Deutsches Aktieninstitut

EU Commission's Proposal on Whistleblower Protection:

- **Acknowledge voluntary measures taken by companies**
- **Respect subsidiarity and proportionality**

Balanced approach for protection mechanisms is essential

Comments of Deutsches Aktieninstitut on the
EU Commission's Proposal for a Directive on the Protection of Persons reporting Breaches of Union Law

General Remarks

Listed companies in Germany as well as throughout the European Union Member States are aware of the tremendous importance of a functioning Compliance Management System (CMS). Systems to protect whistleblowers are today a crucial part of a modern CMS, as they enable an early detection of misconduct or shortcomings within a company and allow corresponding action to prevent or limit damage.

Deutsches Aktieninstitut therefore supports the establishment of mechanisms for whistleblower protection. As procedures enabling persons to anonymously report misconduct or legal offenses in a range of different languages are standard today not only in large listed companies but in public interest entities at large, Deutsches Aktieninstitut feels that regulatory action on the European level is not needed.

In our opinion, the broad existence of whistleblower protection-mechanisms on a voluntary basis within companies has not sufficiently been taken note of by the Commission. Furthermore, we believe that the Commission's "Proposal for a Directive on the protection of persons reporting on breaches of Union Law" does not strictly correspond to the principles of subsidiarity and proportionality and appears to contain imbalances with regard to the following features:

- The legal basis of the proposal and the quasi-horizontal approach seems questionable. Other than explicitly mentioned in its title, we doubt that the proposal will be limited to breaches of Union law. The broad range of subjects covered by the proposal suggests a vast interaction with national rules. Legal uncertainties are likely to be created by an uncontrolled overlap of national and European rules as well as industry-specific- with general rules.

- The personal scope of application of the Commission's proposal (Art. 2) reaches too far and should be limited from our point of view. Especially the Commission's intention of granting third parties (self-employed persons, contractors and subcontractors, suppliers or shareholders) protection under the directive is problematic. Not only do these parties stand outside the company's CMS but including them into the scope of application could lead to possible abuses of protected reporting mechanisms. From this background, the intention to even extend the personal scope of application to facilitators of the whistleblower - as expressed in the European Parliament's Draft Report (Amendments 34 and 40) is likewise to be rejected. In addition, malicious employees raising

pretended retaliatory measures against the employer in order to forestall measures included in art. 14 should not enjoy protection.

- Corresponding to this, the proposal does not contain efficient safeguards against abuses. Especially the motives of the whistleblower - who might not have acted for altruistic reasons exclusively - should be taken into account when determining whether protection under the directive is to be granted or not. Subjective reasons within the sphere of the whistleblower (i.e. reasonable grounds to believe that the reported incident was true at the time of reporting and the belief that the information reported was subject to the directive – Art. 13) cannot alone be considered as sufficient safeguards against abusive reporting as such subjective features will be almost impossible to rebut.

- The criteria determining whether private sector entities (companies) fall within the scope of the proposal (Art. 4) should be reconsidered. It should be taken into account that the costs of establishing protected reporting mechanisms are not strictly proportionate to the size of a company and its turnover. Since costs for establishing reporting mechanisms will be static to a certain degree, there might be cases where smaller companies are hit by similar costs as larger listed enterprises. From this background, the application thresholds set for private sector entities should be set much higher.

- The designated principle to follow up on reports and to provide the whistleblower with feedback within a fixed period is problematic. First, it is not understandable why internal and external reporting mechanisms are treated differently (three month-period for internal channels within e.g. private entities whereas six month for external channels, i.e. competent authorities – art. 5 No. 1 lit. d vs. art. 6 No. 2 lit. b). Secondly, providing feedback within a fixed and relatively short period of time may not be possible since every case has an individual set-up and a different level of complexity. From this perspective, the intention expressed in the European Parliament's Draft Report to even shorten the feedback-period envisaged by the Commission to one month seems unfeasible.

  In addition, a delay of follow up-activities and corresponding feedback to the whistleblower could also be in the interest of the latter. This will e.g. apply for compliance-cases within entities of a limited number of persons. In such a set-up, the identity of the whistleblower could be obvious for the person suspected of and confronted with an offense. The whistleblower would thus have an interest in a delay of follow up-activities in order to give the company time to take efficient measures for protecting his anonymity. Furthermore, depending on the nature of such a feedback-statement, a collision with data privacy rules, the presumption of

innocence ("nemo tenetur") and the interest of a company not to reveal investigation tactics is likely to occur.

- Overall, the proposal misses the right balance between the interests of the whistleblower on one side and legitimate company- and third party-interests (confidentiality of trade- and business secrets, data privacy) on the other side.

Details

Protected mechanisms enabling persons to report misconduct or legal offenses are today standard in large companies. Companies are well aware of the "ecosystem" that such a whistleblowing-system is placed in. Protection mechanisms require a balanced and proportionate approach, trading off the interests of the whistleblower with the ones of the company and third parties. From this perspective, listed companies throughout the EU have developed sophisticated reporting systems corresponding to the subsequent three aspects:

1. ***A whistleblowing-protection system must be embedded in the company's CMS; internal reporting should be the first and principal rule. Only in cases where internal reporting mechanisms are not in place or if the company fails to react on substantial internal reports without valid reasons should a whistleblower be entitled to turn to the public or to the media (graduate approach).***

The broad personal scope of the Commission's proposal (Art. 3), which addresses not only persons within but also outside of an organization (self-employed persons, contractors, sub-contractors, suppliers, shareholders) goes beyond the group of people that a CMS is able to address. Third parties are frequently not covered by a company's CMS. Making them subject to protected internal reporting mechanisms could lead to abuses, especially as they might be controlled by competitors of the concerned company, who will welcome any opportunity of shooting its (the concerned company's) reputation.

At present, the Commissions acknowledgment for a graduate reporting approach (Art. 13 para. 2), which we welcome, is challenged by plans of the European Parliament's rapporteur to allow whistleblowers to turn to the public and the media unconditionally without having undertaken or at least tried to undertake previous internal reporting activities. Such plans are bound to harm a healthy competition-environment. Plans for an abolition of graduate reporting mechanisms are to be rejected!

2. ***Whistleblowing protection systems are to be complemented by appropriate "filtering-mechanisms" in order to separate substantial reports received from malicious, false or unsubstantial ones. In practice, not all – in fact the least - information reported amount to serious infringements of the law affecting the general public. Anonymous***

reporting channels are instead often used by employees, who feel left behind or discriminated and follow the exclusive purpose of causing harm to or taking revenge on potential rivals within the company.

From this background, reports on shortcomings or breaches of the law, which are received, must be treated with an intensity according to their validity. For the sake of a sound and healthy working-environment, the unintended creation of an atmosphere of mistrust by a felt surveillance or observation among employees should be avoided. Thus, precise rules on when a whistleblower qualifies for protection are needed. The Commission's proposal (Art. 13) could be improved here:

- The whistleblower should at least be required to come up with well-founded reasons to believe that the information reported was true at the time of reporting and that this information falls within the scope of this Directive;
- He or she should only qualify for protection if the misconduct reported was personally and directly witnessed.
- Furthermore, the absence of any form of financial reward granted to the whistleblower for his report should be a precondition for protection. In the US, financial rewards granted to whistleblowers have led to an abuse of the system at large.
- In addition, the motives of the whistleblower should be duly considered. In many cases, the whistle will not be blown exclusively for altruistic motives. A lot of persons will report only for the purpose of limiting damage for themselves. These will be cases when the respective person has been involved in misconduct/violations of the law and now hopes to either enjoy the benefits of a principal witness or to simply cover his/her own legal offenses or those of others. Such a situation has to be taken into account!

3. ***The right balance is to be struck between the protection of the whistleblower on one side and legitimate company interests as well as interests of third parties on the other side. The confidentiality of trade- or business secrets, of personal data and investigation tactics must be ensured. Especially independent third parties not involved in the reported incident deserve to be protected. In addition, the presumption of innocence must be retained and not be undermined by legal requirements for the company to report back to the whistleblower.***

The obligation of a company to follow up on reports as described in Article 6 of the Commission's proposal appears to be problematic:

First of all, it is not entirely clear from the proposal's wording , what "providing feedback" to the whistleblower means. Recital 46 suggests that the reporting person has to be informed about the action envisaged or taken as follow up to the report. This idea is to be rejected if such a reporting back includes the revelation of trade- or business secrets or personal data of independent third parties or of persons accused of misconduct by the whistleblower.

The company as recipient of the report finds itself in a difficult position:
On the one hand, it has to protect the whistleblower. On the other hand, it has a legitimate interest and an obligation to ensure the confidentiality of trade- and business secrets as well as of personal data with respect to e.g. employees and independent third parties according to data privacy rules. A breach of data privacy rules is considered a serious legal offense and subject to large fines according to the European General Data Protection Regulation. From this background, a detailed feedback report to the whistleblower revealing confidential data cannot be rendered. Such a report could furthermore shaken the presumption of innocence with respect to persons accused of misconduct and the legitimate interest of the company to keep investigation tactics confidential. Furthermore, a feedback report should be tailor-made corresponding to the individual features of the underlying case. A one size fits all-approach is therefore bound to fail. The detailed content of the feedback report should remain within the discretion of the corporate investigator and the investigating compliance unit.

The designated period of time (3 months) for private sector institutions to report back to the whistleblower seems too short especially from the background, that reports often tend to be rather generic and unprecise. An investigation of reported incidents might furthermore require more than 3 months, especially, for example, in cross-border cases within a group of companies or in cases of pending litigation. In addition, there is no apparent reason for different feedback-periods (3 months/ 6 months, see 'General Remarks' above, page 3).

Conclusion

Overall, we feel that the Commission's proposal contains significant imbalances. Since German and European listed companies have themselves implemented carefully balanced whistleblower protection mechanisms corresponding to the above-mentioned features, we consider no legal action on the European level as required. In addition, the German Corporate Governance Code and further Corporate Governance Codes of EU Member States have adopted recommendations to implement whistleblower protection mechanisms into the CMS's of companies.

Companies themselves have the most vital interest in implementing smart protection mechanisms catering for and efficiently trading off all interests involved while effectively ensuring the early detection of shortcomings in order to prevent severe damages either in form of voluminous fines or, even worse, of a harmed reputation.

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