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How a strong compliance culture affects whistleblowers

an interview with Stephen Cohen

Former Associate Director, Enforcement Division
Securities and Exchange Commission;
Partner, Sidley Austin LLP

See page 16

Contents

May 2017

FEATURES

COLUMNS

DEPARTMENTS

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Stephen Cohen
Former Associate Director
Enforcement Division
Securities and Exchange Commission;
Partner, Sidley Austin LLP

an interview by Gabriel Imperato

Meet Stephen Cohen

This interview was conducted by Gabriel Imperato (gimperato@broadandcassel.com), Broad and Cassel Managing Partner, Fort Lauderdale, FL in early March 2017.

GI: Please tell our readers about your background and experience with the Securities and Exchange Commission (SEC) and your involvement with organizational compliance?

SC: Thanks, Gabriel. It is a pleasure to have a chance to share my thoughts with your readers. I had a fantastic twelve years at the Commission. I joined the SEC in 2004 as a trial attorney, having spent my career to that point as a litigator both at the Justice Department and in private practice. One of my cases involved the American Stock Exchange, which was owned by the National Association of Securities Dealers (NASD). One of my key witnesses in that case was the NASD's CEO, Mary Schapiro. I could not have known that, years later, President Obama would nominate her to be SEC Chairman. I went to work for her in early 2009 in the midst of the financial crisis and in the wake of the revelation of Bernie Madoff's fraud. It was a tumultuous time.

I began working closely with the Compliance industry during my tenure with Chairman Schapiro. One of my key projects was overseeing the agency's work with Congress on whistleblower legislation, and then after Dodd-Frank became law, the SEC's rulemaking and creation of its whistleblower program. Public companies and the Compliance industry were keenly interested in this rulemaking, as they feared that

whistleblowers would end-run around compliance programs or that compliance officials would run to the SEC with concerns rather than to their management. We received critical input from compliance professionals about their concerns, and I believe the Commission rules reflect that input.

When I returned to Enforcement as Associate Director, having learned a lot from the Compliance industry, I continued to work collaboratively with the industry to send strong messages at conferences, in speeches, and through cases, about the importance of having a strong culture of compliance and ethics.

GI: Generally describe for our readers the jurisdiction and responsibilities of the SEC and the agency's connection to compliance and compliance standards?

SC: The SEC is tasked with a very broad mission—to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. This broad mandate for a relatively small agency is carried out in many ways, ranging from the Enforcement Division, which protects investors through investigations and actions to stop misconduct and punish wrongdoers; to an exam program, which has on-site authority to do compliance examinations of registered entities; to rulemaking divisions with regulatory authority over public companies, registered stock exchanges, broker-dealers, investment advisers, and other types of entities and individuals with impact on our financial markets.

I think of the agency's connection to compliance and compliance standards in two distinct but overlapping buckets. The first involves entities directly regulated by, and registered with, the SEC. Certain firms such as brokers, investment advisers, and others subject to the SEC's examination authority have explicit obligations under the federal securities laws regarding various areas of compliance, and the SEC has promulgated rules, put out guidance, and holds firms accountable for required compliance. Second is the agency's interest in compliance at public companies and in the audit industry. Ensuring and encouraging robust and accurate disclosures by public companies and the integrity of financial statements is a principal focus of the SEC. To that end, the agency has occasionally issued guidance such as the joint Foreign Corrupt Practices Act (FCPA) Guide with the Department of Justice. The Enforcement Division examines compliance programs periodically when considering allegations about companies or when seeking to gain comfort about an internal investigation. And, when companies commit serious violations of the federal securities laws, the agency often will impose undertakings or monitorships to ensure the improvement of a company's compliance program and culture so that the mistakes are not repeated.

GI: What is the connection between the work of the SEC and the healthcare industry and, specifically, healthcare compliance? What are the major compliance risks that you are seeing from the vantage point of the SEC in the healthcare industry?

SC: I think about the SEC's connection to the healthcare industry in a few ways. First of all, many healthcare companies are public companies with securities listed on stock exchanges. As such, the SEC is interested in healthcare companies' ethics and compliance programs regarding any aspect of their business that might be material to investors. This could involve accounting and finance compliance; avoiding foreign bribery, sanctions, and export controls; or the accuracy of public disclosures regarding financial health, drug trials, or other important information. In addition, pharmaceutical company stocks are actively

traded around the results of drug trials, which can have enormous impacts on a company's revenue for years. This creates risk of insider trading, and it is critical for such companies to have strong compliance programs to ensure that people are not illegally profiting from this sensitive, market-moving news.

GI: What has been the impact of technology and big data on investigations by the SEC and for organizational compliance and compliance programs?

SC: Technology has been every bit as critical for the SEC as it has for private industry, although the agency is incredibly resource-constrained. The agency has begun to harness big data to protect investors and the integrity of the markets. In no area is this more pronounced than insider trading. The SEC has developed a number of incredible tools to surveil for anomalous trading in the markets. This has resulted in a profound change in how the SEC investigates and prosecutes insider trading. The stock exchanges and FINRA are the front line in surveilling for insider trading by looking for anomalous trades around big events such as mergers, earnings announcements, and even drug trial results. This is often referred to as the "issuer based" or "event based" approach to insider trading surveillance. Using technology, however, the SEC can now examine huge volumes of trading data from the perspective of a trader rather than just issuers. In other words, the SEC can look for unusual patterns of anomalous trading by traders—including coordinated trading resembling an insider trading ring—as opposed to focusing on a single event. This has yielded several very large insider trading prosecutions and actions that may not have been previously detected or prosecuted.

Another example of the use of big data is the Enforcement Division's examination of public corporate data, including financial information, to look for anomalies in earnings, expenses, or other financial metrics compared to a company's peers. This has allowed possible early warnings of unusual activity by a company before any serious misconduct occurs or before it otherwise comes to the attention of shareholders or the government.

As for corporate compliance programs, I have seen the positive impact technology—including surveillance—has had on compliance programs as these systems make it easier for companies to detect conduct that may be illegal or improper before problems grow.

GI: Please explain the whistleblower program adopted by the Dodd-Frank Law and how it works with the SEC?

SC: As a result of efforts by former Chairman Mary Schapiro and her staff, the SEC worked with Congress to craft a program that rewards whistleblowers who provide high-quality, original information that leads to a successful enforcement action with over $1 million in sanctions. This program provides anti-retaliation protections for whistleblowers, including a private right of action, as well as the potential for a reward of 10%–30% of the sanctions awarded in the SEC action and related government actions such as a criminal case. This program has resulted in numerous cases, many of them massive frauds, which were greatly aided by these whistleblowers and may have never come to light without them.

GI: How is this whistleblower program different form the *qui tam* provisions of the False Claims Act? Is the SEC whistleblower program better, or are the False Claims Act *qui tam* provisions more effective in identifying fraud and false claims?

SC: The SEC's whistleblower program differs from the False Claims Act in very material ways. The biggest difference is the lack of any *qui tam* provision in it. As a result, only the government can file actions (with the exception of private class actions), and whistleblowers must bring their concerns to the SEC to participate in the program. They cannot file an action on behalf of the United States like *qui tam* relators can. I think that is good policy, because the delicate balance of enforcement and regulation that occurs at the SEC would be undermined if individuals without the knowledge, experience, or authority of the Commission could file public actions. Notably, the victims of False Claims Act violations are the taxpayers who are being defrauded. The SEC has a much broader mandate, and complex policy considerations often go into charging decisions by the Commission. I think the two programs are aimed at somewhat different societal harms, and each can be effective in their own way to mitigate harm.

GI: What has been the SEC's experience with its whistleblower program, in particular as it relates to healthcare companies and their compliance programs?

SC: The SEC's whistleblower program has been a force multiplier for its enforcement efforts as evidenced by the fact that they've surpassed $142 million in awards in cases yielding nearly $1 billion in financial remedies. Many actions originating with whistleblowers involve insiders who can provide detailed information that save enormous government resources or result in cases that never would have been brought without the whistleblower. This is exactly as it was envisioned by Chairman Schapiro—leveraging third parties to supplement the SEC's limited resources to detect fraud and return money to injured investors where possible.

As it relates to healthcare companies, I think whistleblowers come into play in a variety of ways. First, many healthcare companies are public companies with the same accounting and disclosure issues that other companies have. In addition, however, there are issues particular to healthcare companies that can lead to disclosure fraud and insider trading investigations, especially pharmaceutical companies. For example, the results of drug trials typically are material to investors, even for a large company. Such news moves stock prices. As a result, false or misleading statements about drugs or drug trials can constitute securities fraud, and sharing non-public information about drug trials can constitute illegal insider trading.

Finally, as it pertains to compliance programs, the SEC thought long and hard how to craft its program without undermining compliance programs. That's why whistleblowers are encouraged to report to their companies, and compliance personnel have to fulfill certain conditions before they can be whistleblowers. Anecdotally, my experience was that whistleblowers typically reported their concerns to management or Compliance before coming to the government. My experience with the whistleblower program teaches that companies are well-advised to have strong compliance cultures, where employees feel empowered to raise their hands without retaliation, if they don't want employees to report their concerns to the government instead of them.

GI: Does the SEC have jurisdiction over an anti-retaliation statute or policy? How important is anti-retaliation to effective compliance?

SC: There are two anti-retaliation laws that impact the SEC's sphere of influence. Sarbanes-Oxley, in 2002, created an anti-retaliation regime for public company whistleblowers who report wrongdoing. This program is

administered by the Department of Labor, although the allegations often end up with the SEC.

The Dodd-Frank Act, however, created a new regime for whistleblower protection. The statute prohibits retaliation in any fashion against those who provide information or assist the SEC, and it creates a private right of action with a range of remedies as well as a cause of action for the SEC against companies who violate the provisions. Because fear of retaliation is often why corporate employees don't come forward to report fraud, I believe it is incumbent upon companies to persuade their employees that they will not tolerate retaliation, because that is the only way that whistleblowers will report internally rather than going to the government. One question on a lot of folks' minds is whether the administration will continue to champion whistleblowers and compliance programs—including through amicus briefs in court proceedings—the way the previous administration did. That remains to be seen.

GI: Where do you see Compliance heading in the future in the healthcare industry, in the financial services industry, and generally, under federal law? Can we expect any changes because of the new Administration and, if so, what kinds of changes?

SC: I am not aware of any legislative proposals directly aimed at compliance programs. It is often government policy instead (guidance from the Department of Justice [DOJ] or SEC) that addresses the importance of compliance programs to obtain leniency from the government, sometimes in conjunction with the enforcement of specific federal laws such as the FCPA, False Claims Act, or other statutes.

As to the broader part of your question, it remains to be seen whether the new Administration will continue to advance guidance on compliance issues or champion compliance programs in the same way as in recent years. In January, the Criminal Division at the DOJ issued guidance on important topics and key questions in evaluating compliance programs. There has been much debate already about whether companies will ramp down spending in compliance, based on a belief that compliance will be less critical in the coming years. That is inadvisable for several reasons. First of all, it is not clear that premise is even true. Career prosecutors and enforcement staff will presumably continue to look at corporate compliance programs to evaluate the context within which violations of the law occurred and what a company's culture is. It is also a useful way for the government to gauge what kind of self-policing is going on at a company, sometimes in deciding how much leeway (or weight) to give a company conducting an internal investigation. This will be true for companies facing SEC or DOJ scrutiny and certainly for healthcare companies trying to settle healthcare fraud investigations. It is also critical in determining whether to appoint a monitor or consultant. Also, imagine how difficult it would be facing an investigation after a fraud is revealed where, in the years leading up to the fraud, the company slashed its compliance budget. That is not a position of strength in negotiation with the government. But, the most compelling reason to invest in compliance programs is that strong compliance and ethics programs make good business sense.

GI: Has the SEC had an "outreach program" for leadership in Compliance in the financial services industry? If so, what has been some of the features of this effort?

SC: Yes, the SEC has a Compliance Outreach Program to promote open

communication and coordination among securities regulators and industry stakeholders. Through regional events and a national program in DC, the program allows opportunities for discussion of compliance issues, education about effective practices, and shared experiences. These events include relevant regulatory staff, examiners, enforcement personnel, and self-regulatory staff.

GI: What does the SEC look for in assessing the work, value, and effectiveness of an organization's compliance program?

SC: The best explanation of how the SEC looks at these issues is the FCPA Resource Guide, which can be found on the SEC's website. Among the hallmarks it mentions are a commitment from senior management to a culture of compliance; a code of conduct and compliance policies and procedures; oversight, autonomy, and resources for personnel charged with the Compliance function; strong risk assessment in focusing compliance resources; appropriate incentives and disciplinary measures to enforce the compliance program; confidential reporting and internal investigation functions; and continuous improvement.

GI: What impact can an effective compliance program have on SEC enforcement actions and resolutions?

SC: There are a couple of ways that the ability of a company to tell a compelling story about its compliance culture, and the effectiveness of its compliance program can be helpful when interacting with the SEC. First, it provides excellent context and possibly confidence to the SEC staff when a company is conducting an internal investigation. Second, it can provide further context around negative facts or circumstances. In other words, demonstration of an effective compliance program can better lead to a conclusion that isolated wrongdoing is anomalous rather than systemic or cultural. Third, it can be important in satisfying the staff that no enforcement action is warranted in certain circumstances to the extent that the company effectively self-policed and had the ability to self-report misconduct, or because minor misconduct can be shown to be isolated. And, finally, it can help in the analysis the staff uses to evaluate penalties and undertakings when enforcement action is warranted.

GI: What do you think are the measures or earmarks of an effective compliance program?

SC: I've been most impressed by companies who have a strong story to tell about how compliance and ethics is part of their company's governance, including a chief ethics and compliance officer with the necessary resources, independence, standing, and authority to be effective. They encourage leaders to promote integrity and ethical values in decision-making and incentivize the right behaviors through performance management systems and compensation. And, they can demonstrate a clear record of consistent discipline without retaliation while continuing to self-evaluate and improve their programs.

GI: Is the SEC out front as a leader in promoting effective compliance? How does it compare to the Department of Justice or the Health and Human Services Inspector General (OIG)?

SC: I think that, in recent years, the government—both the SEC and the DOJ—ramped up promoting effective compliance in many ways. In 2012, they issued a joint Resource Guide to the US Foreign Corrupt Practices Act. In that guide, the agencies laid out hallmarks of an effective compliance program. In subsequent years, senior SEC officials from the Chair to Division

Directors to others, including myself, gave speeches promoting effective compliance and the importance of compliance officers. In addition, the Department of Justice hired a compliance counsel expert and put out further guidance. Over the years, the HHS Inspector General has also issued compliance-related guidance. Collectively, all of these actions demonstrate that the government expects companies to have robust compliance programs and is extremely supportive of the Compliance industry. It is also clear that the government will look at how companies implement these programs in the context of their investigations and in making charging decisions. I believe, however, that the SEC should take more of a leadership role regarding public company compliance programs and standards relating to them.

GI: What have you observed with respect to evaluating organizational compliance and the developments of compliance programs in the last 15 years?

SC: I have seen many good and bad compliance programs over the years. It is very clear that there has been a positive trend in building out compliance programs and integrating them into companies and firms. I discussed some of the better attributes of compliance programs earlier.

Nevertheless, too many companies still do not focus enough on ethics and compliance. I have seen companies get in trouble when their culture encourages risk-taking around legal and ethical issues, where approaches to compliance are overly technical, or where behavior around disparaging or diminishing the importance of respect for the law is tolerated. In addition, I've seen pockets of fraud where legal and compliance personnel are not empowered to do their jobs or don't have access to the information or resources they need to help the organization. At a very basic level, I have been most discouraged when witnesses came in and testified that they should have followed up on their hunches, but failed to do so. I have seen many frauds where opportunities to detect them were missed, because someone didn't understand an explanation they were given or was intimidated by the person giving the explanation, even if it didn't add up, and yet they failed to pursue their skepticism.

GI: What do you think are the most important qualifications for a compliance officer?

SC: Obviously, technical skills are important, including knowledge of compliance concepts. It is also useful for a compliance officer to be knowledgeable about the industry in which they operate. But, once you get past those, judgment and strong leadership and people skills are critical, especially for senior compliance officers and managers. It is a difficult job, which often requires deftness in persuading business personnel how to do something differently or even not to do something they really want to do. Strong people skills are critical to the success of senior compliance officers.

GI: Thank you, Stephen for sharing your insights with us

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