



October 2010

# ESG Focus: Bribery – a risk for all business

The UK's new Bribery Act is expected to be enacted in 2011. This Act will be more stringent than any other similar regulation on bribery across the world. Companies caught up in bribery and corruption face damage to reputation, significant fines, lawsuits, lost business opportunities and damaged business relations, all of which may have a significant impact upon shareholder value. Through engaging with companies, Newton is able to gain an insight into the complexities companies face in dealing with this issue. Newton's responsible investment team works closely with Newton's global sector analysts to encourage companies, where necessary, to avoid falling foul of bribery regulation and to safeguard Newton's clients' interests.

## 1. Bribery – a form of corruption

Companies practicing corruption are operating a high risk strategy that is focused on short-term gain, while ignoring the long-term risks for a business. Companies that are linked to bribery and corruption may face significant financial costs (prosecution and fines), lawsuits and lost business opportunities, as well as damage to reputation, staff morale

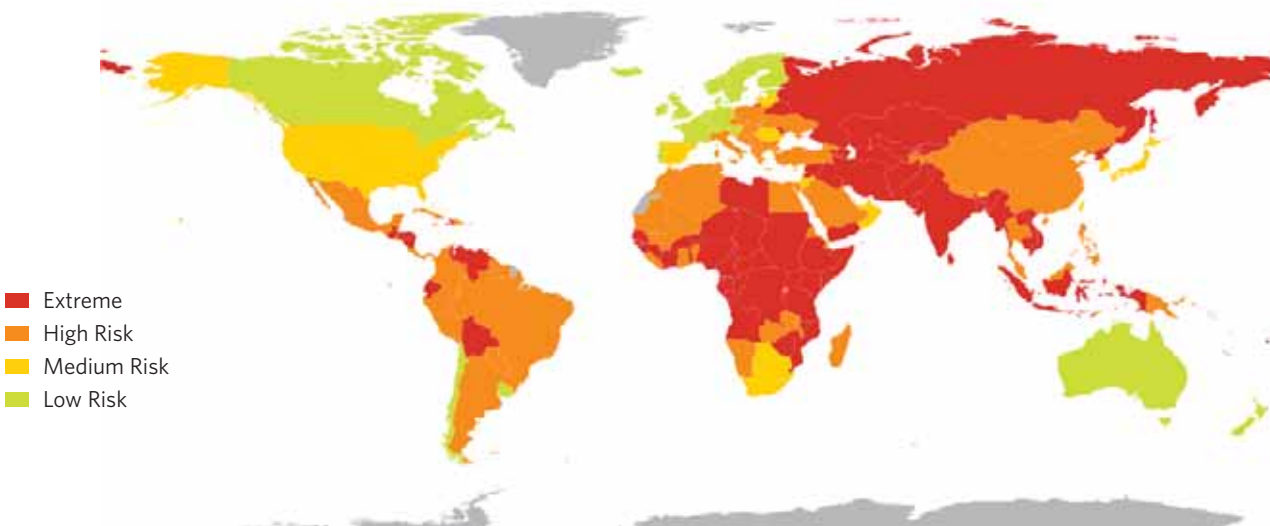
and business and government relations. In addition, managing any scandal is very costly in terms of management time. Avoiding corruption is one of the most significant challenges for multi-national companies.

Corruption has been defined by Transparency International<sup>1</sup> as "the abuse of entrusted power for private gain".

While corruption may occur at state level and with civil organisations, many forms of corruption exist within the private sector. Corruption in the private sector includes corporate fraud, account manipulation, conflicts of interest, embezzlement, facilitation payments and money laundering. The most common form of corruption is bribery, the act of offering an item of value in

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## GLOBAL BUSINESS INTEGRITY AND CORRUPTION



Source: Maplecroft

<sup>1</sup> Transparency International is a global non-government organisation focusing on fighting corruption.



order to influence the recipient's conduct. An example would be an individual giving money to a foreign official in order to influence that official's behaviour. For investors, corruption can be a feature of country risk. Countries with high levels of corruption pose greater risk and are unlikely to attract foreign investment from the private sector. Bribery has the ability to impede economic growth, distort competition, hinder sustainable development and represents a serious legal and reputational risk for companies operating in areas where bribery and corruption are prevalent.

## 2. Geographic risks

The prevalence of bribery differs from country to country and may have a bearing on how company employees conduct business. Companies based in emerging economies such as China, India and Russia are perceived to be routinely engaged in bribery<sup>2</sup>. For companies with stringent anti-corruption policies in place, this can create an uneven playing field and make operating in the region difficult or, in extreme cases, impossible.

Maplecroft<sup>3</sup> has mapped business integrity and corruption, globally. The map, on the front page, measures the extent and endemic nature of corruption across state organisations, as well as business involvement in the giving or taking of bribes or other corrupt practices, including facilitation payments.

In addition to geographical risks, the risk of corruption varies between sectors. Those companies operating in the construction, real estate, defence and extractive industries are most exposed to corruption.

<sup>2</sup> Transparency International 2008 Bribe Payers Index,  
<sup>3</sup> Maplecroft is a risk mapping research provider

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## BAE CASE STUDY

The British arms firm, BAE Systems, faced allegations that it had paid bribes to win contracts from several nations in Africa and Eastern Europe, as well as in dealings in Saudi Arabia. Following lengthy investigations by both the British and American governments, the company pleaded guilty to charges of false accounting and making misleading statements. The company reached settlements with both the US Department of Justice and the UK's Serious Fraud Office and agreed to pay fines of over \$400m.

As a result of these allegations, the Woolf Committee was appointed by the Board of BAE. The Committee was set up to deliver an independent report on the company's ethics policies and make recommendations to the company aimed at achieving robust ethical business conduct. The company now reports regularly on its implementation of the Woolf Committee recommendations and how it is managing anti-corruption in its business.

Newton has had a detailed and constructive dialogue with BAE Systems. Alongside the global sector analyst with responsibility for research into the defence sector, the responsible investment team has held regular discussions with the company. These discussions involved understanding and influencing the company's approach to anti-corruption measures.



### 3. The UK Bribery Act

In 2009, Transparency International's Corruption Perceptions Index, which ranks 180 countries according to perceived levels of public sector corruption, placed the UK at an all-time low of 17th least corrupt country, level with Japan and just ahead of the US.

The UK's laws governing bribery date back to the nineteenth century and, although relevant for the time, are no longer wholly effective. These outdated laws, coupled with a number of bribery allegations in the UK, have undermined the UK's reputation and have highlighted the need to introduce new laws on corruption. In addition, countries that have signed the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (entered into force in 1999) are required to put in place legislation that criminalises the act of bribing a foreign public official. The UK has been slow to amend its laws and regulations and has received international criticism for its inaction.

As a result, the UK introduced new regulation on bribery, the Bribery Act, which received Royal Assent in April 2010. The Act has yet to become law but is expected to be implemented in April 2011. Before its enactment, the Secretary of State and the Serious Fraud Office need to provide companies with guidance

on its implications. This guidance needs to be issued three months prior to the Act becoming law and is due to be published in January 2011.

Under the old legislation, the test that determined prosecution was whether a "directing mind" was involved in the allegation of bribery. In other words, that the board of the company concerned was actively involved in, or had knowledge of, instances of bribery. Given that the majority of incidents of alleged bribery occur at the operations level of a business, where the board has little or no direct involvement, only a few companies faced prosecution, historically. The new Act is broader and will cover any incident of an employee acting for the benefit of the company, with or without the Board's knowledge.

There are four key offences under the Bribery Act

- 1 The bribing of another person
- 2 Being bribed or accepting a bribe
- 3 Bribing a foreign official
- 4 The failure by commercial organisations to prevent a bribe

Under the Act, a corporate presence establishes jurisdiction and allows the Act to prosecute any incident of bribery committed in the UK or abroad by any company that has a corporate presence in the UK, even if its stock exchange listing or main country of domicile is elsewhere.

Specifically, this is covered under the Clause 7 offence, the failure to prevent bribery.

The Act allows a company to report another company should it suspect incidents of bribery. The Serious Fraud Office would then conduct its own investigation. It is likely that this process of reporting other companies will be the main foundation for future investigations by the Serious Fraud Office.

Differences with the US

Foreign Corrupt Practices Act

The UK's Bribery Act is more stringent than the United States Foreign Corrupt Practices Act (FCPA). The FCPA is the US law that contains anti-bribery provisions. A key difference is that the UK Bribery Act applies not only to the government sector but also to the private sector. Another significant difference with the FCPA is that, under the new Act, facilitation payments are considered bribes. Facilitation payments are small unofficial payments which are made to facilitate or speed-up transactions, such as paying to fast-track a shipment of goods through customs. Under the FCPA, facilitation payments are not explicitly prohibited. The penalties also differ between the two laws. The FCPA sets a maximum penalty of five years' imprisonment per offence; the maximum penalty under the Bribery Act is ten years imprisonment. The table on page 4 outlines the differences between the US and UK laws.

## DIFFERENCES IN LIABILITY BETWEEN THE UK BRIBERY ACT AND THE US FOREIGN CORRUPT PRACTICES ACT

Provisions	The UK Bribery Act	The US FCPA
Bribery of foreign public officials	Yes (section 6).	Yes, the FCPA applies to only the bribery of foreign officials.
Private-to-private bribery	Yes, the main provisions of the Bribery Act apply to the private sector as well as the public sector except for the Foreign Public Official offence.	No.
Receipt of a bribe	Yes (section 2).	No.
Intent	Mixed. Intention is required for some "cases" of section 1 and 3 offences. No "corrupt" or "improper" intent is required for the Foreign Public Official offence in section 7.	In alleging violations of the bribery provisions of the FCPA, the government must show that the defendant had the requisite state of mind with respect to his actions i.e. negligence, intent, recklessness.
Facilitation payments	The Act does not permit an exception for facilitation payments.	Permitted under very limited circumstances when paid to foreign officials in order to expedite or secure the performance of a "routine governmental action".
Promotional expenses	The Act makes no specific provision for promotional expenses.	Yes, affirmative defence if they are reasonable and bona fide business expenses that are directly related to the promotion, demonstration or explanation of products of services or in connection with the execution of a particular contract with a foreign official.
Extra-territorial application	Yes, persons are liable for sections 1, 2, or 6 offences committed outside the UK if they have a "close connection" with the UK. The "failure to prevent bribery" offence applies to UK entities, wherever they conduct business; any corporation, wherever formed, which carries on business, or part of a business, in the UK.	Yes, the FCPA applies to violative acts by US issuers, domestic concerns and their agents and employees that occur wholly outside US territory and to acts by US citizens or residents, wherever they occur.
Third parties	Yes, liability for acts of associated persons who perform services for or on behalf of the company.	Yes, the FCPA prohibits corruption payments through intermediaries.
Failure to keep accurate books and records	Covered by other legislation.	Yes.
Criminal penalties	<b>Individuals:</b> up to ten years sentences and unlimited fines; <b>Companies:</b> unlimited fines.	<b>Individuals:</b> a fine up to \$250,000 per violation and up to five years imprisonment; <b>Corporations and businesses:</b> a fine of up to \$2m per violation.

Source: Transparency International, Newton Investment Management

Given these differences, companies that are under the impression that they have protected themselves under the FCPA cannot be complacent about the implications of the UK Bribery Act on their businesses. Furthermore, the FCPA has indicated it may consider tightening its legislation to outlaw facilitation payments.

#### 4. Corporate considerations

With the UK Bribery Act coming into force, there are a number of issues that companies will need to consider. For example, it is important that companies are aware that their directors may be liable for prosecution for failing to maintain adequate procedures. In addition, companies facing criminal, rather than civil, prosecution under the Act may be banned from bidding for public contracts and face debarment under the 2004 European Union Procurement Directive.

Gifts, hospitality and donations may also be perceived as bribes, even if given after a service has been provided. This will be a challenge for multinational companies. Some companies have raised concerns that, under the wording of the Act, taking officials to see their facilities in another country or region and paying for their expenses may be construed as a bribe.

This is a regular practice for extractive industry companies where, in order to ensure that officials have a full prior knowledge and understanding of the operations being proposed for new projects, trips are arranged to view other similar facilities that are operated by the company.

Companies have some guidance that they can refer to, such as Transparency International's guidance on good practice procedures when considering anti-bribery programmes. It will be important for companies to consider anti-corruption issues carefully, particularly as it is generally viewed that the government guidance will be "principles", as opposed to "rules", based.

Companies will also need to be aware that they will be unable to use cultural differences as a defence. In addition, the Serious Fraud Office will be encouraging companies to report facilitation payments and suspected misconduct.

Companies will need to ensure that they have adequate procedures in place to prevent their own employees, as well as subsidiaries or partner companies in joint ventures, from engaging in bribery.

This is important when considering the terms of joint ventures, vetting new business partners and conducting due diligence of potential acquisitions. If a partner is found to be paying bribes that will ultimately benefit the company, the company is liable and may be prosecuted.

Companies that are able to demonstrate that these issues have been given considered attention and that the correct processes are in place, including auditing procedures and mechanisms for whistle-blowing, will be able to minimise the risk of being prosecuted under the new law. This would also ensure that a company suspected of bribery would face the lesser civil, as opposed to criminal, charges.

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#### PENALTIES

##### Corporate bodies

- Unlimited fines
- Disbarment from tendering for government contracts under Article 45 of the EU Public Sector Procurement Directive 2004

##### Individuals

- 10 years in prison
  - and/or unlimited fine
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## 5. Responsible investor initiatives

Newton encourages multi-national companies, in which it invests, to consider joining the UN Global Compact. The Compact comprises of a set of 10 principles that provide a framework for any company on managing environmental, human rights, labour and anti-corruption issues within their business. The 10th principle explicitly deals with corruption and states “Businesses should work against corruption in all its forms, including extortion and bribery”. This principle commits Global Compact participants to work towards avoiding bribery, extortion and other forms of corruption as well as to develop policies and concrete programmes to address corruption.

In addition, the International Corporate Governance Network has published a statement and guidance on anti-corruption practices. This document discusses the effects of corrupt practices and the detrimental impact on long-term shareholder value. It also provides basic investor guidance for assessing a company’s policies, procedures and practices as they relate to bribery and corruption.

## 6. Newton’s approach and engagement

The introduction of the Bribery Act has been identified as a risk for the companies in which Newton invests, particularly given the lack of clarity around its application.

Newton has been engaging with investee companies on the matter of the new Bribery Act. In particular, Newton’s focus has been on whether these companies have considered the implications for their business of the UK Bribery Act and how they may avoid falling foul of the Act. Newton has also sought to ascertain whether adequate training procedures are in place to ensure that employees are aware of the standards expected of them.

In order to demonstrate an understanding of the risks, Newton expects companies to have:

- Board awareness and ownership of anti-corruption mechanisms;
- Publicly disclosed policies and a code of ethics that relate to bribery;
- Adequate procedures and internal controls in place;
- Effective risk assessment focusing on high risk countries and transactions;
- Regular auditing and monitoring;
- Independent whistle-blowing systems;

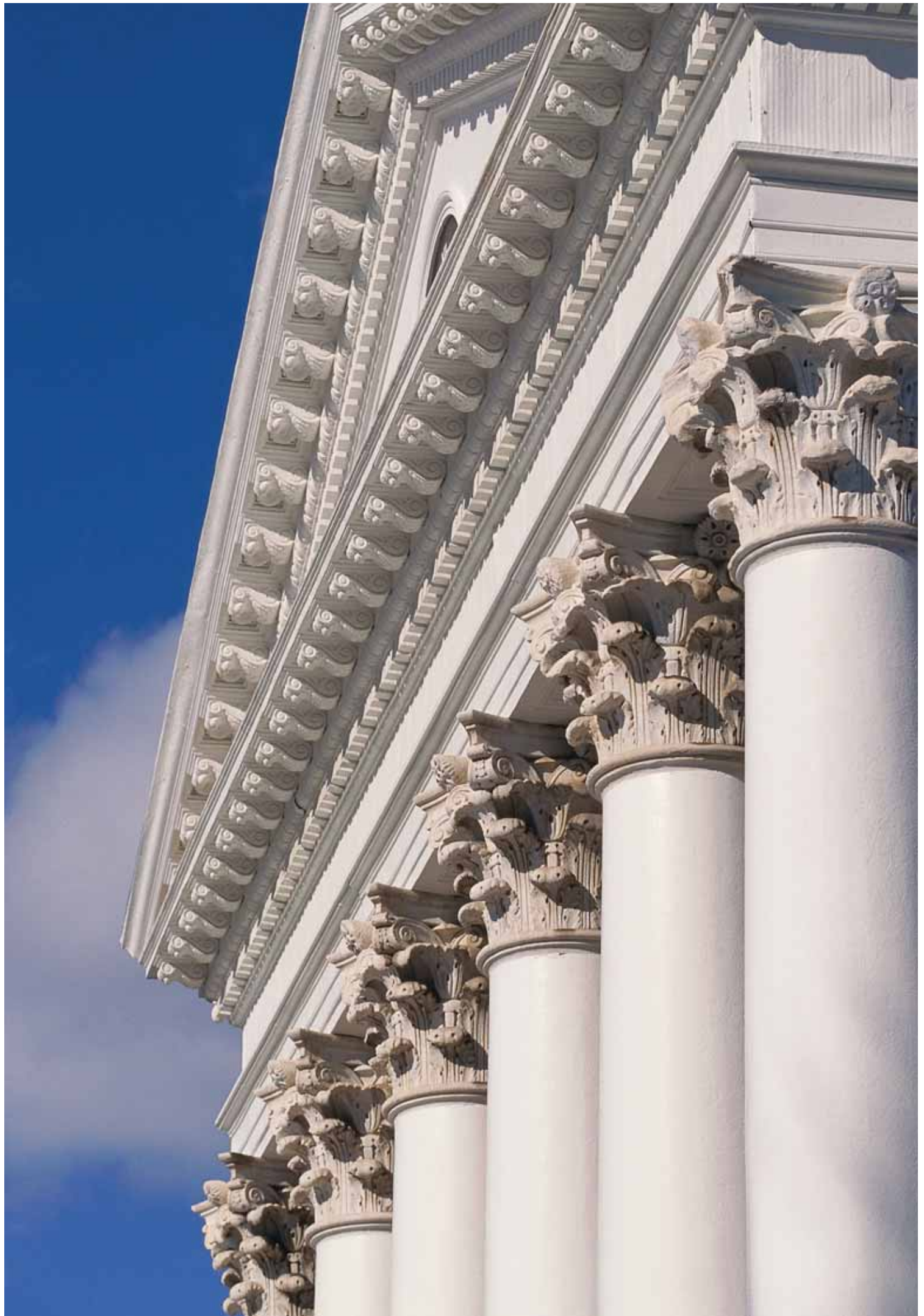
- An effective system of reporting incidents and facilitation payments;
- A culture that is aligned with its business principles;
- Adequate and regular training of staff on anti-corruption.

Newton’s investment team is concerned that companies which have failed to assess whether their anti-corruption policies are adequate to deal with the new regulation, will be at greater risk of being prosecuted for bribery. This could lead to reputational damage, increased costs, operational challenges and a destruction of shareholder value. Newton would expect the companies in which it invests to have identified the key areas within their business operations, as well as the key individuals, most exposed to bribery.

Newton continues to raise this issue with the companies in which it invests. To date, Newton’s experience is that corporate awareness of the issue is most advanced amongst some of the large UK international companies, although, even here, there are some which have done little to grasp the importance of the issue. Newton will continue to monitor the issue, as with all responsible investment matters, to safeguard its clients’ interests.

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