

Mitigating Personal Liability Risk for Chief Compliance Officers

Chief compliance officers (CCOs) increasingly face personal liability for corporate mishaps and violations. A change of guidelines and a string of enforcement actions by federal agencies have transformed the environment that CCOs operate in. Now, regulators are pursuing cases of negligence where the CCO was not involved in or aware of the wrongdoing. CCOs are concerned that their personal assets may be at risk if regulators pursue them for unintentional wrongful conduct.

Beyond the protections offered by their employers through indemnification agreements, CCOs are looking at what insurance protections are in place to cover their potential legal fees and settlement and judgment costs. Although directors and officers (D&O) liability insurance may provide coverage for CCOs, it may not be enough.

CURRENT REALITY OF PERSONAL LIABILITY FOR CCOs

State and federal regulators' approach to CCO liability for corporate compliance failures is transforming. Regulatory enforcement priorities such as the 2015 "Yates Memo" from the US Department of Justice provide

specific guidance about naming and prosecuting individuals in cases of wrongdoing. And a proposed regulation in New York would require CCOs of regulated entities to certify annually that they have implemented a sufficient compliance program to identify and prevent illegal transactions. If they fail to certify — or illegal transactions took place and were not detected — the CCO would be exposed to potential criminal liability.

As a result, CCOs may be pursued for corporate failures where they were not involved in or aware of the wrongdoing, but because of their position, were potentially capable to have prevented or detected and reported the misconduct.

For example, in one case, the US Department of Treasury sought \$1 million in penalties against a CCO who allegedly failed to prevent, detect, or report fraudulent conduct. The complaint did not allege that the CCO actually knew of or was involved in any compliance violations.

Other recent US Securities and Exchange Commission (SEC) enforcement actions support this trend. For example, the SEC asserted personal liability against a CCO for alleged failure to implement compliance policies and



SPOTLIGHT

Brief History of CCO Personal Liability Risks

Historically, enforcement actions and awards against CCOs were fairly rare. They usually involved particularly egregious factual circumstances, such as a CCO being actively involved in wrongdoing and/or an attempt to cover up violations by misleading or withholding information from regulators. Penalties were typically minor.

For example, the SEC fined a CCO \$100,000 and barred him from the industry for having no employee compliance training program, and for repeatedly failing to conduct quarterly reviews of employee transactions, despite a previous SEC warning (in re Thomas E. Meade, SEC Release No. 3855 (June 11, 2014)).

This approach was repeatedly reinforced by the SEC. In a 2014 statement, SEC Enforcement Director Andrew Ceresney said: "[SEC actions] typically...occur when the division believes legal or compliance personnel have affirmatively participated in the misconduct, when they have helped mislead regulators, or when they have clear responsibility to implement compliance programs or policies and wholly failed to carry out that responsibility."

The SEC has now moved from pursuing active participation in wrongdoing to focusing on CCOs' potential failure to properly oversee misconduct.

procedures that could have revealed long-term theft of client assets by the firm's president (In re SFX Financial Advisory Management Enterprises, Inc. and Eugene Mason, SEC Release No. 4116 (June 15, 2015)).

THE INSURANCE LANDSCAPE FOR CCOS

CCOs are questioning whether they can rely on corporate indemnification and insurance to pay for defense costs and any settlement or judgment that may result if they are pursued for unintentional wrongful conduct. To address some of these concerns, many organizations purchase the below policies, but are they enough?

D&O liability insurance: The policy is shared among all officers and directors — and in some cases, the company and certain employees as well — for securities or a broader set of claims. In the event of a multifaceted regulatory and/or litigation situation, insurance proceeds may erode and be insufficient to protect the CCO. Other issues for CCOs to consider include:

- Is the policy triggered by a regulatory investigation (formal or informal) and/or proceeding against an individual officer?
- Does the CCO qualify as an officer of the company under the policy's

definition of "insured person?"

- Will coverage extend to unintentional wrongdoing? Can the insurer argue that the underlying wrongful act arose from professional liability rather than simply status or capacity?
- If coverage exists, when will it potentially terminate and what types of relief are covered?

Side-A difference-in-conditions (DIC) insurance: Addressing some of the above concerns, this policy is dedicated only to the company's officers and directors and includes broader coverage and narrower exclusions. However, potential issues remain as to the sharing of limits among all the officers and directors and whether fines and penalties are covered.

MANAGING PERSONAL LIABILITY RISKS

It is important for CCOs to understand before any regulatory action — perhaps at the time of negotiating employment — the scope of indemnification offered by a current or prospective employer:

- Will they be indemnified for defense costs related to allegations of fraud, gross negligence, or negligent criminal conduct? If so, when will such indemnification terminate? Upon an adverse decision by an SEC administrative

law judge, the SEC, a court decision, or only upon a final non-appealable adjudication?

- Will such indemnification extend to a settlement or judgment? If so, will it extend to civil and criminal fines and penalties (to the extent permitted by law)?

As their jobs become more perilous under the current enforcement trends, CCOs are well-advised to evaluate and understand regulatory expectations of their oversight of compliance policies and procedures. They should examine and review current and available insurance protection against regulatory investigations and proceedings. Some D&O insurers are recognizing the personal asset risks of CCOs with new products that address potential coverage gaps. CCOs and their companies should work with their insurance advisor to understand how D&O and other available coverages work.

For more information on CCO personal liability, contact your Marsh representative or:

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