Enforcement Focus on CCO Liability

AUTHOR
Rosemary Fanelli
Managing Director and Chief Regulatory Strategist
Duff & Phelps
rosemary.fanelli@duffandphelps.com

It says something about our times that the big name at this year's Academy Awards was not Emma Stone, Meryl Streep or Denzel Washington, but an obscure audit partner called Brian Cullinan. Almost immediately after the mix-up over the Best Picture award, a virtual mob began furiously demanding a head.

Cullinan endured nothing less than global condemnation – including death threats – with paparazzi surrounding his home. No one cared what the vote-counting protocol was, where the process may have been weak, or how it could be remediated; they just wanted someone punished. After several days of unrelenting uproar, the mob claimed Mr. Cullinan. The Academy announced that neither he nor his colleague that night would ever work at the awards again.

So, what does the global humiliation of an accountant for handing the wrong envelope to Warren Beatty have to do with the investment industry? If we look at the increasing clamour for individual responsibility in banking and finance, plenty.

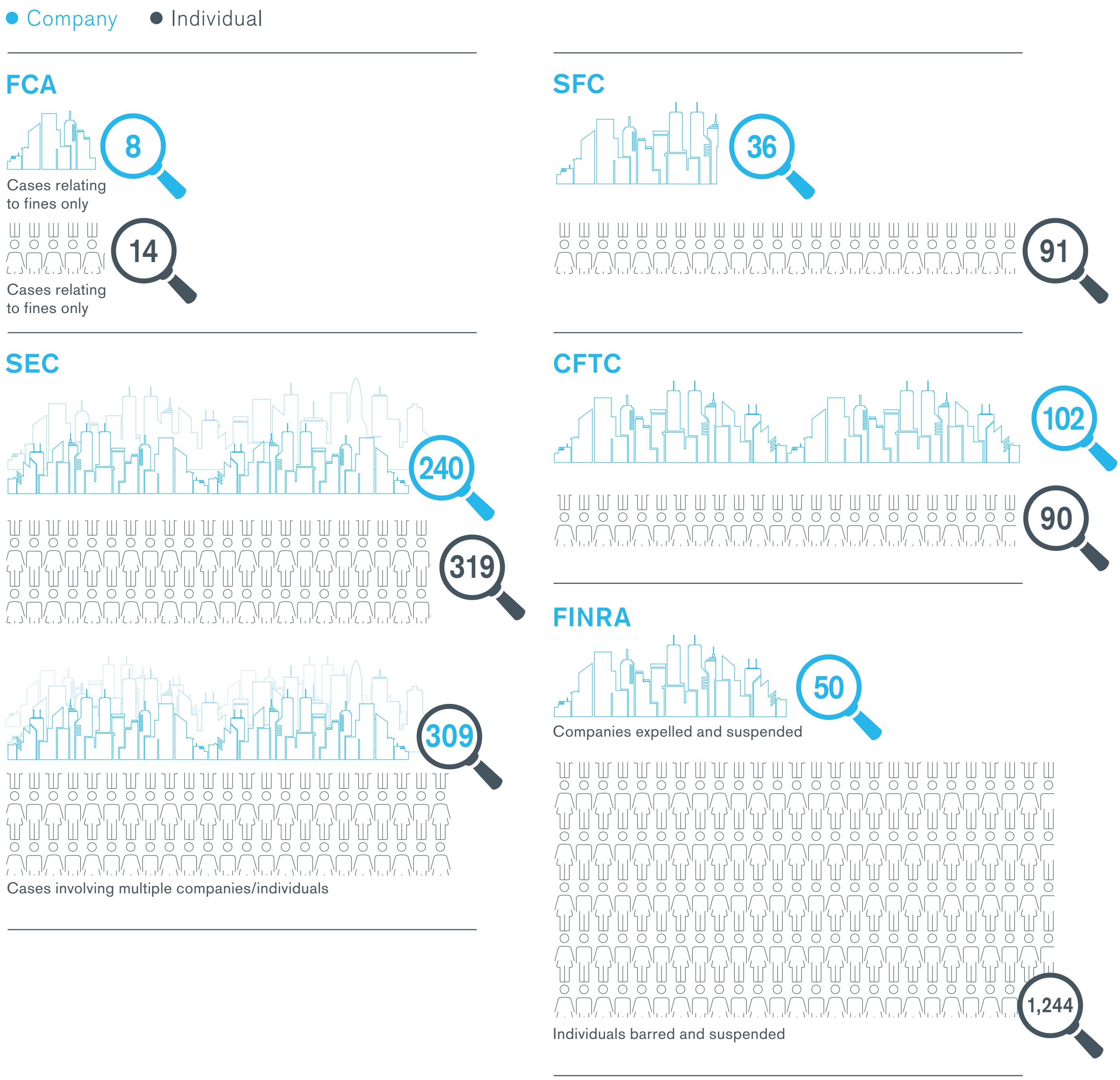
Consider the words of former Fed Chairman Ben Bernanke on the financial crisis: 'Everything that went wrong or was illegal was done by some individual, not by an abstract firm.'

Or Senator Bernie Sanders: 'It is an outrage that not one major Wall Street executive has gone to jail for causing the near collapse of the economy.'

Senator Elizabeth Warren has demanded an investigation into the DOJ itself for its failure to bring charges against individuals responsible for the financial crisis. Even Jay Clayton, President Trump's nominee to head the SEC, agreed, at least with her sentiment.

'I firmly believe that individual accountability drives behaviour more than corporate accountability. And as we work together, that will be in my mind', he promised.

Figure C – Enforcement Focus on Companies and Individuals in 2016



Taking Aim

Let's be clear: There is no doubt that wrongdoers should be held accountable for their crimes. Many years ago in *The Wall Street Journal*, Arthur Levitt Jr. said 'hurt people where it hurts most, freedom or their pockets.' As Mr. Clayton correctly stated, '[I]ndividual prosecution, particularly in the white-collar area, has a significant effect on behaviour.'

However, in our zeal to wield the stick, we run the risk of whacking those whose only crime is to be in the vicinity. Several recent enforcement actions have been brought and financial penalties imposed against individual compliance officers for offences that were purely administrative – even where there was no claim of intentional wrongdoing or harm to investors. This should give us all pause.

Notwithstanding the government's best efforts to elevate compliance officers to positions of real authority, they are not yet truly part of the senior management. They do not typically report to the CEO, do not have a say in decision-making, and are not comparatively compensated for the risks they bear. Their role remains advisory, so holding them personally and financially responsible for decisions made by the true power brokers may be ineffectual. It may even be counterproductive, giving managers someone else to blame and potentially discouraging talent from assuming these important roles.

To avoid this and ensure we attract and retain people with the experience and skills necessary for an effective CCO, I offer a modest proposal – a safe harbor that would CARVE out liability by asking questions on five key areas:

Compensation – Is the CCO compensation comparable to other senior executives?

Access – Does he have access to information necessary to evaluate risk?

Reports – Does he report directly to the CEO?

Votes – Does he have a vote on the launch or management of products?

Executive committees – Does he sit on an executive committee or the equivalent?

If the answer to any of the above questions is 'no', then imposing personal liability may not be fair.

The CARVE rule would not require every compliance staffing arrangement to meet the test – quite the contrary; executives should structure the risk function and the personnel responsible for it in whatever way they deem best for the business. But the degree to which responsibility is shared should be commensurate with the degree of authority possessed. Otherwise we are left with the injustice of individuals being held responsible for decisions beyond their control, or immaterial transgressions resulting in irrevocable reputational penalties that few would say are proportionate.

Just ask Mr. Cullinan.