POHLMANN & COMPANY

International Compliance Update

4/2016

Our "International Compliance Update" portrays current developments and trends in international compliance legislation, jurisdiction and practice with a focus on their relevance for Germany.

Europe

Governance and Compliance Issues Resulting from the Revised Proposal to Amend the Shareholder Rights Directive

Nicole Willms / Christopher Hsu

- The adoption of the amendment proposal to the European Shareholder Rights Directive (2007/36/EC; henceforth "**SRD**") is expected for 2017 and will strengthen shareholder's rights but also their duties.
- The new regulations will result in a shift of competence within stock corporations in favour of its shareholders.
- As a result, a more intensive dialogue between shareholders and supervisory boards and possibly also alterations to the corporate governance structures of the affected companies will be required in the future.

>>>

Also in this issue:

Subscribe to the International Compliance Update here.

History and Nature of the Proposed Amendments

In April 2014, a proposal to amend the SRD was put forward by the European Commission to strengthen long-term shareholder engagement in EU-listed companies ("**Proposal**")[1] On July 8, 2015, faced with strong opposition from Germany and others, the European Parliament made several revisions to the Proposal. The revisions are expected to provide greater compatibility with the German two-tier board structure, in which the supervisory board already acts as the central oversight body. Since then, the Proposal has been caught in the "trilogue" stage of discussions between the European Parliament, the European Council, and the European Commission.

During this period, there has been widespread discussion on the potential implications of the amendments, especially for the relationship between shareholders and supervisory boards. The anticipated adoption of the revised Proposal in 2017, together with the recent intention of the German government to amend the Corporate Governance Code, invites an updated consideration of the relevant implications.

Main Revisions in Detail

The Proposal makes important alterations to several governance-relevant areas.

Say on Pay

The Proposal requires shareholders to vote at least every three years on the principles of directors' remuneration ("say on pay").[2] However, it gives Member States the option to decide whether such shareholders' vote on directors' remuneration principles shall be binding or only advisory.[3] In addition, as part of the annual general meeting, shareholders will have the right to vote on the remuneration report prepared by the company, which provides an overview of all salaries/benefits in whatever form granted to individual directors, for the previous year. If shareholders reject the remuneration report, companies will be required to engage with shareholders to identify the reasons behind this.[4]

Related-Party Transactions

The Proposal also stipulates that "material transactions" with related parties, which influence the decisions of those involved in a company's approval process and have an impact on the company's results, assets, turnover, and risks, should be approved by the shareholders or the supervisory board.[5]

Transparency

The Proposal intents to make shareholders / investors behaviour more transparent and thus traceable. With respect to advisory firms, which provide information and advice to shareholders regarding their voting rights (i.e. proxy advisors), the revised amendment proposal requires Member States to ensure that proxy advisors adopt and follow a code of conduct.[6] Institutional investors and asset managers will be required to devise a shareholder engagement policy with the Proposal now explicitly adding that this policy should focus *inter alia* on the mitigation of social and environmental risks.[7]

[1] European Commission Proposal to Amend Directive 2007/36/EC and Directive 2013/34/EU, http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2014%3A213%3AFIN, accessed September 8, 2016.
[2] Article 9a, Paragraph 1, European Parliament Revision to the European Commission's Proposal to Amend Directive 2007/36/EC and Directive 2013/34/EU, http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P8-TA-2015-0257+0+DOC+XML+V0//EN#def_2_1, accessed September 8, 2016.
[3] See above, Article 9a, Paragraph 1.
[4] See above, Article 9b, Paragraph 3.
[5] See above, Article 9c, Paragraphs 2 and 4a.
[6] See above, Article 3i, Paragraph 1a.
[7] See above, Article 3f, Paragraph 1b.

>>>

Ongoing Process and Implications of Recent Developments for Companies

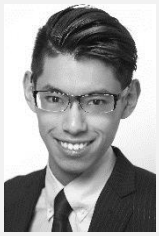
It now seems that the Proposal will be adopted without major changes and will become effective soon. Apart from proxy advisors and institutional investors, this will be of special concern to European listed companies and their corporate governance structure.

Such companies should consider any ways in which the shift from supervisory boards' responsibility towards the greater integration of shareholders might disrupt their existing governance systems and introduce additional administrative burdens. This is especially true in matters relating to directors' remuneration policies and material related-party transactions. Pursuant to current German law, shareholders on the remuneration committee could only assist with preparatory work, with the final decision still being taken by the supervisory board.[8] Furthermore, a shareholder authorization of material transactions with related parties will also require organizational changes. In summary, the supervisory boards' authority and competence will need to be rebalanced within the new system.

Shareholders will increasingly be obliged to assume co-responsibility for a company's compliance efforts. Focusing on this, in addition the 'Developing Shareholder Communication' initiative has provided some useful guidance and gained support from several industry leaders and regulatory authorities in Germany to develop transparency and mutual trust between shareholders and supervisory boards.[9] Supervisory boards are encouraged to enter into a voluntary dialogue with shareholders on topics that fall within the board's remit. Under the proposed framework, the requirement profile for management board members, the composition of the supervisory board and the remuneration system for both could be discussed. In addition, the supervisory board could explain to the shareholders its role in the management board's strategy process, as well as its assessment of the implementation. These and some other guiding principles are designed to encourage shareholder engagement and prepare for the upcoming challenges of resolving the overlap of competencies.

As the Proposal will not be implemented prior to 2018, it leaves affected companies and actors with sufficient time to re-familiarise themselves with the proposed amendments and to consider how they will need to take action on matters relating to shareholder engagement, the role of the supervisory board, and other compliance issues, particularly those affecting institutional investors and asset managers.

Nicole Willms
is Partner at Pohlmann & Company in Frankfurt. She advises German and international clients in the areas of corporate law, mergers & acquisitions and corporate restructurings as well as compliance and corporate governance.



Christopher Hsu
is Research Associate at Pohlmann & Company in Frankfurt. He completed his Master's degree in Law and Finance at Oxford and is currently a doctoral scholar in Law and Economics at the House of Finance, Goethe University Frankfurt.

[8] Bundesverband der Deutschen Industrie e.V. and Deutsches Aktieninstitut. Position on the Draft revised Shareholder Right[s] Directive for trilog[u]e nego[t]iations, https://www.dai.de/files/dai_usercontent/dokumente/positionspapiere/2015-11-12%20SHRD-Position%20BDI%20und%20DAI.pdf, accessed September 8, 2016.

[9] D. Mattheus: Guiding Principles for the Dialogue Between Investors and German Supervisor Boards, https://www.bvi.de/uploads/tx_news/2016_07_11_Guiding_Principles_for_Shareholder_Communications_with_Supervisory_Board.pdf, accessed December 7, 2016.

World

ISO 37001: New ISO standard for anti-bribery management systems

S. Bartsch / J. Murschall

- The new ISO standard provides guidance regarding the implementation of an anti-bribery management system.
- Obtaining a certification is possible, but its value is debatable.

The new ISO standard

On October 15, 2016 the International Organization for Standardization ("**ISO**") adopted a new standard ISO 37001 – anti-bribery management systems ("**ISO 37001**"). ISO 37001, with its cross-border and cross-sectoral set of rules, is intended to provide companies and organizations of all kinds with a consistent guidance regarding the implementation of anti-bribery and corruption measures.

Under ISO 37001 appropriateness regarding inter alia the size and business activities of the organization is key and must be taken into account when developing the anti-bribery management system. Accordingly, a corresponding risk analysis must be carried out as a first step. Such risk analysis typically has to consider additional compliance risks as well (compliance risk analysis).

ISO 37001 further establishes specific requirements regarding the prevention, detection and remediation of bribery cases in the organization. In this regard, based on internationally accepted best practices, ISO 37001 requires a number of measures to be implemented. These include in particular the implementation of an anti-bribery policy as well as appropriate measures and controls to avoid and detect misconduct. Furthermore, the top management and executives must actively support the implemented measures through leadership, commitment and demonstrated responsibility. ISO 37001 follows like many international anti-corruption legislations a risk-based approach. Therefore risk analysis and risk assessment (Due Diligence) play a central role in the implementation and performance of individual measures such as project risk assessments and business partner checks. Further requirements include training of employees, implementation of financial or non-financial controls as well as reporting, investigation and remediation measures.

ISO 37001 in comparison

ISO 37001 is based on the common High Level Structure for ISO management system standards. Thus, ISO 37001 is compatible with other management systems implemented according to ISO management system standards. Organizations can thus build on already existing structures and integrate their new anti-bribery management system into existing management processes and controls.

In 2014, ISO 19600 Compliance Management Systems ("**ISO 19600**") had already been adopted as a guidance for setting up and maintaining an overarching compliance management system ("**CMS**"). However, ISO 19600 only provides recommendations and does not contain any requirements on which a certification could be based on. The newly published ISO 37001 on the contrary contains clear requirements regarding a specific compliance topic. An organization that implemented an anti-bribery management system according to ISO 37001 can thus be audited and certified by third independent parties.

The national chartered auditors standard IDW PS 980 *Grundsätze ordnungsmäßiger Prüfung von Compliance Management Systemen* (principles for the duly auditing of CMS) ("**IDW PS 980**") of the *Institut der deutschen Wirtschaftsprüfer* (institute of the German

chartered auditors) has been in place since 2011. IDW PS 980 and ISO 19600 overlap with regard to many aspects. However, whereas ISO 19600 comprises consistent recommendations for the implementation of a CMS, IDW PS 980 provides additional requirements for the audit of a CMS. CMS audits according to IDW PS 980 focus on the written specification of an organization's CMS. This, however, does not provide a sufficient basis to verify the actual appropriateness and effectiveness of a CMS.

Outlook

The new ISO 37001 certainly offers another opportunity to strengthen actions against bribery and corruption by supporting organizations on implementing a proactive anti-bribery management system. Nonetheless, obtaining certification does not automatically lead to the reduction of an organization's liability or even prevent criminal prosecution at all. The mere introduction of policies against bribery and corruption is not sufficient. In fact, for a CMS to be effective, compliance rules and standards must be understood and lived by as indispensable elements of the corporate culture and as integral parts of the business model.

Sebastian Bartsch
is Senior Consultant at Pohlmann & Company. He focuses on Compliance Risk Analyses, maturity analyses of Compliance Management Systems (CMS) as well as business partner reviews and the implementation of risk-based processes.

Johanna Murschall
is Research Associate at Pohlmann & Company in Frankfurt. During her studies at the Justus Liebig University in Giessen, she specialized in criminal justice and criminology.

Germany

German draft bill on *Corporate Social Responsibility* (CSR) Directive Implementation Act

E. Mayer / V. Vocke

- The draft bill for implementing the Corporate Social Responsibility (CSR) Directive into German law is expected to be adopted by mid-December 2016.
- Companies will be required to report on matters of sustainability and diversity.

Introduction

On September 21, 2016 the German federal government published a draft bill for implementing the Corporate Social Responsibility (CSR) Directive into German law.[1] According to the draft, companies will be required to disclose non-financial sustainability reports. Listed companies will additionally be required to disclose information related to their concepts on diversity in their management reports. The goal is to provide consumers with access to additional information that could affect their buying decisions. The draft bill is expected to be adopted by mid-December 2016. The requirements will have to be fulfilled the financial year 2017 and the following.

Non-financial reporting (§ 289c or rather § 325b HGB-E)

Major publicly traded corporations, limited liability companies as well as major credit institutions and insurance companies with an annual average number of employees in excess of 500 will be required to incorporate a non-financial report into their management reports. The non-financial statement must at least contain information on environmental, social, employee-related, human rights and anti-corruption matters. Such statement should include a description of the concepts, major risks, non-financial performance indicators and outcomes related to those matters. Companies can either provide a non-financial report as part of their management report or a separate non-financial report. Such separate report, in addition to the management report must be made publicly available within four months or made available on the company's website within six months after the balance sheet date. If a company does not provide any information on relevant concepts a detailed explanation will have to be provided ('comply or explain'). Subsidiaries are exempted from the obligation to report as far as this obligation is addressed in the consolidated management report of their parent company.

Reporting obligation for listed companies to disclose diversity policies (§ 289f or rather § 315d HGB-E)

Listed stock corporations are further required to describe their diversity concepts for executive positions on their management and supervisory boards. The disclosure of these diversity concept should be part of the corporate governance statement. The report shall include concept objectives and the nature of the implementation as well as their results within the respective financial year. If no diversity concept is applied, the corporate governance statement should include an explanation as to why this is the case.

>>>

[1] Implementing the directive 2014/95/EU, see Federal Government's bill, https://www.bmjv.de/SharedDocs/Gesetzgebungsverfahren/Dokumente/RegE_CSR-Richtlinie.pdf;jsessionid=D9F2E78BB8798C56760CC458BBA8B2EA.1_cid289?__blob=publicationFile&v=1

Impact

There are no concrete specifications as to how companies should structure their non-financial reports. For general guidance, they can adopt internationally recognized and accepted frameworks (e.g. the "G4" of the Global Reporting Initiative and the "Integrated Reporting Framework" provided by the International Integrated Reporting Council).

Furthermore, violations against the new reporting obligations will be covered by the existing provisions governing criminal penalties and administrative fines under the German Code of Commercial Law (*Handelsgesetzbuch* or "**HGB**").

Outlook

This legislative initiative does not come as a surprise and is not devoid of context. More and more legislators have started to require companies to provide transparency and to particularly report on non-financial matters. From the California Transparency in Supply Chains Act 2010 to the UK Modern Slavery Act 2015[2], international companies have to adapt to the more frequent and extensive reporting obligations – including (the intended) corresponding effects of self-commitment and potential reputational and legal consequences that might occur if the company has not implemented what it has reported. Only a strategic approach reasonably combining Corporate Social Responsibility and Compliance Management will be able to assist in complying with current and future legal obligations.

Eric Mayer
is Partner of Pohlmann & Company in Munich. He advises international corporations on the design and implementation of Compliance Management Systems focusing on business partner checks and M&A compliance due diligences.

Vincent Vocke
is Associate at Pohlmann & Company in Frankfurt. He studied law at the Johannes Gutenberg University of Mainz and spent 6 months at a commercial law firm in Boston, USA during his legal traineeship.

[2] See E. Mayer: The UK Modern Slavery Act 2015: New Compliance Challenges in international Supply Chain Management, ICU 1/2016.

China

"Chinese Princelings" – International Recruitment Practices on Trial

Andrea Sprenger

- Recruitment of candidates referred by public officials to increase future business opportunities may result in criminal liability under FCPA.
- The provision of clear HR-processes is essential to ensure lawful conduct in the recruitment process through the use of standardized procedures.

Financial Penalties of over USD 264 Million

Not only industrial companies but also banks are becoming more innovative when it comes to developing or expanding a lucrative market like China. After the current third-largest semiconductor manufacturer in the world, Qualcomm Inc.,[1] and the Bank of New York Mellon[2], now JP Morgan Chase also had to dig deep in its pockets due to similar allegations to reach an agreement with the American authorities after an extensive investigation due to suspicions of corruption.

On November 17, 2016, the US Department of Justice announced that the criminal investigations against JP Morgan Chase for a violation of the Foreign Corrupt Practices Act ("**FCPA**") have been discontinued for a payment of more than USD 264 million. From this total amount, approximately USD 130.5 million will be paid to the investigating US Securities and Exchange Commission ("**SEC**"), USD 61.9 million to the central bank Federal Reserve, and USD 72 million to the US Department of Justice.

"Sons and Daughters" Program

Between 2006 and 2013, JP Morgan Chase hired around 200 candidates who were referred to the firm by current or future clients. Within the framework of a so-called "Sons and Daughters" program, the targeted sons and daughters of Chinese decision-makers and officials ("princelings") were recruited in the People's Republic of China to increase the future business opportunities of JP Morgan Chase in the Chinese market. Although the abilities of the candidates thus recruited often did not extend beyond the proofreading of documents, their salary could by contrast correspond to the typical starting salary of an investment banker. The range of positions involved was wide. Special unpaid summer internships were also set up for such client-recommended candidates.[3]

It is noteworthy that this by no means only involved referrals from public officials. In around half of the cases cited by the SEC, the decision-makers were working in the private sector. However, liability under the FCPA requires that "anything of value" be granted or at least passed on to a public official. Only a breach of accounting obligations does not require the involvement of a public official. Nevertheless, the SEC leaves open the basis on which it also addresses corruption in the private sector.

The complexity of the granting of benefits and the fact that this practice has extended to the highly competitive job market, is hardly surprising. It was to be expected that the American authorities would not shy away from a strict application of the FCPA.

[1] Qualcomm Inc., Securities Exchange Act of 1934 Rel. No. 77261

[2] Bank of New York Mellon Corporation, SEC Exchange Act Release No. 75720 (August 18, 2015)

[3] www.justice.gov/opa/pr/jpmorgan-s-investment-bank-hong-kong-agrees-pay-72-million-penalty-corrupt-hiring-scheme

Recommendations to Avoid Corruption in the Application Process

Such business practices should be counteracted by consistently integrating the HR-processes into an effective compliance management system ("**CMS**"). In particular, the following points must be observed:

- Any recruitment, be it for an internship or a permanent job, paid or unpaid, should be carried out through a standardized application program and under the responsibility of the relevant HR department to prevent "maverick recruiting" which is difficult to control.
- There should be no "special" positions or newly-created positions for candidates referred by third parties.
- Referred candidates have to meet the same minimum qualification requirements as other employees at the same rank.
- In close cooperation with the compliance function, it is important to thoroughly screen candidates in advance in certain regions, for certain specialist functions or management-level assignments, depending on the concrete risk-profile of the recruiting company. In addition to a potential family relationship to public officials or politically exposed persons ("**PEPs**"), it is also necessary to reliably identify any existing references to private sector decision-makers and current tenders or large-scale projects.
- In addition, it is recommended to carry out specific compliance trainings for the responsible HR officers and recruitment decision-makers.

Andrea Hienzsch
is Senior Associate at Pohlmann & Company in Munich. She was admitted to the bar in Germany in 2013. During her studies and her legal traineeship, she worked for several international law firms in Germany and in Washington D.C., USA.

Corporate. Compliance. Governance.

We'd like to know your areas of interest.

Please send us your suggestions via e-mail to:

update@pohlmann-company.com

Pohlmann & Company

Guiollettstrasse 48
D-60325 Frankfurt a.M.

P: +49 (0)69 260 1171 40

Nymphenburger Strasse 4
D-80335 Munich

T: +49 (0)89 217 5841 70

1000 Rue de La Gauchetière West 24th Floor
Montreal, QC H3B 4W5, Canada

P: +1 514 448 7487

www.pohlmann-company.com

update@pohlmann-company.com

Subscribe to the International Compliance Update here.

Imprint (Link)