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The whistleblower protection directive: new compliance obligations in the financial sector

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The transposition of the content of Directive (EU) 2019/1937 of 23 October requires a reform of the Spanish system of channels for reporting actual or potential breaches, also in financial services.

1. Introduction

The recent Directive (EU) 2019/1937 of 23 October 2019 on the protection of persons who report breaches of Union law (known as whistleblowers) lays down a framework for the protection of persons reporting actual or potential breaches of European Union law in the most varied areas, which are detailed in Article 2: from public procurement to transport safety, protection of the environment or consumer protection. In this analysis we will study this piece of legislation from the perspective of financial services.

As a continuation of Blanca Lozano's *GA_P Analysis* "The 'whistleblower directive'" and although it could be thought that our domestic law in the financial sector is almost entirely adapted to Directive (EU) 2019/1937, this is not the case with regard to the internal communication channels that financial institutions must set up for the reporting by their staff of actual or potential breaches of Union law in the financial sector. The same can be said of what the directive calls *external reporting channels*, i.e. the reporting of breaches to financial supervisors. The deadline for transposition of the Directive is set by Article 26 at 17 December 2021.

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Although, as we shall see, the obligation to set up internal reporting channels already existed, amongst others, for credit institutions, investment firms or managers of undertakings for the collective investment in transferable securities (UCITS), given the extension of the financial legislation referred to in the new Directive, it will be necessary to modify our domestic law in order to impose on other undertakings - such as private investment (venture capital/private equity) entities or even listed companies - the setting up of these internal channels for reporting breaches of Union law in matters other than market abuse or markets in financial instruments referred to in MiFID II.

2. Financial law affected by the whistleblower protection directive

The scope of the whistleblower protection directive concerns, with regard to the system of financial law, breaches of Level I rules "establishing a regulatory and supervisory framework and consumer and investor protection in the Union's financial services and capital markets, banking, credit, investment, insurance and re-insurance, occupational or personal pensions products, securities, investment funds, payment services and the activities listed in Annex I to Directive 2013/36/EU" (access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms). These include the Markets in Financial Instruments Regulation (MiFIR), the Transparency Directive, the European Market Infrastructure Regulation (EMIR), the Benchmarks Regulation, the E-Money Directive and the Alternative Investment Fund Managers Directive, the Short Selling Regulation, the European Venture Capital Funds and European Social Entrepreneurship Funds regimes, the Mortgage Credit Directive, the Regulation on statutory audit of public-interest entities and the Payment Services Directive, the Takeover Directive and the Shareholder Rights Directive, directives on insurance and reinsurance undertakings, the Bank Recovery and Resolution Directive, the Financial Conglomerates Directive, the Deposit Guarantee Schemes Directive, the Investor-Compensation Schemes Directive, and the Capital Requirements Regulation (as recently amended by Regulation (EU) 2019/2033).

3. Channels for reporting actual or potential breaches of banking, insurance and financial instrument markets legislation

The reporting channels provided for in Directive (EU) 2019/1937 (the "Directive") must be established within the internal sphere of financial institutions and listed companies (the directive refers to them as "internal reporting channels" in Arts. 7 to 9). The Directive also regulates the "external reporting channels" (Arts. 10 to 14) to the sectoral supervisory authorities; in Spain, the Spanish Securities Market Authority, the Bank of Spain and the Directorate-General for Insurance and Pension Funds.

3.1. *External reporting channels*

The possibility of reporting actual or potential breaches to national supervisors is included in our law in Arts. 276 *bis* to 276 *sexies* of the Securities Market (Recast) Act, in Arts. 119 to 122 of the Regulation, Supervision and Solvency of Credit Institutions Act 10/2014 (LOSSEC) and in Art. 211 of the Insurance and Reinsurance Undertakings Act 20/2015.

Article 276 *bis* of the Securities Market (Recast) Act provides that communications to the Spanish Securities Market Authority may be made verbally or in writing in respect of actual or potential breaches due to non-compliance with securities market law, in particular, the statutory recast version itself; with the regime provided for in matters of market abuse; with the markets in financial instruments regulation (MiFIR) and with that on key information documents for packaged retail and insurance-based investment products; with Regulation (EU) No. 575/2013 of 26 June as regards investment firms and the Collective Investment Schemes Act.

In this regard, as stated by the Spanish Securities Market Authority in page 218 of its 2018 Annua Report, during that year and up to 31 December, the supervisor received seven hundred and four reports of actual or potential breaches, almost half of them (three hundred and twenty-six) through the specific section created for this purpose on the supervisor's website.

It calls attention that these external channels for the communication of breaches, in the case of reports to the Spanish Securities Market Authority, admit anonymous reports, unlike communications of breaches to the Bank of Spain, in which the reporting person must identify himself or herself (Art. 120 LOSSEC). In this Regulation, Supervision and Solvency of Credit Institutions Act, the knowledge or well-founded suspicion of non-compliance with prudential supervision obligations must be based on the obligations laid down in Directive 2013/36/EU or in Regulation (EU) 575/2013. The whistleblower protection directive has a broader personal scope in relation to financial institutions subject to the supervision of the Bank of Spain (for example, the reference to payment service providers), so that the sectoral legislation will have to be amended as reporting in the financial sector cannot rely on Art. 62 of the Common Administrative Procedure Act 39/2015, inasmuch as the whistleblower protection directive contains specific measures, e.g. against retaliation, that are not envisaged in the aforementioned Act.

3.2. *Internal reporting channels within an organisation*

The obligation to establish internal reporting channels provided for in Art. 8 of the Directive is not exempted in the area of financial markets for companies with fewer than 50 employees, unlike in other sectors to which the Directive applies; the derogation also applies to actual or potential breaches that may have occurred or will occur in the company in the area of money laundering and terrorist financing (Art. 8(2) of the Directive).

In Spanish law, the existing regulation of internal reporting channels is frugal and does not affect all the entities referred to in the legislation cited in Part I B of the Annex to the Directive: Art. 197 of the Securities Market (Recast) Act requires investment firms, market operators, data reporting services providers, credit institutions in relation to investment services or activities and branches of third country companies to "have adequate procedures so that their employees can report actual or potential breaches internally through an independent, specific and autonomous channel". Employees who report breaches at

the entity must be protected from retaliation, discrimination and other unfair treatment. In the same sense, Art. 48 *bis* of the Collective Investment Schemes Act, added by the first final provision of Act 11/2018 of 28 December.

For credit institutions, the obligation to establish an independent, specific and autonomous channel through which their employees can report breaches is expressly provided for in Art. 116 of Act 10/2014, specifying, as is the case for securities markets and collective investment schemes, that the procedure must guarantee the confidentiality both of the person reporting potential breaches and of those presumed responsible for the breaches.

However, domestic law does not include this obligation to have internal reporting channels in the financial institution itself for private investment (venture capital/private equity) entities, other collective investment firms of a closed-ended type or the managers of collective investment firms of a closed-ended type referred to in Act 22/2014 (managers of alternative investment funds, AIFMs). Nor, for example, for listed companies on matters other than market abuse, insofar as the Takeover Directive or the Shareholder Rights Directive lay down a series of obligations with which non-compliance may lead to the imposition of administrative penalties. It should be recalled that Art. 4 of the Directive refers, in addition to the company's workers, to shareholders and directors as reporting persons who must enjoy the protection afforded to them by the law by virtue of their report.

In Spain, listed companies have internal reporting channels in application of market abuse legislation (Art. 32(3) of the Market Abuse Regulation) and recommendation 42 of the Corporate Governance Code for Listed Companies (2015), which attributes to the audit committee of the listed company's board the function of establishing and supervising a mechanism that allows employees to report, confidentially and - if possible and appropriate - anonymously, potentially significant irregularities, especially financial and accounting irregularities, that they detect within the company.

The effectiveness of these internal reporting channels is dubious insofar that it is not easy for an employee to report certain conduct internally, no matter how much confidentiality and the absence of retaliations is supposedly ensured, not to mention when the accused are senior management personnel or directors of the financial institution or of the listed company; for this reason, the statement of the directive that "[r]eporting persons normally feel more at ease reporting internally, unless they have reasons to report externally. Empirical studies show that the majority of whistleblowers tend to report internally, within the organisation in which they work" cannot be shared. This could be true in the case of minor or even serious breaches of financial rules contained in Union law, but it is hard to believe that very serious breaches are reported through the company's internal channels: take the LuxLeaks or the Panama papers cases. Hence - more correctly, in our view - recital 62 recognises that, where reporting persons have valid reasons to believe that they would suffer retaliation in connection with the reporting, including as a result of a breach of confidentiality, competent authorities would be better placed to take effective action

to address the breach [...], for example, where the ultimate responsibility holder within the work-related context is involved in the breach, or there is a risk that the breach or related evidence could be concealed or destroyed".

It seems more effective to delegate to a third party the management of internal reporting channels - in accordance with the provisions of Art. 8(5) of the Directive - with the same guarantees provided for internal channels within the company. Or, make use of the possibility offered by Article 8.6 to legal entities in the private sector with 50 to 249 workers of sharing "resources as regards the receipt of reports and any investigation to be carried out", which "shall be without prejudice to the obligations imposed upon such entities by this Directive to maintain confidentiality, to give feedback, and to address the reported breach". Given that the obligation to establish internal reporting channels already exists in Spain for certain financial institutions -regardless of the number of employees in the company-, it is foreseeable that also for financial institutions with less than fifty employees, the Spanish legislator will allow the sharing of resources for the receipt of reports and the conduct, where appropriate, of proceedings.

Although it appears that the European legislator's intention is for the reporting person to first go through the internal reporting channels before going through the competent administrative authority - and in this sense, Member States are required to encourage the former - this is the case provided that the breach can be addressed effectively internally and where the reporting person considers that there is no risk of retaliation (Art. 7(2)).