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When the Paper Tiger Bites: The Myriad Dangers of Ineffective Compliance Programs

Corporations need to take a close look at their compliance programs, making sure that these programs are delivering, not just promising, real oversight.

By **Andrew St. Laurent** | March 26, 2021

American corporations spend billions of dollars every year on compliance programs, which do help to protect them from lawsuits and regulatory actions.

But, poorly implemented compliance programs can be worse than useless, giving companies false confidence in their effectiveness. In a recent example of this, Goldman Sachs was fined over $2.9 billion by U.S. regulators in connection with the 1MBD scandal, with additional substantial fines and penalties being imposed by foreign governments. As shown by documents recently revealed in *US v. Roger Ng*, 18-CR-538 (MKB), some part of these fines may be attributable to the aggressive positions Goldman took with regulators regarding the effectiveness of its compliance programs, which it ultimately retreated from in reaching a settlement.

For this reason, corporations need to take a close look at their compliance programs, making sure that these programs are delivering, not just promising, real oversight.

Compliance Programs Designed To Seem Effective Instead of Being Effective

In response to a series of corporate scandals in the 1970s and 1980s, corporations instituted internal compliance programs as a form of self-regulation, with the intent of heading off more comprehensive and penetrating oversight by regulators. To that end, corporations expanded compliance departments with more personnel and greatly expanded training.

These changes were made in light of the U.S. Sentencing Guidelines (USSG §§8B2.1, 8C2.5(f), and 8C2.8(11)) and the Justice Manual issued by the Department of Justice to assist federal prosecutors (JM 9-28.300 et al.) that give substantial credit to corporations in charging and sentencing decisions for effective compliance programs. Other regulators, such as the SEC, either require such programs (see, e.g., Rule 206(4)-7 under the Investment Advisers Act of 1940) or give credit for compliance programs to violators. See, e.g., Criminal Division of the U.S. Dep't of Justice & the Enforcement Division of the U.S. Sec. & Exch. Comm'n, A Resource Guide to the U.S. Foreign Corrupt Practices Act, at 56 (2d ed. 2020) (credit given to "self-policing prior to the

discovery of the misconduct, including establishing effective compliance procedures and an appropriate tone at the top[.]").

There is good reason, however, to believe that this expanded regime has had little effect on ensuring corporate compliance with the law, especially in light of numerous recent corporate scandals. In addition to Goldman, major scandals have rocked some of the world's largest corporations. Wells Fargo defrauded millions of its own customers by signing them up for bank accounts that they did not want or agree to opening. Volkswagen deceived regulators about emissions reductions. Billions of dollars were stolen from Petrobras in a kickback scheme that reached the highest levels of the Brazilian government. All of these companies had well-financed, extensive, and well-staffed compliance departments. What could possibly have gone so wrong?

In February 2017, the U.S. Department of Justice issued new guidance focused on the actual effectiveness of compliance programs:

The Principles of Federal Prosecution of Business Organizations require prosecutors to assess 'the adequacy and effectiveness of the corporation's compliance program at the time of the offense, as well as at the time of a charging decision.' JM 9-28.300. Due to the backward-looking nature of the first inquiry, one of the most difficult questions prosecutors must answer in evaluating a compliance program following misconduct is whether the program was working effectively at the time of the offense, especially where the misconduct was not immediately detected.

Two years later, the DOJ's Criminal Division issued an updated version of the Compliance Program Guidance that distilled the 2017 guidance into three "fundamental questions": (1) "'Is the corporation's compliance program well designed?'"; (2) "'Is the program being applied earnestly and in good faith?' In other words, is the program being implemented effectively?"; and (3) "'Does the corporation's compliance program work in practice?" U.S. Dep't of Justice Criminal Division, Evaluation of Corporate Compliance Programs, at 2 (April 2019). Additional guidance issued by the Department of Justice and the SEC in 2020 emphasized the same "fundamental questions" while adding a fourth: "Is the corporation's compliance program adequately resourced to function effectively?" Criminal Division of the U.S. Dep't of Justice & the Enforcement Division of the U.S. Sec. & Exch. Comm'n, **A Resource Guide to the U.S. Foreign Corrupt Practices Act**, at 57 (2d ed. 2020).

While these recommendations describe in clear terms the types of compliance programs regulators want to see, they leave an unanswered question: How much credit can a corporation possibly get from a compliance program that obviously failed?

Goldman's Compliance System Defense Failed

The Department of Justice and the SEC may have answered that question in the Goldman Sachs settlement.

Between 2012 and 2013 Goldman Sachs raised billions of dollars in a series of bond transactions for the Malaysian sovereign fund, 1Malaysia Development Berhad (1MDB), reaping approximately $600 million in fees. More than $1 billion of the funds raised by Goldman were misappropriated to pay kickbacks to government officials in Malaysia and Abu Dhabi, in a scheme

that was masterminded by Low Jho Taek Low (Low), a Malaysian businessman who remains a fugitive.

When this scheme triggered regulatory scrutiny, which Goldman responded to with a vigorous defense based on its allegedly effective compliance program, which is detailed in a document released by prosecutors in the related case of *United States v. Ng*, 18-CR-538 (MKB) (Docket No. 58-1) (the November 13th Letter).

As revealed in that document, Goldman's Counsel represented and argued that its compliance and control functions "were rigorous and working effectively during the relevant time period" (id. at 5); "there was no evidence that any transaction had not been executed in accordance with management's direction, that any assets had been accessed without management's authorization or that any of Goldman's controls had been deficient" (id. at 7); the company had increased compliance program budget and personnel during that time period (id. at 3); that those involved were rogue personnel that had violated Goldman's procedures (id. at 9); and that Goldman itself didn't make any payments to a corrupt official as money was not transferred from a Goldman-controlled account (id. at 10).

Goldman's "rogue banker" defense ultimately failed and it entered into a deferred prosecution agreement under which Goldman itself escaped a guilty plea, although Goldman Malaysia was required to plead guilty. The company agreed to pay over $2.9 billion in fines, disgorgement, forfeiture, and other penalties to the DOJ, the SEC, and foreign regulatory authorities. In addition, Goldman agreed that it was responsible for the acts of its officers and employees and that the allegations in the statement of facts attached as Exhibit A to the agreement were true and accurate. Deferred Prosecution Agreement at ¶2. Goldman also had to admit that it had committed crimes and that it had not taken reasonable steps to ensure the so called "rogue actors" were not violating compliance policies.

In addition, and tellingly, as part of the Deferred Prosecution Agreement, the Department of Justice required Goldman to implement a "compliance and ethics program designed to prevent and detect violations of the FCPA and other applicable anti-corruption laws or money laundering laws throughout its operations" and to provide updates on the implementation of its compliance program to the Department of Justice." Id. at ¶ 12; Attachment C, D. The first paragraph of the attachment emphasizes that Goldman's revamped compliance program, consistent with the Department of Justice recommendation in 2017, 2019, and 2020, must be effective and must start "at the top": "The Company will ensure that its directors and senior management provide strong, explicit, and visible support and commitment to its corporate policy against violations of the anticorruption laws and its compliance codes, and demonstrate rigorous adherence by example." Id. at C-1.

Conclusion

While it is impossible to know for certain to what extent, if at all, Goldman was penalized for its decision to mount a strong defense of its compliance program, given the result, it certainly cannot have helped. Moreover, separate and apart from the penalties imposed, Goldman's evidently sincere belief in the bona fides of its own program may have made it slow to react to employees who identified red flags in connection with the 1MDB bond offerings.

Accordingly, compliance programs should be judged on their own merits: Are they effective in preventing, detecting, and deterring misconduct by persons (including third parties) who act on behalf of the corporation? The Department of Justice and other regulators have made clear the corporations will get little, if any, credit for programs that generate large amounts of paperwork but that in fact do little to prevent, detect or deter misconduct.

In sum, ranking corporate officers should know what their compliance functions are doing, and should be careful about relying on the "paper tiger."

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