

FALL 2016

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Compliance:
Understanding the Dark Alleys





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Developing Global Leaders at
the Crossroads of the Americas®

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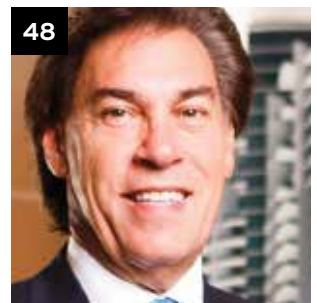
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Navigating Compliance



It's a new era of personal accountability when it comes to corporate wrongdoing - which means that you need to understand compliance, no matter what your position, and no matter how small or large your company.

By Lauren Comander

When news broke in September that, in order to meet sales goals, thousands of Wells Fargo employees had opened bogus accounts for millions of Americans, proponents of holding individuals accountable for corporate wrongdoing wondered whether this might be a test case. Last year, U.S. Deputy Attorney General Sally Quillian Yates released a memo announcing that federal prosecutors would be focusing on culpable individuals personally, possibly putting them criminally on the hook for a company's wrongdoing. The so-called "Yates Memo" sent shockwaves of concern through corporate America. Up until then, the penalty for not complying with laws such as the Foreign Corrupt Practices Act and Sarbanes-Oxley had been fines, generally for the company. Some companies even considered these fines – albeit increasingly large ones – merely "the cost of doing business."

Enter Wells Fargo and the shocking allegations that employees, succumbing to internal pressure, created unauthorized accounts on behalf of clueless customers. This case, explains Anita Cava, director of the Business Ethics Program, professor of business law at the School and compliance expert, perfectly illustrates the friction in corporate America between the drive for profits and the requirements to operate within legal norms. Compliance – conforming to laws, rules and regulations, and being able to prove that the company has done so – "is really in the

crosshairs of trying to mediate between those tensions," she says.

Cava's opinion is that Wells Fargo executives may have some explaining to do, even though it is always difficult to prove the required criminal intent. "Wells Fargo settled charges of fraud and is now dealing with criminal charges of identity theft in California," Cava says. "If I'm them, I'm getting concerned about personal liability."

The bank initially responded by firing about 5,300 employees but not one senior manager, although Carrie Tolstedt, who headed the division accused of creating the fake accounts, left the company ahead of her scheduled "retirement" and agreed not to exercise certain stock options. As former employees came forward claiming they had been dismissed for complaining to the company ethics line, anger grew over the lack of accountability at the top. Regulators leveled a \$185 million fine, and congressional hearings ensued. Sen. Elizabeth Warren, long a proponent of Wall Street regulation, grabbed headlines with her takedown of Wells Fargo Chief Executive John Stumpf. "This is about accountability," Warren said. "You should resign. You should give back the money that you took while this scam was going on, and you should be criminally investigated." Ultimately, Stumpf "retired" with no mention of the scandal, walking away with an estimated \$130 million.

While it is too soon to tell what, if any, criminal charges will come from this investigation, one thing is clear: “Personal accountability is the new watchword in our scrutiny of corporate behavior,” says Cava, who teaches in the School’s compliance programs. “People need to be careful. Every company needs to worry about compliance.” That includes small companies, because hot-button compliance concerns, ranging from cybersecurity to sexual harassment, can occur regardless of company size.

Concern about failing to hold individuals personally accountable for corporate wrongdoing dates back to the financial crisis. When documentary filmmaker Charles Ferguson took the stage in 2011 to accept his Oscar for “Inside Job,” he said to thunderous applause: “I must start by pointing out that three years after our horrific financial crisis caused by massive fraud, not a single financial executive has gone to jail, and that’s wrong.”

Says Cava: “That refrain has echoed over the last five years, and that conversation has become a strong selling point for government enforcement



actions now.” In 2015, the Federal Reserve System barred six bankers from the industry, twice the number it barred during 2014. In 2013, the Fed didn’t bar anyone. In a recent televised interview on CNBC, Daniel Tarullo, a Federal Reserve governor who leads many of the central bank’s regulatory oversight efforts on Wall Street, said, “There is a need, I think, for focus on individuals as well as the fines put on the institutions.”

With possible criminal convictions on the table, and governments around the world leveling increasingly higher fines for violating laws and regulations, companies of all sizes need to

build up their compliance programs, ensure that every employee understands the regulatory and legal rules of their work, plus regularly update and strongly enforce the compliance programs they create.

“There was a concern that a lot of businesses were simply deciding it was cheaper to not comply and run the risk of fines or enforcement procedures,” says Mark Shapiro, a business law lecturer at the School who teaches courses on risk and compliance. “With criminal exposure, that’s a lot less likely to happen. Businesses are creating their own infrastructure to make sure their employees are aware of the rules, are doing what they’re supposed to be doing and understand what the requirements are.” Part of that is because companies that have strong compliance programs in place can look for “cooperation credit” under federal sentencing guidelines to mitigate their exposure. The Yates Memo, however, added a requirement that in order to get credit, companies must disclose to the government everyone involved in the wrongdoing. “That’s super difficult for everyone concerned,” Cava says. “Someone is going to get made the sacrificial lamb. Personal accountability – it’s all very new.”

ENFORCEMENT INCREASES

The laws enacted to regulate the behavior of businesses date back

LAW & ETHICS

The Seven Pillars of Compliance

For an effective compliance program, a company must:

- Establish standards and procedures, to be followed by employees, that are reasonably capable of reducing the prospect of criminal conduct (in essence, policies for self-policing)

- Hire specific high-level personnel to oversee compliance – people with substantial control over the organization or a substantial role in making policy within the organization
- Take due care not to grant substantial discretionary authority to those with a propensity for illegal conduct

- Effectively communicate compliance standards and procedures within the company
- Take reasonable steps to achieve compliance, including having active auditing, monitoring and reporting mechanisms

- Consistently enforce compliance policies by taking appropriate disciplinary measures
- Take reasonable steps to respond appropriately to misconduct if it occurs and to prevent the recurrence of misconduct

decades. Consider the 1977 Foreign Corrupt Practices Act (FCPA), which prohibits American companies operating internationally from bribing public officials to secure contracts. Under the FCPA, even if an employee's actions are legal in the country in which they take place, the company is still breaking U.S. law, and can face both civil and criminal penalties. However, the FCPA was not only amended to allow "grease payments" to expedite an already-signed contract, but also simply not enforced. In the 1990s, the Federal Sentencing Guidelines for Organizations (FSGO) added the idea of giving credit to a company accused of wrongdoing if it had an effective ethics program in place. The FSGO outlines the "Seven Pillars of

Compliance," the basic requirements companies need to meet to receive "cooperation credit."

In 2008, Siemens, the German engineering giant, agreed to pay a record \$800 million to American authorities to settle charges that it routinely used bribes and slush funds to secure public works projects around the globe. Large multinational companies took note and began expanding their compliance programs and training.

Then, around the time of Ferguson's Oscar acceptance speech in 2011, other countries began seeking ways to wrestle bribery and corruption issues into line. The United Kingdom passed the UK Bribery Act, a law that goes further than the FCPA by prohibiting bribes to both private and public officials. Latin American countries passed their own laws.

"Having the statute doesn't mean it's enforced, but it shows increasing concern with the huge cost of corruption to the fabric of society," Cava says.

Putting compliance programs in place and meeting regulatory requirements is costly as well, especially for smaller companies, Shapiro notes. It's a problem, he says, for which there is little recourse. Big or small, domestic or international, health care or food service – no company can escape the long arm of compliance. "Every business has its own risk profile," Shapiro explains. "Multinational corporations are the ones that have the most exposure, but this applies to small businesses just as much as it does big businesses."

NAVIGATING A MURKY PATH

Health care and banking are two mammoth industries that must contend with a myriad of compliance laws. In countries where health care is nationalized, every doctor, hospital administrator and nurse is a public official subject to the FCPA – meaning that a pharmaceutical rep who brings

lunch and a seminar to a doctor's office there may be breaking U.S. law.

Wells Fargo probably broke the law when it opened accounts without customers' authorization, and it's easy to understand that a gift or cash payment to a public official is an illegal bribe. But, says Cava, "a lot of times compliance doesn't have such a clear area of misconduct." For instance, what if a company needs to hire a subcontractor to help it install its software at a foreign ministry? Can it hire a company owned by the sister-in-law of the deputy minister? What if that company is the best qualified for the job? What if, in order to win a government contract in a foreign nation, a company hires a local lobbying firm? Does it violate the FCPA to pay that firm a bonus if it gets the contract? The answers to these questions are complex and require careful monitoring.

Another difficult area of compliance involves U.S. companies hiring the adult children of high-ranking public officials in their foreign offices. These so-called "princelings" often happen to be among the most well-educated, qualified job candidates in locales where companies are eager to find top employees. But through a compliance lens, hiring a "princeling" could be "something of value" to their important parent, a public official, and therefore a possible violation of the FCPA. Back in the U.S., there's no similar law prohibiting companies from hiring the children of public officials.

Cava is about to publish a law review article on the "princeling" conundrum, which has become a focus of U.S. Department of Justice enforcement. "When Congress drafted the FCPA, it likely intended to prohibit bribing public officials with money and expensive gifts, but the notion of value has come to include luxury trips and even the perceived favor of hiring a family member," Cava explains. "U.S.

IN THE FIELD

High Risk, High Opportunity: The Compliance Officer's Job

While lawyers head many compliance departments, other staffers often just have an interest in law, management or accounting. Compliance officers look for patterns and red flags by working with big data, metrics and computer programs. They develop policies, and they keep an eye on employees. Advantages include relatively high salaries and access to C-level executives. "It's an exciting entry-level job, and the opportunities are endless," says Mark Shapiro, a business law lecturer at the School who teaches risk and compliance classes. "You have to be a jack of all trades. But it's not for everybody. You have to be detail-oriented. You have to like rules and

getting people to follow rules. You have to have really good people skills, because a lot of times, you have to convince businesses to comply with the rules that get in the way of their day-to-day mission. You have to say no to people a lot." Compliance officers also need to be able to handle a fair amount of stress. "This is not a risk-free job," Shapiro notes. "Your failure, depending on the severity of the failure and the degree of due diligence to assure compliance, can lead to real personal exposure. You are responsible for all these people, yet you have no ability to control them other than through policies and procedures." -LC



companies would like to be able to hire the best and the brightest in developing countries, but they have to be very careful in how they select those people. The process must be transparent and consistent in order to survive government scrutiny. Otherwise, the employment offer might be viewed as an improper offer of something of value to that educated person's well-placed parent."

Hiring officials' family members has proven a particular problem for foreign banks in places like China, where social connections often are more important than business experience. JP Morgan Chase once had a formal program called "Sons and Daughters," which facilitated hiring the children of China's elite. One internal document even linked the hires to "revenue" the bank obtained from companies or government organizations run by their parents.

Federal agencies have been investigating those hiring practices for the past three years. The bank settled with federal prosecutors and the Security and Exchange Commission (SEC), avoiding criminal charges, paying roughly \$264 million in fines and securing a rare nonprosecution agreement, although the Justice Department's investigation is still ongoing.

JP Morgan Chase wasn't the first bank cited for violating the FCPA with its overseas hiring practices, although cracking down on big banks

for violating the FCPA is a relatively new phenomenon. Last year, Bank of New York Mellon agreed to pay \$14.8 million to the SEC to settle similar accusations. Interestingly, it appears that no individual employees will be criminally charged in either case.

The SEC may be just getting started on its "princeling" hiring investigations. Banks including HSBC and Deutsche Bank have disclosed ongoing investigations into their hiring practices, and it's expected that regulators will focus additional attention there now that they have settled with JP Morgan Chase.

COMPLIANCE AND ETHICS

Though it's true that detecting and preventing wrongdoing depends on the type of business and its particular risks, every company needs a framework for a system of compliance thinking. Asking employees to memorize a list of rules and regulations won't really do the job – they need a solid system of principles to guide them, says Imelda Alvarez, Novartis' regional integrity and compliance officer for Latin America and Canada. She is an alumna of the School's Latin American Health Care Compliance Certificate Program and on the program's advisory board. "Compliance and ethics are two different concepts, but they live together," she explains. "There is a lot of discussion worldwide about what is

better: principles only or rules only. I think it's a mix."

Rules outline what is unacceptable in an organization. For example, in the heavily regulated pharmaceutical industry, there are specific rules governing how employees interact with health care professionals. "Either talk about educational programs or talk legitimately in accordance with the rules about products," Alvarez says. "That's it. Compliance in this environment is clear and evolving." But, she adds, echoing Cava, compliance isn't always so clear. A majority of the time, when dilemmas crop up, employees are guided not by rules, but by principles. "Ethics allows us to think about what is the right thing to do even beyond what is regulated," Alvarez says. "It's a different standard, and it's very subjective: What is expected by patients, by society and by new generations like millennials and the e-generation from us?"

Novartis has specific rules for specific situations, and also offers its employees guidance through its code of conduct, posted on its website for all to peruse. Employees are told that when they have doubts about how to conduct themselves, they should ask themselves a set of questions: Would their conduct allow the company to maintain the trust of its stakeholders? Would they be comfortable if their conduct appeared in the media? Would their family and friends think their conduct was ethical? "It may be that there are no regulations, but at the end of the day, these questions are really helpful," Alvarez says.

Compliance experts agree that companies need strong policies and procedures to communicate the legal requirements, clear protocols for employee expectations, and mechanisms to monitor adherence. Many businesses conduct

data-driven audits, building software to flag instances that warrant further investigation. But the real goal of any company should be to create a culture in which employees do the right thing, Alvarez says. "One of the biggest challenges for compliance professionals is that we need to embed our culture to do the right thing when nobody is looking at you," she adds. "That, together with the reputation built with patients, doctors and society, is really the actual metric for compliance program effectiveness."

Such a culture is particularly important because laws and regulations are continually evolving. Companies must plan for the future, even as the very definition of what is and what is not acceptable – both in terms of rules and principles – is constantly changing. Cava says companies must continuously evaluate and update their practices. "They can't be stashed on a shelf and just rolled out year after year," she says. "In order to show the government that you're making a legitimate effort to detect and prevent wrongdoing, you have to make sure you're doing it better and better. You get credit for trying new things and using new strategies. After this thing with Wells Fargo, you might have a component of compliance that says, 'If goals include breaking the law, don't do it.' Some things just have to be said." U

Editor's Note: Imelda Alvarez's comments reflect her personal opinions and not those of Novartis.

IN THE CLASSROOM

The School's Compliance Programs



As the demand for entry-level compliance jobs explodes, the School of Business is preparing students for careers in the field. Six years ago, the School, led by Anita Cava, director of the Business Ethics Program and professor of business law, worked with Johnson & Johnson to create the Latin American Health Care Compliance Certificate Program. The three-day executive education program, initially funded by Johnson & Johnson, was the brainchild of Clivetty Martinez, who was then with J&J and is now the vice president of global compliance and chief privacy officer at health care products company Perrigo. "I had 28 employees throughout Latin America; I needed to find a forum where they could get education on Latin American compliance laws and regulations. Other

multinational companies in the industry were also looking for similar continuing education opportunities for their employees. At the time, no such forum existed," Martinez recalls.

After putting together criteria for selecting the best university partner for creating such a program, she interviewed 10 schools. "From my first visit, I could tell the UM School of Business was willing to dedicate the resources to the development of a program that could be repeated over and over again, and I'm extremely proud of what it has become," Martinez says.

In 2014, Cava worked with Martinez and Imelda Alvarez, Novartis' regional integrity and compliance officer for Latin America and Canada, to create a Compliance Boot Camp for undergraduates – helping to fill a void in entry-level compliance

education. Believed to be the only such option in the country, the four-day, no-cost and no-credit, program teaches students the pillars of compliance theory and practice, and it has grown to cover both the health care and financial industries. Now funded by an anonymous donor, the boot camp will expand this year to include graduate students.

To prepare even more students for the burgeoning field, this fall the School launched the Art and Science of Corporate Compliance, an undergraduate course that proved so popular it garnered a waitlist. Mark Shapiro, a business law lecturer at the School who teaches in the compliance certificate program, crafted and teaches the course. He also teaches a module for the capstone MBA class on compliance and how it impacts the decision-making of executives and businesses.

Michael Scher, a former compliance officer who is a senior editor of the FCPA blog, co-taught the first two boot camps and wrote about it for the blog. His post piqued the interest of Bruno Grandguillotte, vice president and chief compliance officer at

Miami-based technology supplier Ingram Micro. Grandguillotte and Cava teamed up to convene a meeting of compliance officers from large companies at the School of Business. The resulting Compliance Office Network now meets regularly to share best practices and hear from guest speakers. And, Shapiro's undergraduate course includes a class project that puts the students face-to-face with the compliance officers who attend the luncheons, so the students can network and learn about their jobs.

In January 2017, the School will host the American Society of International Lawyers' Anti-Corruption Law Interest Group semiannual conference, bringing together academics and compliance practitioners from around the world. Co-sponsored by the Wharton School of the University of Pennsylvania, the University of Richmond School of Law and Bentley University, the theme is "Controlling Corruption: Possibilities, Practical Suggestions & Best Practices." Topics will range from the UK Bribery Act to data-driven compliance. – LC