9

SEC-Imposed Monitors

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The SEC often requires companies, broker-dealers, investment advisers, and others to engage a monitor in order to resolve an enforcement action. This chapter addresses SEC and DOJ guidance for determining whether to impose a monitor, the scope of the monitor's responsibility, and other terms of the monitor's engagement.

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Overview

Q 9.1 What is a monitor?

The SEC defines a monitor as "an independent third party who assesses and monitors a company's adherence to the compliance requirements of an agreement that was designed to reduce the risk of recurrence of the company's misconduct."[1] Monitors, in contrast to forensic investigators, typically look forward and assess whether a company's compliance program is adequate to guard against future misconduct. Monitors serve under various titles and can be an individual or firm.

There are generally two types of SEC-imposed monitors: an "independent compliance consultant" and an "independent compliance monitor." The basic difference between these two types of monitors is their scope of responsibility; independent compliance monitors tend to have a more expansive role than independent compliance consultants. The differing scope and authority of each type of SEC-imposed monitor is discussed below in Q 9.4. An independent compliance consultant is generally imposed as part of the settlement of a standalone SEC enforcement action,[2] while an independent compliance monitor is generally imposed in the context of parallel criminal and civil cases when the company simultaneously enters a plea, a deferred prosecution agreement, or a non-prosecution agreement with the DOJ.[3]

Q 9.2 What other agencies can impose monitors?

In addition to the SEC, numerous federal, foreign, and state government and quasi-government agencies use monitors as an enforcement remedy, including the Drug Enforcement Agency, the DOJ, the Environmental Protection Agency, the Federal Trade Commission, FINRA, the Department of Health and Human Services, the National Highway Traffic Safety Administration, the New York State Attorney General's Office, the New York State Department of Financial Services (NYSDFS), the U.K. Financial Conduct Authority, and the U.K. Serious Fraud Office. These regulators refer to monitors variously as "Independent Review Organizations,"[4] "Financial Monitors,"[5] "Independent Compliance Auditors,"[6] and, in the U.K., "Skilled Persons."[7] Some of these regulators occasionally use monitors to supplement the agency's investigative resources.[8]

Q 9.3 When does the SEC impose monitors?

The SEC appoints monitors in resolutions of civil suits and administrative proceedings. The Exchange Act authorizes the SEC in civil actions to seek "any equitable relief that may be appropriate or necessary for the benefit of investors," which includes imposition of a monitor.[9] The SEC has been imposing monitors in settled enforcement actions since the early 1990s.[10] The SEC has recently imposed monitors to assess a wide range of matters, such as compliance programs relating to the issuance and transfer of securities,[11] the preparation of performance reports,[12] the underwriting of municipal securities,[13] anti-money laundering,[14] the application of generally accepted auditing standards,[15] the books and records provisions of the FCPA,[16] the disclosure of fees by investment advisors,[17] and insider trading.[18]

Although the SEC Enforcement Manual does not provide guidance on monitors, SEC guidance appears in the Resource Guide co-authored with the DOJ Criminal Division, which explains:

> Appointment of a monitor is not appropriate in all circumstances, but it may be appropriate, for example, where a company does not already have an effective internal compliance program or needs to establish necessary internal controls. In addition, companies are sometimes allowed to engage in self-monitoring, typically in

> cases when the company has made a voluntary disclosure, has been fully cooperative, and has demonstrated a genuine commitment to reform.[19]

The SEC and DOJ consider many of the same factors in deciding whether to impose a monitor as they do in determining whether to file criminal charges[20] or enforcement proceedings,[21] including the:

- Seriousness of the offense;
- Duration of the misconduct;
- Pervasiveness across geographic and product lines;
- Nature and size of organization;
- Quality of compliance program at time of misconduct; and
- Adequacy of the remediation and corrective measures.

After an investigation has begun, companies and counsel can impact only the final factor; that is, they cannot after-the-fact change the seriousness, duration, and pervasiveness of the misconduct, or the nature and size of the company. Similarly, the company can seek to defend, although it cannot change, the pre-existing compliance program. The SEC's decision about whether to impose a monitor often depends fundamentally on whether it trusts the company and its commitment to ethics and compliance. Accordingly, upon learning of misconduct or an investigation, it is critical for companies and counsel to address remediation in a rapid and thorough way.

Compliance, Remediation, and Self-Monitoring Programs

Q 9.3.1 How does the SEC assess "pre-existing" compliance programs?

Although the SEC does not explicitly include the company's pre-existing compliance program among the factors that it considers in determining whether to file an enforcement action,[22] it has implicitly adopted the DOJ's approach to give that factor consideration in the Resource Guide.[23]

DOJ policy requires federal prosecutors to consider "the existence and effectiveness of the corporation's pre-existing compliance program" in determining whether to bring charges, and negotiating plea or other agreements.[24] In November 2015, the DOJ Fraud Section retained a full-time compliance expert to provide guidance to prosecutors as they perform this assessment and to develop benchmarks for evaluating compliance and remediation measures.[25] In February 2017, the DOJ issued guidance on how it assesses the quality of pre-existing compliance programs.[26] The guidance is organized into eleven sections[27] and draws from prior DOJ pronouncements, the Resource Guide, the U.S. Sentencing Guidelines, and a handbook co-authored by the Organization for Economic Co-operation and Development, the United Nations Office on Drugs and Crime, and the World Bank.

If an investigation is underway, a company should assess its pre-existing compliance program. Misconduct does not necessarily mean that the compliance program is ineffective. On the contrary, timely detection of misconduct may demonstrate that the program was indeed effective.

Compliance program deficiencies typically occur in one or more of three areas: (1) failure of the risk assessment to identify the potential risk; (2) overreliance on ineffective controls; and (3) failure to investigate risk indicators and red flags. Organizations can minimize the impact of any deficiencies by seeking credit for strengths in the compliance program existing at the time of the misconduct (e.g., strong tone at the top, effective risk assessment, compliance training, and forensic auditing programs).

Q 9.3.2 What are the attributes of an effective remediation program?

Effective and timely remediation is essential if there is any chance of an organization avoiding imposition of a monitor in the wake of serious, lengthy, and pervasive misconduct.[28] Neither the SEC nor the DOJ has issued detailed standards for effective remediation, although some guidance appears in the DOJ's expectations for remediation in the context of qualifying for mitigation credit in an FCPA matter.[29] The guidance requires:

- Implementation of an effective ethics and compliance program, the criteria for which will be periodically updated and may vary based on the size and resources of the organization, but will include:

- ○ Whether the company has established a culture of compliance, including an awareness among employees that any criminal conduct, including the conduct underlying the investigation, will not be tolerated;
- ○ Whether the company dedicates sufficient resources to the compliance function;
- ○ The quality and experience of the compliance personnel such that they can understand and identify the transactions identified as posing a potential risk;
- ○ The independence of the compliance function;
- ○ Whether the company's compliance program has performed an effective risk assessment and tailored the compliance program based on that assessment;
- ○ How a company's compliance personnel are compensated and promoted compared to other employees;
- ○ The auditing of the compliance program to assure its effectiveness; and
- ○ The reporting structure of compliance personnel within the company.

- Appropriate discipline of employees, including those identified by the corporation as responsible for the misconduct, and a system that provides for the possibility of disciplining others with oversight of the responsible individuals, and considers how compensation is affected by both disciplinary infractions and failure to supervise adequately; and
- Any additional steps that demonstrate recognition of the seriousness of the corporation's misconduct, acceptance of responsibility for it, and the implementation of measures to reduce the risk of repetition of such misconduct, including measures to identify future risks.[30]

Additional remediation criteria the government considers include:

- Timeliness—it is one thing for an organization to represent that it will take steps to prevent recurrence, it is quite another to demonstrate that it has already taken action;

- Knowledge, skills, experience, and independence of the remediation team;
- Quality of root cause analysis;
- Efforts to detect other misconduct by the perpetrators and similar misconduct by others in the company;
- Design and operating effectiveness of corrective measures; and
- Restitution.[31]

Q 9.3.3 How do companies use "self-monitoring" to avoid an SEC-imposed monitor?

In lieu of an independent monitor, the SEC sometimes allows companies to either engage in self-monitoring or appoint as an independent consultant a third-party firm that assesses the company's program in advance of the SEC settlement.[32] This outcome is consistent with the U.S. Sentencing Guidelines, which recommend that companies consider using "an outside professional advisor to ensure adequate assessment and implementation of any modifications" to the ethics and compliance program.[33]

In the SEC's recent enforcement action against Barclays Capital, for example, the SEC noted that Barclays Capital's remediation included engaging an independent third-party consultant to review Barclays Capital and permitted the company to continue with the same consultant in lieu of appointing another.[34] The SEC's order requires the consultant to make findings and recommendations and opine on "whether the revised policies, procedures, and practices and their implementation and enforcement by Respondent and Respondent's auditing of the implementation and enforcement of those policies, procedures, and practices are reasonably designed to ensure compliance with the federal securities laws."[35] Similarly, the U.K.'s Serious Fraud Office recently allowed Rolls-Royce to avoid a government-imposed monitor because it had hired an expert to "conduct an independent review of its ethics and compliance procedures and to act on an ongoing basis as a 'quasi-monitor' of its compliance programme."[36]

The SEC recently applied a hybrid approach in its enforcement action against LAN Airlines. The SEC's order imposes an independent compliance monitor for a twenty-seven-month term that terminates and moves into a self-reporting period if the monitor determines that the company's anti-corruption program is effective.[37] During the self-reporting period, the company must submit written reports to the SEC and self-disclose "any credible evidence that corrupt or otherwise suspicious transactions occurred, or payments of things of value were offered, promised, or provided to foreign officials, that it learns of that occurred after the date of this Consent."[38]

Scope and Authority

Q 9.4 What is the scope and authority of an SEC-imposed monitor?

As noted above in Q 9.1, the role of an SEC-imposed monitor differs depending on whether the SEC requires an independent compliance consultant or independent compliance monitor. SEC orders imposing independent compliance consultants typically define, in a single paragraph, the monitor's role to evaluate the organization's controls to prevent recurrence of the same type of misconduct. In a 2017 FCPA matter, for example, the SEC charged the independent compliance consultant to:

> [R]eview and evaluate Respondent's internal controls, record-keeping and financial reporting policies and procedures as they relate to its compliance with the books and records, internal accounting controls, and anti-bribery provisions of the FCPA . . . as actually implemented and how FCPA compliance fits within Respondent's ethics and compliance function. The [monitor] shall consider whether the ethics and compliance function has sufficient resources, authority, and independence, and provides sufficient train ing and guidance.[39]

Similarly, in a 2017 settlement with the Port Authority of New York and New Jersey involving disclosure obligations in the offering of municipal securities, the SEC defined the independent compliance consultant's role as being "to conduct a review of Respondent's policies and procedures as they relate to disclosures concerning legal and governance risks in connection with municipal securities offerings."[40]

The SEC is sometimes more prescriptive about the independent compliance consultant's role. In a 2016 matter involving an audit failure, the SEC directed the independent compliance consultant to review "quality controls, including policies and procedures for audits and reviews . . . to determine whether [the policies] are adequate and sufficient to provide reasonable assurance of compliance with all relevant Commission regulations and auditing standards and rules."[41] The SEC's order in that case went on to provide the independent compliance consultant with guidance regarding specific areas for it to consider and procedures for it to employ.[42]

By contrast, the role of an independent compliance monitor, which is generally imposed as a part of parallel criminal and civil proceedings, tends to be more expansive. For example, while an independent compliance consultant typically conducts a single review, an independent compliance monitor typically conducts an initial review and two follow-up reviews.[43] In addition, the scope of the independent compliance monitor's review often goes beyond assessment of the company's remediation and extends more generally to compliance with applicable laws. For example, SEC orders imposing independent compliance monitors in FCPA cases typically require the monitor, in addition to assessing remediation efforts, to make recommendations for improvements to the design and operating effectiveness of the company's anti-corruption program.[44]

Selection of Monitors

Q 9.5 How are SEC-imposed monitors selected?

The SEC varies on how it selects monitors. In standalone enforcement actions, its most common practice is to allow the company to select a monitor "not unacceptable" to the SEC Staff.[45] The SEC Staff occasionally requests that the company submit three candidates to give the Staff the opportunity to comment, but leaves the ultimate decision to the company.

In 2008, Acting Deputy Attorney General Craig Morford issued guidance relating to the use of monitors (the "Morford Memo"). The Morford Memo delineates nine principles for monitor-related provisions in DOJ settlement agreements.[46] These principles, which the SEC has often adopted in parallel criminal and civil proceedings, relate to:

1) Selection;
2) Independence from government or company;
3) Primary responsibility;
4) Understanding of misconduct leading to appointment of monitor;
5) Communications and recommendations;
6) Implementation of government recommendations;
7) Reporting previously undisclosed or new misconduct;
8) Duration; and
9) Extension and resolution.

The Morford Memo instructs prosecutors that the selection of a monitor must be "based on the merits" and the selection process must be designed to: "(1) select a highly qualified and respected person or entity based on suitability for the assignment and all of the circumstances; (2) avoid potential and actual conflicts of interests; and (3) otherwise instill public confidence by implementing the steps set forth in this Principle."[47]

The DOJ appoints individuals, not firms, to serve as monitors. The Morford Memo explains that, although attorneys can serve as monitors, "other individuals, such as accountants, technical or scientific experts, and compliance experts, may have skills that are more appropriate to the tasks contemplated in a given agreement."[48] Monitor candidates now commonly include pre-identified, multi-disciplined advisers in their applications (e.g., counsel, forensic advisers, industry experts, and foreign resources).

The Morford Memo does not prescribe whether the government or company should select the monitor, although it notes that the parties "should consider a pool of least three qualified monitor candidates."[49] The common practice is for the DOJ to select a monitor from a slate of three candidates recommended by the company.

In parallel criminal and civil matters, the SEC often adopts the DOJ's selection process.[50] In a 2016 FCPA-related matter involving an asset manager, for example, the SEC order provided for the company to nominate three candidates with: (1) expertise in anti-bribery laws and counseling; (2) experience with the Advisers Act; (3) expertise in compliance policies, procedures, and controls; and (4) global resources. The order provided for the SEC Staff to make the final selection in their sole discretion.[51]

Independence Requirements

Q 9.6 What are the independence requirements of SEC-imposed monitors?

To ensure monitor independence, the Morford Memo requires the:

- Government to decline a candidate whose relationship with the company "would cause a reasonable person to question the monitor's impartiality";
- Company to commit "not [to] employ or be affiliated with the monitor for a period of not less than one year from the date the monitorship is terminated"; and
- Monitor to serve as an "independent third-party, not an employee or agent of the corporation or of the [g]overnment."[52]

The SEC typically imposes similar requirements. For example, in a recent enforcement action, the SEC's order requires that:

- Monitor candidates must be sufficiently independent to ensure effective and impartial performance;
- The company agrees that "no attorney-client, auditor-client, or similar relationship shall be formed";
- The company does not have the authority to terminate the monitor without SEC permission; and
- During and for two years after the conclusion of the monitorship, the company and its then-current or former affiliates or employees cannot discuss the possibility of any employment, consultant, attorney-client, auditing, or other professional relationship with the monitor.[53]

Monitor Retention Agreement

Q 9.7 What are the key terms of a company-monitor retention agreement?

The monitor and company typically enter into an engagement letter to memorialize the retention. Common terms include:

- Length and scope of monitor's engagement, often including by reference the settlement agreement;
- Tolling provisions in the event of company delay in providing materials or making individuals available;
- Identified representatives of the company and monitor;
- Statement of no agency, attorney-client, or fiduciary relationship between monitor and the company;
- Confidentiality and non-disclosure, including monitor's agreement not to disclose information except to the company or as required under the agreement, law, regulation, or legal or judicial process;
- Procedures and financial arrangements in the event that monitor receives subpoenas or other requests for documents or testimony;
- Indemnification for claims against monitor; and
- Fees and expenses.

Monitor Obligations

Q 9.8 What are the monitor's obligations?

The Morford Memo explains that the monitor's primary responsibility is "to assess and monitor [the] corporation's compliance with those terms of the agreement that are specifically designed to address and reduce the risk of recurrence of the corporation's misconduct, including, in most cases, evaluating (and where appropriate proposing) internal controls and corporate ethics and compliance programs."[54] DOJ settlement agreements and SEC orders in parallel criminal and civil cases mirror this language. As part of the monitor's assessment, the SEC typically requires the monitor to make recommendations for changes in or improvements to the company's policies and procedures. The monitor typically must provide written reports that describe the procedures performed, the conclusions reached, and the monitor's recommendations.

DOJ settlements and SEC orders in parallel criminal and civil cases also typically require the monitor to certify to the effectiveness of the company's compliance program. The breadth of the required certification varies and is essential as it impacts directly the nature and scope of the monitor's activities. Some settlements limit the monitor's certification to the effectiveness of the compliance program related to the specific misconduct that gave rise to the monitor (e.g., the anti-corruption compliance program in an FCPA matter).[55] Other settlements call for a much broader certification (e.g., effectiveness of the company's program to prevent and detect fraud).[56]

In instances when there is no parallel criminal case, the SEC sometimes requires that the monitor certify that the company has completed the undertakings required by the SEC order to the monitor's satisfaction. In one 2016 enforcement action, for example, the SEC barred an auditor from accepting new clients until it had received the monitor's certification.[57] The SEC is not prescriptive regarding the basis of the monitor's certification, which leaves monitors free to develop their own criteria. Available guidance includes: (1) DOJ policy statements and guidance on the evaluation of compliance programs; (2) the U.S. Sentencing Guidelines; and (3) the Committee of Sponsoring Organizations of the Treadway Commission Integrated Internal Control Framework. Taken together, the monitor will typically develop criteria and testing procedures for its certification relating to the company's:

- Control environment, including its efforts and accomplishments to instill a culture of integrity;
- Processes to identify, assess, and form a response to misconduct risk;
- Policies, programs, and controls to prevent and detect misconduct;

- Information and communication, including the use of data analytics and information technology; and
- Monitoring and internal audit.

Q 9.8.1 Must the monitor issue a work plan?

SEC orders typically require the monitor to develop a work plan for its initial and subsequent reviews, which, as discussed above, is affected by the monitor's certification requirement.[58] The company has the ability to submit comments on the work plan and the government settles any disputes if the company and monitor cannot agree upon the work plan.[59]

Q 9.8.2 How does the monitor conduct the evaluation?

Monitors employ many of the same procedures used in financial audits related to design and operating effectiveness of internal controls over financial reporting ("ICFR audits").[60] Design effectiveness refers to whether a control, if operating as prescribed by competent persons possessing the necessary authority, meets the control objectives. Operating effectiveness refers to testing whether a control is operating as designed and whether the person performing the control possesses the necessary authority and competence to perform the control effectively.

Certain procedures require specialized training (e.g., transaction testing and re-performance of controls). "Walkthroughs" are a common and effective audit procedure for evaluating design and validating operating effectiveness. When performing a walkthrough, an auditor follows a financial or non-financial transaction from start to end through the company's processes. Walkthroughs typically involve a combination of interview, observation, document review, and re-performance of controls.[61]

Monitoring, however, is not the same as an ICFR audit and differs in a number of respects:

First, an ICFR audit involves an audit of management's assertion as to the effectiveness of the company's financial reporting controls. The monitor, in contrast, expresses the monitor's evaluation of the company's controls.

Second, the monitor and ICFR auditor have very different objectives. The monitor assesses the company's controls to prevent and detect illegal acts. ICFR audits, in contrast, evaluate only the adequacy of the company's internal controls to prevent financial misstatements.[62] ICFR audits consequently revolve around financial statement materiality which, to the monitor, is irrelevant.

Third, an ICFR audit is static; that is, the auditor's report represents an opinion on the internal controls as of a particular point in time. Monitoring is continuous throughout the term of the monitorship.

Fourth, monitors often perform forensic procedures with respect to the books and records of the company in order to detect misconduct. A forensic audit usually involves a higher degree of skepticism than an ordinary financial statement audit or an ICFR audit and requires experience in conducting interviews and reconstructing transactions.

Q 9.8.3 Can the monitor rely upon the company's resources or work product conducted by or on behalf of the company?

SEC orders often encourage the monitor to coordinate with in-house counsel, compliance personnel, and internal auditors and rely, as appropriate, on audits, studies, reviews, and other work product conducted by or on behalf of the company, as well as the company's internal resources. Monitors can apply analogous auditing standards relating to reliance on work of others to develop a framework for relying on a company's policies and resources. These standards require the monitor to consider the objectivity and competence of the individuals on whom the monitor will place reliance and to re-perform certain of the procedures.[63]

Q 9.8.4 Will the monitor re-investigate the misconduct leading to the appointment?

The Morford Memo instructs DOJ prosecutors that it is not the monitor's mandate to investigate historical misconduct, while also noting that "in appropriate circumstances, an understanding of historical misconduct may inform a monitor's evaluation of the effectiveness of the corporation's compliance with the agreement."[64]

DOJ settlement agreements typically allow for the monitor to conduct procedures to understand "the facts and circumstances surrounding any violations that may have occurred before the date of the [a]greement," but caution the monitor "to rely to the extent possible" on information available from the company and note that parties do not intend for the monitor to "conduct his or her own inquiry into the historical events that gave rise" to the settlement.[65] SEC orders often include similar language.[66]

Q 9.8.5 What are the monitor's obligations regarding undisclosed or new misconduct?

The Morford Memo requires DOJ settlement agreements to "clearly identify any types of previously undisclosed or new misconduct that the monitor will be required to report directly to the [g]overnment. The agreement should also provide that as to evidence of other such misconduct, the monitor will have the discretion to report this misconduct to the [g]overnment or the corporation or both."[67]

DOJ settlement agreements vary regarding the breadth of conduct that must be reported to the government. Some agreements track reporting obligations quite narrowly to the type or pattern of misconduct that gave rise to a monitor. Other DOJ settlements set a lower threshold. In one DPA, for example, the provisions relating to undisclosed or new misconduct extend to "improper activities," which the agreement defines to include: (1) questionable, improper, or illegal practices relating to anti-fraud laws or antitrust laws; or (2) violations of the company's compliance or ethics programs.[68] The settlement agreement then explains the circumstances under which the monitor must report information directly to the government and the monitor's reports to address the adequacy of the company's response to misconduct.[69]

SEC orders contain similar language. The SEC's order related to its enforcement action against Och-Ziff, for example, requires the monitor to "disclose to the Commission staff any credible evidence that corrupt or otherwise suspicious transactions occurred, or payments or things of value were offered, promised, made, or authorized by any entity or person within Och-Ziff, or any entity or person working directly or indirectly for or on behalf of Och-Ziff, or that related false books and records may have been maintained by or on behalf of Och-Ziff or that relevant internal controls were circumvented or were not reasonably designed or implemented."[70] The order also requires that the Och-Ziff monitor "contemporaneously notify Och-Ziff's General Counsel, Chief Compliance Officer, and Audit Committee for further action unless at the monitor's discretion he or she believes disclosure to Och-Ziff would be inappropriate under the circumstances."[71]

Company Obligations

Q 9.9 What are the company's obligations?

SEC orders require that the company fully cooperate with the monitor. This cooperation includes providing the monitor with all non-privileged information, documents, records, facilities, and employees as reasonably requested by the monitor and using the company's best efforts to provide access to former employees, third-party vendors, agents, and consultants.[72] Additionally, the SEC requires the company to pay the monitor's fees and expenses.[73]

Practices vary as to how monitors access information. Some monitors directly contact company personnel to set meetings and request documents. Many companies establish internal project management offices ("PMOs"), staffed with business personnel, compliance officers, and in-house counsel, to facilitate and track the monitor's requests for information.

Practices also vary as to the presence of company personnel at meetings and interviews. Some monitors insist upon one-on-one meetings without PMO personnel or outside counsel. Other monitors allow PMO personnel and/or outside counsel to attend. Many monitors and companies employ a hybrid practice that allows company representatives to be present at some, but not all, meetings and interviews or during certain portions of an interview.

Q 9.9.1 Must the company provide privileged information?

SEC orders require the company to work cooperatively with the monitor to resolve situations in which the company seeks to withhold information or access to employees on the basis of attorney-client privilege, attorney work product doctrine, or other applicable law (e.g., data privacy statutes). SEC orders typically require the monitor to notify the SEC if it believes that the company is unreasonably withholding access, and require the company to provide the legal basis for withholding access. The SEC then determines whether to request further information.[74]

Q 9.9.2 Is the company required to implement the monitor's recommendations?

The Morford Memo instructs DOJ prosecutors to consider the company's failure to implement the monitor's recommendations in deciding whether the company is in breach of the agreement.[75] In practice, DOJ settlement agreements follow the same process for companies to object to a monitor's recommendations:

- Within sixty days of receiving the monitor's report, the company must notify in writing the monitor and government of recommendations that the company regards as "unduly burdensome, inconsistent with applicable law or regulation, impractical, excessively expensive, or otherwise inadvisable" and propose "an alternative policy, procedure or system designed to achieve the same objective or purpose."
- The company and monitor have forty-five days from the date that the company serves its objection notice to attempt in good faith to reach an agreement.
- If the company and monitor are unable to agree, the company must consult with the government, which will consider the recommendation and the company's response in deciding whether the company has breached the agreement.[76]

The SEC often follows a similar process whereby the company can object to the monitor's recommendations. In some instances, the SEC's order makes clear that the SEC Staff "in its sole discretion" shall resolve disputes between the company and monitor regarding recommendations.[77] In other cases, the SEC order requires the monitor to make the "final determination concerning the disputed [r]ecommendation."[78]

Unlike DOJ settlements, many SEC orders require that the company certify that it has implemented the monitor's recommendations.[79] Some orders also require that the monitor place limits on the company's ongoing business activities until the company receives the monitor's certification. For example, in one recent enforcement action, the SEC barred an audit firm from accepting new clients until it received the monitor's certification.[80] In another, the SEC required an audit firm to provide a copy of the SEC's order to any new clients until it received the monitor's certification.[81]

Monitor Reports

Q 9.10 What is a monitor required to report?

SEC orders typically require the monitor to provide written reports to the SEC Staff and the company. These reports are required to describe: (1) the scope of the monitor's review; (2) the procedures performed; (3) the conclusions reached; and (4) the monitor's recommendations.

The Morford Memo also provides that "it may be appropriate for the monitor to make periodic written reports to both the [g]overnment and the corporation."[82] As a practical matter, the DOJ almost always requires the monitor to issue written reports, typically with the caution to focus the report on recommendations rather than narrate in detail the company's history and compliance policies. The DOJ also allows monitors to share draft reports with the company on an ongoing basis, consider the company's comments and input, and share reports with both the company and employees prior to finalizing them. The SEC typically follows similar practices.

Initial reports range in length depending on the scope of the monitor's mandate; in some instances, they have exceeded 1,000 pages. The reports typically begin with an executive summary of the monitor's findings and recommendations. Subsequent reports tend to be shorter and include updates on the company's response to the monitor's recommendations and enhancements to the company's ethics and compliance program.

Q 9.11 Is the monitor's report confidential?

Recognizing the need for confidentiality of the monitor's work and reports, SEC orders provide for the monitor's report to remain confidential. SEC orders, for example, provide:

> Public disclosure of the reports could discourage cooperation, impede pending or potential government investigations or undermine the objective of the reporting requirement. For these reasons, among others, the reports and the contents thereof are intended to remain and shall remain non-public, except (i) pursuant to court order, (ii) as agreed to by the parties in writing, (iii) to the extent the Commission determines in its sole discretion that disclosure would be in furtherance of the Commission's discharge of its duties and responsibilities, or (iv) as is otherwise required by law.[83]

Over the past few years, third-party plaintiffs and journalists have sought access to monitor reports. Two recent examples are illustrative:

United States ex rel. Fisher v. Ocwen Loan Servicing, LLC involved a False Claims Act action in which the plaintiffs sought production of the report and working papers of a monitor appointed by NYSDFS.[84] NYSDFS argued that New York state banking law barred disclosure of the documents and that the federal banking examination privilege should also be extended.[85] Applying a balancing test, the court ordered production of the monitor's report and working papers.[86]

United States v. HSBC Bank USA, N.A. concerns a motion to unseal a monitor's report issued pursuant to a DPA.[87] The court considered whether the monitor's report: (1) was a prosecutorial or judicial document; (2) was subject to the First Amendment; and (3) justified blanket sealing.[88] The court ordered disclosure of a redacted version of the report.[89] The case is currently on appeal[90] and has attracted considerable media attention and an *amici curiae* brief from the Reporters Committee for Freedom of the Press and twenty-five news media organizations.[91]

Duration of Monitorship

Q 9.12 How long does the monitor serve?

Generally, prosecutors and regulators impose monitorships that last from less than a year to seven years.[92] SEC independent compliance consultant terms typically last nine months[93] to two years,[94] while SEC independent compliance monitors typically serve for three years.[95]

The Morford Memo sets criteria in considering the duration of a monitor's term:

> (1) the nature and seriousness of the underlying misconduct; (2) the pervasiveness and duration of misconduct within the corporation, including the complicity or involvement of senior management; (3) the corporation's history of similar misconduct; (4) the nature of the corporate culture; (5) the scale and complexity of any remedial measures contemplated by the agreement, including the size of the entity or business unit at issue; and (6) the stage of design and implementation of remedial measures when the monitorship commences.[96]

Q 9.13 Under what circumstances can the government extend or early terminate a monitorship?

The Morford Memo instructs that DOJ agreements should allow for extension of the monitor's term at the DOJ's discretion if the company breaches the agreement. The Morford Memo also allows early termination if the company can demonstrate to the DOJ that there is no longer a need for a monitor.

SEC orders usually include similar provisions. The SEC's order in the *Och-Ziff* case, for example, provides for a three-year term, which the SEC can terminate early if "there exists a change in circumstances sufficient to eliminate the need for the [m]onitor"[97] or extend for an additional twenty-four months "at the discretion of the [S]taff"[98] or if the Staff "concludes that Och-Ziff has not successfully satisfied its obligations under the [m]onitorship with respect to the [m]onitor's [m]andate."[99]

Notes to Chapter 9

1. DOJ Criminal Division and SEC Enforcement Division, *A Resource Guide to the U.S. Foreign Corrupt Practices Act* 71 (2012) [hereinafter Resource Guide], https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2015/01/16/guide.pdf.
2. *See, e.g., In re* Orthofix International N.V., Exchange Act Release No. 79,828, at 8 (Jan. 18, 2017) [hereinafter Orthofix SEC Order].
3. *See, e.g., In re* Och-Ziff Capital Management Group LLC, Exchange Act Release No. 78,989, at 36 (Sept. 29, 2016) [hereinafter Och-Ziff SEC Order].
4. *See* Office of Inspector General, Department of Health & Human Services, *OIG Guidance on IRO Independence and Objectivity* (2016), https://oig.hhs.gov/fraud/cia/docs/iro-guidance-2016.pdf.
5. Amended Consent Decree, New York v. The Bd. of Trs. of the Cooper Union, No. 155185/2014 (N.Y. Sup. Ct. Sept. 21, 2015).
6. Stipulation to Entry of Order for Permanent Injunction and Monetary Judgment, FTC v. Herbalife Int'l of Am., Inc., No. 2:16-cv-05217 (C.D. Cal. July 15, 2016).
7. *See* United Kingdom Financial Conduct Authority, *Skilled Persons Reviews* (Feb. 1, 2017), https://www.fca.org.uk/about/supervision/skilled-persons-reviews.
8. NYSDFS, for example, recently appointed monitors to investigate alleged manipulation of foreign exchange rates. *See* Karen Freifeld, *NY Monitor in Deutsche to Probe Possible Forex Rigging*, REUTERS (Feb. 9, 2015) (a report on appointment of investigative monitors to Deutsche Bank and Barclays).
9. 15 U.S.C. § 78u(d)(5); *see generally* Jennifer O'Hare, *The Use of the Corporate Monitor in SEC Enforcement Actions*, 1 BROOKLYN J. CORP., FIN. & COM. L. 89, 93 (2006).
10. Richard G. Wallace and Benjamin R. Dryden, *Use of Independent Consultants as a Remedy in Securities Enforcement Actions*, 42 BNA Securities Regulations & Law Report 750 (Apr. 19, 2010).
11. *In re* American Registrar & Transfer Company, Exchange Act Release No. 77,922, at 8 (May 25, 2016).
12. *In re* Apex Fund Services (US), Inc., Advisers Act Release No. 4429, at 6 (June 16, 2016).
13. *In re* Barclays Capital Inc., Exchange Act Release No. 77,018, at 5 (Feb. 2, 2016).
14. *In re* E.S. Financial Services, Inc., Exchange Act Release No. 77,056, at 6 (Feb. 4, 2016).
15. *In re* EFP Rotenberg, LLP, Exchange Act Release No. 78,393, at 13 (July 22, 2016) [hereinafter EFP Rotenberg SEC Order].
16. *In re* LAN Airlines S.A., Exchange Act Release No. 78,402, at Attachment A (July 25, 2016) [hereinafter LAN Airlines SEC Order].

17. *In re* Everhart Financial Group, Inc., Exchange Act Release No. 76,897, at 8 (Jan. 14, 2016).

18. *In re* Steven A. Cohen, Advisers Act Release No. 4307, at 10 (Jan. 8, 2016).

19. Resource Guide, *supra* note 1, at 71.

20. *See* DOJ, *U.S. Attorneys' Manual—Principles of Federal Prosecution of Business Organizations* § 9-28.300 (2016) [hereinafter Principles of Federal Prosecution], https://www.justice.gov/usam/usam-9-28000-principles-federal-prosecution-business-organizations.

21. *See* Resource Guide, *supra* note 1, at 53–54; *cf.* SEC Enforcement Division, *Enforcement Manual* § 6.1.2 (2016) [hereinafter SEC Enforcement Manual].

22. *See* Resource Guide, *supra* note 1, at 53–54; *cf.* SEC Enforcement Manual, *supra* note 21, at § 6.1.2; SEC, *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 (Oct. 23, 2001) (commonly referred to as the "Seaboard Report").

23. *See* Resource Guide, *supra* note 1, at 71.

24. Principles of Federal Prosecution, *supra* note 20, at § 9-28.300.

25. *See* DOJ, *New Compliance Counsel Expert Retained by the DOJ Fraud Section*, https://www.justice.gov/criminal-fraud/file/790236/download.

26. *See* DOJ, *Evaluation of Corporate Compliance Programs*, www.justice.gov/criminal-fraud/page/file/937501/download.

27. The eleven sections include: (1) analysis and remediation of underlying conduct; (2) senior and middle management; (3) autonomy and resources; (4) policies and procedures; (5) risk assessment; (6) training and communications; (7) confidential reporting and investigation; (8) incentives and disciplinary measures; (9) continuous improvement, periodic testing, and review; (10) third-party management; and (11) mergers & acquisitions.

28. *See generally* Jonny Frank, Chapter 13A—*Remediation*, Litigation Services Handbook: The Role of the Financial Expert (Wiley 5th ed. 2015) [hereinafter Remediation Chapter].

29. *See* DOJ, *The Fraud Section's Foreign Corrupt Practices Act Enforcement Plan and Guidance*, www.justice.gov/criminal-fraud/file/838416/download.

30. *Id.*

31. *See generally* Remediation Chapter, *supra* note 28.

32. *See* Resource Guide, *supra* note 1, at 71.

33. U.S. Sentencing Commission, *Guidelines Manual* § 8B2.1, application note 6 (2016).

34. *In re* Barclays Capital Inc., Exchange Act Release No. 77,001, at 13–14 (Jan. 31, 2016).

35. *Id.* at 16.

36. Serious Fraud Office v. Rolls-Royce PLC, No. U20170036, Royal Courts of Justice, at ¶ 43 (Jan. 17, 2017), www.judiciary.gov.uk/wp-content/uploads/2017/01/sfo-v-rolls-royce.pdf.

37. LAN Airlines SEC Order, *supra* note 16, at Attachment A ¶¶ 21–22.

38. *Id.* at Attachment A ¶ 23.

39. Orthofix SEC Order, *supra* note 2, at 9.

40. *In re* the Port Authority of New York and New Jersey, Securities Act Release No. 10,278, at 11 (Jan. 10, 2017).

41. *In re* Grassi & Co., Exchange Act Release No. 79,368, at 29 (Nov. 21, 2016) [hereinafter Grassi SEC Order].

42. *Id.* at 29–31.

43. *See, e.g., In re* Biomet, Inc., Exchange Act Release No. 79,780, at Attachment A ¶¶ 9–23 (Jan. 12, 2017) [hereinafter Biomet SEC Order].

44. *See, e.g., id.* at Attachment A ¶ 7.

45. *See, e.g.*, Grassi SEC Order, *supra* note 41, at 29.

46. *See* Craig Morford, Acting Deputy Attorney General, *Selection and Use of Monitors in Deferred Prosecution Agreements and Non-Prosecution Agreements with Corporations* (2008) [hereinafter Morford Memo], https://www.justice.gov/usam/criminal-resource-manual-163-selection-and-use-monitors. In 2010, Acting Deputy Attorney General Gary Grindler added a tenth principle pertaining to resolution of disputes between the company and the monitor. *See* Gary Grindler, Acting Deputy Attorney General, *Additional Guidance on the Use of Monitors in Deferred Prosecution Agreements and Non-Prosecution Agreements with Corporations* (2010), https://www.justice.gov/usam/criminal-resource-manual-166-additional-guidance-use-monitors-dpas-and-npas. In general, the principle explains that the DOJ should limit its role to disputes regarding whether the company has complied with the terms of the agreement and not arbitrate contractual disputes between the company and the monitor.

47. Morford Memo, *supra* note 46. The Morford Memo forbids United States Attorneys and Assistant Attorneys General from unilaterally making, accepting, or vetoing the selection of candidates and requires final approval from the Deputy Attorney General.

48. *Id.*

49. *Id.*

50. *See, e.g.*, Och-Ziff SEC Order, *supra* note 3, at 36–37.

51. *See id.* at 36–37.

52. Morford Memo, *supra* note 46.

53. Och-Ziff SEC Order, *supra* note 3, at 36–44.

54. Morford Memo, *supra* note 46.

55. *See, e.g.*, Och-Ziff SEC Order, *supra* note 3, at 43.

56. *See, e.g.*, Deferred Prosecution Agreement at Attachment C ¶ 20, United States v. Deutsche Bank AG, No. 3:15-cr-00061-RNC (D. Conn. Apr. 23, 2015) [hereinafter Deutsche Bank DPA] (monitor to certify to whether compliance program is "reasonably designed and implemented to prevent and detect violations of the anti-fraud or anti-trust laws").

57. EFP Rotenberg SEC Order, *supra* note 15, at 13.

58. *See, e.g.*, Biomet SEC Order, *supra* note 43, at Attachment A ¶ 9.

59. *See, e.g., id.* at Attachment A ¶ 7.

60. *See generally* PCAOB, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, Auditing Standard No. 5 (2007).

61. *See id.* at ¶¶ 37–38.

62. *See id.* at ¶¶ 1–5.

63. *Cf.* PCAOB, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, AU Sec. 322 (1991).

64. Morford Memo, *supra* note 46.

65. Deferred Prosecution Agreement at Attachment D ¶ 11, United States v. Och-Ziff Capital Mgmt. Grp. LLC, No. 16-516 (NGG) (E.D.N.Y. Sept. 29, 2016).

66. Och-Ziff SEC Order, *supra* note 3, at 39.

67. Morford Memo, *supra* note 46.

68. Deutsche Bank DPA, *supra* note 56, at Attachment C ¶ 21.

69. *Id.*

70. Och-Ziff SEC Order, *supra* note 3, at 42.

71. *Id.* at 43.

72. *See, e.g., id.* at 37.

73. *See, e.g.*, Grassi SEC Order, *supra* note 41, at 29.

74. *See, e.g.*, Och-Ziff SEC Order, *supra* note 3, at 38.

75. *See* Morford Memo, *supra* note 46.

76. Deutsche Bank DPA, *supra* note 56, at Attachment C ¶¶ 14–15.

77. *See, e.g.,* Och-Ziff SEC Order, *supra* note 3, at 40.

78. *See, e.g., In re* Royal Alliance Associates, Inc., Exchange Act Release No. 77,362, at 9 (Mar. 14, 2016).

79. *See, e.g.,* Och-Ziff SEC Order, *supra* note 3, at 43.

80. EFP Rotenberg SEC Order, *supra* note 15, at 13.

81. *In re* MaloneBailey LLP, Exchange Act Release No. 77,755, at 20 (May 2, 2016).

82. Morford Memo, *supra* note 46.

83. *See, e.g.*, Och-Ziff SEC Order, *supra* note 3, at 44.

84. U.S. *ex rel.* Fisher v. Ocwen Loan Servicing, LLC, No. 4:12-CV-543, 2015 WL 3942900, at *1–2 (E.D. Tex. June 26, 2015).

85. *Id.* at *2.

86. *Id.* at *3–6.

87. United States v. HSBC Bank USA, N.A., No. 12-CR-763 (JG), 2016 WL 347670, at *1 (E.D.N.Y. Jan. 28, 2016).

88. *Id.* at *1–7.

89. *Id.* at *7.

90. United States v. HSBC Bank USA, N.A., No. 16–308 (2d Cir.).

91. Brief of Amici Curiae the Reporters Committee for Freedom of the Press and 25 News Media Organizations in Support of Appellee, United States v. HSBC Bank USA, N.A., No. 16–308 (2d Cir. Oct. 28, 2016).

92. *See, e.g.*, Stipulation to Entry of Order for Permanent Injunction and Monetary Judgment at 21, FTC v. Herbalife Int'l of Am., Inc., No. 2:16-cv-05217 (C.D. Cal. July 15, 2016) (seven-year term).

93. *See, e.g.*, Grassi SEC Order, *supra* note 41, at 31.

94. *See, e.g., In re* Las Vegas Sands Corp., Exchange Act Release No. 77,555, at 11 (Apr. 7, 2016).

95. *See, e.g.*, Och-Ziff SEC Order, *supra* note 3, at 37.

96. Morford Memo, *supra* note 46.

97. Och-Ziff SEC Order, *supra* note 3, at 37.

98. *Id.*

99. *Id.* at 37, 43.