UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
INTERNATIONAL
AFFAIRS

8 June 2006

Mr. Peter Schaar
Chairman
Article 29 Data Protection Working Party
Directorate-General Justice, Freedom and Security
Data Protection Unit
B-1049 Bruxelles
BELGIUM

Dear Mr. Schaar:

At the request of Chairman Cox, I am writing in response to your letter dated 16 February 2006. The SEC staff appreciates the opportunity to react to the Article 29 Data Protection Working Party opinion adopted 1 February 2006 (the "Opinion").

You expressed an interest in knowing whether compliance with the Opinion also allows compliance with the whistleblower requirements mandated by Section 301 of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"). SEC staff, as a matter of policy, does not opine on or interpret the laws or regulations of a foreign sovereign (or group of sovereigns). Further, we must note that the views expressed in this letter do not necessarily reflect the views or the approval of the Commission or of other members of the Commission's staff. However, we thought it would be useful to provide you with the staff's understanding of certain concepts underlying the whistleblower requirements as they relate to the Opinion. In addition, we are seeking confirmation of certain clarifications of the Opinion offered in an 8 March 2006 meeting between SEC staff and Christophe Pallez, Secretary General of the Commission Nationale de l'Informatique et des Libertés or CNIL, in his capacity as a representative of the Article 29 Data Protection Working Party. These clarifications, if confirmed and made public, may provide useful guidance to companies.

As you are aware, Sarbanes-Oxley mandated sweeping reform in the area of corporate disclosure and financial reporting. To give effect to Section 301 of Sarbanes-Oxley, the SEC adopted Rule 10A-3, which requires that US national securities exchanges and national securities associations prohibit the listing of any security of an issuer that is not in compliance with certain standards applicable to issuer audit committees. The whistleblower requirements are among these listing standards.

Rule 10A-3 provides, in relevant part:

> "Each audit committee must establish procedures for:

i. the receipt, retention and treatment of complaints received by the listed issuer regarding accounting, internal accounting controls or auditing matters; and

ii. the confidential, anonymous submission by employees of the listed issuer of concerns regarding questionable accounting or auditing matters."

A. Key Concepts Underlying Rule 10A-3 and Potential Areas of Concern in the Opinion

Set forth below is the SEC staff's view of four key concepts underlying the rule as they relate to items discussed in the Opinion. Although we have not exhaustively analyzed the Opinion to identify all potential conflicts with Sarbanes-Oxley, we have sought to highlight major areas of potential concern in the Opinion in relation to these key concepts. In doing so, where appropriate we refer to interpretations of the Opinion offered by the Working Party's representative in the 8 March 2006 meeting that we believe may help companies in addressing these potential concerns. We also seek clarification of certain additional issues not raised at that meeting.

1. Role of the Audit Committee

Under Rule 10A-3, the responsibility for oversight of whistleblower requirements and treatment of related complaints rests with the audit committee. The audit committee, wherever it may be located, should be able to receive all complaints obtained through the whistleblower procedures that relate to accounting, internal accounting controls, and auditing matters. The audit committee has the flexibility to develop appropriate procedures in light of the company's circumstances including, for example, hiring an outside service provider or using local employees to perform ministerial functions including collecting and routing, in the first instance, any reports made through the system, or hiring outside service providers (such as law firms or forensic auditors) to assist in investigation. As a matter of general business practice, we understand that audit committees typically establish procedures which require appropriate investigations and due diligence.

- Potential concern: Local handling of reports

The second sentence of Section IV.6 (iii) of the Opinion reads: "As a rule, the Working Party believes that groups should deal with reports locally, *i.e.* in one EU country, rather than automatically share all the information with other companies in the group." The third paragraph of this section provides for an exception to this requirement, stating: "The data received through the whistleblowing system may be communicated within the group if such communication is necessary for the

investigation, depending on the nature or the seriousness of the reported misconduct, or results from how the group is set up."

- *Helpful interpretation provided by Working Party representative*

  The Working Party's representative explained that the final clause of the sentence, "or results from how the group is set up," is intended to provide flexibility to corporate groups in carrying out complaint review. Accordingly, if the persons within a corporate group responsible for administering whistleblower procedures are located outside the EU, then data can be transmitted directly to them. In such cases, there is no requirement that a determination must be made locally as to the necessity of such communication for investigation or the nature or seriousness of the reported misconduct.

- Potential concern: Ability of audit committee to provide information to the company's auditors or competent regulatory authorities outside of the EU

  We seek clarification that the Opinion does not have the effect of prohibiting an audit committee or a company (or any outside service providers which it may have hired to assist in complaint intake or investigations and has authorized to provide such disclosure) from providing information received through whistleblower procedures to its auditors and competent regulatory authorities, wherever they may be located.

2. Confidentiality and Anonymity

Sarbanes-Oxley mandates that audit committees establish procedures for the "*confidential, anonymous* submission by employees of the listed issuer of concerns regarding questionable accounting or auditing matters" [*emphasis added*]. As the Commission elaborated in its public release announcing its adoption of rules implementing Section 301 of Sarbanes-Oxley (the "adopting release")[1]:

> "The audit committee must place some reliance on management for information about the company's financial reporting process. Since the audit committee is dependent to a degree on the information provided to it by management and internal and external auditors, it is imperative for the committee to cultivate open and effective channels of information. Management may not have the appropriate incentives to self-report all questionable practices. A company employee or other individual may be reticent to report concerns regarding questionable accounting or

[1] Release Nos. 33-8222; 34-47654; IC-260001; File No. S7-02-03, which is published at http://www.sec.gov/rules/final/33-8220.htm.

> other matters for fear of management reprisal. The establishment of formal procedures for receiving and handling complaints should serve to facilitate disclosures, encourage proper individual conduct and alert the audit committee to potential problems before they have serious consequences."

In an effort to encourage such employees to come forward, Sarbanes-Oxley requires that whistleblower procedures afford the opportunity to make confidential, anonymous complaints. We believe that in order to cultivate open and effective channels of information, companies should broadly disseminate their procedures on whistleblowing.

- Potential concern: Publicizing whistleblower procedures to employees

  In the second sentence of the fourth paragraph under Section IV.2 (iii), the Opinion states: "In particular, companies should not advertise the fact that anonymous reports may be made through the scheme." As noted above, we believe that companies should inform employees of the option of the confidential, anonymous complaint procedure. Under the Opinion, reporting through the whistleblower procedures, and anonymous reporting in particular, could appear to be discouraged and characterized pejoratively as being less valid than reporting through the company's regular channels.

- *Helpful interpretation provided by Working Party representative*

  The Working Party's representative has explained that Section IV.2 (iii) should be read in conjunction with Section IV.3 of the Opinion, "Provision of clear and complete information about the scheme (Article 10 of the Data Protection Directive)." In Section IV.3, the Opinion states that employees are required to be informed about "the existence, purpose and functioning of the scheme," among other things. The Working Party's representative has suggested that this language would require a full description of any confidential, anonymous option. Typical ways that a company could inform employees would be by written notice or publication on a company website. We understand from the Working Party's representative that Section IV.2 (iii) of the Opinion is not intended to direct companies to discourage or negatively characterize confidential, anonymous reporting, but rather to discourage companies from promoting or favoring anonymous reporting over identified reporting. Furthermore, we understand that Section IV.2 (iii) is not intended to detract from a company's obligation to fully inform employees, which would include informing them of the option of anonymous reporting.

3. Classes of Persons Who Can Use the Procedures and Persons Who Can Be Subjects of Complaints

Sarbanes-Oxley requires procedures to be in place for the submission of complaints by "*employees of the listed issuer*" [*emphasis added*]. In the Commission's adopting release,

the Commission declined to narrow the scope of the statutory language to only a subclass of employees. Whistleblower procedures should cover all employees of a corporate group with a US listing, including employees of foreign subsidiaries. Procedures must provide for complaints to be submitted by *any* employee covering *any* concern related to accounting, internal accounting controls or auditing matters.

- Potential concern: Applicability to all employees

  In Sections IV.2 (i) and (ii), the last sentence of each first paragraph states: "The Working Party acknowledges, however, that the categories of personnel listed may sometimes include all employees in *some* of the fields covered by this opinion" [*emphasis added*]. By stating that it would be permissible to include *all* employees in *some* fields, an inference may arise that including *all* employees in *all* fields would not be permissible. In the adopting release, the Commission expressly declined to limit the employees covered by the whistleblower procedures requirement, stating "... we are not adopting the suggestion of a few commenters that, despite the statutory language, the requirement should be limited to only employees in the financial reporting area."

- *Helpful interpretation provided by Working Party representative*

  The Working Party's representative noted that this language in the Opinion is not intended to limit the latitude given to a company to determine which employees may use, and be subject of complaints under, permitted whistleblower procedures. Companies are free to determine that their whistleblower procedures will cover all employees in all fields.

4. Data Retention

Sarbanes-Oxley requires the audit committee to establish procedures for the receipt, *retention* and treatment of complaints [*emphasis added*]. We note that the Opinion sets out specific time limits for retention, while, in contrast, Rule 10A-3 does not specify how long documents must be retained. Although a minority of comments in response to the Commission's public release of the proposed rules implementing Section 301 recommended that the SEC adopt specific procedures under Rule 10A-3, the Commission declined to do so when adopting final rules. In the adopting release, the Commission clarified that it prefers " ... to leave flexibility to the audit committee to develop appropriate procedures in light of a company's individual circumstances, so long as the required parameters are met." The Commission also clarified in the adopting release that Rule 10A-3 is not intended to preempt or supersede any other federal or state requirements relating to receipt and retention of records. It is the responsibility of the audit committee to establish retention procedures for whistleblower complaints that are appropriate for the company's circumstances and consistent with the requirements of Rule 10A-3.

We are aware that companies and their advisers are struggling to construct retention policies for data processed through whistleblower systems in Europe that they believe comply with both Sarbanes-Oxley and privacy laws in the EU jurisdictions where they have operations. The members of the Working Party may wish to consider providing additional guidance on the interaction of the data retention requirements set forth in the Opinion with national rules relating to archiving data as they publish national whistleblower procedure guidelines. For example, a plain-language reading of the CNIL's "FAQs on whistleblowing systems" issued on 1 March 2006 appears to clarify that archiving certain complaint data in a separate information system may be an acceptable substitution for deletion.[2]

B. Additional Points for Consideration

We understand that the Opinion will have significant influence on the manner in which data protection authorities in EU member states address whistleblower procedures. We further understand that, as has occurred in France, member states are free to adopt additional guidelines and regulations which do not conflict with the Opinion. The Working Party may wish to consider whether additional coordination action among member states would be warranted to prevent a situation in which a company with operations in multiple EU member states may be required to develop separate, slightly different whistleblower procedures for its operations in each applicable European jurisdiction.

In addition, we note that representatives of several multinational companies have conveyed the view to SEC staff that restricting the scope of whistleblower procedures to matters mandated by Sarbanes-Oxley (and excluding other types of complaints) poses administrative difficulties as well as efficacy concerns with respect to whistleblower procedures implemented in companies' EU operations. They have conveyed the view that segmenting complaint procedures by topic and jurisdiction makes it less likely that companies will be able to detect potential problems at an early stage. In theory, at least, it seems that it should be possible to protect the rights of whistleblowers as well as those they may implicate in connection with any company-related complaint, not just those relating to financial reporting and bribery.

We note that it remains possible for companies to establish whistleblower procedures that are permissible under Sarbanes-Oxley, but that would not be compatible with the Opinion, and vice versa. Companies will need to individually assess how they should comply with applicable US and European laws (and other appropriate laws and regulations) in function of their overall business operations. However, we believe that if the Working Party were to publicly confirm the clarifications of the Opinion that are discussed in this letter, it would assist issuers in meeting the requirements of both EU data protection laws and Sarbanes-Oxley. The other members of the

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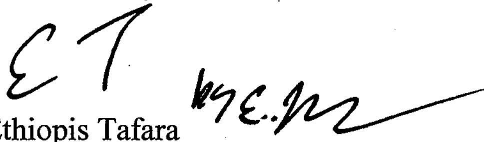
[2] CNIL "FAQs on whistleblowing systems," http://www.cnil.fr/index.php?id=1982#7, response to question 17. Please note that while the information in the CNIL FAQs would appear to provide issuers with greater flexibility regarding retention of certain complaints obtained through whistleblower procedures, the SEC staff does not have sufficient information about this archiving option to determine whether it would tend to resolve issuers' concerns.

SEC staff and I remain available to address any concerns you have regarding this response, or any other concerns regarding these matters that have come to the attention of the Working Party.

We would like to reiterate our appreciation for the opportunity that you have given us to react to the Opinion. We hope that the articulation of several key concepts underlying Rule 10A-3, as they relate to items discussed in the Opinion, as well as our understanding of the Working Party's interpretations will be of assistance to companies seeking to comply with Sarbanes-Oxley-mandated audit committee listing standards on whistleblower procedures and European data protection law.

With best regards,



Ethiopis Tafara
Director