

Preparing For DOJ's Compensation Clawback Pilot Program

By **Jaclyn Whittaker, Martha Stolley and Amy Schuh**

(March 9, 2023, 2:43 PM EST)

The U.S. Department of Justice recently announced a compensation clawback pilot program, as well as changes to the corporate compliance program evaluation criteria in the latest of a flurry of policy updates.

On March 2, Deputy Attorney General Lisa Monaco announced the launch of a significant pilot program[1] on compensation incentives and clawbacks during a speech at the American Bar Association's annual National Institute on White Collar Crime in Miami.[2]

Under the first-ever, three-year pilot program, companies will be able to reduce criminal fines by attempting in good faith to claw back compensation from individual wrongdoers — even if those efforts are unsuccessful — and the companies will be able to retain any recovered funds.

In addition, the DOJ will require every company that reaches a criminal resolution to restructure its compensation and bonus programs to incentivize compliance.

On March 3, Assistant Attorney General Kenneth Polite provided more details about the pilot program[3] and advised that the Criminal Division made significant revisions to its Evaluation of Corporate Compliance Programs, or ECCP, including additions that more explicitly consider whether a company's compensation and bonus program is designed to incentivize compliance.[4]

These announcements come roughly a week after the DOJ announced a formal voluntary self-disclosure policy for all U.S. attorney's offices nationwide — thereby "eliminating geographic disparities and uncertainties," as Monaco noted in her speech — and is part of a broader effort to induce companies to improve their corporate compliance programs, self-report issues and hold individuals accountable for misconduct.

Setting the Stage in September 2022

During the announcement, Monaco referenced her speech at the New York University School of Law in September 2022, during which she announced a series



Jaclyn Whittaker



Martha Stolley



Amy Schuh

of changes meant to strengthen the DOJ's corporate enforcement policy.

One of the more notable announcements was that the DOJ would examine corporate compensation programs with an eye toward shifting the costs of corporate crime from shareholders to wrongdoers.

Monaco explained that, going forward, the DOJ would require companies to show how they are linking compensation to compliance, including by clawing back compensation or perks given to individual wrongdoers.

At the time, her remarks were the DOJ's clearest and most public pronouncement that a healthy corporate culture is tied to compensation.

Additionally, her comments reflected the DOJ's renewed and intensified focus on holding individuals accountable and incentivizing companies to devise robust corporate compliance programs.

At Monaco's direction in connection with her September 2022 announcement, the DOJ's Criminal Division consulted with regulators and practitioners to examine how best to implement a compensation clawback and incentive policy.

Based on that study, the Criminal Division developed the DOJ's pilot program on compensation incentives and clawbacks, a program meant to help companies promote a healthy culture of compliance through compensation models.

The Pilot Program

The pilot program has two components.

First, every corporate resolution involving the Criminal Division will now require that the resolving company develop compliance-promoting criteria within its compensation and bonus system. The criteria can be tailored to fit the company's existing compensation program.

Monaco noted that Criminal Division resolutions over the last several months have increasingly incorporated this requirement.

Second, the Criminal Division will provide fine reductions to companies that seek to claw back compensation from corporate wrongdoers.

At the outset of the resolution, the resolving company will pay the applicable fine, minus a reserved credit equaling the amount of compensation the company is attempting to claw back from culpable executives and employees.

Polite cautioned that, to be eligible for the credit, companies also must fully cooperate with the DOJ and remediate the misconduct and any compliance issues in a timely manner.

In an interesting twist, whatever compensation the resolving company successfully recoups from a responsible executive or employee, it gets to keep. The company does not have to pay the DOJ the amount it recovered, and it is still entitled to the full amount of the fine reduction.

Recognizing the profound difficulties that companies face in pursuing clawbacks, particularly from

employees or executives located outside the U.S., prosecutors will have discretion to award a fine reduction — up to 25% of the compensation sought — to companies that pursue in good faith, but do not succeed in, recouping the money. In other words, it is the effort that counts.

Individual Accountability

The pilot program aligns closely with, and gives effect to, the DOJ's recent emphasis on individual accountability. It rewards — in a material fashion — a company that attempts to punish individual wrongdoers through clawing back compensation, regardless of whether the company is ultimately successful.

Although the use of clawbacks to punish misconduct is not new — the U.S. Securities and Exchange Commission adopted clawback requirements last year^[5] — the DOJ has not formally incentivized their use in this manner before now, nor has it so strongly encouraged companies to take action against individuals in exchange for discounted corporate penalties.

As Monaco explained, "Our goal is simple: to shift the burden of corporate crime away from shareholders who frequently play no role in the misconduct and onto those who are directly responsible."

She reiterated the DOJ's focus on holding individual wrongdoers accountable, "no matter how prominent or powerful they are."

Polite echoed Monaco's focus on individual accountability and explained that the pilot program is part of the DOJ's ongoing efforts to target individuals.

He also explained that the Criminal Division has revised the ECCP to provide prosecutors with additional, structured guidance on evaluating a company's compensation system, and whether it is designed to reward ethical behavior and deter and punish misconduct.

Concurrently, Polite announced changes to the ECCP with respect to the collection of data from third-party messaging applications, noting that companies would not be eligible for cooperation credit unless they appropriately preserve data on third-party applications, communicate their policies to employees and enforce them on a consistent basis.

Implications

Over the past several months, the DOJ has announced several new or revised policies, all of which are meant to incentivize companies to enhance their corporate compliance policies and to punish individual wrongdoers.^[6] The pilot program and ECCP changes are the latest, but certainly not the last, in this line of announcements.

In light of these new policies, companies that are not already taking steps to update their compliance and compensation programs should do so immediately.

First, companies should make the right investments in compliance, including ensuring there is an active executive team, an engaged audit committee, robust policies, adequate resources across the control functions, and leaders and managers that set the tone for the company's culture.

They also should ensure they have sufficiently strong and accessible reporting and investigation functions.

Second, companies should examine their employment and severance agreements specifically as to clawbacks and determine whether any changes are needed.

They also should look at directly linking compensation to compliance-related performance objectives and compliance behavior.

More generally, they should evaluate their disciplinary philosophy and whether it contemplates imposing financial penalties on employees who engage in misconduct — including and especially supervisors who allow or ignore misconduct.

Leaders and managers set the tone for a company's culture, and it is critically important to hold them accountable when they fail to exercise oversight or to address an issue.

Third, companies should develop metrics to measure compliance, despite the challenges this may present.

For instance, a company might be tempted to base its measure of compliance on the number of founded cases or complaints registered with the hotline. However, this provides only a snapshot and not a 360-degree view into other metrics that indicate whether a company has a healthy compliance culture.

And many regulators take the view that a healthy compliance culture is one in which more employees bring potential violations to the attention of the compliance organization, rather than one in which the volume of complaints is low.

Jaclyn Whittaker, Martha Stolley and Amy Schuh are partners at Morgan Lewis & Bockius LLP.

Morgan Lewis partners David Howard and Sandra Moser contributed to this article.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of their employer, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] <https://www.justice.gov/opa/speech/file/1571906/download>.

[2] <https://www.justice.gov/opa/speech/deputy-attorney-general-lisa-monaco-delivers-remarks-american-bar-association-national>.

[3] <https://www.justice.gov/opa/speech/assistant-attorney-general-kenneth-polite-jr-delivers-keynote-aba-s-38th-annual-national>.

[4] <https://www.justice.gov/opa/speech/file/1571911/download>.

[5] <https://www.morganlewis.com/pubs/2022/10/sec-adopts-compensation-clawback-requirements>.

[6] <https://www.morganlewis.com/pubs/2023/02/doj-announces-nationwide-voluntary-self-disclosure-policy-for-us-attorneys-offices>, <https://www.morganlewis.com/pubs/2023/01/doj-criminal-divisions-corporate-enforcement-policy-is-2023-the-year-of-the-carrot.>, <https://www.morganlewis.com/pubs/2022/09/doj-deputy-attorney-general-announces-changes-to-corporate-crime-policy>.