Board oversight of ethics, compliance, and culture

Boards recognize that ethics, compliance, and culture are clearly linked to business results and long-term value. Yet providing effective oversight in these areas can be difficult. Episodes of misconduct or pockets of unhealthy culture can escape senior leaders' attention and threaten to erupt into crisis.

During an April 7 virtual meeting, members of the Lead Director Network (LDN) were joined by David Greenberg, senior advisor at LRN, former chief ethics and compliance officer of Altria Group and member of the board of directors of International Seaways, and Julie Kane, former chief ethics and compliance officer at Pacific Gas & Electric and a director at SIGA Technologies, for a discussion of board oversight of ethics, compliance, and culture.

This *Summary of Themes* provides a brief overview of the meeting. *For a full list of meeting participants, please see page 5.*

Avoid complacency during times of success

Mr. Greenberg reminded members that *"good times in a company can camouflage big problems,"* and that it is easy to *"put too much trust in the stock price and market share."* He encouraged LDN members to cultivate appropriate skepticism in good times. Ms. Kane urged members to ask, *"Are there things coming at us that we haven't anticipated or examined fully? And for those things we believe we've examined, have we done that well enough?"*

They both noted that during a crisis, it takes considerable courage and insight to find the way forward. However, Mr. Greenberg pointed out, *"it is never too late"* to confront difficult questions, change direction, and chart a course to recovery.

Resist a bubble mentality

A board, by its nature, is isolated from the day-to-day operations of a company and risks becoming cut off from trends in the organization and changes in the broader context. Lead directors and guests suggested several ways to counteract that risk and stressed the importance of identifying warning signs within the organization:

- **Avoiding overly inward focus.** Mr. Greenberg said, *"The board at times needs to demand more from management in understanding the societal and political landscape. There is sometimes not enough effort to bring the outside in."* He suggested that this is an area

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where the board can take more direct oversight: *"The normal deference to management is less justified when it comes to the role of the company in the larger society."*

- **Promoting a diversity of perspectives on the board.** Members noted that a board's composition can create a narrowness of perspective that hinders its ability to see an emerging crisis. One lead director said, *"The dynamics of groups can be that they tend to think alike if they don't have enough diversity of thought or experience. Boards need a critical mass of diverse viewpoints to gain a voice in the room."* Another agreed: *"You can't challenge strategy without diversity of thought and credibility in the group that is challenging it."*

- **Fostering transparency throughout the organization.** A company that discourages people from speaking out about known issues or elevating those issues to senior leaders is primed for a crisis. Mr. Greenberg said, *"my theory is that in every significant corporate scandal that has ever happened there was someone who knew about it who didn't speak up."* Creating a culture that encourages people throughout the organization—from frontline workers through the boardroom—to raise issues and challenge assumptions is essential. One director said, *"At the board, we need to look at how open the company culture is. Do contrary points of view get surfaced in front of us? The healthiest boards actually have a window into the debate on the management team."* Ms. Kane added, *"You need people in the organization who are tasked with answering the question, 'Tell me what could really go wrong here.' They need to know that it is okay to come into the board and say something that is contrary to what others are thinking. The board has to send a signal to the rest of management that we want to see it with all the hair on it."* One director, recalling a company that *"ran into compliance problems,"* said, *"As a director, I pushed them to find the 'young jerks' who everyone tended not to like but were more inclined to ask the tough questions. Then management had to protect them. You need more people incentivized in the organization to raise the uncomfortable questions, along with a culture that protects doing so, tolerates it, and even rewards it, as opposed to punishes it."*

Integrate risk management with compliance and culture

Anticipating a potential crisis requires a robust, cross-functional approach to risk management. One director described the challenge: *"On the board, we are responsible for signal-seeking. How do we see the risks that aren't being appreciated? How can people get that message to us? We've all sat through many meetings with reports from the chief compliance officer, with slides of numbers of incidents, kinds of incidents, reports. We need to look below them and ask about the context of these things. How can we call out the signals that are important and not just normal course?"*

The challenge is exacerbated by the fact that a compliance failure or ethical scandal is often the result of a complex combination of both internal and external factors. *"It is almost never just one thing that goes wrong. In many cases, multiple things go wrong at the same time,"* Ms.

Kane said. *"One of the obligations of the board in helping companies avert disaster is to be sure in evaluating risk is that you aren't just doing your standard risk assessment."* One member recommended *"stress-testing assumptions and combinations of those factors that are different than a normal scenario. You have to think about all the intersections as well."* Another member suggested that "*It can be a helpful exercise to have management play through various scenarios. It might not be able to recreate the perfect storm, but they can play though a number of elements and them present to the board."*

Create effective structures of board oversight

Lead directors acknowledged that it can be difficult to create time and space on a crowded board agenda to address ethics, compliance, and culture. Mr. Greenberg said, "*There are structural issues, time issues, and priority issues that prevent some of the deeper discussions that need to be had. For example, I think adding ethics and compliance oversight to the audit committee is not a good idea. They are too busy."*

Boards deploy a variety of processes and structures to pursue effective oversight. Often, oversight of culture more broadly is an issue for the full board, and multiple members noted the practice of setting aside a particular meeting of the full board to have what one member called *"a rich, focused conversation on ESG, culture, DE&I, and market risks we haven't given enough time or attention to."*

Develop avenues of insight into the culture

LDN members stressed that directors need to gain a feel for the culture of the organization that goes beyond what they hear in the boardroom. Mr. Greenberg acknowledged that *"board members struggle to penetrate culture in a disciplined way. We can always do more to learn more about the company we say we are and the company we actually are and how to close that gap. That requires getting underneath typical engagement surveys to understand the degree of trust, fear, willingness to speak out, and perception of genuine organizational justice in a company."* One director agreed, noting *"how difficult it is to get deep enough into the organization to assess culture."*

LDN members described various ways for board members to get a better feel for company culture. One said, *"As nonexecutive chair, I visited the company headquarters once a month. Not with the CEO, but with the management team and people on the floor. I met with the chief ethics and compliance officer every time I went down there. Not in my office, but in their office. It is amazing what you can learn when you spend that amount of time talking to people."* Another member emphasized that *"spending time with people below the executive team gives you insights into the company. Interesting things come out of those discussions, which are different from what you might hear from those people's bosses. It is also worth spending time with the GC or CFO without the CEO present. You will hear some things you may not hear in the boardroom."*

Summary of Themes *reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments made before and during meetings are not attributed to individuals or corporations. Guests, however, have given permission for their remarks to be attributed. Comments by guests and network members are shown in italics.*

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Meeting participants

The following Lead Director Network members participated in the meeting:

Alan Bennett , Lead Director, Fluor and TJX

Don Cornwell, Former Lead Director, Avon

Paulett Eberhart, Former Lead Director, Anadarko

Curt Espeland, Lead Director, Lincoln Electric

Jim Fogarty, Former Lead Director, Assertio Therapeutics

Ann Hackett, Lead Director, Capital One

Les Lyles, Non-Executive Chair, KBR

Bob Murley, Non-Executive Chair, Stericycle

Henry Nasella, Lead Director, PVH

Suzanne Nimocks, Lead Director, Owens Corning

Chuck Noski, Non-Executive Chair, Wells Fargo and Lead Director, Booking Holdings

Craig Omtvedt, Former Non-Executive Chair, Oshkosh Corporation

Pam Reeve, Independent Chair, American Tower

Vicki Sato, Lead Director, Bristol-Myers Squibb

Doug Steenland, Lead Director, AIG