

As good as we are perceived?

A review of the approach to bribery and
corruption by New Zealand business



Executive Summary

In 2006, CAER (Corporate Analysis. Enhanced Responsibility) published research that they had undertaken into the approach taken by Australian companies in restricting bribery and corruption. CAER's research focused on companies listed on the S&P/ASX 100.

In 2009 CAER undertook similar research with respect to companies listed on the NZX 50 as part of a review for ethical and responsible investors. Much of the data in this report has been provided by CAER and we are grateful to CAER for sharing the results of their research with Transparency International (New Zealand). Much of CAER's research was undertaken by reviewing publicly available information particularly code of conduct/ethics related policies.

According to Transparency International's annual Corruption Perceptions Index, New Zealand is perceived as the least corrupt nation in the world. We were interested to see if CAER's research data for New Zealand supports this perception.

Of the companies on the NZX 50, 44% have policies prohibiting bribery and 18% have policies on regulating facilitation payments. This does not compare favourably with the percentage of companies prohibiting bribery in comparable markets overseas. Of the top 100 companies by market capitalisation in the UK, 72% have explicitly prohibited giving and receiving bribes. In Europe the figure is 57% and in the US it is 69%.

Few companies augment their policy with an adequate system to encourage a culture of compliance with anti-corruption policies. Out of the NZX, only 16% of companies have a code of ethics system that CAER rated as 'advanced'. Only 5 companies had a code of ethics that prohibited facilitation payments.

The NZX should seek to increase the number of companies that address the issue directly. Companies are far more likely to include ethics elements suggested by the NZX than those that are not.

Corruption can have uncertain consequences for investors that stem from the additional types of risk corruption introduces. Investors have a role to play in encouraging companies to prohibit bribery and corruption by including this type of risk in investment decisions.

The bottom line of this research appears to be that many of New Zealand's largest listed businesses don't pass some fundamental best practice ethics tests. Transparency International (New Zealand)'s message is that the laggards need to take action and get the ethical dimensions of their businesses sorted out if they are to justify the confidence of their stakeholders including shareholders and the public. As the global financial crisis highlighted, there is a lot at risk including shareholder wealth, employees' jobs and New Zealand's reputation. We need more ethical leadership from New Zealand business in relation to these issues.

Bribery vs Facilitation Payments

A bribe is defined as a favour or gift offered or given with the intention of influencing behaviour or opinions of the recipient. 'Active' bribery is the action of giving a bribe while 'passive' bribery is receiving the payment.

The OECD identifies facilitation payments by the circumstances in which they are made. A payment is a facilitation payment, and not a bribe, where it is paid to government employees to speed up an administrative process where the outcome is already pre-determined.

The difference lies, in the simplest terms, in the decision-making power of the recipient. A payment to hurry along a visa application that is certain to be granted is an example of a facilitation payment. The outcome of whether the visa is granted or not is determined by regulation, and a payment to alter a decision in this respect would be a bribe. A payment to a government employee before a tender process has been concluded is a bribe as the recipient may consider the payment when deciding on awarding the contract.

The United Nations Convention against Corruption prohibits facilitation payments. Nevertheless, these payments are still a part of doing business in many countries, and companies around the world handle the issues in various ways.

The law in New Zealand

Bribery is a crime under the Crimes Act 1961. New Zealand citizens or residents engaging in bribery of foreign government officials can receive a jail term of up to a maximum of seven years. This compares to Australia where the maximum term of imprisonment for bribing a foreign official is ten years. New Zealand companies and individuals may be convicted of bribery whether the act is committed from within New Zealand or from overseas.

There are two defences to the charge of bribery of a foreign official. The first is if the payments made are not illegal in the recipient's country. The other defence is that of facilitation payments where the benefit is "small".

Section DB45 of the Income Tax Act 2007 does not allow for the tax deductibility of bribes except where the bribe is paid outside of New Zealand to a foreign official and the bribe is not an offence under the laws of that country. Facilitation payments are tax deductible as long as it is "given wholly or mainly to ensure or expedite the performance by a foreign public official of a routine government action when the value of the benefit is small." The Act does not define "small".

Australian, US and UK law: a comparison

In Australia, bribery is a crime under the Commonwealth Criminal Code Act 1995. Australian nationals engaging in bribery of foreign government officials can receive fines of up to AUD 66,000 and ten year jail terms. Australian companies face fines of up to AUD 330,000 if convicted of bribing foreign officials. Australian companies and individuals may be convicted of bribery whether the act is committed from within Australia or from overseas.

There are two defences to the charge of bribery. The first is if the payments made are not illegal in the recipient's country. The other defence is that of facilitation payments.

There are discrepancies within Australian law as to what defines a facilitation payment and whether such payments are legal. The Criminal Code defines facilitation payments by stating that the payment must be:

- of a nominal value;
- paid to a foreign official for the sole or predominant purpose of expediting a minor routine action; and
- documented as soon as possible.

The documentation must satisfy the reporting requirements also set out within the Criminal Code.

The Australian Income Tax Assessment Act (1936) (ITA) also sets out a definition of facilitation payments but does not include a reference to the minor nature of the payments. As the ITA Act does not refer to the size of a payment, and the Criminal Code does not define 'minor', it is unclear at what size a facilitation payment ceases being legal and becomes a bribe.

The Foreign Corrupt Practices Act is the predominant legislation governing bribery in the US. US nationals may receive fines of up to USD 100,000 and up to five years imprisonment if convicted of bribing foreign officials. Corporations face fines of USD 2 million if convicted of the charge. Punitive actions against corporations may also include the withdrawal of export approvals and exclusion from government contracts. US law also has provisions to

increase the maximum fines available if the bribe has resulted in a loss or gain. The fine, in this case, may be twice the amount of the loss or gain incurred. The US claims jurisdiction in FCPA matters for American entities which also includes companies that are listed in America. Enforcement of the FCPA by American authorities is particularly rigorous as illustrated in December 2008 when Europe's largest engineering company Siemens AG was fined US\$800 million for various FCPA violations.

The same two defences against allegations of bribery exist in the US. A payment is not a bribe if it is legal in the recipient's country. A facilitation payment is also not considered to be a bribe. The US, like New Zealand and Australia, does not set out an upper limit for facilitation payments. Unlike New Zealand, the US does not make reference to 'small' or 'minor' when defining facilitation payments, and the OECD identifies this as a flaw. Facilitation payments are, like New Zealand, tax deductible in the US.

The UK, unlike New Zealand, Australia and the US, does not recognise facilitation payments as a legal action and has not put forward a definition. In practice, as the OECD notes, it is unlikely that the UK would prosecute individuals or companies making small facilitation payments to officials in areas where this is usual practice.

A summary conviction in the UK may result in fines up to £5,000 and six months imprisonment. An indictment for bribery may result in prison terms of up to seven years and unlimited fines.

While New Zealand is perceived to be the country least susceptible to corruption in Transparency International's 2009 Corrupt Perceptions Index, the possible penalties in Australia, the UK and the US appear harsher than those available under New Zealand law.

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A review of New Zealand business' approach to Bribery and Corruption

Why bother with a Code of Conduct?

Companies, as well as nation states, have an interest in inhibiting corruption and associated misconduct.

Corrupt practices heavily impact on the business environments in areas where it is the norm. Ineffective competition and instability discourage investment in these environments. Controlling assets based on contracts or licences that require illicit payments to secure, or dependence on revenue streams based on these contracts, contributes additional layers of risk for the companies involved. Corruption damages the reputation of companies and industries and impacts on a company's informal 'licence to operate'. As a result, companies have a vested interest in alleviating corruption.

Company policy is another avenue available to business to prohibit or regulate payments made to foreign officials. It is an attempt at self regulation on a company level. While company policy is not legally binding, it is an indication that directors have considered its components seriously. Company policy reinforced by a stringent system to enforce compliance is an effective first step in managing issues such as bribery and corruption. New Zealand investors may wish to consider this issue when reviewing the companies in their portfolios.

Forty six companies on the NZX 50 have a code of conduct or ethics. Of these companies, 68% have made the policies publicly available, and 74% explicitly state that the policy applies to all subsidiaries.

Bribery and Facilitation Payments

Although New Zealand has been identified by Transparency International as the country least likely to be involved in corruption globally, companies listed on the NZX 50 have considerable interests in industries and countries with a more challenging reputation.

As Table 1 shows, 20 of the NZX 50 are involved in high risk sectors such as mining, gas and oil exploration and production and property development. A total of 14 companies on the NZX 50 are involved in countries identified by Transparency International as being high risk (http://www.transparency.org/policy_research/surveys_indices/cpi/2008). A total of 16 of the NZX 50 are involved in at-risk country business activities.

Table 1. Involvement of New Zealand Companies in At-Risk Areas

	Involved in at-risk sector	Involved in at-risk country	Involved in at-risk country business activity	Involved in all three at-risk areas
NZX 50 Companies	20	14	16	5

A total of 22 of companies listed on the NZX 50 have explicitly prohibited their employees from giving and receiving bribes. One additional company has prohibited receiving bribes but does not refer to giving bribes while another company explicitly prohibits giving bribes but does not mention receiving bribes.

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Figure 1. Percentage of companies from New Zealand (NZX 50), Australia, UK, US and Europe which prohibit both the giving and receiving of bribes.

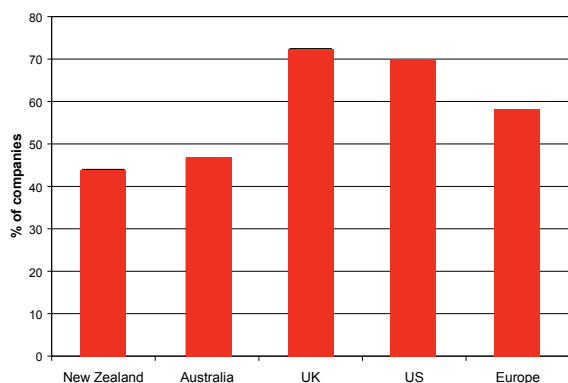


Figure 1 above highlights that the rate of New Zealand companies whose policies prohibit the giving and receiving of bribes does not compare well with companies in Australia (47%), US (69%), UK (72%) and Europe as a whole (57%).

Table 2. Prohibition of Bribery by Companies in At-Risk Areas

	Involved in at-risk sector	Involved in at-risk country	Involved in at-risk country business activity	Involved in all three at-risk areas	Not involved in at-risk area
Number of companies prohibiting bribery	11	11	12	18	4

Table 2 identifies companies that prohibit bribery and have interests in at-risk areas. Of the 20 companies on the NZX 50 involved in high risk sectors (see table 1 above), 11 explicitly prohibit employees from engaging in bribery and corruption. Eleven of the 20 companies with subsidiaries in high risk countries have explicit policies on bribery.

Given that only 55% of companies most exposed to risk in the area of bribery and corruption do not have public policies addressing the issue, there is a clear risk not only for the companies themselves but also for investors in those companies.

The rate of companies incorporating facilitation payment controls into company policies is substantially lower than companies addressing bribery. Only 14% of companies listed on the NZX 50 have sought to control the way in which facilitation payments are made by adding restrictions into their codes of conduct, and only 10% prohibit facilitation payments altogether.

Interestingly, only 4 companies with interests in at-risk areas (sector, country, business activity) prohibit facilitation payments, as shown in Table 3. One company out of the 20 in high risk sectors, and 3 out of the 14 in high risk countries, have prohibited facilitation payments.

Table 3. Prohibition of facilitation payments by Companies in At-Risk Areas

	Involved in at-risk sector	Involved in at-risk country	Involved in at-risk country business activity	Involved in at least one at-risk area	Not involved in at-risk area
NZX 50 Companies	1	3	1	4	1

In terms of restricting, as opposed to prohibiting, facilitation payments only 9 companies on the NZX 50 do this. These 9 companies are all identified as having low or medium risk exposures. Of those companies identified as having high risk exposures none restricted (as opposed to prohibited) facilitation payments.

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The influence of the NZX and regulator

The NZX code of ethics requirements are set out at Appendix 16 (Corporate Governance Best Practice Code) of the NZX Listing Rules, and state:

“An issuer should formulate a code of ethics to govern its conduct.

The code of ethics should address ethical issues, establish compliance standards and procedures, provide mechanisms to report unethical behaviour and ensure that disciplinary measures are in place for any violations.

When drafting the code of ethics, the Issuer should consider the following:

- A. conflicts of interest; and
- B. receipt and use of corporate information; and
- C. receipt and use of corporate assets and property; and
- D. Directors give proper attention to the matters before them; and
- E. A general obligation to act honestly and in the best interests of the Issuer as required by law; and
- F. Compliance with any applicable laws, regulations and rules.”

Whilst these guidelines discuss adherence to applicable laws, regulations and rules, they do not mention bribery, corruption or facilitation payments.

In 2004 the Securities Commission issued a handbook entitled “Corporate Governance in New Zealand Principles and Guidelines: A Handbook for Directors, Executives and Advisers”. The guidelines state:

“The board of every entity should adopt a written code of ethics for the entity that sets out explicit expectations for ethical decision making and personal behaviour in respect of:

- conflicts of interest, including any circumstances where a director may participate in board discussion and voting on matters in which he or she has a personal interest;
- proper use of an entity's property and/or information; including safeguards against insider trading in the entity's securities;

- fair dealing with customers, clients, employees, suppliers, competitors, and other stakeholders;
- giving and receiving gifts, facilitation payments, and bribes;
- compliance with laws and regulations; and
- reporting of unethical decision making and/or behaviour.”

The handbook also recommends:

- measures for dealing with breaches of the code;
- communicating the code to employees;
- providing employee training on the code;
- providing whistleblower procedures;
- every board should have a system to implement and review the code of ethics; and
- monitor adherence to the code.

Figure 2. Inclusion of Ethics Aspects in NZX 50 Codes of Conduct

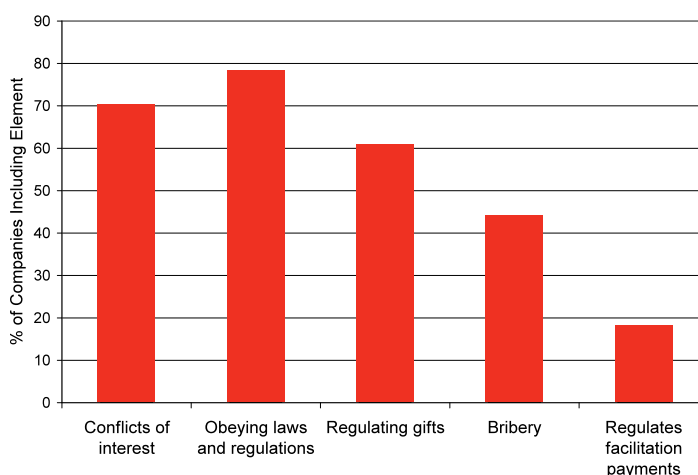


Figure 2 above notes that many aspects of business ethics mentioned in the Securities Commission handbook principles are present in most company codes of conduct. However, only 70% of companies mentioned conflicts of interest (in Australia this was 97%) while less than 80% of companies have incorporated a reference to obeying laws and regulations. Giving and receiving gifts is incorporated into substantially fewer (60%) codes of conducts. As stated earlier, the inclusion for bribery is lower still at 44% and facilitation payments are mentioned in less than 20% of codes.

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Code of conduct systems

There are significant differences in the way that companies on the NZX 50 approach enforcing a culture of compliance with their codes of conduct.

Forty-six percent of companies supply evidence of providing their employees with training on the code of conduct. This ranges from including aspects of the code in a new employee's induction to comprehensive workshops for all employees. Forty-eight percent outline information to stakeholders and the public regarding the systems in place for monitoring compliance with the code. Only 20% of companies report publicly on breaches of the code and the sanctions that were applied.

Seventy two percent of companies have in place systems to protect whistleblowers to encourage employees to report breaches, while 48% of companies indicate that a regular review of the code takes place.

Figure 3. Codes of Ethics Systems for the NZX 50

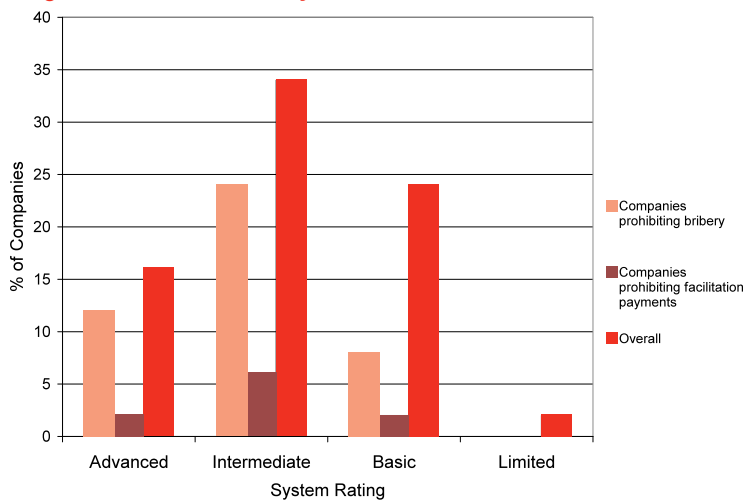


Figure 3 illustrates that 16% of companies have a code of ethics system rating of advanced, 34% have an intermediate rating, 24% have a basic rating, while 2% have a limited rating. Twenty-four percent fail to meet even a limited rating. The majority of companies with systems rated as advanced or intermediate have policies which prohibit bribery. However, relatively few companies have policies which prohibit facilitation payments.

Conclusion

A detailed examination of code of conduct policies among companies listed on the NZX 50 shows us that only 44% prohibit bribery.

This figure is considerably less than that seen in comparable markets in other parts of the world and fails to meet the Securities Commission Corporate Governance Principles and Guidelines. Only 18% of the NZX 50 have policies on restricting (as opposed to prohibiting) facilitation payments. None of the companies identified as having a high risk exposure to corruption have policies that restrict facilitation payments.

Less than half of the NZX 50 supply evidence of providing their employees with training on the company's code of conduct and most also don't report that they outline information to their stakeholders and the public regarding the systems in place for monitoring compliance with the code. Again this suggests that the NZX 50 are not measuring up to international standards or regulators' expectations.

Many of New Zealand's largest listed businesses don't pass some fundamental best practice ethics tests. Transparency International's message is that the laggards need to take action and get the ethical dimensions of their businesses sorted out if they are to justify the confidence of their stakeholders including shareholders and the public. As the global financial crisis highlighted, there is a lot at risk including shareholder wealth, employees' jobs and New Zealand's reputation. We need more ethical leadership from New Zealand business in relation to these issues.

Recommendations

1. Investors work with New Zealand companies to improve the way in which bribery and corruption risk is managed:

The statistics indicate there are gaps in the way New Zealand companies are tackling bribery and corruption. Companies seeking to effectively self-regulate their activities need two components, in addition to the policy, in order to be effective:

- a system of enforcement that includes communication strategies, senior responsibility, review, and appropriate sanctions for breaches; and
- universal application of the code to all subsidiaries, joint ventures and agents in order to capture those incorporated in at-risk countries and at-risk sectors.

Without these factors the existence of a policy lacks meaning and is ineffective.

2. The New Zealand Stock Exchange incorporates bribery and facilitation payments into their Corporate Governance Good Practice Code:

The Code does not mention bribery, corruption or facilitation payments. By including these, companies in NZ may start to incorporate these into their code of ethics and recognise the importance of them. It is, however, not sufficient to just incorporate these issues in their codes of conduct – companies must also enforce them.

3. Regulators and industry work to develop a clear operating procedure for handling facilitation payments:

It is likely that New Zealand companies are currently involved in the payment of facilitation fees to foreign government officials. Most people would assume that such payments are generally of a minor nature and intended purely to speed up the administrative process in overseas operations.

When does a facilitation payment become a bribe? Which companies are taking this risk? There is currently a lack of clarity for New Zealand companies trying to answer the first question, and a lack of public information for investors trying to answer the second question.

We recommend that the government and industry representatives to consider this situation in some detail. An ideal outcome would be a system that:

- allows a company to determine clearly whether a payment is a bribe or a facilitation payment;
- facilitates transparent disclosure of these facilitation payments in a non-critical manner to enable a company to be above reproach in its activities; and
- actively promotes good governance in countries where New Zealand companies are operating. Better government administration in places where New Zealand companies are doing business would be a positive for investors, for companies and for the countries in which these companies are operating.

Investors have a role in inhibiting bribery and corruption by considering the additional risk associated with these issues when making decisions about where to direct their finances.

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Notes:

Transparency International

www.transparency.org

Transparency International (TI) is a not-for-profit organisation committed to combating corruption internationally. The 2009 Corrupt Perceptions Index lists the following as the 10 countries perceived to be most corrupt:

Somalia; Afghanistan; Myanmar; Sudan; Iraq; Chad; Uzbekistan; Turkmenistan; Iran; Haiti.

The 2009 Index lists the following as the 10 countries perceived to be least corrupt:

New Zealand; Denmark; Singapore; Sweden; Switzerland; Finland; Netherlands; Australia; Canada; Iceland.

New Zealand ranks as the country perceived to be the least corrupt.

TI's Bribe Payer Index (2008) outlined the industries perceived to be most likely to be targeted to pay a bribe to government officials. These are as follows:

Public works/construction; real estate & property development; oil and gas; heavy manufacturing; mining; pharmaceutical & medical care; utilities; civilian aerospace; power generation & transmission; forestry.

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CAER

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Corporate Analysis. Enhanced Responsibility (CAER) is an independent, not-for-profit research organization. CAER was established in 2000 to provide independent social and environmental data on companies operating in Australia and the Asia-Pacific region.

CAER collects data on approximately 180 socially responsible investment (SRI) issues for the S&P/ASX 300 and major New Zealand companies. CAER data is based on publicly available information gathered from company and government websites and company Annual Reports. CAER contacts companies directly twice per year, and conducts an annual survey of companies covering all of the SRI criteria addressed. Companies are also provided with the opportunity to review and respond to the information CAER holds twice per year.