—reducing administrative burden
- » **Strategic:** Automating manual disclosure tasks frees up the ethics and compliance team to focus on strategic, high-value risk mitigation initiatives
- » **Fiduciary:** A centralized COI system with aggregated data enables more efficient, comprehensive reporting to the executive team and the board
- » **Regulatory:** Your COI audit trail is not only thorough and reliable with the right COI solution; it's protected from unauthorized access

PROOF POINTS

Here's how several organizations are benefitting from a COI solution to manage and mitigate risk:

Company: Athletic wear retailer, $4B revenue, 10,000 employees
Challenge: Inefficient, manual disclosure processes that yielded minimal disclosures from employees, estimated at 2% of the conflicts of interest that existed
Solution: Convercent Disclosures
Results: An exponential increase in disclosures, with an 86% response rate in their first disclosure campaign

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Company: Global telecom company, $5B revenue, 9,000 employees
Challenge: No formal COI policy and inefficient COI approvals process, allowing many potential conflicts of interest to go unrecognized or unreported
Solution: Convercent Disclosures
Results: A 500% increase in disclosures by leveraging the solution to enhance COI policy training and policy-related campaigns and communications

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Company: High-tech company, $2.8B revenue, 20,000 employees
Challenge: COI policy confusion for employees, plus minimal reporting and cumbersome disclosure management due to a lack of automation
Solution: Convercent Disclosures
Results: COI policy clarity leading to increased, more relevant disclosure reporting and significantly reduced risk—critical with operations in 240 countries

CONCLUSION

The potential for reputation- and business-killing conflicts of interest are hiding around every corner. And the cost of doing nothing—or at least just doing what you've always done—is high and the penalties for failure severe. Dealing with conflicts of interest and other disclosures is a significant challenge for many CECOs. However, employing automated COI management systems can help you assert greater control over your ethics and compliance programs.

Reduce paperwork. Eliminate excuses. Minimize risk.

To learn more about proactively managing conflicts of interest and creating a culture of accountability, visit www.convercent.com or call 303-526-7600 for a free consultation.

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RESOURCES

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