

Policy Position

Table of Contents

1. Towards a comprehensive framework
2. Responses



Making Anti-Corruption Regulation Effective for the Private Sector

A comprehensive regulatory framework for the private sector is a prerequisite for a transparent, honest and just society: where regulation is weak, corruption risks grow strong. As the primary rule makers and enforcers, governments have a responsibility to ensure the effective regulation of markets, protection of citizens and enforcement of laws. Ultimately, an inadequate or unstable regulatory framework for the private sector — without the will, power or resources to enforce legislation — facilitates the marginalisation of stakeholder rights, distortion of markets and negligent or corrupt practices.

The current financial crisis is a timely example. Some of the responsibility for the crisis lies with the poor regulation of financial markets, including inadequate rules and lax regulators. As the international economic system becomes increasingly complex, it requires regulators to be more vigilant and to tighten their regulatory frameworks to minimise corruption risks and ensure that any breaches are detected and punished. Leaders from the Group of Twenty (G20) countries have recognised these demands and have promised to strengthen regulatory regimes, oversight and risk management in order to respond to the current turmoil and prevent further market upheavals. Yet how and to what extent a comprehensive and well-resourced regulatory framework is put into practice for the private sector will define the future of the global economy.

Consent orders: Is the SEBI consenting too freely?

Consent orders are one of the ways in which the Securities and Exchange Board of India (SEBI) is aiming to tackle fraud and corruption. These enable companies to pay monetary fines for financial crimes rather than going through drawn out litigation. In theory this leads to a reduction in SEBI's workload, reducing regulatory costs thus saving resources for pursuing more serious crimes.

Still, there are concerns that consent orders have been issued too freely and for serious crimes. According to the regulations, consent orders should only be issued in cases where there is no need for further investigation. In practice, however, there are examples of serious breaches by large companies being excused for incredibly low payments. In April 2008 a dealer at UTI Securities Ltd was accused of passing on information that led to large quantities of scrip being sold prior to the main sale for considerably lower prices. The company was required to pay only US\$2,200 for a consent order.

The FBI had warned as early 2004 that rising mortgage fraud posed a considerable risk to the stability of financial institutions. Despite this warning and frequent requests for more staff, their white-collar crime investigation unit shrank by more than 30 per cent between 2001 and 2008 as resources were redirected to fighting terrorism. As a result, the number of cases on white-collar crime brought to court or investigated halved between 2000 and 2007.

1. Towards a comprehensive framework

Legislation: robust and refined. Even in the most advanced regulatory environments, legal loopholes exist and are exploited by companies, making it essential that systems are kept robust with continuous refinement.

Regulations need to adapt to challenges brought about by the emergence of new markets. For example, the growing trade in carbon emission credits as an integral part of the global response to climate change comes with considerable conflicts of interest and corruption risks that require co-evolving rules and institutions to keep these potential problems in check.

Along with nascent markets in need of regulation, the global economy is also changing rapidly with the rise of emerging economies such as Brazil, Russia, India and China, providing a new focus for the application of international norms and conventions. The varying quality, reach and consistency of legislation internationally provide opportunities for corruption to flourish. For example, a concise legal definition of bribery is difficult to establish and bribe takers often face harsher punishment than bribe payers. In many countries, the use of intermediaries and facilitation payments, two vehicles that may be used by companies to pay bribes, are inadequately covered by anti-corruption laws. While no distinction is made between bribery and facilitation payments in the UK and Japan for instance, facilitation payments tend not to be prosecuted in practice.

Even countries with good rules on the book and those that are party to comprehensive conventions exhibit shortcomings in their anti-corruption legislation. Research done by Transparency International on the Organisation for Economic Co-operation and Development (OECD) Anti-Bribery Convention illustrates that loopholes — such as short statutes of limitation, low penalties or ineffective criminal liability — can undermine this important legal framework, which seeks to address the supply side of bribing foreign public officials.

Enforcement: resources and political will. As practice has shown, good laws and regulatory institutions are not enough for effective oversight and enforcement. Effective enforcement depends on a combination of appropriate laws and sound institutions as well as adequate resources and political will.

Different resource levels can translate into diverse levels of enforcement, even where similar laws and regulations exist. Transparency and disclosure are key to ensuring that resources are used effectively. Citizens need to know how many people and what level of financial resources are devoted to enforcement. Linking this information with performance indicators, such as the number of cases investigated and fines issued by the regulating body, makes it possible to assess the efficiency and effectiveness of regulators. In today's interconnected global economy, the weakest link, such as an under-resourced or poor-performing national regulator, has the potential to destabilise the entire system.

In the US, the case of funding for the Federal Bureau of Investigation (FBI) illustrates how resource constraints linked to the lack of political will can have a considerable impact on enforcement (see side bar). The UK Serious Fraud Office's decision to halt its investigation into the case of the BAe Systems bribery scandal is also an illustration of political will interfering with enforcement. The decision was a serious setback for the OECD Anti-Bribery Convention. Not only could this decision constitute a green light for UK companies to bribe overseas,

but it also undermines international efforts to encourage states to enact and enforce laws in compliance with the convention. Despite this shortcoming in the UK, the US Securities and Exchange Commission is pursuing the case, illustrating how initial cross-border collaboration would have been a more expedient first step and effective remedy.

Innovation and incentives: leveraging legislation and enforcement. Some regulators have begun to use innovative techniques to increase the efficiency and effectiveness of regulations and their enforcement. These tools complement the remit to sanction wrongdoing with a stronger focus on sustainable prevention and using available resources more efficiently (see side bar).

In some jurisdictions, the use of deferred and non-prosecution agreements can spur companies into compliance. They provide an alternative to protracted and expensive trials by offering delinquent companies the opportunity to enter into an agreement with regulators. These arrangements typically require companies to stop any wrongful practices, implement an improved compliance programme and in some cases hire an independent monitor to oversee and report back on the process, thereby shifting attention towards the prevention of future wrongdoing.

Other examples of innovative tools include partial blackouts, whereby certain business lines or units of a company are frozen for a period of time if bad practice is found and contained. This approach assumes that companies are capable of solving their own problems and that this measure can motivate them to do so. Ethical blacklisting is also an option when companies do not 'play by the rules'. While blacklisted, companies can be removed from bidding processes or prevented from accessing export credits from governments and multilateral development banks. Whitelisting, on the other hand, is used to give companies preferential treatment, including access to bidding processes and inclusion in certain company indices (e.g. the Maala Index in Israel).

For their part, companies can assist efficient and innovative regulation by reporting on their compliance with corporate integrity and anti-corruption standards. Exemplary reporting and a credible track record of compliance can be linked to more lenient treatment by regulators if corruption incidences occur.

2. Responses

For regulation of the private sector to be effective, it must rely on successful enforcement. Punitive action against companies is not enough; regulations need to provide incentives for private sector players to help detect and disengage from corrupt practices. Furthermore, regulators themselves need to be independent and transparent and avoid conflicts of interest to ensure that they have the freedom and resources to enforce regulations when breaches occur.

Businesses must:

Promote transparency, anti-corruption practices and active compliance with laws.

-  Companies should adopt comprehensive anti-corruption policies and systems that are implemented, monitored and checked independently.
-  Companies should make all anti-corruption commitments binding and verifiable, and report on key aspects of compliance and adherence to laws and regulations in a transparent and publicly available manner.

Voluntary Disclosures and Investigations Spike in the US

According to a report by PricewaterhouseCoopers (PWC) in July 2009, investigations and enforcement under the US Foreign Corrupt Practices Act have increased considerably in recent years. While the period 2002-2008 averaged 14 proceedings per year, 19 cases had been initiated in the first half of 2009. The number of prosecutions has risen in line with voluntary disclosures by companies, with almost a half of the cases in 2008 resulting from companies admitting their own wrongdoing.

Disgorgement of profits has also risen dramatically with nearly 80 percent of the US\$ 480 million of monies paid between 2004 and 2008 being collected in 2008 alone. These figures indicate the increased stringency of regulators.

Despite this increase in enforcement, there appears to be a gap between companies' acknowledgement of the need for anti-corruption programmes and their confidence in them. Based on the results of another PWC study (2008), while 80 per cent of companies claimed to have a programme in place, only 22 per cent were confident of its efficacy.²

Making anti-corruption regulation effective for the private sector

This policy position draws on the TI Global Corruption Report 2009: Corruption and the Private Sector. It is one of four papers based on the Report. The others cover corporate integrity, corporate lobbying and cartels. All facts and figures, unless otherwise stated, are cited from the Report.

The GCR 2009 brings together more than 80 leading experts and practitioners to explore a wide range of corruption risks in and solutions for the private sector. To learn more, see: www.transparency.org/publications/gcr.

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Respond proactively to regulators' enforcement efforts.

- Where companies discover breaches in regulations within their own operations they should take advantage of voluntary disclosure policies and work with the regulators to improve compliance.

Governments and public regulators must:

Refine innovative tools for smart regulation and increase the use of such tools.

- Regulators increasingly complement punishment with a focus on sustainable prevention. These tools, such as deferred and non-prosecution agreements, monitors and ethical blacklisting, should be refined and promoted.

Promote transparency and accountability in the management and enforcement activities of regulators.

- It is difficult to assess and compare the resources devoted to public regulation, the way these resources are allocated to different activities and the outputs these resources generate. Governments must make enforcement more transparent and accountable by publicly reporting this information.

Close loopholes, address new challenges and promote international coherence.

- Governments should work to continuously refine laws so that loopholes cannot be exploited. Particular attention should be given to ensuring that new markets are adequately regulated.
- Governments, including those in emerging economies, should strengthen international coordination and consistency of laws, including fully ratifying and implementing international conventions such as the OECD Anti-Bribery Convention and the UN Convention against Corruption.
- Addressing corruption in an increasingly global environment requires anti-corruption agencies, tax authorities and financial market regulators to cooperate more closely across borders.

Civil society must:

Promote awareness of the importance of regulation and effective enforcement.

- Civil society is well placed to promote effective regulation and support regulators by identifying potential loopholes and providing novel solutions.

Demand transparent and comprehensive reporting by companies and regulators

- Civil society can help monitor compliance and regulatory efforts, if related information is publicly available. Civil society should demand transparent and understandable reporting from companies and regulators.

References:

¹ See www.londonsummit.gov.uk

² 'PWC Reports AntiCorruption Compliance Rises on the Boardroom Agenda', Reuters, 27 July 2009.

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Transparency International (TI) is the civil society organisation leading the global fight against corruption. Through more than 90 chapters worldwide and an international secretariat in Berlin, Germany, TI raises awareness of the damaging effects of corruption, and works with partners in government, business and civil society to develop and implement effective measures to tackle it. For more information go to: www.transparency.org

ISSN 1998-6432