BOARD COMPLIANCE

John Armour,[*] Brandon Garrett,[**]
Jeffrey Gordon[***] and Geeyoung Min[****]

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[*] Professor of Law and Finance, University of Oxford.
[**] L. Neil Williams, Jr. Professor of Law, Duke University School of Law.
[***] Richard Paul Richman Professor of Law, Columbia Law School; Visiting Professor, University of Oxford.
[****] Adjunct Assistant Professor of Law and Postdoctoral Fellow in Corporate Law and Governance, Ira M. Millstein Center, Columbia Law School.

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Board Compliance

Abstract

What role do corporate boards play in compliance? This paper seeks to assess public companies' engagement with compliance at the Director and board level. While corporate enforcement and compliance failures could not be more high-profile, and they have placed the board in the position of responding to systemic problems, very little empirical literature exists on the role of boards in compliance. We present empirical evidence describing the use of corporate prosecution agreements to mandate a board-level role in compliance. We then present what is to our knowledge the first empirical account of the pattern of adoption and the role of board compliance committees in U.S. public companies. We explore competing hypotheses concerning the extent of companies' engagement with compliance. The insurance hypothesis suggests companies are motivated to engage with compliance by the prospect of more favorable treatment should they be targeted by prosecuting authorities. The governance hypothesis suggests that corporate engagement with compliance is affected by firm-level governance attributes, including board structure and director compensation. To shed light on these hypotheses, we explore the relationships between corporate engagement with compliance (proxied by the creation of compliance committees) and, on the one hand, firm-specific governance, and on the other, exogenous enforcement intensity. We conclude that despite a standard account that compliance has boomed in response to enforcement, particularly criminal enforcement, even in areas of aggressive enforcement, boards do not typically adopt compliance committees. Given the failure of a deterrent "stick" to promote a formal board role in compliance, we conclude by examining alternative proposals for how boards can be more centrally involved in compliance.

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Introduction

Do corporate boards care about compliance? Surely, they must, because of the potentially catastrophic consequences of ignoring it. Take the example of the recent compliance failures at Wells Fargo, the large US bank, which pioneered a strategy of 'cross-selling' financial products to its customers. This turned out to be profitable, and the bank sought to maximize its roll-out by setting branch staff powerful financial incentives to maximize 'sales' of financial products to its customers. Unfortunately, these incentives triggered widespread fraud on the part of the bank's employees, with customers discovering products charged to their names without their consent.[1] After the Wells Fargo scandal broke, regulators identified numerous weaknesses in the firm's compliance programs that permitted the misconduct to go unchecked. The bank paid about $2 billion of dollars in fines and fired over 5,000 employees; the CEO resigned after Congressional hearings.[2] In response, the Board commissioned an outside investigation into how this compliance failure could have happened on its watch.[3]

Similarly massive failures involving some of the largest corporations have been common in recent years—from Enron and Worldcom to BP, HSBC, General Motors, Volkswagen and Wells Fargo—resulting in billions paid to enforcers in the United States.[4] Amidst the notoriety attracted by these failures, have sanguine corporate boards taken on a more substantial oversight role in compliance?[5] Very little literature exists on the role of boards in compliance. In this Article, we examine this question empirically, using data from corporate prosecutions and public filings. Second, based on our findings, we propose how boards can be more responsible for compliance.

Compliance programs are internal enforcement programs, whereby firms train, monitor and discipline employees with respect to applicable laws and regulation. For the past quarter-century, U.S. authorities have offered explicit incentives for corporations to implement such programs. The federal Sentencing Guidelines contains separate provisions for organizations that provide a discount for an "effective" compliance program.[6] Prosecutors state that they weight the

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[1] *In re Wells Fargo & Co Shareholder Derivative Litigation* (N.D. Cal., 2017); *In the matter of Wells Fargo & Company*, Federal Reserve Docket No 18-007-B-HC (2018).

[2] Michael Corkery, *Wells Fargo Fined $185 Million for Opening Accounts*, N.Y. TIMES, Sept. 8, 2016; Chris Arnold, *Wells Fargo Fires 5,000 Employees Over Fake Accounts*, NPR, Sept. 9, 2016.

[3] Independent Directors of Board of Wells Fargo & Co., Sales Practices Investigation Report (Apr. 10, 2017).

[4] See BRANDON L. GARRETT, TOO BIG TO JAIL: HOW PROSECUTORS COMPROMISE WITH CORPORATIONS 292-93 (2014).

[5] See Jeffrey N. Gordon, *Governance Failures of the Enron Board and the New Information Order of Sarbanes-Oxley*, 35 Conn. L. Rev. 1125 (2003). For other examples of board-solicited investigations into compliance breakdowns, see, e.g. Anton B. Valukas, *Report to Board of Directors of General Motors Company Regarding Ignition Switch Recalls*, May 29, 2014.

[6] US SENTENCING COMMISSION, 2016 GUIDELINES MANUAL, §8C2.5, §8C2.6.

effectiveness of a company's compliance program as well as subsequent remedial compliance measures when deciding whether to charge a firm criminally and the Department of Justice has provided increasingly detailed guidance on compliance.[7] A range of regulatory agencies similarly use both carrots and sticks to leverage compliance.[8] Such approaches prescribe more lenient treatment for firms whose employees commit misconduct, if the firm had in place a meaningful compliance program. Corporate law also recognized these developments, through a contemporaneous innovation—that directors' fiduciary duties entail establishing a system of oversight within the firm.[9]

The Wells Fargo case is a sharp reminder that compliance programs do not always deliver. Many have asked, in the wake of large corporate scandals, why responsible officers such as CEOs and managers did not detect and prevent wrongdoing. Such questions should also be asked about corporate boards. Boards are formally responsible for oversight of corporations.[10] Compliance with regulations and criminal statutes can dramatically affect the performance and success of a company; the stakes are as high as those for product design, marketing, or strategic planning. Yet, little is known about the board's role in supervising and ensuring compliance. Indeed, very little is actually known about the nature, extent, and efficacy of corporate compliance endeavors generally. Compliance may be effective or merely "cosmetic."[11] Firms are not required to report details of their compliance

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[7] US Dep't of Justice, Criminal Division, Fraud Section, Evaluation of Corporate Compliance Programs (Feb. 8, 2017); see also U.S.A.M. 9-28.000.

[8] *See Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions*, Exchange Act Release No. 44,969, 76 SEC Docket 296 (Oct. 23, 2001), at http:// www.sec.gov/litigation/investreport/34-44969.htm (asking, among factors informing SEC discretion, "[d]id the company adopt and ensure enforcement of new and more effective internal controls and procedures designed to prevent a recurrence of the misconduct?"); EPA Incentives For Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations, 65 Fed. Reg. 19,618 (Apr. 11, 2000); FAR Contractor Business Ethics Compliance Program and Disclosure Requirements, 73 Fed. Reg. 67064, 67091–92 (Nov. 12, 2008); Enforcement Advisory, Div. of Enforcement, U.S. Commodity Futures Trading Comm'n, Cooperation Factors in Enforcement Division Sanction Recommendations (Aug. 11, 2004); Office of Foreign Assets Control, Dep't of the Treasury, 31 C.F.R. § 501.601–.606 (2006); IRS, *Governance and Related Topics--501(c)(3) Organizations* (2008), 2015 WL 9182494, at *7, http://www.irs.gov/pub/irs-tege/governance_practices.pdf (""[t]he organization's governing body bears the ultimate responsibility for setting ethical standards and ensuring they permeate the organization and inform its practices.").

[9] *In re Caremark International Inc., Derivative Litigation* (Del. Ch., 1996).

[10] See e.g., DGCL § 141(a) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors…"). See also Lawrence E. Mitchell, A Critical Look at Corporate Governance, 45 Vand. L. Rev. 1263, 1273 (1992) ("It is the law of American corporations that the corporation's business is to be managed by, or at least under the direction of, its board of directors. It is now a platitude that the reality is different, at least in the case of large and medium-size corporations. In reality, management manages and the board rarely acts in even a supervisory capacity.").

[11] Kimberly D. Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 Wash. U. L. Q. 487, 500-11 (2003).

activities and few, if any, make voluntary disclosures regarding compliance.[12] Nevertheless, practitioner surveys consistently report that compliance plays a growing influence in corporate life, including the boardroom.[13] This has led some commentators to conclude corporate governance has undergone a "revolution," with the board's oversight role in internal corporate affairs "overtaken by compliance."[14]

In this paper, we exploit the fact that firms are required to report details of their board structure in their public filings, to compile evidence on the board's role in compliance. Both directors' fiduciary duties and DOJ and other regulator guidance suggests that the board should have a continuing role in overseeing compliance activity. Moreover, there should be a direct reporting channel from compliance officers to independent members of the board, to avoid possible conflicts created by going through the CEO.[15] The guidance from the DOJ and from other enforcers and regulators does not, however, prescribe any particular way in which firms should govern the compliance function. While some boards choose to implement oversight through their Audit Committee—a committee mandated for all public firms by the Sarbanes-Oxley Act—an increasing number choose to establish a separate board-level Compliance Committee (CC). We explore the determinants of CC adoption in US public firms.

For some firms, adoption of a CC may not be a matter of choice. CC adoption may be *mandated* by regulation for firms in a particular industry, or as part of a deal struck with prosecuting authorities. For other firms, the adoption of a CC is a voluntary choice. This could be for at least two reasons. On the *insurance* view, CCs are adopted to benefit from a reduction in penalties should a violation be discovered. At first blush, this would seem to predict that CCs should be associated with firms in heavily-regulated industries, or for which the risk of prosecution is otherwise high. However, matters are likely complicated by the fact that the executives and boards likely have better information about a firm's propensity to misconduct than do its investors. Implementing a compliance program may therefore signal to the market that a firm's management believes it has a compliance problem—and that the probability of enforcement is otherwise high—which could result in a reduction in the firm's stock price.[16] This would attenuate firms' propensity to adopt CCs for insurance reasons—that is, to benefit from a reduction in penalties should a violation be discovered. Taking this into account, the most likely time for establishment of a CC would be after a compliance failure has been publicized (e.g. through prosecution): at this point, the firm has strong incentives to repair its reputation by signaling investment in compliance.

A second *governance* perspective looks to prior characteristics of the company's board as determinants of whether a CC would be adopted. Board oversight of

[12] Sean J. Griffith, *Corporate Governance in an Era of Compliance*, 57 Wm. & Mary L. Rev. 2075, 2100 (2016).
[13] See e.g., PwC, *State of Compliance Study 2016* (2016).
[14] Griffith, *supra*.
[15] Department of Justice, Evaluation of Corporate Compliance Programs, 2 (2017).
[16] See John Armour, Geeyoung Min and Jeffrey Gordon, Short-Changing Compliance, working paper (2018).

compliance could be carried out either by an Audit Committee as part of a wider portfolio, or by a CC. The choice between them may depend on characteristics of the board—how many independent directors, how large is the Audit Committee, what relevant expertise is available, and so forth.

Another important question is whether CC adoption actually makes any difference to the *efficacy* of compliance: does it reduce the probability a firm will be the target of enforcement? Of course, a firm might adopt a CC even if this is only a cosmetic measure, in order to benefit from a more lenient treatment by enforcers. Consequently, the efficacy of CCs is a logically distinct question from the determinants of their adoption.

We explore these hypotheses using director-level data from BoardEx and data on federal organizational prosecutions from the Duke University and University of Virginia Corporate Prosecution Registry. We find that, contrary to statistics reported in practitioner surveys, board level CCs are still quite rare in U.S. public companies, although the proportion of firms adopting such committees is rising over time. There is, consistently with the insurance hypothesis, considerable industry variation, with the highest proportion of adoptions being in finance and pharmaceuticals. However, even in these heavily-regulated sectors, no more than 30% of firms adopt CCs, suggesting that insurance is only part of the story.

It seems plausible that signalling concerns may explain the only partial adoption of CCs in heavily-regulated sectors. Consistently with this, firms that undergo enforcement actions by the DOJ are much more likely to implement CCs in the two years subsequently. This is despite the fact that the DOJ almost never (in only one case in our dataset) required firms to implement a CC as part of the conditions of a deferred prosecution agreement. This suggests that firms are more willing to implement CCs as insurance against future prosecution where the market is already aware of the firm's propensity for misconduct.

Some of our evidence is also consistent with the governance view, that CC adoption is associated with firms that have more independent directors, suggesting that the low rates of adoption of CCs may have limited consequences for actual compliance rates. We also test the efficacy hypothesis by exploring whether adoption of a CC affects the likelihood that a firm will subsequently be prosecuted. We find that there is a negative relationship between having adopted a CC at least two years beforehand and a firm being prosecuted: this suggests that CCs are associated with more effective compliance programs. On the other hand, however, there is a positive relationship between CC adoption in the previous *year* and prosecution. This implies that, when confronted with evidence of internal misconduct, boards hurry to implement structures they imagine may gain them credit with prosecuting authorities.

In this Article, Part I begins by reviewing the rationale for compliance programs and the role of board oversight within them, the role that the board plays in compliance. Section B presents empirical findings concerning prosecutions that require public companies to involve the board in compliance. Section C describes the potentially conflicted relationship between the board and compliance, including due

to compensation, but then fiduciary duties, and it describes the role of audit committees versus compliance committees. Part II begins in Section A by reviewing prior empirical literature and outlining our hypotheses. Section B describes our data and presents results. Part III concludes with a discussion of the implications of these findings for corporate governance, enforcement, and for policy.

I. BOARDS AND CORPORATE COMPLIANCE

A. The Rationales for Compliance Programs

Corporations are structured to give managers incentives to generate returns for their investors. In areas where corporate activities may create negative externalities, regulatory obligations—with civil or criminal penalties—are commonly imposed on firms to ensure that investors' returns are aligned with social welfare. For example, environmental obligations seek to ensure that the costs of industrial pollution are internalized by polluters and not shed onto society at large; workplace and product safety regulations set minimum standards for firms with respect to harms to which their work environment or products may expose workers or consumers; and laws prohibiting bribery and corruption, such as the Foreign Corrupt Practices Act of 1977, seek to prevent firms undermining the functioning of public institutions.[17]

For regulatory internalization to work, however, there must be enforcement.[18] Where the probability of enforcement is low, then it is necessary to introduce a very high penalty so as to set the *expected* cost of non-compliance equal to the social costs of the proscribed conduct. In the context of corporate misconduct, high penalties are not uncommon. For example, BP paid $62 billion in fines and clean-up costs after its Deepwater Horizon oil spill,[19] and Wells Fargo has been subjected to an order by the Federal Reserve freezing its growth until compliance failures are remedied, as well as a $1 billion fine from enforcement action by two other regulatory agencies, the Office of the Comptroller of the Currency and the Consumer Financial Protection Bureau.[20] Moreover, if a firm depends on a regulatory license, then penalties that remove this license can effectively force it out of business.

However, imposing very high corporate penalties has real *ex post* costs: jobs may be lost and firms forced into bankruptcy. Enforcers do not relish the prospect of destroying a company, particularly the collateral consequences of doing so, where

[17] Foreign Corrupt Practices Act of 1977, 15 USC §§78dd-1 et seq.

[18] Where the firm's actions harm those who contract with it—customers, investors, employees, and so forth—then violations of rules will attract market sanctions, in the form of harm to its reputation. The problem of enforcement is therefore most acute as respects harms caused by the firm's actions to persons with whom it does not contract.

[19] *BP Draws Line Under Gulf Spill Costs*, Financial Times, July 14, 2016.

[20] Federal Reserve, *supra* note 1; Matthew Goldstein, *Wells Fargo Pays $1 Billion to Federal Regulators*, NY Times, Apr 20, 2018.

many employees shared no role in wrongdoing and investors suffer financial losses. It is against this background that corporate compliance programs emerged. The basic idea is that because firms have better information about their employees' character and behavior than does a regulator, firms can monitor misbehavior more cheaply than can public authorities, and it is consequently efficient to delegate.

"Compliance" is the name given to institutions established internally by firms to carry out such delegated enforcement. Such institutions can reduce the incidence of misconduct and the need for socially wasteful corporate penalties. However, installing a compliance program may itself have an ambiguous effect on a firm's expected penalties. While it will likely lower the incidence of misconduct, it will also likely increase the rate of detection of any misconduct that does occur.[21] If the effect on expected liabilities is ambiguous, it may be hard for managers to justify expenditure on compliance programs.

1. Regulating Compliance

To combat this problem, firms have since 1991, with the adoption if the Organizational Sentencing Guidelines (and earlier in certain regulatory settings), been offered explicit discounts to any penalties that might be imposed for misconduct, provided the firm had previously implemented an effective compliance program. These incentives are primarily delivered in the form of a discount to sentencing under the Federal Sentencing Guidelines, [22] a factor to be taken into consideration in deciding whether to prosecute a corporation,[23] and guidance for a range of government agencies assessing whether to exclude a convicted firm from procurement exercises.[24]

There are also specific requirements associated with 'compliance' and 'internal controls' for a range of sector and activity-specific regulatory obligations. These include anti-money laundering, insider trading and structural separation checks for financial institutions,[25] checks regarding the making of corrupt payments for all firms,[26] internal controls over the production of financial information for publicly-

[21] Jennifer Arlen, *The Potentially Perverse Effects of Corporate Criminal Liability*, 23 J. Leg. Stud. 833 (1994).

[22] U.S. Sentencing Commission, 2016 Guidelines Manual, §8B2.1.

[23] Department of Justice (Offices of the United States Attorneys), US Attorneys' Manual, §9.28.800; Department of Justice, Evaluation of Corporate Compliance Programs (2017).

[24] General Services Administration (GSA), *Federal Acquisition Regulation*, §9.406-1(a) (debarment); §9.407-1(a)(2) (suspension). The burden of demonstrating responsibility is on the contractor.

[25] Investment Advisers Act of 1940, Rule 206(4)-7 (safeguards against insider trading by personnel); Bank Secrecy Act of 1970, 31 USC §5318(h) (Anti-Money Laundering Programs) and 12 CFR 21.21 (Procedures for Monitoring Compliance); Volcker Rule, Subpart D 12 CFR §44.20 (here); enhanced requirements for large banks: 12 CFR §44.20(c); Appendix B to Part 44, Enhanced Minimum Standards for Compliance Programs (here) Dodd-Frank.

[26] Foreign Corrupt Practices Act of 1977, 15 USC §§78dd-1 et seq.

traded firms,[27] and a set of model compliance program guidelines for clinical laboratories.[28] Thus, sometimes compliance is required by statutes and regulations.

2. Effective Compliance Programs

An effective compliance program, in theory, would be one that minimizes the sum of the costs of misconduct and of the costs of avoiding and detecting such misconduct.[29] In practice, there is little consensus as to how this should be achieved, although companies can and are encouraged to use a variety of techniques to evaluate the effectiveness of compliance efforts, ranging from internal audits, data analytics, to employee surveys, to external assessments. In some industry surveys, large numbers of companies, in a Lake Wobegon fashion, view their compliance as "well above average relative to their peers."[30] When industry participants speak of 'effective compliance programs', they may refer rather to programs that meet regulators' stipulations. What this means is that programs meeting these requirements are *deemed* by regulators to be 'effective'; it does not necessarily follow that they are *actually* effective in the sense of minimizing joint costs.[31] Indeed, despite much exhortation, especially from professional consultants who offer to assist in designing compliance programs, relatively little is known about the structure and efficacy of corporate compliance.[32]

In light of these difficulties, and the fact that firms' compliance activity is primarily incentivized by the prospect of (waiving) regulatory sanctions, we focus here on the structure of 'effective' compliance programs as envisaged by regulatory stipulations. It is possible to synthesise from the various regulatory initiatives a series of components generally regarded as components of an 'effective' compliance program. At the core of this, firms are expected to ensure that there is an executive function within the firm designated as 'compliance', to whom responsibility has been

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[27] Sarbanes-Oxley Act of 2002 §404; SEC Rules (here).

[28] See OIG Model Compliance Plan for Clinical Laboratories, 62 Fed. Reg. 9435 (1997).

[29] Geoffrey P. Miller, *An Economic Analysis of Effective Compliance Programs*, in Arlen (ed) Research Handbook on Corporate Crime and Financial Misdealing, 247 (2018).

[30] See, e.g. PRICEWATERHOUSECOOPERS, State of Compliance 2018 SURVEY, at https://www.pwc.com/us/en/services/risk-assurance/library/state-of-compliance-study.html (reporting that 85% of respondent corporations rated their compliance as well above average relative to their peers).

[31] For critiques of the current approach, see e.g. Miriam Hechler Baer, *Governing Corporate Compliance*, 50 BC L Rev 949 (2009); Todd Haugh, *The Criminalization of Compliance*, 92 Notre Dame L Rev 1216 (2017). *Cf* Dan Richman, *Corporate Headhunting*, 8 Harv L & Pol Rev 265, 277-78 (2014) (practice of deferred prosecution agreements is only ten years old and so may be too soon to evaluate long-run impact).

[32] See e.g., Donald J. Langevoort, *Cultures of Compliance*, 54 Am Crim L Rev 933, 933 (2017); Tom R. Tyler, *Reducing Corporate Criminality: The Role of Values,* 51 Am. Crim. L. Rev. 267, 291 (2014) (calling for "an attempt to develop empirically based policies and practices through a neutral and independent review of what works.").

assigned for implementing the compliance program. The head of this function is often designated as a Chief Compliance Officer.

Traditionally, these functions were supervised by General Counsel, but today, some companies designate at least some types of ethical and legal compliance as separate from the General Counsel.[33] There is not a scholarly consensus, and nor is there any in industry, whether separating the compliance function or functions from those centered in the General Counsel's office is preferable.[34]

Obviously, in whichever department or reporting line it is located, the compliance function should be adequately resourced—in this respect, the size of the firm and the nature of the risks assessed in relation to compliance will be determinative.[35] The 'resourcing' of compliance should be understood to include not only the direct costs of employing compliance staff and training employees regarding compliance, but also the indirect costs of integrating the program into the firm's business structure. Done properly, this entails careful assessment of the incentives created by aspects of the firm's business model, especially performance targets set for employees. Managers seeking to improve performance are often drawn to implementing performance targets for employees that focus on metrics like sales, costs, or task completion, because these metrics are readily measurable and have an obvious link to the firm's performance. However, the pursuit of such metrics to the exclusion of other considerations has potential to trigger failures in other harder-to-measure and/or less immediately financially relevant aspects of performance, such as safety measures or compliance with law. While most employees have natural instincts to be concerned with these other issues, their internal ethical or safety concerns can be crowded out by sufficiently strong financial incentives.[36] Taking full account of the compliance implications of these variables may necessitate significant modifications, dulling the performance impact of the incentive schemes. As a consequence, effective compliance can involve substantial indirect costs, at least in the short run.

B. Evidence from Corporate Prosecution Agreements

As described, one source for information about what effective compliance means, can come from authoritative statements, such as in the Organizational Sentencing Guidelines. The Guidelines were amended in 2010 to highlight the responsibility of the Board. Section 8B2.1 now requires the board to "be

[33] Michele DeStefano, *Making a Culture of Compliance: Why Departmentalization May Not be the Answer*, 10 Hastings Bus. L. J. 71, 101, 155(2014) ("Departmentalizing compliance from legal so as to remove general counsel oversight of compliance may not necessarily be in the public's best interest.")

[34] Tanina Rostain, *General Counsel in the Age of Compliance: Preliminary Findings and New Research Questions*, 21 Geo. J. Legal Ethics 465, 469 (2008).

[35] The experience and qualifications of the CCO may expect to be scrutinized. An ex post review may scrutinize whether the compliance department ever asked for additional resources and the responses received from management.

[36] See e.g. Sverre Grepperud and Pal Andreas Pedersen, *Crowding Effects and Work Ethics*, 20 Labour 125 (2006). Also: Frey, Fehr & Gachter, Science article.

knowledgeable about the content and operation of the compliance and ethics program and ... exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program." Second, the Guidelines state that the board should have a direct reporting relationship and obligation from the Compliance Officer directly to the board or a board committee.

The Guidelines state that effective compliance must be "reasonably designed, implemented, and enforced so that the program [was] generally effective in preventing and detecting criminal conduct."[37] Moreover, the Guidelines state that "the organization's governing authority shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program."[38] When the Guidelines refer to a "governing authority," they refer to the Board, if the company has one.[39]

The U.S. Sentencing Commission amended the Guidelines to make clear that even if a high-level employee was involved in or willfully ignorant of the crime, effective compliance can still be credited.[40] Corporations may receive mitigation if persons with operational responsibility for the compliance and ethics program "have direct reporting obligations to the governing authority or an appropriate subgroup thereof (*e.g.*, an audit committee of the board of directors)" and that program detected and reported the misconduct.[41] The compliance personnel "shall be given adequate resources, appropriate authority, and direct access to the governing authority or an appropriate subgroup of the governing authority."[42] Thus, the Guidelines reward board involvement in compliance.

However, in practice, those Guidelines seem rarely to be used. For example, in the fiscal years 2009 through 2012, the U.S. Sentencing Commission reported no companies received credit for having such a compliance program.[43] Rather, it seems likely that prosecutors offer leniency to firms to reward compliance through the use of deferred and non-prosecution agreements ('DPAs'). As a consequence, these firms never get to be sentenced under the Guidelines.

How, then, do Prosecutors take compliance programs into account? Public statements about compliance from the DOJ had in the past been quite vague. Take this statement:

> The Department has no formulaic requirements regarding corporate compliance programs. The fundamental questions any prosecutor should ask

[37] Id. at § 8B2.1(a)(2).
[38] Id. at § 8B2.1(b)(2).
[39] Definitions, U.S.S.G. 8B2.1 ('Governing authority' means the (A) the Board of Directors; or (B) if the organization does not have a Board of Directors, the highest-level governing body of the organization.")
[40] U.S.S.G. §8C2.5(3).
[41] U.S.S.G. § 8C2.5(f)(C).
[42] Id. at § 8B2.1(a)(3).
[43] U.S. Sentencing Commission, "2009-2012 Sourcebook," Tbl. 54 (2012). Five companies received credit for effective compliance from 1992 through 2012.

are: Is the corporation's compliance program well designed? Is the program being applied earnestly and in good faith? Does the corporation's compliance program work?[44]

The DOJ guidelines then state that prosecutors should try to assess whether the program is just a "paper program," and should consider "whether the corporation has provided for a staff sufficient to audit, document, analyze, and utilize the results of the corporation's compliance efforts." [45]

What prosecutors say may not be as informative as what they do. Information about what effective compliance means and what it means for the Board may potentially be found in the terms of individual DPAs negotiated with firms, which are typically made public. Over time, the contours of compliance initiatives disclosed in DPAs can become an additional source—beyond sentencing guidelines, statutes, and regulations—of incentives to involve the Board in compliance, revealing at a granular level the what prosecutors consider important. Federal prosecutors have over the past fifteen years taken the lead in seeking compliance changes to the governance of target firms; the DOJ adopted some of the first compliance-focused enforcement guidelines, prosecutors pushed for adoption of corporate monitors to oversee compliance, and prosecutors have often stated that a central goal of a corporate prosecution is not just to punish corporate crime but also to rehabilitate corporations.

That said, the compliance terms of many deferred and non-prosecution agreements with corporations have in the past been criticized as lacking. A study of federal deferred and non-prosecution agreements from 2001 through 2012, found that few require that the company evaluate the effectiveness of its compliance program to find out if it is really working or not (21% or 54 of 254 agreements).[46] Judge Rakoff has criticized the DOJ as "imposing internal compliance measures that are often little more than window-dressing."[47] Professor Miriam Baer has criticized the use of compliance in settlements, particularly where prosecutors traditionally did not audit compliance.[48]

More recently, the DOJ hired a Compliance Counsel Expert, who issued guidance to add more rigor to the scrutiny of corporate compliance. In February 2017, the DOJ's Criminal Fraud Section produced this new guidance, titled "Evaluation of Corporate Compliance Programs."[49] The guidance contained a list of "common questions" and "sample topics" but not any definitive guide, emphasizing that prosecutors must make an "individualized determination" in each case. [50] That document, however, in the section on "oversight," emphasizes the role of the board. It asks: "What compliance expertise has been available on the board of directors?" It

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[44] Id.
[45] Id.
[46] Garrett, Too Big to Jail, *supra* note xxx, at Ch.3.
[47] Jed S. Rakoff, "The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?", *New York Review of Books,* January 9, 2014.
[48] Miriam Hechler Baer, *Governing Corporate Compliance*, 50 B.C. L. REV. 949, 976 (2009).
[49] Evaluation of Corporate Compliance Programs, supra note xxx.
[50] Id. at 1.

then asks, "Have the board of directors and/or external auditors held executive or private sessions with the compliance and control functions? What types of information have the board of directors and senior management examined in their exercise of oversight in the area in which the misconduct occur."[51] The DOJ's Evaluation document then goes on to ask, in the section headed "autonomy": "Have the compliance and relevant control functions had direct reporting lines to anyone on the board of directors? How often do they meet with the board of directors? Are members of the senior management present for these meetings?"[52]

An important question, then, given the mixed formal and practical status of compliance in corporate prosecutions is whether in corporate prosecution agreements themselves, is the board given some role or responsibility over the compliance provisions of the agreement? Whether prosecutors entrust compliance to the board, specifically, can shed some light on prosecution priorities regarding the board's role. To explore this question, we examined the terms of all prosecution agreements entered with public companies since 2001, in the Duke & University of Virginia Corporate Prosecution Registry.[53] This information does not include compliance that may also be ordered as part of court-supervised probation, since the terms of special probation are not always available on public dockets. [54] There are 381 firms in the Registry, prosecuted from 2001-2018. Thirteen received declinations, one was acquitted at trial, four received pre-trial dismissals, and three received trial convictions; those cases are not examined here.

In this analysis, we focus on the 374 of the public firms prosecuted in that registry, including 192 that received deferred and non-prosecution agreements and the 168 that received plea agreements.[55] We coded all agreements that referred to the board by imposing any new affirmative obligation on the board (as opposed to not referring to the board at all, or acknowledging prior acts of the board with respect to compliance). Of the 374 cases, the text of 45 public companies' agreements are missing; they are not available on dockets or were not made available by the DOJ. Of the 329 remaining cases, 115 included terms that imposed some obligation on the board.

Of those cases, only four agreements required the creation of board compliance committees. The Computer Associates Agreement from 2004 required the company to establish a compliance committee (or a combined audit and compliance committee), as well as add two independent directors to its board, and create a new audit

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[51] Id. at 2.

[52] Id. at 3.

[53] See Ashley & Garrett, supra note xxx. A prior study has examined board related terms in just deferred and non-prosecution agreements. Wulf A. Kaal & Timothy Lacine, *The Effect of Deferred and Non-Prosecution Agreements on Corporate Governance: Evidence from 1993-2013*, 70 BUS. LAW. 61, 85 fig.1 (2014) (finding that 31 percent of agreements had requirements affecting boards, but only 8 percent mandated new board committees). Our analysis includes plea agreements and declinations with corporations as well.

[54] U.S.S.G. § 8D1.4, Application Note 1.

[55] We do not examine the cases of 13 more public companies that received declinations, 4 dismissals, three were convicted at trial, and 1 was acquitted at trial.

department that reports to the new board committee. The 2008 Unum group agreement required the establishment of a new compliance committee of the Board. The 2012 Moneygram International agreement required the bank to create "an Independent Compliance and Ethics Committee of the Board of Directors with direct oversight of the Chief Compliance Officer and the Compliance Program," and asking the committee with responsibility "for ensuring that the Company is in compliance with all aspects of the Agreement."[56] The 2014 Stryker Corp. agreement required the creation of a new compliance committee and that the Board, or a designated committee, "shall conduct a review of the effectiveness of Stryker's Compliance Program as it relates to the marketing, promotion, and sale of medical devices."[57]

Ninety-six of these prosecution agreements created new positions requiring reporting to the board. For example, 71 settlements, chiefly in FCPA cases, contained the following language, requiring that the company: "Assign responsibility to one or more senior corporate executives for the implementation and oversight of the company's anti-corruption compliance policies. These officials shall have authority to report directly to independent monitoring bodies, the company's board of directors, and shall have an adequate level of autonomy from management." How involved the boards become in anti-corruption compliance as a result of such terms is hard to say. Other cases, however, specified that it is a new Chief Compliance Officer who reports to the board or to a board committee. In some of those cases, still more is required, such as that the compliance officer must make at least quarterly reports to the board. Some agreements required creation of a compliance officer for a specific compliance risk, such as the Online Pharmacy Compliance Officer created in the United Parcel Services agreement. [58] Other cases, specifically suggest a more occasional role; the Monsanto agreement, for example, asks that the board hire an outside auditor to assess its FCPA compliance not less than once every five years. [59]

Still fewer prosecution agreements specify a role for the CEO. The Royal Bank of Scotland, PLC agreement, for example, states that any material compliance failures be reported to both the CEO and the board. Similarly, the Reliant Energy Services case tasks the new compliance officer with a "direct report" to both the CEO and board.

In some cases, the board was tasked with taking on a particularly active role. For example, in the UBS case, the bank agreed to exit the U.S. cross-border business entirely and limit its activities to individual private clients in the U.S. The board was required to oversee this Exit Program through its Risk Committee. In the Par Pharmaceuticals case, a new Recoupment Committee has authority to claw back

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[56] Moneygram Int'l Deferred Prosecution Agreement (M.D.P.A. 2012), at http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/agreements/MoneyGram.pdf.
[57] United Parcel Service Deferred Prosecution Agreement (N.D.C.A. 2013), at http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/agreements/UPS.pdf.
[58] Moneygram Int'l Deferred Prosecution Agreement (M.D.P.A. 2012), at http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/agreements/MoneyGram.pdf.
[59] Monsanto Deferred Prosecution Agreement (D.D.C. 2015), at http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/agreements/monsanto.pdf.

executive compensation, and the board may in its discretion provide that it consists only of independent members of the board.

In additional cases, an independent monitor is appointed and the reports of that monitor would be normally reviewed by the board (even if the publicly released agreement does not say so specifically). Some agreements do discuss the board-monitor relationship. For example, the Exactech case requires that the Chairman of the board, CEO, President, CFO, Executive Vice President for R&D, Corporate Counsel, and Chief Compliance Officer all will meet quarterly with the Monitor.[60] Such a role would end when the agreement ends.[61] Additional cases may also involve parallel agreements with regulators who themselves imposed obligations on the board. Thus, these data may understate not just the board involvement in compliance, but also the formal requirements that such involvement be enhanced.

Is this a high or low degree of mandated-board involvement? One might ask why the other two-hundred-plus cases did not directly mandate board involvement. Even among the cases that did mandate board involvement, most do so at the level of a reporting-line and not creation of a compliance committee or more direct board responsibility. Now, there are good explanations for why that might be the case. It could be that the board already had a compliance committee and had already undertaken measures; some agreements acknowledge as much. Nevertheless, there would be little harm and potential gain and formalizing the board's role going forward as responsible for assuring compliance. The results of this granular analysis of prosecution agreements suggest that even in the cases involving prosecutions of public companies for crimes, the role of the board is important, perhaps, but it is not consistently emphasized.

C. The Relationship Between Boards and Compliance

1. Compliance and Directors' Fiduciary Duties

Some engagement with oversight of compliance is expected of directors through their fiduciary duties. Where it comes to directors' attention that there is, or may be, misconduct taking place, then this will trigger a fiduciary duty to investigate and take appropriate consequent steps.[62] The degree of investigation and subsequent action demanded will be a function of the extent of the evidence of the misconduct

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[60] Exactech Deferred Prosecution Agreement (D.N.J. 2010), at http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/agreements/exactech.pdf.

[61] Some agreements similarly state that the board must review compliance pursuant to the agreement during the term of the agreement, without imposing a further ongoing obligation. The AmerisourceBergen Specialty Group agreement is an example. Plea Agreement, U.S. v. AmerisourceBergen Specialty Group, 1:17-cr-00507 (E.D.N.Y. 2017), at http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/agreements/amerisourcebergen.pdf.

[62] *Graham v Allis-Chalmers*; *In re Massey Energy Company Derivative and Class Action Litigation,* 2011 WL 2176479 (Del. Ch., 2011); *Melbourne Municipal Firefighters' Pension Trust Fund v. Jacobs,* 2016 WL 4076369 (Del. Ch., 2016); *In re Wells Fargo & Co Shareholder Derivative Litigation* (N.D. Cal., 2017); *Oklahoma Firefighters Pension & Retirement System v. Corbat* (Del. Ch., 2017).

available to the directors, and the seriousness of the consequences of potential misconduct. Note, though, that the extent of this *ex post* duty depends crucially on the quality of the information coming to the board. To what extent do the board have a positive duty to ensure an upward flow of information regarding compliance?

Since the well-known 1996 Delaware Chancery Court opinion in *In re Caremark International Inc., Derivative Litigation*,[63] directors have also been expected to ensure some system of oversight is implemented in the first place. As Chancellor Allen explained:[64]

> [I]t would, in my opinion, be a mistake to conclude that … corporate boards may satisfy their obligation to be reasonably informed concerning the corporation, without assuring themselves that information and reporting systems exist in the organization that are reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with law and its business performance.

However, the duty is merely one of good faith, failure to meet which would require "a sustained or systematic failure of the board to exercise oversight -- such as an utter failure to attempt to assure a reasonable information and reporting system exists."[65] Or, as it was subsequently put by the Delaware Supreme Court in *Stone v. Ritter*:[66]

> (a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.

Thus, the Delaware caselaw is as unspecific and general as much of the guidance that comes through both DOJ guidelines and enforcement. Compliance matters and complete failures of the board to oversee compliance will have grave consequences. But what consists in effective or sound compliance is left unstated.

2. Audit and Compliance Committees

Neither the DOJ Guidance nor corporate law specify the process through which the board should exercise compliance oversight; as described, even when companies are prosecuted, this process is typically unstated. Because public companies are

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[63] Del. Ch. 1996.

[64] *Caremark* at 970.

[65] *Caremark* at 971.

[66] *Stone v. Ritter* at 370.

required to establish an Audit Committee, which has responsibility for internal financial controls,[67] many firms simply append compliance to the Audit Committee's terms of reference. Both audit and compliance oversight functions involve review of executives' implementation of a system of controls—financial controls or a compliance program, respectively—and a role as arbiter of first instance of any conflicts that arise in relation to executives' conduct and the system of controls or compliance.[68]

On the other hand, some firms have established distinct Compliance Committees, composed of independent directors. When staffed with different personnel from the Audit Committee, this opens up greater bandwidth for engagement, permits the selection of individuals with different expertise, and facilitates any appropriate difference in ethos with respect to decision-making. Of course, such division results in loss of potential complementarities from joint oversight of financial and non-financial compliance, making it desirable for there to be at least some overlap in membership. Another approach, which preserves complementarities, is to retitle the Audit Committee as the 'Audit and Compliance Committee', reflecting a difference in emphasis as respects expertise and role.

The text of corporate charters that create compliance committees provide some additional insight into their structure and role. For example, at LABCORP, the relevant charter states that the new Quality and Compliance Committee was created "to assist the Board in carrying out its oversight responsibility with respect to quality and compliance issues and attendant risks."[69] The committee consists in "no fewer than three members of the Board," with members appointed by the Board. The committee was to meet no less than three times in each year. Further, the committee was tasked with annually reviewing programs and practices concerning quality and compliance, and then making recommendations in response. The Compliance Committee Charter for Las Vegas Sands Corp., specified that the three directors on the committee shall all be independent directors. That committee meets at least four times a year, but with similar oversight responsibilities (although a specified focus on gaming law compliance and ant-corruption and money laundering law).[70] These charters call for annual review of their own performance and regular meetings with Chief Compliance Officers. Having reviewed a group of these committee charters, we observe that they contain much of the same language, suggesting that public companies adopt quite similar frameworks and text to create such committees.

3. Conflict Between Boards and the Compliance Function

Apart from the priorities placed on compliance by enforcers, boards themelves have conflicting incentives regarding the compliance function. In particular,

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[67] Sarbanes-Oxley Act of 2002 §301.

[68] See generally Lawrence A. Cunningham, *The Appeal and Limits of Internal Controls to Fight Fraud, Terrorism, Other Ills*, 29 J Corp L ___ (2004).

[69] Labcorp, Quality and Compliance Committee Charter, at 1 (on file with authors).

[70] Las Vegas Sands Corp., Compliance Committee Charter at I-II (on file with authors).

conflicts may emerge between immediate financial considerations prioritised by managers and the objectives of effective compliance. Executive compensation is typically tightly linked to a firm's stock price, so as to encourage focus on shareholder value.[71] This can create conflict over the establishment of a compliance program, and over how such a program is run.[72] Assuming that the penalties for regulatory violations are set so as to give shareholders appropriate incentives to internalize social costs, such conflict is a corporate governance problem. That is, managers may fail to take actions to minimize expected penalties that would be in the interests of shareholders.

To see how such costs could emerge, note that although establishing a compliance program can reduce a firm's expected penalties, doing so sends a compound signal to investors. It signals both (1) that the firm is taking compliance seriously (a good thing for investors) and (2) that the firm considers it is *appropriate* to take compliance seriously. This second component may have a negative impact on the stock price. *Ceteris paribus*, whether the firm thinks it is appropriate to invest in compliance is a function of the likelihood of enforcement. Consequently, a firm that discloses a compliance program signals that it anticipates it has a relatively high chance of attracting enforcement.[73] Although the fact that the firm is taking compliance seriously is good news for investors, this can only ever reduce, but not eliminate, expected penalties:[74] the net effect of the signal is therefore likely to be negative. Consequently, managers seeking to maximize the stock price likely prefer not to disclose details of a firm's compliance activities.[75] Consistently with this proposition, firms do not voluntarily disclose any meaningful information about their compliance activity.[76]

Conflicts are also likely to emerge in the running of a compliance program. If misconduct is detected, a manager believing the probability of enforcement otherwise to be low may seek to cover up the misconduct, so as to avoid an adverse impact on the stock price. Chief Compliance Officers may find themselves side-lined or even fired by CEOs anxious to avoid this sort of revelation. The fear of such treatment will undermine the efficacy of a compliance program, and consequently the DOJ's guidance now provides that the compliance team should enjoy autonomy from management, facilitated by a direct reporting channel to independent directors.

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[71] See e.g. Steven N. Kaplan, *CEO Pay and Corporate Governance in the US: Perceptions, Facts, and Challenges*, 25 J. App. Corp. Fin. 8 (2013).

[72] Jennifer Arlen and Marcel Kahan, *Corporate Governance Regulation through Nonprosecution*, 84 U. Chi. L. Rev. 323, 354-57 (2017); John Armour, Jeffrey Gordon and Geeyoung Min, *Taking Compliance Oversight Seriously*, working paper, Columbia Law School / Oxford University (2018).

[73] *Ibid.*

[74] The presence of an effective compliance program can reduce a firm's penalty by between 60 to 80 per cent: see US Sentencing Commission, *supra* note 22, §§8C2.5(f), 8C2.6.

[75] *Ibid.*

[76] Griffith, *supra* note 14, _ 2138-39. Our own searches of EDGAR filings turned up no meaningful information about corporate compliance activity.

The board is increasingly viewed as a forum for resolving such conflicts.[77] The DOJ's memorandum and other guidance regarding effective compliance provide that responsibility for internal oversight and monitoring of compliance programs should lie with the board of directors, usually through a committee of independent directors—either the Audit Committee or, where established, a separate Compliance Committee.[78] Boards are expected to understand the goals and operation of their firm's compliance function, which knowledge should be supported by regular reporting and a clear flow of information. Moreover, it is increasingly thought that a direct channel of reporting from compliance to the board is a means of fostering not only autonomy within the compliance program but also open upward transmission of information. The Department of Justice guidance cites to such communication as relevant both to oversight and autonomy.

The board's role in managing conflict between the firm's compliance function and other senior executives lies outside traditional accounts of corporate governance.[79] Most such accounts see the board's role as being to monitor the executives' management of the company in the interests of shareholders, with a view to reducing agency costs.[80] To this end, much emphasis is placed on the need for directors to be independent of executives, to buttress against conflicts of interest. In overseeing compliance, the board are monitoring the executives' resourcing and implementation of the firm's compliance program, and the way in which conflicts between the needs of the compliance function and the pursuit of the business' strategic goals are managed. Because of the financial implications of compliance, the resolution of such conflicts in accordance with regulatory guidance regarding best practice is ultimately in the interests of shareholders.

II. Empirical Analysis of Board Compliance

A. Prior Literature and Hypotheses

1. Prior Empirical Literature

[77] See e.g., Martin Lipton, *Risk Management and the Board of Directors*, Harvard Law School Forum on

Corporate Governance and Financial Regulation, Nov 19, 2017.

[78] DOJ, *supra* note 15, 2 ("Oversight – What compliance expertise has been available on the board of directors? Have the board of directors and/or external auditors held executive or private sessions with the compliance and control functions? What types of information have the board of directors and senior management examined in their exercise of oversight in the area in which the misconduct occurred?"). See also Ethics & Compliance Initiative, Principles and Practices of High-Quality Ethics & Compliance Programs: Report of ECI's Blue Ribbon Panel, 19 (2016) ("The E[thics] & C[ompliance] structure ensures independence and regular access to the board and/or the audit committee.")

[79] Griffith, *supra* note 14.

[80] See e.g. Frank H Easterbrook & Daniel R Fischel, The Economic Structure of Corporate Law (1991); Reinier Kraakman et al, The Anatomy of Corporate Law, 3rd ed (2017).

There is a dearth of academic empirical literature on corporate compliance activities, including the frequency with which firms adopt Compliance Committees (CCs). This seems likely to be due to firms' unwillingness to disclose the details of their compliance activities. What little information is available comes in the form of practitioner surveys, typically conducted by large accounting firms. For example, PwC's annual *State of Compliance* report, a widely-cited source,[81] reported in 2016 that "20% of companies have a board-level compliance committee".[82] These figures are, however, questionable when attention is paid to the survey methodology. PwC states that the survey was conducted on "more than 800 executives globally", most of whom are compliance professionals.[83]

2. Hypotheses: Which Firms Adopt Compliance Committees?

Our starting point is that firms reduce their expected penalties from enforcement if they have in place an effective compliance program. If establishment of a CC is a way of achieving more focused compliance oversight than merging the function with the Audit Committee, or is perceived as such by enforcement authorities, then CCs should be adopted by firms that perceive the benefits of effective compliance programs to be the highest. *Ceteris paribus,* these would be firms that perceive their risk of attracting an enforcement action to be high.

> *Hypothesis 1 (Insurance): CCs are more likely to be adopted by firms that perceive their risk of enforcement to be high.*

If there are fixed costs to establishing a CC, then there should also be a size effect, with larger firms being more likely to do so. A countervailing consideration is that revelation of investment in compliance may signal to the market that the firm perceives it has a high risk of attracting enforcement. This is because the firm is likely to have better information about the character and conduct of its personnel than do its investors. Establishing a CC is likely observable by investors, and so firms whose boards are focused on contemporaneous share price performance will prefer not to send this signal.

> *Hypothesis 2 (Signaling): CCs are unlikely to be adopted by firms that perceive their risk of enforcement to be high unless investors share that perception.*

The enforcement and signaling effects cut in opposite directions in many cases. However, in some sectors, the establishment of a compliance program is mandated

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[81] Griffith; Robert C. Bird and Stephen Kim Park, *Turning Corporate Compliance into Competitive Advantage,* 19 U. Pa. J. Bus. L. 285 (2017).

[82] PwC, State of Compliance Study 2016: Laying a Strategic Foundation for Strong Compliance and Risk Management, 15 (2016).

[83] PwC, *supra* note 82, foreword.

by substantive regulation. In such sectors, there is no signaling effect, because all firms are expected to establish compliance programs. Consequently, to the extent that CCs are a useful component of a compliance program, we would expect to see them adopted in such industries.

> *Hypothesis 3 (Regulation)*: *CCs are more likely to be adopted by firms in industries for which establishment of a compliance program is mandated by regulation.*

There would also be no signal in cases where a firm is already known by investors to face a high risk of enforcement—for example, if enforcement has already occurred. In such cases, investment in enhancing a compliance program may signal to investors that the expected enforcement costs will now be reduced.[84]

> *Hypothesis 4 (Revelation): CCs are more likely to be adopted by firms that have been on the receiving end of enforcement actions.*

Our discussion to this point has been premised on the assumption that CCs are generally associated with increased efficacy for compliance programs. This may not always be the case. We know from DOJ guidance that while board oversight is necessary, there is no prescription as to the form this should take—whether via the audit committee, a compliance committee, or the board *en banc*. Firms may therefore choose to handle compliance oversight as part of the Audit Committee's mandate, or to estalbish a stand-alone CC. The choice may plausibly be driven by firm-specific governance characteristics such as the size of the audit committee, the number of independent directors on the board, and their respective attributes.

> *Hypothesis 5 (Governance attributes): CCs are more likely to be adopted by firms that have larger (smaller) numbers of independent directors (Audit Committees).*

Finally, we consider questions of the efficacy of CC adoption. If CCs are associated with better-functioning compliance programs, we should expect to see a negative association between adopion of a CC and the likelihood of a subsequent enforcement actions against the firm and the size of penalties conditional on enforcement.

> *Hypothesis 6 (Efficacy): Adoption of a CC is likely to be associated with a reduced probability of subsequent DOJ enforcement against the firm.*

B. Results: When Boards Create Compliance Committees

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[84] This may overlap with Hypothesis 3 where the enforcement action mandates the firm to implement a CC. However, as we saw in Section [], this is very rare in practice.

If a company establishes a board committee that specifically focuses on compliance, the committee's charter is generally disclosed on the company's website and sometimes also in its proxy material.[85] The committee charter typically describes in general terms the compliance program of the company and determines the qualification for and role of the directors who sit on the committee. These data are amongst the items compiled by BoardEx, a large database detailing board membership and structure, including committees.[86] We use BoardEx to determine whether companies have established a CC, and if so, when. BoardEx has data from 1999, but the inclusion of public companies is incomplete prior to 2005 mainly because companies were not under pressure to disclose committee information, so we begin our sample period then. We also cross-refer EDGAR filings (proxy statements and annual filings) to confirm/supplement information about CCs from BoardEx. From this we compile a panel of 6513 unique firms for the period 2005-2016, giving a total of 47,205 firm-years.

We retrieve details on federal corporate prosecutions from the Corporate Prosecution Registry that one of us established at Duke University and the University of Virginia.[87] From here we obtain details on all federal organizational prosecutions from 2001 onwards, including plea agreements, trial convictions, and all deferred and non-prosecution agreements ("D/NPAs") entered into by the DOJ with organizations from 1990 onwards. We obtain details of firm financial attributes from CRSP-Compustat. Table 1 sets out details of our variable names and data sources.

[Table 1 about here]

Figure 1 shows the number (vertical axis) and proportion (bold numbers) of US public companies having adopted a Compliance Comittee during the period 2003-2016. We take a 'compliance committee' for these purposes to include (i) a 'stand-alone' Compliance Committee, (ii) a 'Risk and Compliance Committee' or (iii) restyling their Audit Committee as 'Audit and Compliance' during the period 2003-2016. While the trend is strongly upward, the overall level remains low, with only 5 per cent of public companies having adopted such a committee by 2016.

Our findings are is in marked contrast to the results reported in the PwC survey, which estimated that 20 per cent of companies had established a CC by 2016.[88] It appears likely that the survey has been carried out with PwC's clients,

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[85] The New York Stock Exchange Listed Company Manual only requires the disclosure of three committee charters (audit, compensation, and nomination/governance committees) on a company's website: see Website Posting Requirement and Disclosure Requirements of NYSE Listed Company Manual Section 303A.07(b); see also SEC Regulation S-K Item 407(d)(1). In practice, however, companies disclose a committee charter of every committee in addition to the three required ones, presumably to avoid any potentially misleading omissions regarding the interpretation of the charters of the committees for which disclosure is mandated.

[86] BoardEx, at http://corp.boardex.com/data/.

[87] Jon Ashley and Brandon L. Garrett, Duke and UVA Corporate Prosecution Registry, at http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/index.html.

[88] *Supra*, notes 82-83 and text thereto.

raising an obvious issue of selection bias: firms that have compliance officers are likely to report that they engage in other compliance activities.

[Figure 1 about here]

Figure 2 shows the breakdown of Compliance Committee adoption by these three types (namely: stand-alone Compliance Committee, Risk and Compliance Committee without a stand-alone Compliance Committee and restyling the Audit Committee as 'Audit and Compliance' without a stand-alone Compliance Committee) over the period 1996-2016. As can be seen, the adoption of a stand-alone Compliance Committee is by far the most frequent way in which a compliance function is recognized at board level. From the early 2000s onward, the number of Audit and Compliance committees has remained constant, whereas the number of Compliance Committees has continued to grow.

[Figure 2 about here]

Table 2 presents summary statistics.

[Table 2 – summary statistics]

Table 3 shows the industry distribution of firms that have established CCs. Industry classification is according to the Fama-French 48-industry classification scheme for Computstat firms.[89] As can be seen, the industries that are the heaviest adopters of CCs are banking, pharmaceutical products, healthcare and medical equipment. These industries are all heavily regulated, for some form of compliance program is mandated by substantive regulation.[90] We are not, however, aware of any case in which a compliance *committee*, as opposed to a compliance program in general, is mandated by regulation.

[Table 3 – CC adoption by industry – about here]

At first blush, the higher rates of adoption in regulated industries would seem to be straightforwardly consistent with Hypothesis 1 (enforcement): where regulation requires a compliance program, failure to establish would seem to be more likely to attract enforcement than where it is not so required. This seems borne out in part by the column in Table 2 showing the proportion, by industry, of firms on the receiving

[89] Eugene Fama and Kenneth French, *Industry Cost of Equity*, 43 J. Fin. Econ. 153 (1997). See generally https://wrds-www.wharton.upenn.edu/pages/support/research-wrds/research-guides/procedures-using-fama-and-french-48-industry-classification/.

[90] For banking, see e.g., Bank Secrecy Act of 1970, 31 USC §5318(h) (Anti-Money Laundering Programs) and 12 CFR 21.21 (Procedures for Monitoring Compliance); Volcker Rule, Subpart D 12 CFR §44.20 (here); enhanced requirements for large banks: 12 CFR §44.20(c); Appendix B to Part 44, Enhanced Minimum Standards for Compliance Programs (here). For pharma, healthcare and medical equipment, see [check].

end of DOJ prosecutions during our sample period. Pharmaceuticals and medical equipment have two of the highest prosecution rates during our sample period. However, the same is not true for banking and healthcare, which have relatively low prosecution rates yet high rates of CC adoption. Moreover, the petroleum and natural gas industry has a relatively high prosecution rate (the second-highest of any industry over our sample period) but a very low rate of CC adoption.

To the extent that industries such as PNG have low CC adoption rates relative to enforcement rates, this appears contrary to Hypothesis 1 (insurance), and more consistent with Hypothesis 2 (signaling). The higher rates of adoption in regulated industries is also consistent with Hypothesis 3 (regulation). Because compliance programs are mandated by regulation for these industries, adoption of a CC does not send a firm's investors a negative signal about its expectation of being prosecuted. Conversely, for firms in industries that are not heavily regulated, rates of adoption are much lower.

C. Multivariate Analysis of Compliance Committee Adoption

We now consider the determinants of CC adoption in a multivariate setting. Table 4 reports our main OLS regression results for our panel of US public firms during the period 2006-2016. The dependent variable is whether a firm adopts a compliance committee in a particular year. 'Compliance committee' creation for these purposes includes standalone compliance committees, risk and compliance committees, and audit and compliance committees, although we have seen in Figure 2 that the lion's share of this activity is standalone compliance committees.

[Table 4 about here]

In model (1), we include only covariates with no fixed effects; in model (2) we add industry fixed effects; in model (3) we add year fixed effects, and in model (4) we add year and industry fixed effects. All the principal results are robust across these specifications. In this setting, we consider Hypothesis 4 (remediation): is DOJ enforcement associated with subsequent adoption of a CC? To explore this, we include one- and two-year lags of DOJ enforcement on the right-hand side. The coefficients are positive and strongly statistically significant.

This suggests that prior enforcement by the DOJ is associated with subsequent implementation of a compliance committee. This is consistent with both Hypothesis 2 (signaling) and Hypothesis 4 (revelation). In the case where a firm has been prosecuted or otherwise the subject of enforcement action, investors are already aware that the firm had a high risk of prosecution. Consequently, investing more in compliance—as indicated by establishing a compliance committee—will signal only that the firm is working to reduce its exposure going forwards.

Another possible channel through which prior DOJ enforcement might trigger subsequent CC adoption is if the DOJ demands such adoption as part of a D/NPA. Prior literature reports that D/NPAs frequently contain details of compliance

programs firms are expected to implement.[91] To check this, as described in Part I, we examined the text of all available plea agreements and D/NPAs in the UVA Corporate Prosecution Registry. While many agreements provided for some type of Board involvement, typically through reporting by a compliance officer, in only **[four] case**s did we find reference to the establishment of a board committee as a term of the agreement. Consequently, we rule out this direct channel and prefer the interpretation that the association between prior enforcement and subsequent CC adoption is best explained by firms' desire to signal to their investors their improved performance going forwards.

Table 4 also provides support for Hypothesis 5 (governance attributes). Compliance committee adoption is positively associated with the number of independent directors on a firm's board. This is intuitive, in that compliance committees are typically populated by independent directors, and a firm with relatively few will have less capacity on which to draw to establish a new committee. The coefficient on *Audit Committee Size* is negative, as might be expected, but is not statistically significant. Overall, these results suggest that compliance committee adoption is at least in part explained by a firm's governance attributes.

D. Criminal Enforcement and Compliance Committees

In Table 5, we consider Hypothesis 6 (efficacy) by exploring the determinants of DOJ Enforcement in a multivariate setting. The dependent variable is whether the DOJ initiates enforcement proceedings (whether a prosecution or a D/NPA) against a firm in a particular year over the period [2006-2016]. *Compliance Committee (CC) Creation* for these purposes includes standalone compliance committees, risk and compliance committees, and audit and compliance committees.

[Table 5 about here]

In model (1), we include only covariates with no fixed effects; in model (2) we add industry fixed effects; in model (3) we add year fixed effects, and in model (4) we add year and industry fixed effects. All the principal results are robust across these specifications. In each specification, we include one- and two-year lags for *CC Creation*, to determine whether the firm having adopted a Compliance Committee has an impact on the likelihood it will face DOJ enforcement. Consistently with Hypothesis 6, the two-year lag for *CC Creation* has a negative coefficient and is statistically significant at the 95% level. This indicates that adoption of a CC two years previously is associated with a reduced likelihood of DOJ enforcement, consistent with the notion that the CC improves the functioning of the firm's compliance effort.

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[91] See, e.g. Wulf A. Kaal & Timothy A. Lacine, *The Effect of Deferred and Non-Prosecution Agreements on Corporate Governance: Evidence from 1993-2013,* 70 Bus. Law. [1], [11]-[22] (2014); Jennifer Arlen & Marcel Kahan, *Corporate Governance Regulation through Nonprosecution*, 84 U Chi. L.R. 323, 330-343 (2017).

Interestingly, however, the coefficient for the one-year lag for *CC Creation*, while also statistically significant at the 95% level, has a *negative* sign. This implies that adoption of a CC one year previously is actually associated with an *increased* likelihood of DOJ enforcement. We interpret this result as consistent with Hypothesis 1 and 2. Boards of firms are likely to get wind of internal problems before the DOJ launches an enforcement proceeding. Where the board consider the problem to be sufficiently serious, then they may seek to improve the firm's compliance efforts—including establishing a CC—in order to maximize any discount they might be able to obtain from imminent DOJ enforcement. This is consistent with Hypothesis 1 (Enforcement). Moreover, if the problem is sufficiently serious that the board anticipates imminent enforcement, then they will realize that negative information is going to be released shortly in any event once the DOJ arrives, meaning that the fear of generating an adverse signal (Hypothesis 2) is marginalized.

A very interesting implication of this result is that the effect postulated by Hypothesis 2 may actually be stronger than initially anticipated. If a significant subset of firms holds off from creating a CC until internal problems are severe and 'the writing is on the wall' for DOJ enforcement, then CC creation will rightly be interpreted by the market as a strongly adverse signal.

III. Rethinking Board Compliance

A. Board Incentives and Compliance Committees

In the wake of corporate scandals, many have asked how to create accountability within corporations. There is, as Samuel Buell has described, a responsibility gap, where in the largest corporations, the CEOs and high-level officers may not have been aware of misconduct, but they also may have presided over a non-compliance system in which strong incentives existed to profit from misconduct.[92] Criminal prosecutions have not been effective at targeting higher-level officers, including because it is often quite difficult to show that they were aware of misconduct; indeed they may have been unaware. Yet, the public has clamored for accountability, including through criminal convictions.[93] Such convictions might lead to severe punishment for misconduct with grave social consequences, but it does not prevent future compliance breakdowns. One way to accomplish those forward-looking goals is to require corporations to create better compliance programs. However, as discussed, little consensus exists regarding what sort of compliance works or what type of oversight boards should provide over compliance. Enforcers, whether regulators or prosecutors, are not able to easily ensure day-to-day oversight over compliance reforms, although they have sometimes attempted to do so with the

[92] Samuel Buell, *The Responsibility Gap in Corporate Crime*, 12 Crim. L. & Phil. 471 (2018).
[93] Jed S. Rakoff, *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?*, N.Y. REV. BOOKS, Jan. 9, 2014; Jean Eaglesham & Anupreeta Das, *Wall Street Crime: 7 Years, 156 Cases and Few Convictions*, Wall St. J., May 27, 2016.

use of independent corporate monitors.[94] Instead, it often lies to the board to ensure that compliance reforms are in place.

For some time now, "the OIG, DOJ, U.S. Sentencing Commission, Sarbanes-Oxley Act, and other authorities all agree that an effective compliance program is a 'top-down' program beginning with the board."[95] Yet, as we have described, board structure commonly does not reflect that view. Clearly, enforcers have not sufficiently conveyed their preferences to corporate boards. One way to do so might be to use regulation of corporations to accomplish similar goals more directly. In the healthcare context, for example, the Department of Health and Human Services, Office of Inspector General issued in 2015 guidance to corporate boards on healthcare compliance, highlighting that "every Board is responsible for ensuring that its organization complies with relevant Federal, State and local laws."[96] There was a perception that boards were "inclined to address only global issues and view matters such as compliance as technical 'day-to-day' issues, which are the province of trained staff."[97] For that reason, regulators have intensified their focus on the responsibility of Directors.[98] They have emphasized the role of the Board in ensuring ongoing risk assessment and auditing as well as regular "executive sessions" with members of the compliance team.[99] Boards may have taken heed of this.[100] Again, however, this is guidance and not a regulatory requirement.

Similar to the enforcement decisions by prosecutors, in civil regulatory cases, settlement agreements have also imposed responsibilities on Directors and Boards. Agreements in the health care context often include "a resolution, signed by each member of the Board summarizing its review and oversight of [the center's] compliance with Federal health care program requirements and the obligations of this CIA."[101] These agreements have included certifications of compliance, that the Board has made a "reasonable inquiry" into compliance, including a "Compliance Review," and that based on this, the Board has concluded that the company has an

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[94] Vikramaditya Khanna & Timothy L. Dickinson, *The Corporate Monitor: The New Corporate Czar?,* 105 Mich. L. Rev. 1713 (2007).

[95] Richard P. Kusserow, *Ineffective Compliance Programs Common Compliance Program Failures That Lead to Major Enforcement Actions*, 19 J. Health Care Compliance 47, 48 (2017)

[96] OIG, *et al. Practical Guidance for Health Care Governing Boards on Compliance Oversight*, (2015), https://oig.hhs.gov/compliance/compliance-guidance/docs/Practical-Guidance-for-Health-Care-Boards-on-Compliance-Oversight.pdf.

[97] Joseph T. Kelley, *Board Governance, Compliance, and Behavioral Health*, 2015 WL 9182494, at *1.

[98] OIG and AHLA, *The Health Care Directors Compliance Duties: A Continued Focus of Attention and Enforcement* (2011).

[99] Kelley, supra, at *5-6.

[100] Deann M. Baker, *Key Methods to Develop and Mature Your Compliance Program Changing an Organization's Culture May Take A Lot of Time and Energy, but It Can Be Done*, 10 J. Health Care Compliance 37 (2008).

[101] Jeremy Sternberg, *HHS-OIG Corporate Integrity Agreements Are Now Aiming at Corporate Directors and Executives*, Holland & Knight, LLP, (2013), at http://www.jdsupra.com/legalnews/hhs-oig-corporate-integrity-agreements-a-11456/. See, e.g. Hutchinson Regional Medical Center's Corporate Integrity Agreement, at http://oig.hhs.gov/fraud/cia/agreements/hutchinson_regional_medical_center_09092013.pdf.

"effective compliance."[102] The OCC has required creation of board compliance committees as well.[103]

Another indirect source for greater board involvement could be through professional organizations. The National Association of Corporate Directors (NACD) has recently recommended that Boards provide substantial oversight over compliance in the area of cybersecurity, for example. A related problem is, if boards are to have more substantial compliance committees, will they have Directors with substantial compliance experience?[104] One solution advanced in some settlement agreements has been to require the appointment of a board compliance expert, who participates in all meetings with compliance presentation.[105]

B. Mandating Board Compliance

Could regulators require alterations to board structure, to require the creation of compliance committees? Many view the rise of compliance as the result of government mandates. Sean Griffith writes, "Compliance is a de facto government mandate imposed upon firms by means of ex ante incentives, ex post enforcement tactics, and formal signaling efforts."[106] If that is so, it has reached the highest levels of corporations in a far more incomplete form than previously appreciated. Creation of a compliance oversight function at the board level has been understood as relevant to the board's oversight role and as a way for the compliance function to be elevated in importance and relatively more autonomous from management. Regulations could require such a structure, if it was thought to be far superior to alternatives. It would not be an overly intrusive requirement. Boards have committees and adding a compliance committee or a compliance function alongside the audit committee that exists, would not greatly multiple the tasks facing a board---and compliance has increasingly become a crucial task.

That said, perhaps boards have rejected these structural compliance preferences as undesirable. Perhaps creating compliance committees, even if it would satisfy regulators and send useful reputational signals, is not a good proxy for sound board oversight over compliance. If that is so, and too little is known about what makes for effective compliance or effective board oversight over compliance, what should enforcers do to ensure the board takes on a more effective and active role in compliance? Traditionally, boards may view compliance as a matter for lower-level

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[102] Kathleen McDermott, Arianne Callender, *Compliance Certifications and the Era of Accountability-A Forecast to Debate*, 5 J. Health & Life Sci. L. 158, 174-75 (2012).
[103] *OCC Orders Bank to Refund Up to $14 Million*, 60 Consumer Fin. L.Q. Rep. 223 (2006).
[104] Roy Snell, *It's Time to Get Serious About Board Expertise Not Just Anyone Should Be Serving As the Compliance Expert on Your Board*, 13 J. Health Care Compliance 3 (2011).
[105] Tuomey Healthcare System Agreement, at oig.hhs.gov/fraud/cia/agreements/Tuomey_dba_Tuomey_Healthcare_ System_10162015.pdf; see also Meghana Joshi, *Doj and Oig Increasing Focus on Personal Executive and Board Accountability in Light of Recent Changes, Compliance Officers Should Incorporate A Number of Guidelines into Their Everyday Practice*, 18 J. Health Care Compliance 23, 26 (2016).
[106] Griffith, supra note xxx, at 2078.

employees. The Sentencing Guidelines and actions by prosecutors have placed decided emphasis on the role of the board in compliance, but indirectly, through guidelines for largely-negotiated resolutions of enforcement actions. Perhaps in doing so, they have left it to companies to decide what is best ex post, but at the same time, assuring harsher ex post enforcement if a company choose a sub-par option.

C. Enhancing Board Responsibility for Compliance

The mechanisms that we have examined, having a chief compliance officer report to the board and having a compliance committee of the board, are designed to ensure that compliance-related information is conveyed directly to the board. Such information is crucially important for the board to hear. There are other routes for such information to make its way to the board, and some might even be preferable to those explicitly labelled under the compliance heading. But that said, this evidence suggests that boards resist the compliance heading and may similarly resist being told how to structure their involvement in the compliance function. That evidence raises real cause for concern. There are more direct ways that enforcers could enhance board responsibility for compliance, without specifying the manner or structure of its use. Alternatively, courts and sentencing guidelines could far more clearly say (then either the Delaware courts or Organizational Sentencing Guidelines have to date) that a robust compliance function must exist or Directors will be held liable. Rather than require boards to engage in additional oversight of compliance, such financial incentives could be brought to bear on Directors. Should board liability for compliance failures be increased? On one view, Director compensation has increased in its generosity and the responsibilities that come with that should be made clearer and more conditional on informed exercise of that responsibility. On another view, the company itself should bear responsibility as an entity for compliance failures; that has been the view of enforcers to date. We view this evidence as suggestive of approaches that do focus on the board separate and apart from the entity as a whole.

CONCLUSION

We have examined the pattern of adoption of board compliance committees in public companies in the U.S. We find that contrary to industry surveys, that only 3.4 per cent of public companies had stand-alone Compliance Committees; including any board committee with "compliance" in its name (like "Audit and Compliance"), we found that 5.1 percent of public companies had such committees. What explains this pattern, largely of non-adoption of board compliance committees? We explore competing hypotheses concerning the extent of companies' engagement with compliance. The insurance hypothesis suggests companies are motivated to engage with compliance by the prospect of more favorable treatment should they be targeted by prosecuting authorities. The governance hypothesis suggests that corporate engagement with compliance is affected by firm-level governance attributes,

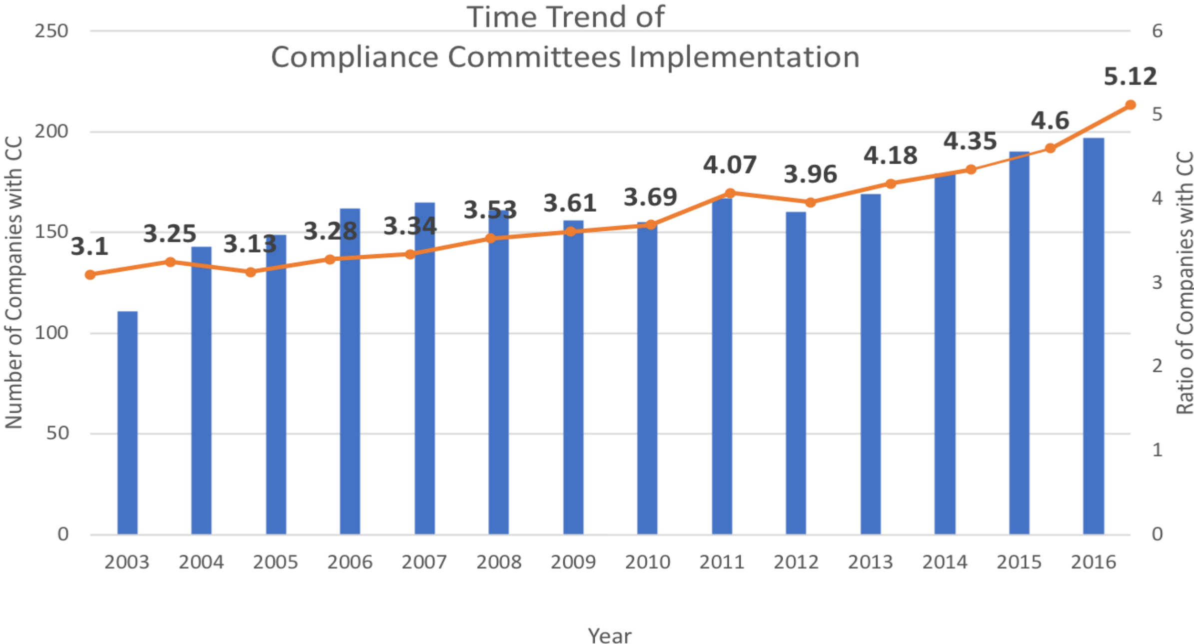
including board structure and director compensation. To shed light on these hypotheses, we explore the relationships between corporate engagement with compliance (proxied by the creation of compliance committees) and, on the one hand, firm-specific governance, and on the other, exogenous enforcement intensity (focusing on federal criminal prosecutions).

We find that even in areas of aggressive criminal enforcement, boards do not typically adopt compliance committees. How hard would it typically be for a board to simply rebadge an audit committee as an audit and compliance committee? Those results suggest that even punitive enforcement has not affected the board's structure with regards to compliance. There seems to be a real discomfort with placing compliance in the board's formal purview. Any incentives to enhance compliance oversight will have to come from other sources. That said, we should not be too surprised or troubled at the failure of a deterrent "stick" to promote a formal board role in compliance; after all, even in criminal prosecutors, prosecutors often do not require a substantial board role in compliance. Prosecutors themselves are ambivalent to some degree about interfering with board structure.

We finally examine alternative proposals for how boards can be more centrally involved in compliance. We conclude that despite prosecutions and major compliance failures, boards have not fundamentally reconceived their role. Enforcers and prosecutors, and compliance experts have all made forceful recommendations that board take on a more substantial compliance role. Boards have resisted doing so. This account raises new questions about the role of corporate boards and their willingness and ability to exercise the oversight with which they are entrusted, and this account raises new questions about the accountability of the largest corporations.

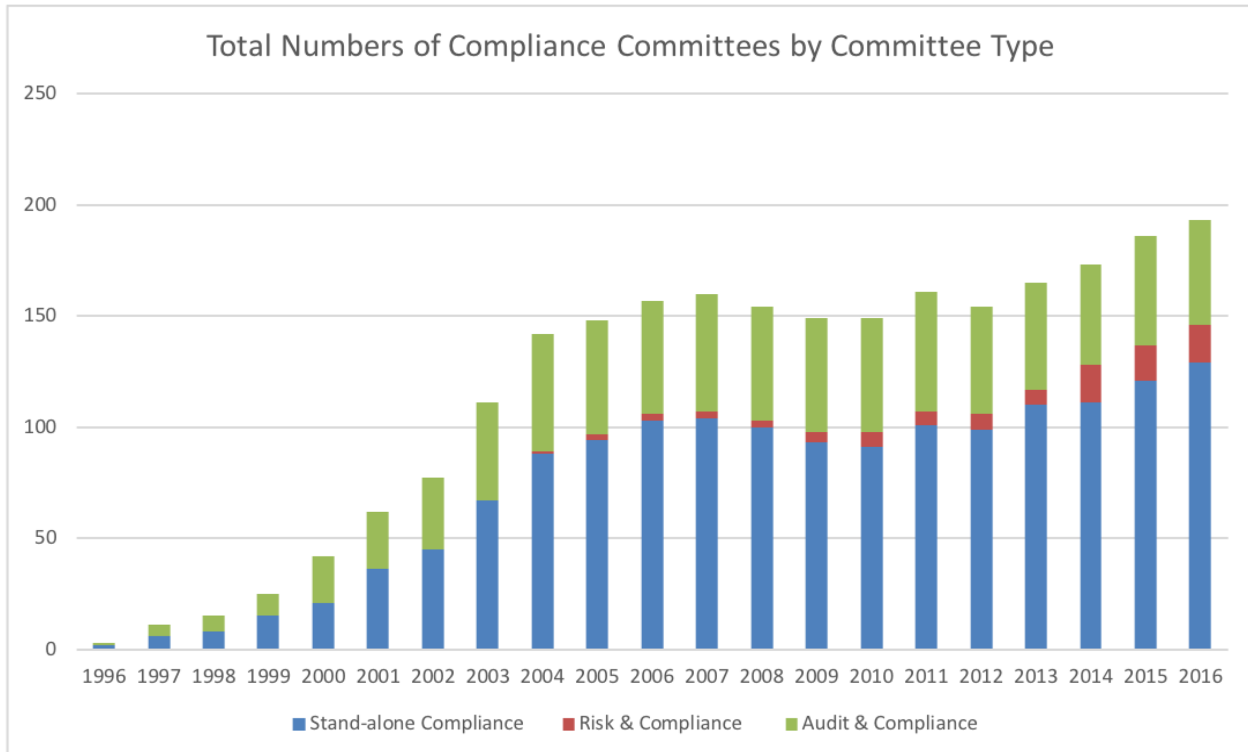
Appendix

Figure 1: US public companies implementing Compliance Committees, 2003-2016.



Note: data are from BoardEx. Blue bars show number of public companies having adopted a 'stand-alone' Compliance Committee, a 'Risk and Compliance Committee' or restyling their Audit Committee as 'Audit and Compliance' retitled their Audit Committee as "Audit and Compliance". Orange line shows proportion of the total population of US public companies represented by the blue bars.

Figure 2: Adoption of compliance committees by US public companies by type, 1996-2016.



Note: data are from BoardEx. Sample is all US public companies. Blue bars show number of public companies having adopted a 'stand-alone' Compliance Committee; red bars show numbers adopting a 'Risk and Compliance Committee' (without a stand-alone Compliance Committee) and green bars show numbers restyling their Audit Committee as 'Audit and Compliance' without a stand-alone Compliance Committee.

Table 1. Data Sources

Variable	**Data Source**
Board Size: number of directors on company's board	EDGAR, BoardEx
(Audit, Compliance) Committee Size: number of directors on audit committee	EDGAR, BoardEx
Compliance Committee Adoption: dummy variable for compliance committee adopted	EDGAR, BoardEx
Ratio of Independent Directors	EDGAR, BoardEx
Delaware Incorporation: dummy variable for incorporation in Delaware	EDGAR, CRSP-Compustat
DOJ Enforcement Action: dummy variable for DOJ enforcement action.	Duke/UVA Corporate Prosecution Registry
Market Value	CRSP-Compustat
ROA	CRSP-Compustat
ROE	CRSP-Compustat
Tobin's Q	CRSP-Compustat

Table 2: Summary Statistics.

Variable	Obs.	Mean	Std. Dev.	Min	Max
Board Size	47,205	7.326	2.864	1	31
Audit Committee Size	47,205	2.116	1.220	0	9
Compliance Committee Size	47,217	0.073	0.444	0	9
Compliance Committee Adoption	47,217	0.006	0.080	0	1
Ratio of Independent Directors	47,205	0.918	0.126	0	1
Delaware Incorporation	47,205	0.587	0.492	0	1
DOJ Enforcement Action	47,217	0.003	0.054	0	1
Firm Size	46,439	6.536	2.126	-0.981	14.761
ROA	46,410	-0.038	0.231	-1.185	0.265
ROE	46,398	-0.079	0.431	-3.096	0.262
Tobin's Q	46,423	1.886	1.381	0.675	8.128

Table 4: Determinants of Compliance Committee Creation (OLS Panel Regression Results)

	Dependent variable:			
	Compliance Committee Creation			
	(1)	(2)	(3)	(4)
Company Age	-0.0003***	-0.0001	-0.0003***	-0.0001
	(0.0001)	(0.0001)	(0.0001)	(0.0001)
Board Size	0.001	0.0004	0.001	0.001
	(0.002)	(0.002)	(0.002)	(0.002)
Audit Committee Size	-0.001	-0.001	-0.001	-0.001
	(0.001)	(0.001)	(0.001)	(0.001)
Ratio. Indep Directors	0.004***	0.004***	0.004***	0.004***
	(0.001)	(0.001)	(0.001)	(0.001)
Sales	-0.00000	-0.00000	-0.00000	-0.00000
	(0.00000)	(0.00000)	(0.00000)	(0.00000)
ROA (t - 1)	0.00000**	0.00001**	0.00000**	0.00001**
	(0.00000)	(0.00000)	(0.00000)	(0.00000)
DOJ Enforce (t -1)	0.124***	0.116***	0.122***	0.115***
	(0.043)	(0.040)	(0.043)	(0.040)
DOJ Enforce (t -2)	0.156***	0.146***	0.154***	0.144***
	(0.047)	(0.044)	(0.047)	(0.044)
Constant	-0.016			
	(0.011)			

Industry Fixed Effects	No	Yes	No	Yes
Year Fixed Effects	No	No	Yes	Yes
Observations	36,159	36,159	36,159	36,159
R^2	0.028	0.077	0.028	0.078
Adjusted R^2	0.028	0.076	0.028	0.076
Residual Std. Error	0.197 (df = 36150)	0.192 (df = 36103)	0.197 (df = 36135)	0.192 (df = 36088)

Note: *Compliance Committee Creation* includes standalone compliance committees, risk and compliance committees, and audit and compliance committees. Data on board membership and structure are from BoardEx. *Company Age* is age since incorporation. Financial data are from Compustat. *DOJ Enforce* indicates the firm was the subject of enforcement proceedings by the Department of Justice. Industry fixed effects use Fama-French 48 industry classification. *p<0.1; **p<0.05; ***p<0.01

Table 5: Determinants of DOJ Enforcement (OLS Panel Regression Results).

	Dependent variable:			
	DOJ Enforcement			
	(1)	(2)	(3)	(4)
Company Age	0.00004***	0.00005***	0.00004***	0.00005***
	(0.00002)	(0.00002)	(0.00002)	(0.00002)
Board Size	0.00001	0.0002	0.0001	0.0003*
	(0.0001)	(0.0001)	(0.0001)	(0.0001)
Audit Committee Size	-0.0002	-0.0002	-0.0001	-0.0001
	(0.0001)	(0.0001)	(0.0001)	(0.0001)
Ratio. Indep Directors	0.0002**	0.0003**	0.0002**	0.0002**
	(0.0001)	(0.0001)	(0.0001)	(0.0001)
Sales	0.00000***	0.00000***	0.00000***	0.00000***
	(0.00000)	(0.00000)	(0.00000)	(0.00000)
ROA (t-1)	-0.00000	0.00000*	-0.000	0.00000
	(0.00000)	(0.00000)	(0.00000)	(0.00000)
CC Creation (t - 1)	0.028**	0.028**	0.029**	0.028**
	(0.013)	(0.013)	(0.013)	(0.013)
CC Creation (t - 2)	-0.026**	-0.026**	-0.026**	-0.026**
	(0.013)	(0.013)	(0.013)	(0.013)
Constant	-0.003**			
	(0.001)			

Year Fixed Effects	No	No	Yes	Yes
Industry Fixed Effects	No	Yes	No	Yes
Observations	36,159	36,159	36,159	36,159
R^2	0.010	0.013	0.011	0.014
Adjusted R^2	0.010	0.012	0.010	0.013
Residual Std. Error	0.050 (df = 36150)	0.050 (df = 36103)	0.050 (df = 36135)	0.050 (df = 36088)

Note: *DOJ Enforcement* indicates that firm was the subject of enforcement proceedings by the Department of Justice during the period [2006-2016]. Data on DOJ enforcement are from UVA Corporate Prosecution Registry. Data on board membership and structure are from BoardEx. *Company Age* is age since incorporation. Financial data are from Compustat. *Compliance Committee (CC) Creation* includes standalone compliance committees, risk and compliance committees, and audit and compliance committees. Industry fixed effects use Fama-French 48 industry classification. *p<0.1; **p<0.05; ***p<0.01.