quicktake: the time to prepare has now come

days ahead of the closing of the EU’s legislature period, ahead of the European Parliamentary (EP’s) elections, the EU’s “Whistleblowing Directive” (the Directive) was adopted on April 16, 2019 by 591 votes in favor, 29 against and 33 abstentions. The law, which the EP had amended, is presented now to the Consilium for approval—which is expected without further amendments at the next meeting—after which it will be published in the Official Journal of the European Union. EU Member States will have two years from the date of publication in which to apply and comply with new EU-wide common minimum standards ensuring effective whistleblower protection set out in the Directive. This not only affects the 10 EU jurisdictions (including the UK that already has comprehensive rules on whistleblowing in place) but also requires the remaining 17 in the EU to introduce new measures.

This Client Alert should be read in conjunction with our coverage of the proposal in its earlier stages as well as contributions to coverage that our Dentons Eurozone Hub provided to the BBC World Service’s “World Business Report” Program on April 16, 2019. Moreover, clients may wish to consult Dentons’ unique online comparative tool on national whistleblowing laws and requirements as they apply across major jurisdictions.

Aims of the Directive

The Directive marks a step forward over the proposal, and the new rules will encompass, inter alia, the introduction of reporting mechanisms across all industry sectors within both private companies and public institutions. The Directive also provides protection against dismissal, demotion and other forms of retaliation by the employer. All of this is supposed to strengthen whistleblowing as a valuable detection and compliance mechanism.

For financial services, an area where whistleblowing measures are more prevalent due to existing requirements, this Directive pushes the scope of existing coverage much further. It also delivers on regulatory and supervisory policymakers’ aims that firms embed a deeper compliance and challenge culture. Whether this Directive, i.e. requiring implementation by individual EU Member States rather than taking effect in the form of an EU Regulation, will achieve its intended and rather transformative aims or instead merely cause firms to take some basic compliance action and update policies remains to be seen. Equally, the Directive does not—in contrast to practice and law in the United States—cater for the ability of whistleblowers to receive financial rewards for blowing the whistle on wrongdoing. It is conceivable that some EU Member States in the EU’s legislative actions may choose to act unilaterally.

Which firms are in scope of the rules?
The Directive’s rules will apply to all employers as far as protection against retaliation is concerned as well as the ability to report to competent authorities in confidence where internal whistleblowing channels are compromised or could not reasonably be expected to work properly. Additionally, all enterprises with at least 50 employees (although this threshold does not apply to those firms that are within the scope of legislation and thematic areas set out in Annex 1) or with an annual turnover or total assets of more than €10 million will be required to set up internal processes for whistleblower reporting. The obligation to set up such reporting mechanisms and channels for whistleblowers will apply to all financial services firms and firms vulnerable to money laundering or terrorist financing, irrespective of their size or turnover. Micro- and small companies will be exempt from the rules on setting a reporting mechanism. However, Member States may further extend the rules to small companies in specific sectors. In summary, the Directive will cover a wide range of financial services firms and other market participants. This could translate into increased initial costs in terms of reviewing existing policies or drafting new policies as well as documenting how compliance with the new obligations is evidenced and how this is monitored and audited. While the new Directive aims to reduce fragmentation by introducing minimum EU-wide standards, there is a risk that policies and processes across affected firms will remain fragmented despite increased common obligations and standards.

What type of disclosures will be covered?

The Directive, like the proposal, pertains to whistleblower protection when breaches of EU law are reported. Breaches of national measures remain a national matter. Leaving aside the potential for confusion for persons wanting to report a breach, whistleblowers will thus be entitled not only to disclose information about unlawful activities, but also about abuse that goes against the spirit of the law. The areas where EU-wide rules exist and where breaches can be reported have been listed in the Directive as well as their Annex (see below). These include:

1. Public procurement
2. Financial services, products and markets and prevention of money laundering and terrorist financing
3. Product safety and compliance
4. Transport safety
5. Protection of the environment
6. Radiation protection and nuclear safety
7. Food and feed safety, animal health and welfare
8. Public health
9. Consumer protection
10. Protection of privacy and personal data, and security of network and information systems
11. Breaches or avoidance of corporate tax avoidance
12. EU competition law

In cases of areas such as protection of privacy and personal data, the whistleblowing rules may become a powerful tool to ensure compliance with stringent new legislation, the General Data Protection Regulation (GDPR), in force since May 25, 2018. The proposed rules are also likely to be of relevance and importance for stakeholders affected by the EU’s proposal on collective redress (class actions) proposed in a Communication and additional documents published by the Communication on April 11, 2018.4

How does the Directive differ to the Proposal and the impact for financial services firms?

The Directive expands what it mentions ought to be reported including by setting out in the Annex a list of thematic
areas grouped by EU laws where the Directive should protect whistleblowers and do so in a “dynamic” form i.e., the relevant area should be read to such legislative acts as amended, replaced or supplemented. The Directive also introduces the notion of in-scope entities having to maintain an “integrity officer” which could be a role shared by another company officer well placed to report directly to the organizational head, such as a chief compliance or legal officer, etc.

In a welcome clarification, the Directive however does state explicitly that the Directive will not affect the protection of confidentiality of communications between lawyers and their clients as well as medical privacy in accordance with principles of national and EU law.

Moreover, in Recital 49, the Directive now permits a more proportionate application of the aims of the Directive for those private sector entities with fewer than 50 employees to establish reporting and follow-up channels in a less prescriptive manner than otherwise provided for in the Directive. This extends the scope of who is caught and needs to comply while at the same time permitting smaller firms to comply in a more proportionate manner.

While the Directive still does not, like the Proposal, include any real measures akin to those in the United States, Recital 33 does state that: “To enjoy protection, the reporting persons should reasonably believe, in light of the circumstances and the information available to them at the time of the reporting, that the matters reported by them are true. This is an essential safeguard against malicious and frivolous or abusive reports, ensuring that those who, at the time of the reporting, deliberately and knowingly reported wrong or misleading information do not enjoy protection. At the same time, it ensures that protection is not lost where the reporting person made an inaccurate report in honest error. In a similar vein, reporting persons should be entitled to protection under this Directive if they have reasonable grounds to believe that the information reported falls within its scope. “The motives of the reporting person in making the report should be irrelevant as to whether or not they should receive protection.” This aims to provide an additional level of comfort for those seeking to blow the whistle and receipt of protection. The same approach is set out in a new Article 5.

What are the Directive’s key compliance requirements?

The Directive’s key measures focus on common standards of reporting mechanisms, protection against retaliation and protection as part of judicial proceedings. These items are explored in turn below.

1. Reporting mechanism

The Directive details the internal workings and external reporting mechanisms. Three means of reporting are foreseen, involving recourse to different institutions:

1. Internal reporting within companies – This is the first point of call for whistleblowers; however, this may be omitted if the whistleblower has grounds to believe that an internal report could jeopardize subsequent investigations into the company’s alleged wrongdoing. Legal entities in the private sector with between 50 to 249 employees are permitted to share resources on some aspects of the internal reporting mechanisms.

2. External reporting to the competent national authorities – This route opens if the company does not respond to the report within three months or if the internal route has been otherwise exhausted.

3. Media reporting – A whistleblower can only make a public disclosure if the whistleblower first reported internally and externally or directly externally, but no timely action has been taken by either the company or the public authorities, or if the breach must be disclosed immediately as there is an imminent danger to the public interest. This does not apply where a person directly discloses information to the press pursuant to specific national provisions establishing a system of protection relating to the freedom of expression and information—in most
2. Protection against retaliation

If the appropriate procedure is followed, including the exceptions detailed above, the Directive requires that a whistleblower be granted protection. The definition of a “whistleblower” in the Directive is broad, and thus companies will need to handle reports from not only employees but also shareholders, interns, volunteers and the self-employed. This potentially opens an entire new range of persons who may want to report. It is worth noting that to prevent an abuse of the reporting mechanism; penalties for malicious reporting have also been envisaged.

In-scope firms will need to ensure the reporting channels are secure and confidential and that a response is provided within a three-month frame. Organizations must facilitate written (electronic or paper) or telephone reports, as well as the possibility to have a physical meeting. Moreover, in-scope firms are required to designate a person or a department responsible for following up on the reports. The Directive foresees that the reporting mechanism may be either operated internally or outsourced, and the defined term of a “facilitator” has been included in the Directive as “a natural person who assists the reporting person in the reporting process in a work-related contact, the assistance of which should be confidential.” In-scope firms will also need to be able to provide information about reporting procedures.

So why all of this now? The willingness to strengthen firms’ internal procedures for reporting whistleblowing may be motivated by cases including specific regulatory investigations into the conduct of senior management and/or key function holders across a breadth of financial services firms as well as a number of instances that have seen the misuse of a company’s internal security channels to identify a whistleblower.

Public authorities will also need to ensure confidentiality and reporting security and will need to keep the reporting channels separate from other means used to communicate with the public. The external reporting mechanism should facilitate at least three ways of reporting: a written paper or electronic report, a dedicated telephone line and a physical meeting with staff. The authorities must have dedicated staff members for this purpose who must be trained to provide the public with information on whistleblower reporting procedures and receive and follow up on the reports. In addition, the authority will be obliged to respond to the report within three months and to keep records of all the reports.

2. Protection against retaliation

A wide range of actions have been listed as classifying as retaliation, including lay-off, demotion of positions, transfer of duties or location, a reduction of salary or hours or failure to convert from temporary into permanent employment, disciplinary or financial penalties, discrimination and financial loss. In contrast to the proposal, the Directive specifically emphasizes situations of damage to reputation caused “particularly in social media”.

The burden of proof will be on the employer to demonstrate that they did not act in retaliation. In cases of retaliation, the whistleblower will be entitled to remedies to prevent workplace harassment or dismissal, as well as access to free advice.

3. Protection as part of judicial proceedings

Further proposed measures include protection of the whistleblower as part of judicial proceedings. This special legal status would address cases such as the one of Antoine Deltour, who helped reveal large-scale tax avoidance. Mr. Deltour was repeatedly tried in Luxembourg by his employer for an alleged breach of law. The protection includes the right to an effective remedy and fair trial, the presumption of innocence and the right of defense.

That being said, the Directive—in contrast to the proposal—clarifies that the: “Reporting persons shall not incur liability in respect of the acquisition of or access to the relevant information, provided that such acquisition or access did not constitute a self-standing criminal offence. In the latter case, the criminal liability shall remain governed by..."
applicable national law." The Directive goes on to state further: “Any other possible liability of the reporting persons arising from acts or omissions which are unrelated to the reporting or are not necessary for revealing a breach pursuant to this Directive shall remain governed by applicable Union or national law.” In summary, if the whistleblowers report to public authorities or media in a lawful way, they will be exempt from liability for breach of any restriction on disclosure of information imposed by contract, such as an employment agreement, or by law. Those who blow the whistle (and facilitators) will also be entitled to legal aid from the state.

Estimated impact on business

Firms will be required to budget the cost of any required external services, assess additional staffing requirements and review current policies and procedures. The policy review should cover areas such as existence of anti-retaliatory measures. The instrument puts the onus on the employers to prove that they did not apply retaliation, such as dismissal or demotion, against the whistleblower, and companies can face penalties for doing so. Therefore, it is important to determine whether anti-retaliatory measures exist and whether they are documented in the form of a policy and consistently enforced.

An internal reporting procedure for handling whistleblower reports, ensuring confidentiality (which interfaces with the GDPR) will need to be set up or made compliant with the legislation. Companies will also need to respond to whistleblowers’ reports within three months, which may require further compliance effort. In terms of staff requirements, a specific person or department will need to be designated to follow up on the reports.

What problems lie ahead?

The Directive’s expansion to the more favorable treatment clause by adding non-regression language in that complying with the terms of this Directive, Member States shall not reduce the level of protection already offered by Member States in the fields covered by this Directive. That is of course welcome, but may mean that while the Directive provides minimum common standards, fragmentation may still exist. This could become more of an issue when the EU’s class/collective action proposals take effect, and as the calls for the EU to introduce class-action lawsuits as a tool for consumer protection became louder after various emissions and other public scandals.

As with the proposal, the Directive lacks significant financial incentives for whistleblowers, comparable to the bounty system adopted by the Securities Exchange Commission (SEC) in the United States. The SEC’s regime allows whistleblowers to claim between 10 to 30 percent of any penalty exceeding US$1 million paid as a result of an investigation based on information provided by the whistleblower. Given the press coverage on whistleblowers who brought to light the corporate scandals of recent years, including reports on their lives being destroyed, the new EU legal protection may not be enough to incentivize individuals to blow the whistle on breaches of EU law.

Outlook and next steps

In conclusion, although the Directive, as compared to the proposal, is perhaps much more ambitious in scope in terms of who it covers but also pragmatic in compliance standards. In part this is due to the Directive permitting certain firms to comply with requirements in a proportionate manner while at the same time delivering on the overall legislative aim to create a uniform EU-wide middle ground between the existing and lacking national whistleblowing regimes. While this of course welcome the impact of the new rules is nevertheless likely to be high. This is not only the case in terms of one-off and ongoing compliance burdens being imposed on a much wider set of firms, but also in terms of the intended social empowerment.
As with the proposal, what should not be discounted is the increased strength, in light of various scandals and shortcomings, of EU and national level political support to foster greater transparency and accountability. Consequently, these pieces of legislation have the potential to introduce a long-lasting change by handing EU citizens the legal means first to identify and report failures of corporates to abide by EU law, as well as potentially to seek redress in court by way of a class-action. However, such change also requires a strong corporate compliance commitment and/or a stronger institutional-led enforcement culture.

Even if the Directive aims to harmonize rules in a much stronger fashion and offer a common minimum standard, the relevant cultural change may require much more to cause shifts to deep rooted views. The degree that EU and national authorities will dictate the pace of change happening may also be linked to the nature of financial incentives offered, if at all, to potential whistleblowers to report breaches of EU law in connection with the new Directive.

The Directive as part of a wider movement, notable in the EU proposals for class action lawsuits to encourage individuals to take action against corporate wrongdoings, marks a differing tone set by the EP to relevant authorities to encourage whistleblowing proactively as a supervisory tool. For financial services firms, the immediate practical priority to operationalizing compliance on the one hand is likely to mean updating internal guidelines and policies coupled with other whistleblowing channels and procedures, and on the other hand conducting self-assessment risk reports to gauge where a firm’s conduct may lead to new risks from whistleblowing reports or incorrect compliance with the rules inasmuch as class-action risks.

In summary, the time for taking preparatory action has now arrived in respect of creating new or amending existing policies and processes at various levels. This could, unless firms take an overarching top-down view, lead to duplication, even if one tenet of the practical impact of this Directive is that firms need to adopt a much more rounded view of their own obligations with respect to whistleblowing exposure and protections as well as those of exposures to which they are directly or indirectly connected.

If you would like to receive further analysis on the Directive or any other issues raised herein with regard to how to prepare in relation to documentation and non-documentation workstreams, please contact one of our Eurozone Hub key contacts to the right.

1. Formally the “Directive (EU) 2019/[NUMBER PENDING ASSIGNMENT FROM OFFICIAL JOURNAL of the European Parliament and of the Council of [DATE PENDING] on the protection of persons reporting on breaches of Union law.” The EP’s adopted text is available here, and changes are shown in bold and italics where the EP has made additions to the text proposed by the European Commission.
2. See our dedicated coverage here.
3. Further details are available here.
4. See here, here and related documents.
5. A whistleblower is referred to as the “reporting person” in the Proposal and is defined in Article 6(7) of the Directive as “a natural or legal person who reports or discloses information on breaches acquired in the context of his or her work-related activities.”

Your Key Contacts

Dr. Michael Huertas
Partner, Co-Head Financial Institutions Regulatory
Europe, Frankfurt
D +49 69 45 00 12 330
michael.huertas@dentons.com