Internalizing Corporate Law or Externalizing Labour Law

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The financial crisis has spurred the development of new frameworks for making different corporate constituents accountable to securities regulators, financial markets and other parties. This process already started a number of years ago with the market crises at the start of the millennium. The proliferation of rules and recommendations in this field will require a reconsideration of the relationships between corporate law and labour law.

In section 302 of the Sarbanes-Oxley Act the chief executive officer (CEO) and the chief financial officer (CFO) must certify that a financial report fairly presents the financial condition and results of operations and internal controls are established and maintained. Section 404 continues to state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting as well as an assessment thereof.

According to Article 6 of MiFID, level 2[1] investment firms must appoint a compliance officer who is responsible for the compliance function and for the reporting, at least annually, regarding this compliance function, deficiencies regarding compliance and whether appropriate remedial measures have been taken. This compliance function should be empowered with the authority, resources, expertise and access to all relevant information. The compliance officer is not allowed to be involved in the performance of services or activities he monitors. His remuneration must be set so as to prevent any compromise of his objectivity.

Solvency II[2] requires insurance undertakings to provide for an effective internal audit function. This function must be objective and independent from the operational functions. It needs reporting to the administrative or management body. Similarly, a management company of Belgian UCITS must make sure that an appropriate independent audit function, as well as an appropriate independent compliance function, is guaranteed.[3]

In Schedule 46 of the UK Finance Act 2009 senior accounting officers of qualifying companies are made liable to taxes and duties and responsible for ensuring and certifying that appropriate tax accounting arrangements have been established and are maintained. The senior accounting officer can be the director or the officer with the overall responsibility for the company's financial accounting arrangements. In the accompanying guidance reference is made to section 1173 of the Companies Act 2006 to identify the 'officer'. It includes a director, manager or secretary. This liability will be assessed via a comparison of the reasonable steps that 'a person in this situation would normally be expected to take to ensure that risks to tax compliance are properly managed and to enable the various returns to be prepared with an appropriate degree of confidence'.[4]

Who is taking care of these functions and positions? It can be expected that 'senior' management is taking care of these functions. The legal position of senior managers varies from jurisdiction to jurisdiction.[5] In two-tier board structures the board of directors can take up these responsibilities. Section 76 of the German Companies Act states that the *Vorstand* carries out the management of the company independently and has its own responsibilities. In a one-tier board, power resides with the board of directors. Some (executive) directors can have specific responsibilities. Regularly – though certainly not always – the CFO is a director. Often the senior manager, like the CFO and the other officers, such as the chief accounting officer and the compliance officer, are not related to the company via a directorship but via an employment agreement.

It raises a number of questions that neither corporate law nor employment law have fully taken into consideration. First, a number of positions, like the compliance officer and the internal audit officer must be independent. Is independence supported? An important feature of a directorship and the board of directors in

1 Commission Directive 2006/73/EC of 10 Aug. 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organizational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, *OJ L* no. 241, 2 Sep. 2006, 26–58.

2 European Parliament Legislative Resolution of 22 Apr. 2009 on the Amended Proposal for a Directive of the European Parliament and of the Council on the Taking-up and Pursuit of the Business of Insurance and Reinsurance (Recast) (COM(2008)0119 – C6-0231/2007 – 2007/0143(COD)).

3 Article 153, s. 3 and s. 4 of Loi du 20 juillet 2004 relative à certaines formes de gestion collective de portefeuilles d'investissement/Wet van 20 juli 2004 betreffende bepaalde vormen van collectief beheer van beleggingsportefeuilles, Official Belgian Gazette, 9 Mar. 2005.

4 HMRC, *Guidance – Duties of Senior Accounting Officers of Qualifying Companies*, 17 Aug. 2009, No. 64.

5 A. Dorresteijn, T. Monteiro, C. Teichmann & E. Werlauff, *European Company Law*, European Company Law Series, (Alphen aan den Rijn: Kluwer Law International, 2009), 157–202.

Van der Elst, Christoph, 'Editorial'. *European Company Law* 6, no. 6 (2009): 244–245.

many jurisdictions is independence to make the appropriate decisions. The board is accountable to the general meeting of shareholders, and the company law framework provides the board and its members with the power to run the company (in the interest of all corporate constituents or in the interest of the shareholders depending on the view defended).[6] If directors are empowered with the functions of compliance officer or risk manager, corporate law provides adequate tools to mitigate the conflicts between independence in mind, independence in appearance and independence in fact. However, often the chief accounting officer, the compliance officer and risk management officer are not directors but officers submitted to the authority of the board. As employees of the company they have to work under the authority, the direction and supervision of the board of directors. At least the independence in appearance is affected and often independence in fact will be difficult to support. Balancing the trade off between the independence and the accountability and responsibility is a very difficult exercise in labour relationships .

It is clear that many companies struggle to implement these requirements in their business structures. In many large firms the compliance department is not integrated in the business lines but separated from the divisions. The separation guarantees that most components of COSO's integrated risk management framework are incorporated. At the highest level, the compliance officer, the risk management officer and even the accounting officer directly report to the board of directors or to the audit committee, a subcommittee of the board of directors. However, this method can only be successful when 'the tone at the top' or the internal environment, probably one of the most important internal control components,[7] is appropriately operating. As a number of debacles over the last decade have shown, some directors might not support the highest ethical values, putting the model under high pressure.

Second, the significant legal differences between a director and an officer has an effect on compensation practices. In a number of countries the power of the general meeting to set or to influence the remuneration package of the board of directors and its members has significantly increased. In the UK, and recently in Germany, a non-binding vote on the directors' remuneration report is required.[8] In the Netherlands and Norway the vote is even binding. A rejection of the report is a very strong signal from the shareholders that the remuneration package is considered inappropriate. In most countries, shareholders have a say on directors' remuneration packages and often company law provides instruments to modify the remuneration package.

The situation is different for senior officers. Especially, in one-tier countries where senior managers are not board members, remuneration packages are negotiated between the board of directors and the manager. The recent proposals to reform these procedures will require another approach in company and labour law. The Pittsburgh Summit endorsed the Financial Stability Board's (FSB) reform of compensation policies to increase financial stability.[9] The FSB supports, for senior executives and employees whose actions have a material impact on the risk exposure of the firm, a compensation package with a significant portion of variable and deferred compensation. If exceptional governance intervention is necessary, the compensation package can be restructured and can be subject to independent review. In employment agreements this will not only require an appropriate board mechanism to make use of the 'ius variandi' but also a procedure that a third party, the 'supervisors', can align the remuneration with sound risk management. As far as we can ascertain, in many countries this new approach demands serious thoughts on the collaboration of labour law and company law. A recent decision of the German *Bundesgerichtshof* of 17 July 2009[10] which found the compliance officer guilty and referred to a criminal 'Garantenpflicht'[11] of this officer shows this reflection is imminent.

6 For a recent overview of the position and role of the board in a number of countries see B. Sjafjell, *Towards a Sustainable European Company Law*, European Company Law Series, (Alphen aan den Rijn: Kluwer Law International, 2009), 45–63.

7 COSO, *Enterprise Risk Management – Integrated Framework*, 2004, 6.

8 For a recent analysis see, H. Fleischer, '"Say on Pay" im deutschen Aktienrecht: Das neue Vergütungsvotum der Hauptversammlung nach §120 Abs. 4 AktG', *Die Aktiengesellschaft* (2009): 677–686.

9 Financial Stability Board, *FSB Principles for Sound Compensation Practices*, 25 Sep. 2009, <www.financialstabilityboard.org/publications/r_090925c.pdf> (last consulted on 8 Oct. 2009).

10 Unpublished but discussed in S. Mutter & D. Quincke, 'Vorstand und Aufsichtsrat – Garantenstellung bei pflichtwidriger Compliance', *Die Aktiengesellschaft* (2009): R416–R418.

11 'Duty to guarantee'.