SQUIRE SANDERS

HOW GLOBAL COMPLIANCE IS AFFECTING YOUR BUSINESS

White Paper - March 2013

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FOREWORD

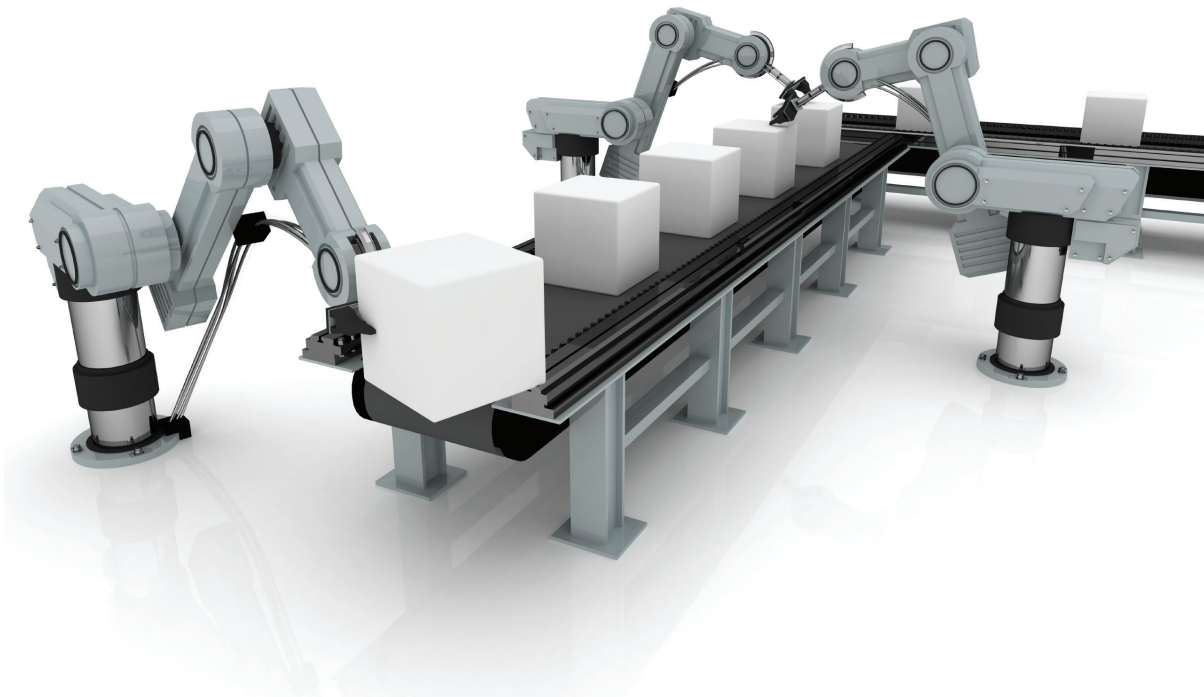
In a world of budget deficits, austerity and tough market conditions, business and in particular manufacturing is being exhorted to lead the country's economic recovery through export led growth. Whilst our political leaders may look back to the days when Britain was the "workshop of the world" and seek to persuade us that the thrust of policy is to encourage exports and reduce red tape, what is the reality? This paper looks at current themes in regulatory compliance for companies seeking to access or working in overseas markets and focusses on the practical experience of those surveyed who deal with international business on a daily basis.

Regulatory compliance breaks down broadly into the rules that apply "over here" and the rules that apply "over there". This paper focusses on the general approach of companies surveyed to compliance with overseas rules (without going into specific detail on particular countries) and also the UK laws that apply to business undertaken by UK companies both in the UK and overseas. In particular, is there a level playing field or do our rules impact upon exports and put UK businesses at a competitive disadvantage in tough international markets?

Notwithstanding the political enthusiasm to ensure that regulation does not get in the way of economic recovery, under pressure from the OECD, the Labour Government introduced the Bribery Act in April 2010 in the dying days of Gordon Brown's administration. This received all-party support and was brought into force by the Coalition Government in July 2011 following the publication of guidance on compliance.

Against this backdrop, now that businesses have had to live with the Bribery Act for 18 months, we asked companies in Yorkshire and the North East about their attitude to compliance, their practical experience and the impact upon their businesses.

We are grateful to everyone who participated in the interviews. The findings from our research, together with our thoughts on the position as we have found it and actions required to address some of the concerns raised, are set out in this paper.



PART ONE - THE RESEARCH

Introduction

Our research consisted of a series of interviews conducted in November 2012 with CEOs, COOs and the General Counsel of 20 major companies based in Yorkshire and the North East. Respondents operated in a variety of industries including oil and gas, insurance, software, pharmaceuticals, engineering, publishing, clothing, consumables and logistics. Given the sensitivity of regulatory compliance for most of the businesses involved, respondents have not been identified nor quotes attributed.

Each of the companies interviewed were trading globally and, in most cases, in emerging markets. Not surprisingly, most identified exports, and in particular emerging markets, as offering the greatest opportunity for growth in their businesses.

Our research focussed on experience and views in the following key areas:

- Attitudes towards compliance generally.
- Processes and the approach taken to comply with global regulation.
- The impact of compliance on international growth.

Whilst clearly the experience is not the same across all sectors and jurisdictions, a number of common themes emerged:

- All businesses recognised the growing importance of global compliance but to varying degrees, although in most cases the prevailing view was that the regulations were not really targeted at them or their industry sector.
- Certain emerging markets were identified as presenting particular challenges.
- A number of respondents did not have detailed awareness of possible sanctions and the approach taken by the authorities to enforcement.
- There was a general view that in some countries the impact of UK regulations restricted the growth of business and that in some sectors there was not a level playing field for UK companies. Whilst most emerging countries have their own regulations dealing with issues such as bribery and business efficacy, there was also a general view that in many cases the enforcement of these locally was limited and had relatively little impact upon the conduct of business in practice.

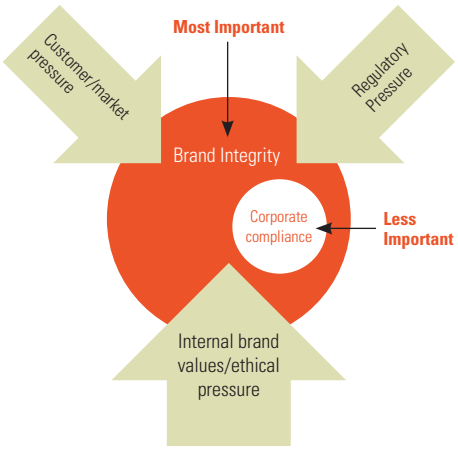
What Drives Corporate Compliance?

In almost all cases, corporate compliance was expressed to be driven by the requirement to maintain reputation and brand integrity and by the respondents' internal brand values and desire "to do the right thing" ethically, rather than purely as a result of regulatory pressure. The pressure from customers and markets to supply in an ethical manner was also cited as a strong driver for some companies, although this varied significantly between sectors and the nature of customers dealt with.

'One of our mission statements is that we operate in accordance with the laws of the country we are in; if you don't it's viewed as gross misconduct and you get fired.'

At a time when international companies are voluntarily paying UK taxes as a result of comment and consumer pressure (notwithstanding that legitimate tax planning might allow them not to), it is hardly surprising that whilst many respondents acknowledged that regulatory pressure contributed to their approach to compliance, this was a far weaker driver of behaviour than the internal culture of most organisations. Compliance was very much seen as a subset of maintaining reputation – ultimately it is commercial pressure that drives most respondents to take compliance seriously.

'Integrity is part of the brand and what [we do] everyday; compliance simply slides into this concept wherever [or not] it is appropriate. Because there is not a huge amount of regulation, it isn't a huge part of the notion of brand integrity.'



PART ONE - THE RESEARCH

Internal Processes for Compliance

All but one respondent had a developed strategy in place to ensure that their organisation operated with integrity. These typically took the form of an overarching philosophy or core values plus a set of rules and predetermined practices which were communicated widely within organisations. Compliance was typically policed by the Company Secretary/General Counsel with support from external advisers (usually accountancy or law firms). Several of the larger organisations interviewed had dedicated in-house compliance roles.

'We have a compliance function… and they're the ones who provide the entire company with policies and guidelines and standard operating procedures, but it is the business leaders themselves who have to ensure there is compliance within their business.'

In some areas there was a divergence of approach between respondents:

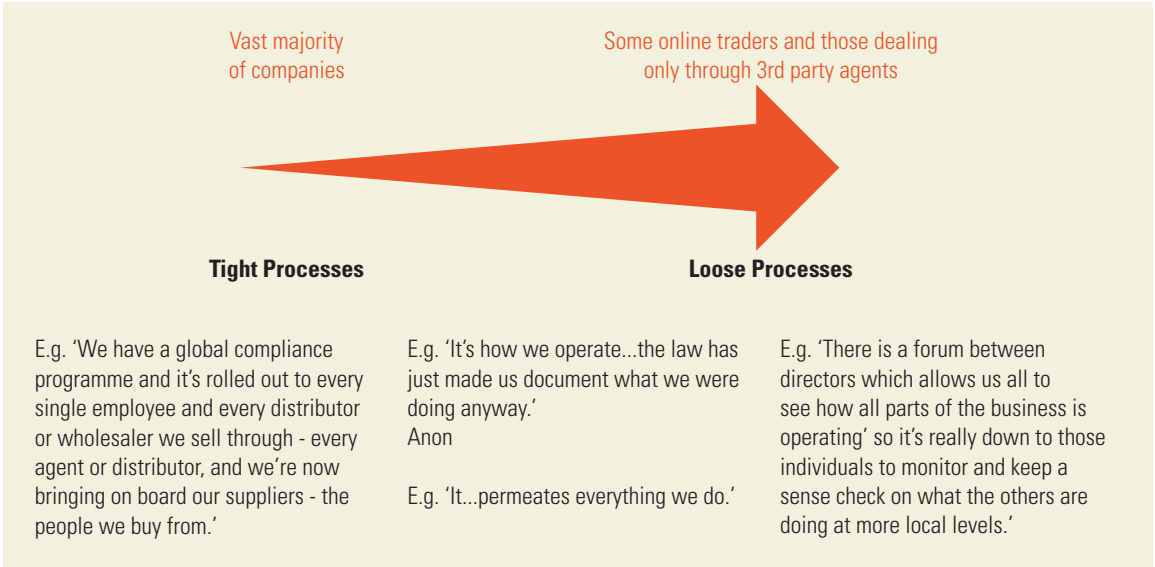
- Whilst most respondents appear to operate fairly tight processes, this does not appear to be universally the case, with companies which predominantly trade online or through third party agents more likely to operate looser "tick box" processes.
- There appears to be a degree of confusion in relation to third party agents/distributors and the extent to which companies can be found responsible for their actions – in many cases companies took active steps to ensure such third parties signed up to their policies but sometimes there was a disconnect in ensuring subsequent adherence. In a small number of cases respondents did not consider themselves responsible for their agents' business practices.
- Whilst all respondents were able to identify the person responsible for compliance, the approach at board level varied widely, with some companies' boards regularly reviewing regulatory risks as a standing item and others reviewing the position much less frequently (in some cases only where an issue had been identified and escalated to the board).

Awareness of Sanctions

The Bribery Act sanctions available to the UK authorities range from up to 10 years' imprisonment for individuals and unlimited fines for companies (where there has been a failure to prevent bribery). In addition, the courts also have power to impose confiscation orders, civil recovery orders (which do not depend on a successful criminal conviction), financial reporting orders and debarment from competing for UK public contracts. US regulations (most notably the Foreign and Corrupt Practices Act) may also have an impact on UK companies that have a connection with the US. The US authorities have historically had a much more aggressive and extra-territorial approach to prosecutions than the UK authorities.

'They are really not interested in companies like us.'

All of the respondents interviewed were aware that ultimately directors could be held liable for regulatory failures and be subject to imprisonment, which unsurprisingly was seen to be the primary concern for most. However, our research confirmed that most respondents had relatively little knowledge of the full range of sanctions or the approach of the authorities.



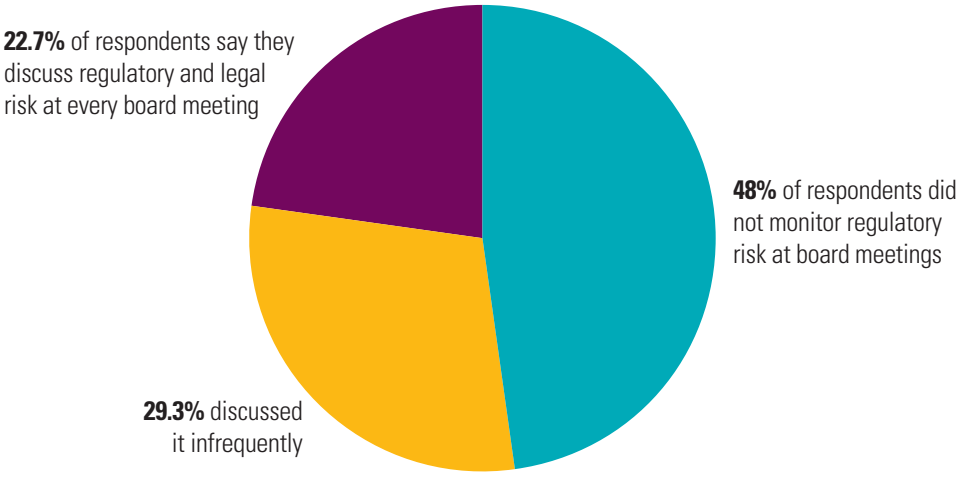
PART ONE - THE RESEARCH

- Most respondents were of the view that the regulations were targeted at major international companies and that their own businesses were unlikely to be the focus of the authorities. A number of respondents referred to the example of BAE as the sort of company that the Bribery Act was intended to apply to (in 2010, BAE entered into a plea agreement with US and UK authorities to settle bribery charges, which resulted in a US fine of US$400 million and a UK penalty of £500,000 and reparations of £28.5 million).
- Few respondents were aware of the risk that US regulations might apply to them or the extra-territorial approach of the US authorities to the application of US legislation. In most cases, respondents assumed that these would only be of a concern if they had US subsidiaries or undertook business directly in the US – the UK authorities approach to extradition and the example of UK businessman Christopher Tappin, who was recently convicted in the US on charges of selling weapons parts to Iran, may cause this to be reassessed.

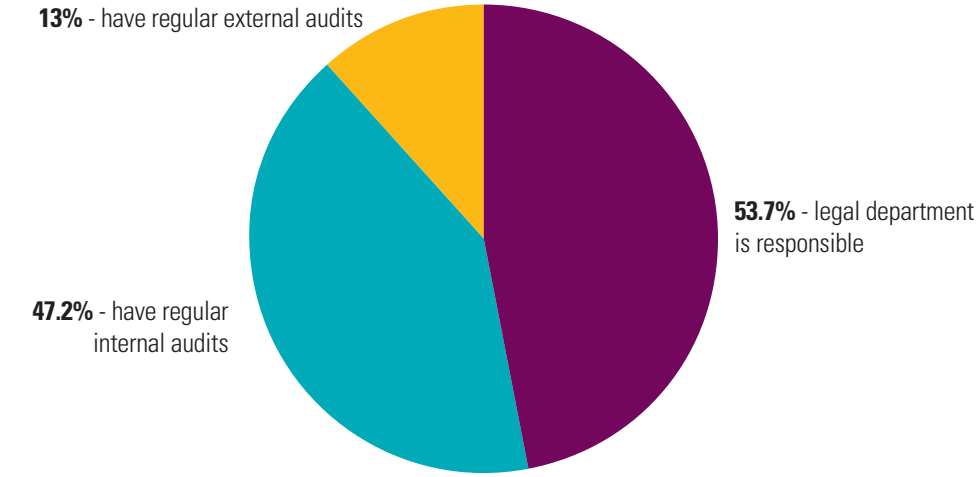
Impact of Regulation on Growth

The restrictions imposed by UK regulations and/or the complexity of local regulatory requirements were not considered to be primary drivers of which markets respondents exported to. The decision about which markets to pursue was made primarily on commercial grounds with limited consideration for the regulatory framework. In most cases, the principal drivers of growth were considered to be superior technical products, service and brand, which were not significantly limited by regulation.

A 2012 Deloitte/Legal Week study of global corporates' GCs/ Heads of Legal – risk aspects of regulatory compliance



Who is responsible for risk management?



PART ONE - THE RESEARCH

'The regulatory bar is being raised all the time… There comes a point where you think is the volume of business really worth the compliance and regulatory headache?'

Most respondents were of the view that it was possible to find a way through local regulatory issues using local distributors, agents and partners and/or seeking help from external law firms and accountancy firms. Whilst the cost of compliance fed into the commercial decision-making process, few respondents thought that this ultimately determined which markets were pursued.

A number of respondents commented that regulatory burden often discriminated against smaller businesses seeking new markets compared to their larger competitors, who may have greater experience of relevant markets and ability to absorb the regulatory costs within their existing cost structures.

'There are too many regulatory areas that are complex and difficult, and they can be time-consuming to understand to make sure that we comply with them. They can range from anti-trust or competition law through to particular product regulation. But as long as it's a level playing field – as long as regulations apply to our competitors as well as to us – then that's ok. But you've got to remember that we have the resources of really quite a large company. If you were to talk to small or medium sized enterprises, they wouldn't have our resources and that's where regulation is more of a limiting factor.'

Barriers to Regulatory Compliance

Most respondents identified one of the main barriers to compliance as being local customs and practice in many emerging markets. In particular, the requirement to make minor "facilitation payments" to government officials was seen as a normal way of life in certain economies. Many respondents considered themselves to be at a disadvantage where their international competitors are not subject to similar regulation to the UK and do not have the same cultural attitude to such payments.

Whilst historically most respondents have contracted in English and their commercial dealings have been subject to English law, this appears to be increasingly challenged in some sectors as customers exert commercial pressure on suppliers to contract in local language and subject to local laws. As one respondent explained "We try to use UK law……they've got the money, do we want the business or do we give it to our competitor". Whilst not directly related to regulatory compliance, the overall effect of this shift was that the cost of doing business in some emerging markets has grown as companies either have to increase their legal capacity internally or become more reliant on outside advisers.

All respondents identified the difficulty of making sure they are aware of and understood compliance requirements in local markets where they are new entrants or undertook a limited amount of business. Companies dealt with this in a variety of ways, with some relying on local agents to keep them informed of requirements, but with a majority relying on local external advisers (although a number commented on the variable quality of advice received). Relatively few respondents referred to making use of the CBI, UKTI or other government agencies.

'We'll find a way to operate in just about every country in the world, except those where we're prohibited from working. I think the difference is there are some countries in the world where local conditions [i.e. political issues/countries where corruption is rife] mean that we can't grow the business as fast as we'd like to… [but] we would forego growth in order to comply. If the only way to secure business was to make an illegal payment, we would just walk away from the business.'

PART TWO – CONCLUSIONS

Introduction

We have sought to draw together some of the common themes which were highlighted during the course of our survey. In some cases, there is a general message to which government agencies need to respond and in others, specific changes which could be considered.

In the case of almost all respondents it is fair to say that where there is valuable business to be had they find a way through the regulatory requirements with which they are confronted. However, in many cases the practical experience of interviewees was that this could be a frustrating and time consuming process which added cost. Particular frustration was expressed where overseas competitors took a more "laissez-faire" approach to matters without any obvious risk of penalty.

Size Matters

'First time we'd probably go to UKTI to talk to their people about different businesses customs – I can get that advice for free and it's usually very good.'

A common theme was that generally larger organisations found it easier to deal with regulatory burden because in many cases they had existing in-house capacity and experience or could more easily absorb the additional cost. Larger organisations were also more likely to have existing relationships with advisers who could access the necessary advice across multiple jurisdictions. The issues faced were invariably felt more keenly by SMEs particularly where they were looking to enter markets for the first time.

Whilst it is self-evident that those companies with greater resources are likely to find it easier to deal with additional regulatory burden, it is important that SMEs are not discouraged from exporting because of this. This is an area where government assistance should play an important role. Whilst most respondents were aware of the existence of various government agencies whose role was to promote exports (such as UKTI), the level of understanding and engagement with such agencies was very varied. According research conducted in 2010 by to the Institute of Chartered Accountants in England and Wales, 70 percent of small and medium sized businesses that already export are not aware of UKTI's work.

In some cases interviewees commented very positively on the quality of the advice received and responsiveness of government agencies, whilst in others (notably in relation to obtaining export licences) the response was more varied. In a number of cases respondents thought other countries governments (notably Germany's) were more proactive in supporting exports. A number of respondents felt that not all government departments had the same focus on promoting export growth.

In our view, the decision to cut funding to UKTI as part of the Coalition Government's cost reduction strategy, and for UKTI to charge for certain services to cover its costs, was misplaced in an environment where economic recovery is focussed on exports. We are pleased to see that in the Autumn Statement, the Chancellor of the Exchequer George Osborne announced a 25 percent increase over two years in the budget of UKTI (of around £140 million) to help promote exports, which is a welcome step forward in reversing the previous cuts. We believe UKTI should now move away from charged services and increase its effectiveness in working with companies of all sizes and communicating the support available.

'We go through strenuous processes to audit all our vendors to ensure that they're ethical and that they are complying with the various regulations in their country. We employ third parties to carry out the audits, so that's costly. But it goes hand in hand with our reputation.'

Level the Playing Field

Those interviewed were concerned that in many countries that there was not a level playing field for UK companies, either with local competitors or other international companies, because of the different attitude to the enforcement of regulation. In cases where the interviewees had products with a significant technological advantage or a strong brand offering this was considered to be less of an issue – again, this was more likely with larger and better known companies than for new entrants to overseas markets.

'The competitive advantage is that you can provide a service for a product that is of a higher standard than other economies can produce.'

PART TWO – CONCLUSIONS

Whilst the UK government and international organisations such as the OECD can seek to put pressure on other countries to comply with similar standards to those in the UK, this is not a short term (or even medium term) solution likely to change the outlook any time soon. In response to criticism that UK regulation has placed UK business at a disadvantage in export markets, the SFO has made a number of statements that, given the very wide ambit of the Bribery Act, the SFO would look to prosecute international companies with a UK presence who are involved in bribery and corruption overseas if there is a UK public interest in doing so (i.e. if UK plc has been disadvantaged as a result). David Green QC, the director of the SFO, indicated on his appointment at the end of 2011 that "importantly [the SFO] will contribute to economic recovery to ensure a level playing field in the markets". Such an approach is to be welcomed, although commentators have suggested that the politics around prosecuting companies headquartered overseas may make this difficult – certainly there have not been many public examples of this approach.

Whilst it is unrealistic for the UK authorities to take the role of global policeman, the authorities should take a more proactive and public approach to dealing with international companies with a UK presence that unfairly compete with UK companies in overseas markets.

'Customers DO respect you for playing by the rules, which can lead to a competitive advantage in itself.'

Facilitation Payments/Self Reporting

'There are certain parts of the world you just wonder how you operate. In Africa you wonder how people win contracts without smoothing the way or making facilitation payments. It's a question of whether or not people get found out.'

Facilitation payments are typically unofficial payments to government officials to expedite the performance of routine or necessary actions. Respondents unsurprisingly and overwhelmingly disapproved of facilitation payments but indicated that in a number of jurisdictions such payments were often a fact of life when doing business. A number commented that making such payments illegal for UK companies, whilst a principled approach, ignored the reality of doing business in certain countries.

In some countries, such as the US and Australia, there are limited exceptions in relevant legislation for certain facilitation payments to be made. This contrasts with the UK and a number of other OECD countries which include no such exception and adopt a zero tolerance approach to facilitation payments. However, the position is not entirely clear cut, with Prosecution Guidance issued by the SFO and DPP indicating that there are a number of factors which will be taken into account when deciding whether to prosecute and the level of penalty to be applied (such as the frequency and size of payments and whether the individual concerned was in a vulnerable position at the time the demand was made).

Ultimately, in the UK it appears to be a question of the SFO's discretion whether or not to prosecute. Importantly, if companies have a policy of allowing facilitation payments, the SFO is likely to take the view the company have failed to implement "adequate procedures" to satisfy legal requirements under the Bribery Act.

In 2011 the then SFO Director Richard Alderman outlined the SFO's position when he said:

"I do not expect facilitation payments to end the moment the Bribery Act comes into force. What I do expect though is for corporates who do not yet have a zero tolerance approach to these payments, to commit themselves to such an approach and to work on how to eliminate these payments over a period of time".

Unfortunately where a corporate discovers that facilitation payments or any other form of bribery and corruption are involved in its business, recent guidelines issued by the SFO are unhelpful. In particular the SFO has moved from a posititon where self reporting was likely to result in no criminal charges being brought (and a civil settlement instead being entered into) to expressly stating that "self reporting is no guarantee that a prosecution will not follow. Each case will form on its own facts".

What this means in practice is that companies need to weigh up very carefully whether they should self report - in some cases this will still be the best course of action, but it would be rash to assume this in all cases in light of the SFO's statements. This position is unsatisfactory given the uncertainty and we suggest that the SFO should consider reviewing the position to provide greater clarity and incentives for companies to self report.

SUMMARY OF RECOMMENDATIONS

1. Global compliance needs to be seen as more than a subset of maintaining reputation and brand integrity.
2. Clear advice should be provided by UKTI/ SFO as to the sort of audit trail that is viewed as best practice.
3. Authorities need to take a more proactive approach to dealing with international companies with a UK presence that unfairly compete with UK companies in overseas markets.
4. Improve UK rules surrounding self reporting. The SFO should review their position and issue further guidance.
5. There should be clearer rules around the application of sanctions, which need to be publicised to the wider business community.
6. More companies should monitor regulatory and legal risk at board level.
7. A level playing field needs to be established for UK companies either with local competitors or other international companies because of the different attitude to enforcement regulation.

What are your views? If you would like to participate in our next survey, or have any comments, please let us know.

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