

AT THE INTERSECTION OF LEGAL AND COMPLIANCE:

THE OPPORTUNITY FOR GENERAL COUNSEL TO
MEET INCREASINGLY COMPLEX COMPLIANCE
REQUIREMENTS AND LOWER BUSINESS RISK

Compliance challenges for corporations are on the rise, creating intense scrutiny on the increasing business risk that has resulted from these challenges. A Google search of press releases with the phrase “compliance challenges” revealed 60 news articles in just one month (July 22 - August 22, 2014) – ranging from high-profile Foreign Corrupt Practices Act (FCPA) cases across the globe to the impact of increased compliance regulations in the U.S. footwear industry to the emerging risks to corporations associated with social media engagement.

In this increasingly complex compliance environment, the role of the corporate legal department and the General Counsel is constantly evolving. No longer are GCs simply concerned with handling legal matters

that come in the door. As compliance demands expand in both quantity¹ and financial impact,² compliance and regulatory issues are at the forefront as a top priority for GCs,³ although the role that the GC can play in this arena is still not fully being capitalized upon. In fact, a recent *Inside Counsel* magazine article stated: “Regulatory is still the area providing GCs the most compelling opportunity to show leadership. It’s their substantive bailiwick, and the one area where their predictive instincts can have the most telling business impact.”⁴

To better understand the impact that increasing compliance challenges are having on legal departments, and to identify trends in how legal departments are organizing in order to better meet these needs,

¹ <http://www.heritage.org/multimedia/infographic/2013/04/obamas-first-term-costs-and-number-of-new-major-regulations>

² <http://www.complianceweek.com/blogs/boards-governance/walmart-costs-for-fcpa-probe-hit-439-million-and-counting#.U9ezi7FB0z8>

³ <http://consero.com/2014-general-counsel-data-survey/>

⁴ <http://www.insidecounsel.com/2014/07/24/crisis-prevention-and-management-global-gcs-step-f>

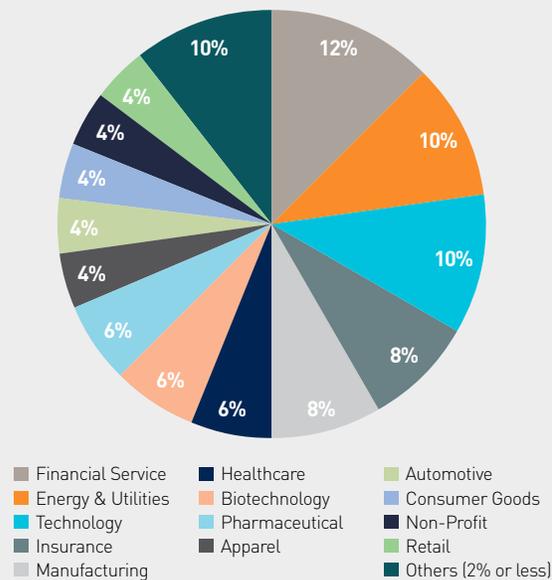
Mitratech undertook a market-wide survey of legal departments during July and August of 2014. The survey respondents represented a broad cross-section of industries, including Financial Services, Energy & Utilities, Technology, Manufacturing, Insurance, Healthcare, Biotechnology, Pharmaceuticals, Apparel, Automotive, Consumer Goods, Non-Profit, and Retail. The median size of respondents was 6,000 employees and included an even split of both Mitratech clients and non-clients.

The survey highlighted **five key trends at the intersection of legal and compliance:**

1. The legal department owns the enterprise compliance function in 40% of respondents' organizations and owns a portion of compliance functions in another 24% of organizations.
2. The role of the legal department in enterprise compliance is increasing as the responsibilities of the Chief Compliance Officer (CCO) and General Counsel become more tightly intertwined.
3. Legal departments are consistently staffing up to meet these compliance needs.
4. There is wide variability in the amount of influence that individual legal departments have in each sub-area of enterprise compliance (Regulatory Intelligence, Policy Management, Incidents Management, Controls Management, Obligations Management, and Compliance Management).
5. The legal department is most likely to be responsible for Incidents Management and least likely to be responsible for Controls Management.

This paper will provide further details on each of the five key findings and highlight how the best-run legal departments organize around compliance as a strategic business driver.

Responses by Industry



Enterprise Compliance Functions

REGULATORY INTELLIGENCE – Manage intake, evaluation, interpretation and disposition of any external change (regulatory, contractual, standard, etc.) that may affect obligations or policies

MANAGE OBLIGATIONS – Provide a single source of truth for enterprise obligations arising from regulatory or other sources

POLICY MANAGEMENT, AWARENESS – Manage the workflow involved in authoring, editing and publishing policies, as well as ensuring awareness and attestation of employees/ third parties

CONTROLS MANAGEMENT – Define and document the controls required to optimize compliance risk

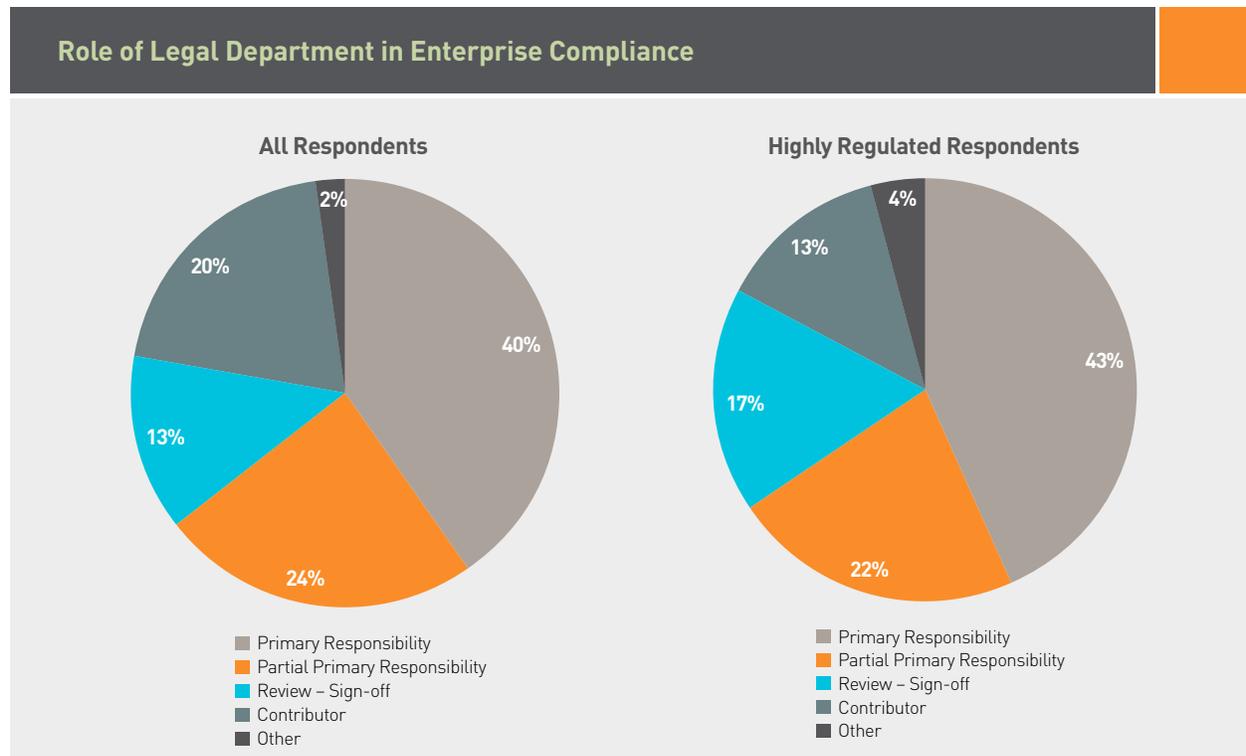
COMPLIANCE MANAGEMENT – Document and manage the state of compliance posture, including assessment, issue, and exception management

INCIDENT & INVESTIGATIONS MANAGEMENT – Manage the intake, evaluation, and disposition of compliance related incidents

FINDING 1:

The legal department owns the enterprise compliance function in 40% of respondents' organizations and owns a portion of compliance functions in another 24% of organizations

The survey found that the Legal Department (or GC) held primary responsibility for the firm's enterprise compliance program in 40% of respondents. In an additional 24%, legal had primary responsibility for one or more of the firm's compliance functions. In highly regulated industries,⁵ respondents were even more likely to assign ownership of this function to legal, at 43%. Across all respondents (highly regulated and others), a full 64-65% of legal organizations have primary responsibility for at least one of the major enterprise compliance functions.⁶



⁵ Banking, Financial Services, Insurance, Energy & Utilities, Healthcare, Biotechnology, and Pharmaceuticals

⁶ Enterprise Compliance Functions: **Regulatory Intelligence** – Manage intake, evaluation, interpretation and disposition of any external change (regulatory, contractual, standard, etc.) that may affect obligations or policies; **Manage Obligations** – Provide a single source of truth for enterprise obligations arising from regulatory or other sources; **Policy Management, Awareness** – Manage the workflow involved in authoring, editing and publishing policies, as well as ensuring awareness and attestation of employees/ third parties; **Controls Management** – Define and document the controls required to optimize compliance risk; **Compliance Management** – Document and manage the state of compliance posture, including assessment, issue, and exception management; **Incident & Investigations Management** – Manage the intake, evaluation, and disposition of compliance related incidents

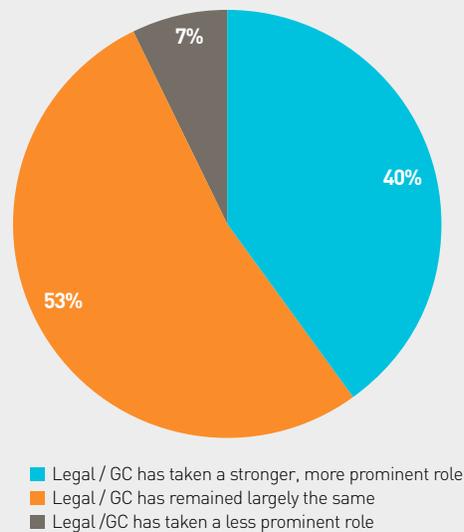
FINDING 2:

The role of the legal department in enterprise compliance is increasing as the responsibilities of the Chief Compliance Officer (CCO) and GC become more tightly intertwined

The survey showed that the role of the Legal Department in enterprise compliance is more likely to increase than decrease by more than a 5:1 margin. In fact, there are at least two Mitrtech clients who, in the past six months, have moved their Chief Compliance Officer (CCO) role to report directly to the General Counsel. Some may find this surprising in light of the fact that many compliance professionals claim that an independent CCO role reporting to the board constitutes a best practice. Some firms have even made moves to shift the responsibility for compliance to a more independent CCO role as a response to their interpretation of Department of Justice guidance.⁷

However, the right structure for the CCO role must always balance the independence potential of separating it from legal, with the significant benefits many of our respondents receive by aligning that role directly with the GC. These benefits include better legal analysis of regulatory obligations and their potential for impact on their firms and tighter linkage of the functional components of the compliance program - ensuring that the policy framework and risk & controls frameworks are tightly integrated in daily operations. This linkage can be critical, as seen in the diverging outcomes of the MorganStanley and Walmart experiences outlined herein.

Change in Role of Legal Department in the Last 18 Months



⁷ <http://www.usssc.gov/guidelines-manual/2012/2012-8b21>

CASE STUDY

In 2012, the NY Times broke a blockbuster story about Walmart and a significant allegation of bribery of Mexican officials to facilitate its aggressive expansion efforts.⁸ There were two key foundations to what now seems to clearly be a lapse of ethics and compliance at Walmart, and a likely very serious violation of the Foreign Corrupt Practices Act (FCPA). First, it seems likely that the allegations of illegal payments to Mexican foreign officials to accelerate permitting did in fact occur. Second, the Times report referenced attempts by senior Walmart management to downplay and even cover up the initial allegations made internally.

The most visible response from Walmart was the reorganization of responsibility for ethics and compliance under its general counsel. "To ... provide closer coordination and integration, Walmart aligned its corporate structure to have the global compliance, ethics, investigations and legal functions under one organization..."⁹ This reorganization was accompanied by a significant increase in investment in domain-specific compliance expertise (e.g. anti-corruption, food safety, labor and employment...).

At around the same time, a MorganStanley employee was charged with FCPA violations, while the firm was exonerated of any role or wrongdoing.¹⁰ Between 2004-2007 a MorganStanley managing director in their China operations had a secret business relationship with a Chinese government official. The two conspired to funnel millions of dollars through mutually agreed real estate transactions, hiding the funds as finder's fees.

The employee in question plead guilty, was sentenced to nine months in prison, and settled with the SEC, paying more than \$250,000 in disgorgement and agreeing to a permanent ban from the securities industry. MorganStanley, on the other hand, was cited by the DOJ for its policy training programs (the guilty employee was trained seven times, was reminded of his duty to comply 35 times, and was fired by the firm)¹¹ and its internal controls framework (which the DOJ indicated were actively subverted by the employee), and was not charged.

While the Walmart actions, after their incident came to light, could be seen as closing the barn door after the horse had already left (Walmart has incurred over \$439 million¹² in costs just during the investigation phase, and fines are likely to be even higher), they do reflect one of the key findings of this survey. Faced with an obvious gap in their ethics and compliance capabilities, Walmart has reverted to a tried and true organizational approach of having the compliance functions report up through the general counsel.

MorganStanley, on the other hand, had already adopted this structural approach to their compliance program. Within this structure they had put in place a policy awareness and attestation program, a risk management framework, and a set of internal controls that allowed them to demonstrate that they had met their obligations under the FCPA, even if they hadn't prevented the incident.



⁸ <http://www.nytimes.com/2012/04/22/business/at-wal-mart-in-mexico-a-bribe-inquiry-silenced.html>
⁹ <http://cdn.corporate.walmart.com/44/e3/07ac7de54ab08acc97290650ba15/2014-compliance-report.pdf>
¹⁰ <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171488702#.U-tixmOriBQ>
¹¹ <http://blogs.wsj.com/corruption-currents/2012/04/25/former-morgan-stanley-exec-pleads-guilty-to-evading-fcpa-controls/>
¹² <http://www.bloomberg.com/news/2014-03-26/wal-mart-says-bribery-probe-cost-439-million-in-past-two-years.html>

FINDING 3:

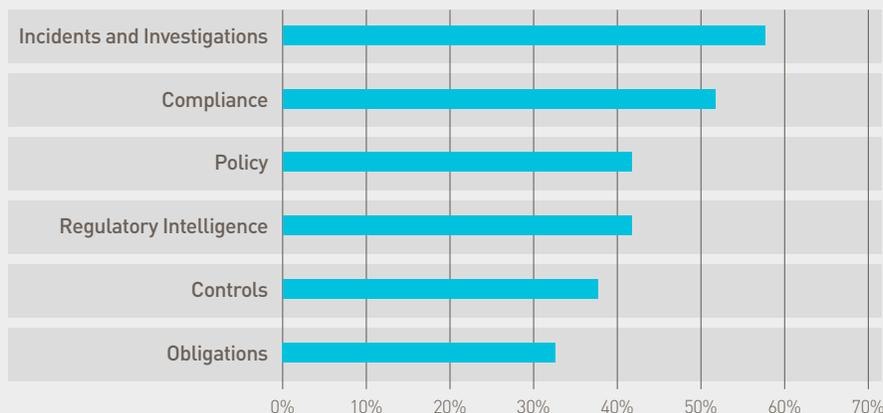
Legal departments are consistently staffing up to meet these compliance needs

Respondents consistently indicated an increase in their staffing over a 3-year period¹³ for every compliance function. Leading this increase were Incident Management and Compliance Management, with over 50% of respondents increasing staff for those functions. This reflects the growing importance of those functions, and in the case of Incident Management, the consistent stewardship role that the Legal Department tends to have over that function.

Close behind were Policy Management and Regulatory Intelligence. Firms have begun to recognize that a good policy management program, including solid awareness and education, as well as bullet-proof attestation, can be critical in reducing regulatory risk. Investments in Regulatory Intelligence are in line with the increase seen in the rate and pace of regulatory change in many industries,¹⁴ especially the already highly regulated ones.

This trend is consistent with what we are seeing in our clients' budgets. Our clients are adding net-new headcount in compliance roles, as well as reallocating existing headcount to fill these roles.

Percent Reporting an Increase in Staffing



¹³ An increase in the past 18 months or an increase in the coming 18 months

¹⁴ <http://www.heritage.org/research/reports/2013/05/red-tape-rising-regulation-in-obamas-first-term>

FINDING 4:

There is wide variability in the amount of influence that individual legal departments have in each sub-area of enterprise compliance

Striking in the responses was that the survey population as a whole rated their firms' capability in these functional areas very strongly, with almost all functions rating a mean and median of 5 out of 7. There was relatively little variation in these assessments. Four of the six functions had variability of less than 1.5 points (standard deviation) of rated capability, while only Policy Management even approached 2 points of standard deviation. That may well reflect the intense focus being placed on Policy Management at the present given recent enforcement actions that highlight policy weaknesses.

The variability of the role of the Legal Department shows a much different story. The variability of the role of every capability is above 2.5 points out of 7, and three of the six functions are near or above 3 points of standard deviation. This tells us that the role of legal in these functions is much more varied, and that firms match the role of their Legal Department to suit the needs of their particular situation, including corporate culture, individual skills, and highest near-term priorities. And they do all of this while delivering very consistent functional capability.

Standard Deviation of Responses



FINDING 5:

The legal department is most likely to be responsible for Incidents Management and least likely to be responsible for Controls Management

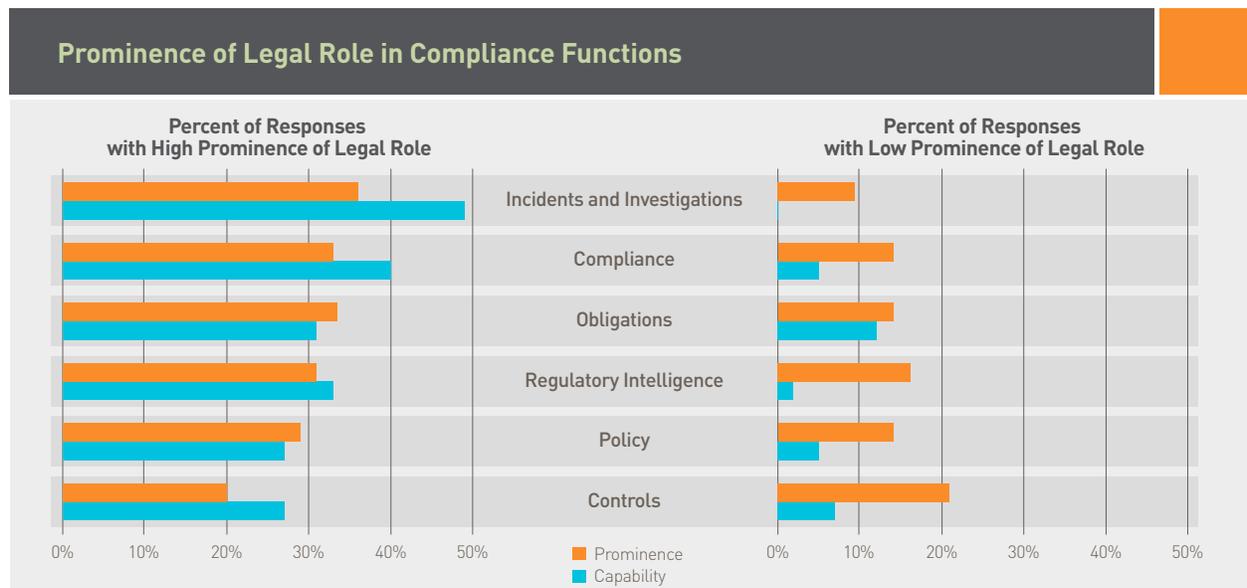
The survey identified which compliance functions were most likely to be owned or strongly influenced by the Legal Department, and conversely which were least likely. Incident Management is the compliance function that legal is most likely to have primary responsibility for, with more than 35% of respondents reporting that function owned or strongly influenced by legal. Incidents and investigation require much the same skillset used in legal teams’ traditional role overseeing matters, so housing this function in legal is logical.

Compliance Management, Obligations Management and Regulatory Intelligence were housed within the legal department for over 30% of respondents. Given that Compliance Management is a significant source of input to the Incident Management process, both in terms of identifying compliance issues as well as looking for patterns that can head them off, this is understandable. Regulatory change and Obligations Management also take advantage of core legal skillsets: both being heavily dependent on the ability to spot the legal implications of a changing regulatory landscape, and then translate those into the specific and tangible implications for the firm.

The survey also identified which enterprise compliance functions were most likely to function without input or assistance from legal. Controls Management was the function most likely, at just over 20%, to be rated at very low or no role for the Legal Department. This can be attributed to the highly operational and tactical nature of the controls framework. The legal team typically is not best suited to designing and testing controls, because frequently other department organizations will have a stronger understanding of the operational realities of the business, and the real-world trade-offs inherent in imposing constraints.

Interestingly, regulatory intelligence and obligations management, which were also among the most likely to be owned by legal, were also among the next most likely to have little role for the legal team. While on the surface this makes little sense (especially in light of the results highlighted in the previous section), these functions are relatively new to enterprise compliance programs, and many firms are struggling with how to best address them. Many firms, even large, highly regulated ones, which do not have any team explicitly accountable for these functions, are relying on ad hoc collaboration to derive these capabilities. Our expectation is that, over time, this will become a function that legal will tend to own for reasons stated above.

Mitratech has clients that span this continuum. Most of our clients participate very actively in their enterprise investigations process, and many own it. Most clients also play a significant role in monitoring and interpreting regulatory changes. To illustrate the cross-functional nature of compliance, one of our high technology clients owns their enterprise policy awareness and attestation program, even though another department manages the policies themselves.



CONCLUSION

Mitratech's recent survey confirms what many in the compliance field – from pundits and compliance professionals to regulators themselves – have said: When it comes to enterprise compliance, truly there is no one-size-fits-all solution. But this survey also clearly reinforces the critical role that General Counsel can and must play in their firm's compliance program and as leaders within the broader organization.

The proactive legal department will continue to assess their skillset and overall role in the organization, and look for opportunities to make their compliance program stronger, more effective, and less resource intensive. Given the cross-functional, collaborative nature of an effective compliance program, Mitratech recommends taking a hard look at your overall program and your team's role in it,

and answer the following questions:

- Does our legal department have ownership and accountability for the right functions in our compliance program?
- Are we contributing all that we should to each of these compliance functions?
- Do we have the right infrastructure (organization, process, and information sharing) to be effective and timely in these compliance functions?

If you can answer “Yes!” to each of these questions, congratulations, and keep up the good work. Where your answer is “No,” “Sort of,” or “I don't know,” don't despair. In asking and answering the question, you have taken the first step to effecting the necessary change. This just means that there is a clear opportunity for GCs to embrace their role as a change agent within the enterprise and to take a leadership position at the intersection of legal and compliance challenges.

ABOUT MITRATECH

Mitratech is the leading provider of fully integrated enterprise legal management solutions for global legal departments of all sizes, including more than 25% of the Fortune 500. Mitratech's offerings include the proven TeamConnect and Lawtrac product platforms, both of which offer integrated matter management, e-Billing, legal hold, contracts management, entity management and GRC solutions. Mitratech clients are able to prove demonstrable value creation for their organization by automating legal workflows, improving business outcomes through actionable data and insight, increasing collaboration with external partners, and reducing overall legal spend.

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