



BEST PRACTICES IN COMPLIANCE MONITORING

From Detection to Prevention and Beyond

WHITE PAPER

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December 2013

EXECUTIVE SUMMARY

Over the past 18 months the Department of Justice and Securities and Exchange Commission have signaled that companies need to increase their ongoing monitoring as a part of a best practices compliance regime. Compliance professionals need to be aware of the most recent developments which allow not only detection and prevention but the proscription of compliance program violations before they become violations of the Foreign Corrupt Practices Act. This article traces the evolution on such thinking and how ongoing monitoring can help a company operate a more robust and at the same time more cost effective compliance program.

INTRODUCTION

As both anti-corruption compliance programs mature and companies seek to maintain a best practices compliance program one of the areas that has continued to evolve is that of monitoring. Further just as companies mature in their thinking so do the regulators such as the Department of Justice (DOJ) and Securities and Exchange Commission (SEC). This has tools to become available to companies to move from using monitoring simply for detection to prevention of corruption violations. However now such tools are available to allow companies to become predictive in trying to head off violations, before they arise. The next step will be to use such tools in a prescriptive basis, not only to head off potential violations but to take active remedial steps to prevent such violations in the future and to document those steps.

TRANSACTION MONITORING

In April of last year, the Department of Justice (DOJ) announced that it was declining to prosecute Morgan Stanley for the FCPA violations of one of its Managing Directors, Garth Peterson, even though Peterson himself pled guilty to FCPA violations. In announcing the Declination, the DOJ listed several factors including the firm's extensive compliance policies and notifications thereof, internal controls and training meant to prevent FCPA violations, all of which had been acknowledged by Peterson. However, the one which struck me was that Morgan Stanley's compliance personnel engaged in transaction monitoring, randomly auditing particular employees, transactions and business units, and testing to identify illicit payments. This was the first time that the DOJ had spelled out transaction monitoring as a key component of a FCPA compliance regime.

enforcement action against Eli Lilly and Company (Lilly). Although this was a civil action and not a DOJ criminal enforcement action, I believe that in many ways the SEC's compliant about the areas of FCPA problems that Lilly got itself into portend the need for wider monitoring of transactions to both prevent and detect violations of a company's compliance program and the FCPA. Lilly used four separate bribery schemes in four different countries, two of which may well be important in the area of transaction monitoring.

“Morgan Stanley's compliance personnel regularly monitored transactions, randomly audited particular employees, transactions and business units, and tested to identify illicit payments.”

-DOJ Press Release.

In December, 2012, the Securities and Exchange Commission (SEC) released its FCPA

I believe that in many ways the SEC's compliant about the areas of FCPA problems that Lilly got itself into portend the need for wider monitoring of transactions to both prevent and detect violations of a company's compliance program and the FCPA. Lilly used four separate bribery schemes in four different countries, two of which may well be important in the area of transaction monitoring. The first was in Brazil, where Lilly sold drugs to distributors who then resold the products to both public and private entities. It was the classic distributor model where Lilly sold the drugs to the distributors at a discount and then the distributors would resell the products "at a higher price and then took their discount as compensation." There was a fairly standard discount given to the distributors which generally ranged "between 6.5% and 15%, with the majority of distributors in Brazil receiving a 10% discount." However in early 2007, at the request of a Lilly sales manager, the company awarded an unusually high discount of between 17% and 19% to a distributor for the sale of a Lilly drug to the government of one of the states of Brazil. The distributor used approximately 6% of this additional discount to create a fund to pay Brazilian government representatives to purchase the Lilly drugs from him. The second was in Poland where Lilly donated money to a charitable foundation, which was founded and administered by the Director General of a regional health authority, at the same time that Lilly was seeking support from the Director General for placing Lilly drugs on the government reimbursement list. There were a total of eight donations made to the charitable foundation at or near the time a business decision was made regarding Lilly's products. The Director General's favorable decisions regarding Lilly's products led to an increase in Lilly's sales in the Province in question. In the Lilly enforcement action, I believe that transaction monitoring would have been a key to detect and prevent FCPA violations. In Brazil, there was one distributor which received a discount rate outside the standard

discount given. Transaction monitoring parameters could be set to notify internal auditor compliance if such situations occurred. In Poland, there was a clear relationship between the dates of the donations to the charitable entity administered by the Director General who was making the decisions on the sale of Lilly products. Once again transaction monitoring would have correlated this connection and flagged it for further investigation.

ONGOING MONITORING OF THIRD PARTIES

Just as transaction monitoring will become a new best practice it is also important that companies move towards continuous monitoring of third parties, particularly those which are representatives for a company in the sales chain. It is well accepted that companies should engage in due diligence before entering into business relationships with third parties. A wide variety of commentaries recommend ongoing monitoring of third parties as a best practice for an anti-corruption and anti-bribery compliance program. For example, the Open Compliance and Ethics Group (OCEG) recommends that a company should "establish monitoring and re-approval requirements for each risk level" for all third party relationships. This means that third party representatives should be continually contacted and monitored by a combination of business unit sponsors and trusted outside professionals. There should be mandatory re-approval at fixed points as well as an action plan to address any red flags which might arise during the relationship.

The Organization of Economic Cooperation and Development (OECD), in its Good Practice Guidance on Internal Controls, Ethics and Compliance (OECD Good Practices) recommends that that risk must be properly evaluated, investigated and managed on a going forward basis. Specifically regarding third parties, this includes ongoing monitoring, auditing and assessment.

From a different perspective, The Wolfsberg Group (Wolfsberg), which consists of a group of internal banks, Transparency International and the Basel Institute on Governance issued a White Paper entitled “Wolfsberg Anti-Corruption Guidance,” which contained guidance on anti-corruption and anti-bribery procedures. In this White Paper, the Wolfsberg Group also advocated continuous monitoring of third party representatives during the life of a contractual relationship.

Finally, this concept of continuous monitoring was enshrined into the Six Principles of Adequate Procedures under the UK Bribery Act; with Principle 6 - Monitoring and Review. This Principle recognizes that a company should monitor and review its anti-bribery and anti-corruption procedures designed to prevent bribery by persons associated with it and makes improvements where necessary. The Guidance from the British Ministry of Justice (MOJ) relates that “The bribery risks that a commercial organization faces may change over time, as may the nature and scale of its activities, so the procedures required to mitigate those risks are also likely to change. Commercial organizations will therefore wish to consider how to monitor and evaluate the effectiveness of their bribery prevention procedures and adapt them

RELATIONSHIP MONITORING

Relationship monitoring utilizes tools, such as those provided by Catelas, Inc., which automatically create a live relationship database for the entire organization—rather like an automatically generated CRM. This is done by tapping into the log files created by email systems such as Microsoft Exchange servers and Lotus Notes. Privacy concerns are met as only people & relationships are derived from the email logs, obfuscating the actual messages themselves. Relationship monitoring then leverages social network analysis and behavioral science algorithms to analyze this relationship database. The networks that exist within companies and between the employees

where necessary. In addition to regular monitoring, an organization might want to review its processes in response to other stimuli, for example governmental changes in countries in which they operate an incident of bribery or negative press reports.”

Under most of the recent expert commentary on what constitutes a best practices compliance program, under laws from different countries and in a wide variety of industries, the ongoing monitoring of third parties is viewed as critical. This is because any due diligence performed on a third party during the time which may lead up to a contract, would only be scheduled to be performed again during the next qualification period, typically every two to three years. Much can happen during this ensuing time frame. I would strongly urge companies to develop techniques to monitor their third parties during the life of the contract period rather than simply at the start of the qualification process.

“*If your company does not ‘expand its knowledge of activities of your business partners,’ the Department of Justice (DOJ) or UK Serious Fraud Office (SFO) may well do so for you in an enforcement action.*

-Carol Switzer, President OCEG

Strengthen FCPA compliance program, including internal controls; top-notch program will improve standing with DOJ.”

-Greg Anders, DOJ., PLI Conference

of companies are thus uncovered and displayed.

Additionally, this Relationship Monitoring capability can be used across the entire end-to-end Compliance process to identify & plug gaps, reduce risk and automatically self-heal processes that are failing – without adding to the resource burden. Existing process can be enriched:



On-boarding

By identifying key people representing the 3rd party, the on-boarding process can automatically be enriched, without any increase in effort. Including these key people representing the 3rd party, but who are below 'officer' level, represents a significant extension of the risk assessment process prior to on-boarding that risk.



Due Diligence

When required, the due diligence process typically involves internal resource, and external consultants and services with the associate high cost. 3rd Party Relationship reports are prepared in minutes and provide the due diligence team with unprecedented insight into how we connect to the third party, the key players and how they do business. This depth of knowledge is currently assembled manually (if at all), incurring significant time and cost.



Periodic Review

Region-wide reports are automatically created for all 3rd parties subject to annual review within a current year. These reports are created in minutes, saving time and effort, and help Compliance conduct a more effective review. The reports include:

- Company Relationship Ranking, detailing current regional rank & change within previous 6 months.
 - Training gap report – listing all non-compliant internal & 3rd party employees.
 - List of all key people with 3rd party & who they connect with in your company
 - Relationship map - details how 3rd party connects & interconnects, collaborative networks & key relationships including sub-contractors.
 - Table showing roles & responsibilities for all key people.
 - Employee risk report for all internal employees, listing breaches of policy rules.
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Training and Certification

Key employees at the 3rd party are automatically identified, and listed in a quarterly training report, sent to the 3rd party sponsor. This automates the process for managing compliance to certification and training policies for all 3rd parties. In light of the Morgan Stanley NPA, communication, training, and certification are very important to the DOJ. Relationship Monitoring automates and expands communication without generating a large resource burden.



Self-healing Program Maintenance

Relationship Monitoring periodically identifies and reports to the 3rd party all new employees / contractors which require training & certification.



Alerts

Utilizing a rules-based engine, specific employee policy breaches & significant changes in a 3rd party's relationship map at the company level are automatically uncovered. Alerts are graded and either generate red flags for Compliance or are mapped into the periodic review process and addressed during program maintenance.



Investigations

With heightened awareness and the increased use of whistleblower programs, the number of internal investigations is on the rise. Relationship Monitoring systems allow Early Case Assessments reports to be generated quickly and help investigators gather the facts early, conduct interviews with greater effect and focus efforts on where the greatest risks are. The Identification & preservation process is also made more effective and the downstream collection process becomes highly focused saving time and money, allowing counsel to get ahead of this issue and make more informed decisions.

DOCUMENT, DOCUMENT AND DOCUMENT

The SEC is investigating JPMorgan Chase regarding its hiring practices in China. It appears that JP Morgan Chase hired children of Chinese government officials or heads of state owned enterprises. While such hirings do not violate the FCPA per se, they do raise red flags. The FCPA Professor was quoted in the New York Times (NYT) for the following, "While the hire of a son or daughter itself is not illegal, red flags would be raised if the person hired was not qualified for the position, or, for example, if a firm never received business before and then lo and behold, the hire brought in business."

However, the item that is noteworthy about this disclosure is that the timing of the alleged hiring is closely connected to important business victories and awards of government business.

How does this FCPA investigation tie into monitoring? It is because this entire episode emphasizes the continuing key concept of the three most important things in any FCPA compliance program; that being: Document, Document and Document. If your compliance program does not document its successes

there is simply no evidence that it has succeeded. In addition to providing your company with the support it needs when working with the DOJ, Monitoring, is the only manner in which to gauge the overall effectiveness of your compliance program. Put another way, if you don't document it, you cannot measure it and if you cannot measure it, you cannot refine it.

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When a company claims that they acted in a specific way in response to a risk, or took some action to ensure compliance, federal prosecutors will ask a simple question—Where is the document which confirms you took that action?”

-Michael Volkov, CEO,
The Volkov Law Group, LLC.

If you need more evidence about why is it important to have 'Document, Document and Document' embedded into your anti-bribery compliance program, you should recall the Morgan Stanley Declination. I believe one of the keys to this Declination was that not only did Morgan Stanley have a rigorous compliance regime but they documented it.

The decision not to prosecute was based on evidence of:

- Rigorous internal controls
- Regular FCPA compliance training and reminders on [your] company's FCPA policy
- Internal anti-corruption policies addressing the corruption risks associated with the giving of gifts, business entertainment, travel, lodging, meals, charitable contributions and employment, that were updated regularly to reflect regulatory developments and specific risk
- Compliance program monitoring and auditing
- Extensive pre-retention due diligence on business partners and stringent controls on payments to business partners.

FROM DETECTION TO PRESCRIPTION

The implementation of an effective compliance program is more than simply following a set of accounting rules, providing effective training or even the right tone at the top. Compliance issues can touch many areas of your business and you need to know not only what your highest risks are but where to marshal your efforts in moving forward.

The JP Morgan Chase investigation and the Morgan Stanley Declination are, in many ways, the mirrors of each other. JP Morgan Chase does not have the documentation to support the allegations that their 'Sons and Daughters' hiring program was not used for corrupt purposes. One of the clear lessons from the Morgan Stanley Declination is that if you have documentation of your position, it will go a long way towards protecting your company from allegations of a FCPA violation.

In addition to ongoing monitoring to inform your compliance program and help you to identify high risks and prioritize their remediation, compliance monitoring should be a regular, systemic part of compliance efforts rather than an occasional, ad hoc exercise cobbled together when convenient or after a crisis. Such ongoing monitoring acts as a strong preventive measure if it is performed before something goes wrong. In addition, enforcement trends and government priorities change rapidly so it is vital to stay up to date and conduct regular assessments. It also avoids a "wait and see" approach.

But with new advances in technology, ongoing monitoring has moved to actively assisting companies to manage risks. This management comes through the predictive nature of some software monitoring tools. Through the combination of Social Network Analysis and Behavioral Science algorithms 3rd party relationship networks can be automatically assessed. By uncovering risk early, Monitoring can help prevent issues from becoming violations. Additionally, an end-to-end audit trail is created underpinning what is both a programmatic & prescriptive Compliance program. Companies can also spot trends before they become full blown issues.

But there is yet another step which companies can take with such tools. It is the prescriptive step. If monitoring identifies an issue or a relationship which may appear problematic, a notice can be sent to the compliance department to not only investigate the matter but also deliver a remedial step such as notice to the employee in question about such behaviors or relationships.

Further such notice can be tied to a training component that will allow the company to deliver focused training in the issue in question; such as a Code of Conduct or specific anti-corruption training.

The DOJ has moved forward with its thinking regarding ongoing monitoring with the language of the recent Diebold Inc. Deferred Prosecution Agreement. As part of its minimum best practices obligations in Schedule C, Diebold agreed to assess its prevention and detection prongs, “taking into account recent developments in the field and evolving international and industry standards.” Clearly the DOJ wants to communicate that companies need to adhere to evolving standards and the tools available to meet those standards.

All of this ties into the continuing lessons from the Morgan Stanley Declination. In addition to compliance reminders which Morgan Stanley sent out regularly, they documented everything they sent out or received from their recalcitrant employee. Through the use of a compliance monitoring tool which not only tracks issues for review and resolution but creates an audit trail, you will have the Document, Document, Document evidence which regulators require for a successful resolution of any FCPA claim.

In other words, you can detect, prevent, predict, proscribe and have all these steps documented for your compliance regime.

SUMMARY

The DOJ and SEC continue to aggressively pursue violators of the FCPA near and far. Ongoing monitoring has moved from a tool which only gold standard compliance programs utilized to a best practice going forward. Each type of monitoring provides a data point, which when aggregated, can provide a much more holistic compliance portrait to assess and manage. In 2014 and beyond, ongoing monitoring will become a mandatory tool for the compliance practitioner going forward. Finally, do not forget the basics of any anti-bribery and anti-corruption compliance program remains the constant, Document, Document, and Document.

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ABOUT CATELAS

Founded in 2007, Catelas develops software for Legal, Security & Compliance. Used by 3 out of the 4 world's leading audit firms, and global corporations, Catelas represents the next generation of solutions which go beyond the detection of adverse events to their prevention.

Catelas uniquely combines social network analysis, behavioral analytics, and relationship algorithms along with more traditional search based technologies to identify, uncover, manage and remediate risk.

The cost of doing business, revenue & reputational risks are all linked to how business is conducted both at home and overseas. Given current regulatory pressure, it has never been more important for companies to be in control. Catelas cuts the cost associated with meeting regulator & operational compliance obligations by automating the process, identifying risk before it hurts. Catelas makes companies smarter, earlier and helps uncover & remediate regulatory uncertainty.

The Catelas 3rd party FCPA Compliance Control & Risk Oversight suite delivers the first automated end to end solution on the market today from on-boarding through to risk monitoring and investigation.

Catelas automatically creates a Relationship Database, using email message logs, which details & ranks all the people & relationship networks that describe how your company does business with each 3rd party, across each region globally.

Catelas applies behavioral algorithms & relationship analytics to identify risk within these networks and programmatically remediate or escalate based on policies.

The process is automated, gaps are plugged, and most issues are automatically remediated ... only the most pressing issues being escalated. By uncovering risk early, Catelas prevents issues from becoming violations. Additionally, an end-to-end audit trail is created underpinning what is both a programmatic & prescriptive compliance program. Catelas cuts the cost of implementing your compliance program, reduces your risk of experiencing an FCPA event and puts Compliance back in control. Deployed and live in days, Catelas works seamlessly within your current processes & leverages existing tools, causing minimal disruption, while accelerating tasks & reducing risk.

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