Sarbanes-Oxley
Five Years Later:
Has Compliance Killed Ethics?

Keith T. Darcy, Executive Director
Ethics & Compliance Officer Association
February 16, 2007
Ethics in the News

Corporate Scandals

- Enron
- Tyco
- Xerox
- Rite-Aid
- Martha Stewart
- K-Mart
- Boeing
- Raytheon
- WorldCom
- Cardinal Health
- Adelphia
- ImClone
- H-P
- Computer Associates
- Tenet Healthcare
- Healthsouth
Ethics in the News

Corporate Scandals

- Mannesmann
- ELF
- Royal Dutch Shell
- VW
- ABB
- France Telecom
- ABN-Ambro
- Heidelberg Cement
- Bank of Italy
- Lufthansa
- Siemens
- Parmalat

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Ethics in the News

Corporate Scandals

- Bank of China
- Samsung
- Livedoor
- NEC Engineering Ltd.
- CAO Singapore
- Hyundai
Ethics in the News

**Accounting Scandals**

-(former) Arthur Anderson
-Ernst & Young
-KPMG
-PWC
Ethics in the News

Financial Services

- Merrill Lynch
- Citigroup
- Group of 10 - $1.4 billion
- Morgan Stanley
- CSFB
- JP Morgan Chase
- Riggs Bank
- Fannie Mae
- NYSE/Grasso
Ethics in the News

Financial Services

- Bank of America
- Janus Capital
- Canary Capital
- Strong Capital Mgmt.
- MFS
- Pimco
- Pilgrim Baxter
- Putnam
- AIM
- Invesco
- American Express Advisors
- Quick & Reilly
- Piper Jaffray
- American Funds
- Edward Jones

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February 16, 2007
Ethics in the News

Insurance Industry

- Marsh & McLennan
- Aon
- Ace
- AIG
- ING
- ULR
- Met Life
- Prudential
- Zurich Financial
Ethics in the News

Pharmaceuticals

- Bayer
- AstraZeneca
- Merck
- Pfizer
- Bristol-Myers Squibb
- Abbott Labs
Ethics in the News

June 1, 2005
The Wall Street Journal

“AIG Reduces Profits by $4 Billion”
February 6, 2006
The Wall Street Journal

“AIG Close to Deal to Settle Charges, Pay $1.5 Billion”
“Fannie is Directed to Restate Results by $9 Billion After SEC Review. Raines Ousted.”
December 16, 2004

"Time Warner Expected to Settle AOL Inquiries for $510 Million"
August 27, 2005

“KPMG Settles for $465 Million”
May 19, 2005

“Judge Approves $715 Million Adelphia Settlement”
“Judge Approves $750 Million WorldCom Settlement”
October 26, 2004

“Citigroup Extends Apology to Japan”
September 13, 2004

“China Executes Bank Staff for Fraud”
May 17, 2004

“I am a big believer that what a culture or society deems to be shameful and illegitimate is the most important restraint on how people behave. It takes a village. But it also takes a silent majority to act.”

“Tyranny of the Minorities”
Thomas L. Friedman
What Happened?

1. Irrational exuberance + uninhibited self-interest
2. Arrogance
3. Fraud
4. Conflicts-of-interest
5. Preferential treatment
6. Accounting arbitrage
7. Failure of independent auditors
8. Failure of analysts
9. Failure of rating agencies
10. Failure of regulators
11. Failure of board oversight
12. Culture of greed
U.S. Response

1991 - U.S. Sentencing Commission – Ch. 8

1996 - Caremark Decision

1999/2003 - The Holder/Thompson Memos

2002 - Sarbanes-Oxley Act

2002 - NYSE Governance Recommendations

2004 - U.S. Sentencing Commission Revision
Comprehensive Crime Control Act of 1984

Nov. 1, 1991
USSC Raised 2 New Risks:

1. Personal threat
2. Corporate threat

Mitigations exist through a comprehensive ‘ethics compliance’ program.
Caremark Decision

September 15, 1996

Caremark pleaded guilty to mail fraud and for kickbacks to physicians for patient referrals, and paid fines of $250 million. Shareholders brought suit alleging Caremark directors bore personal responsibility for failure to supervise.

Delaware Chancery opined that “by establishing and maintaining an effective compliance program, board members can protect themselves from personal liability suits.” Failure to do so, however, may “render a director liable for losses caused by non-compliance.”
Holder/Thompson Memos

June 16, 1999 and January 20, 2003

“Bringing Criminal Charges Against Corporations”

1. Seriousness of offense
2. Pervasiveness of wrongdoing
3. History of similar misconduct
4. Timely and voluntary disclosure
5. Existence & adequacy of compliance
6. Corporate remedial actions
7. Collateral consequences of conviction
8. Adequacy of non-criminal remedies

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February 16, 2007
Sarbanes-Oxley Act 2002

Public Accounting Reform & Protection Act

Accountants - Create Gov’t Oversight Board
- Limit auditor consulting
- Require auditor rotation

Executives - Requires codes of ethics
- Certification of financials (CEO/CFO)
- Disclose stock sale in 2 days
- Ban personal loans
- Easier criminal prosecution

Boards - Require majority independent
- Receipt, retention, treatment of complaints

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February 16, 2007
New York Stock Exchange
Corporate Governance Standards

1. Independent majority on the company BOD
2. Stricter definition of director independence.
3. Regular executive sessions of non-management directors.
4. Appoint a lead director.
5. Require shareholder approval for any equity compensation plans.
6. Ban on all broker votes for such plans.

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Ethics and Compliance Officer Association
February 16, 2007
April 12, 2004

1. Made standards more rigorous.
2. Put **greater responsibility on BOD’s and top management** to take active leadership in promoting *ethical conduct*.
3. “Under the revised guidelines, if companies hope to mitigate criminal fines and penalties, they must also promote an *organizational culture* that encourages commitment to compliance with the law and *ethical conduct*...”

Keith Darcy, Executive Director
Ethics and Compliance Officer Association

February 16, 2007
There has been an extraordinary loss of trust in organizations and their leaders.
<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>11-30-06</td>
<td>Committee on Capital markets Reform SOX revision (&quot;materiality&quot; and &quot;risk-based threshold&quot;).</td>
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<tr>
<td>12-12-06</td>
<td>McNulty Memo re: attorney-client privilege and payment of legal fees.</td>
</tr>
<tr>
<td>12-14-06</td>
<td>SEC extends implementation of 404 for IPOs, easier for foreign firms to de-list.</td>
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<tr>
<td>12-20-06</td>
<td>PCAOB eliminates unnecessary requirements.</td>
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<tr>
<td>12-24-06</td>
<td>SEC allows lower reporting of compensation.</td>
</tr>
<tr>
<td>Date</td>
<td>Event Description</td>
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<tr>
<td>12-28-06</td>
<td>SEC reversal irks Committee Chief</td>
</tr>
<tr>
<td>1-2-07</td>
<td>Spitzer sworn in and begins push on ethics reforms.</td>
</tr>
<tr>
<td>1-19-07</td>
<td>Senate passes vast overhaul in ethics and lobbying rules.</td>
</tr>
<tr>
<td>Date</td>
<td>Event Description</td>
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<tr>
<td>1-5-07</td>
<td>Embezzlement found in many Catholic Dioceses.</td>
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<tr>
<td>1-5-07</td>
<td>OECD challenges Britain for ending bribery probe of Saudi Arabia.</td>
</tr>
<tr>
<td>1-13-07</td>
<td>BP’s problems cost CEO his job.</td>
</tr>
<tr>
<td>1-22-07</td>
<td>Showdown looms in Congress over drug advertising.</td>
</tr>
</tbody>
</table>
The risks of doing business have never been greater!
You can’t legislate trust.
What is trust?
Trust is the expectation that the faith one places in someone or some institution will be honored.
What is culture?
What is “corporate culture?”
“A system of shared values.”
“The underlying assumptions, beliefs, attitudes and expectations shared by an organization.”
“The way we do things around here.”
<table>
<thead>
<tr>
<th>Central Concepts of Corporate Culture</th>
</tr>
</thead>
<tbody>
<tr>
<td>• They’re collective – It’s what members agree about. Persons who do not endorse and practice prevailing beliefs, values and norms become marginalized and may be punished or expelled.</td>
</tr>
<tr>
<td>• They’re emotionally charged.</td>
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<tr>
<td>• They’re historically based.</td>
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<tr>
<td>• They’re inherently symbolic.</td>
</tr>
<tr>
<td>• They’re dynamic.</td>
</tr>
<tr>
<td>• They’re vague – They incorporate contradictions, ambiguities, paradox and confusion. They have both central as well as peripheral elements.</td>
</tr>
</tbody>
</table>
Corporate Culture and Performance

Starbucks
Nordstroms
FedEx
Southwest Airlines
Costco
Intel
Google

Keith Darcy, Executive Director
Ethics and Compliance Officer Association

February 16, 2007
Culture vs. Compliance

Culture trumps compliance!

Keith Darcy, Executive Director
Ethics and Compliance Officer Association

February 16, 2007
Strong cultures self regulate
Self regulation

or

More regulation?
“America is great because America is good.

If America ever ceases to be good, America will cease to be great.”

Alexis de Tocqueville