Angel Gurria: The role of bank supervisors in the fight against corruption

Remarks by Mr Angel Gurria, Secretary-General of the Organisation for Economic Co-operation and Development (OECD), at the International Conference of Bank Supervisors, Mérida, Mexico, 5 October 2006.

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Good afternoon. I am very honoured to be delivering the William Taylor Memorial Lecture this year. This lecture series gives tribute to a man who all agree was a model for bank supervisors, and for human kind more generally. I apologise that I am not able to be with you in Merida in person, and sincerely hope you have been able to take at least a few moments during this busy week to enjoy the beauty of the Yucatan Peninsula!

When Paul Volcker invited me to speak to you, he asked me to talk about corruption. He shared with me his longstanding concern about this phenomenon - which was reinforced when he chaired the Commission that investigated the United Nations Oil-for-Food Programme in Iraq. His Commission revealed billions of dollars in illegal kickbacks and surcharges allegedly paid by more than 2000 companies from 66 countries. Of course there was shame and consternation in countries whose companies were reported to have behaved so badly. Widespread confidence in a programme intended to deliver humanitarian goods and services was torn down.

This is the deep problem with corruption – its extraordinary destructive power. And, unfortunately, it is most destructive where people are poor and where states are fragile. The ravages of corruption are difficult to quantify: corruption stops medicines from reaching hospitals and books from getting to schools. It stops roads from being built, it leaves environmental regulations un-enforced. Corruption undermines justice and the rule of law. It distorts markets and ruins the investment climate. It destroys citizen trust in government and democracy In my view, corruption is the principal cause of the mistrust and pessimism that stifles public and private governance in so many parts of the world.

Some have tried to put a number on the extent and the cost of corruption. The World Bank once estimated that 1 trillion dollars are paid in bribes every year. And according to Nigerian President Olusegun Obasanjo, corruption costs African countries about one-quarter of their combined national income, some 148 billion dollars each year.

In my remarks, I will focus on what we need to do to fight corruption effectively, rather than dwell on its destructive effects. I will highlight OECD and other international efforts to fight corruption and elaborate on the role of bank supervisors in this endeavour.

Initially, I should say that progress has been made in recent years. First, we have gained a good understanding about how corruption works and where it thrives. Lack of transparency, bureaucratic complexity and weak civil society institutions, like business organizations or a free press, create a breeding ground for corruption.

Second, we've brought corruption out into the open. Talking about corruption and even pointing a finger is no longer taboo, including in the important development context. And, corruption is no longer "business as usual" or simply a "cultural difference". Courageous people have seen corruption for what it is, they have named it and condemned it. And today, governments all over the world must at least try to fight corruption. Three years ago the UN General Assembly adopted the United Nations Convention against Corruption and it was later signed, here in Merida. It addresses a wide range of corrupt acts and will reinforce international co-operation in crucial areas such as prevention, investigation, prosecution, and asset recovery. To date, 67 countries have ratified this convention. I believe a significant global engagement against corruption is underway.

Just a few weeks ago, in Singapore, I sat with colleagues from the World Bank and the International Monetary Fund to find ways to work together more effectively to tackle corruption that undermines development. One of the most important ideas I took away from that meeting – and my main message to you today – is that we are all responsible for fighting corruption - rich countries and developing countries, public sector and private sector, international and grassroots organisations, leaders and followers. We have a better understanding of corruption; we have a growing engagement to fight it. But what should we do now?

In fact, the international community has developed powerful anti-corruption tools. The OECD has been a leader in fighting corruption and the keystone of these efforts is the OECD Anti-Bribery Convention. This international treaty addresses the supply side of bribery. Countries belonging to the Convention make it a crime for their companies or nationals to bribe a public official anywhere in the world in order to do business. The treaty requires tough penalties. A related instrument has put an end to allowing companies to claim bribes as a tax deductible expense, a practice that was common even in the late 1990s. We operate a very rigorous monitoring programme to make sure the Convention is implemented, in fact. I am happy to say that since the entry into force of the Convention, there has been a marked increase in the number of investigations and convictions – though this is still not enough. Some important countries are still not giving anti-corruption the priority it deserves – according to Transparency International, only 12 of the 36 countries that are signatories of the Convention actually enforce it rigorously. But we do expect more countries to join and hope to welcome the 37th country – South Africa - in a matter of weeks.

The OECD has also established a code of conduct for multinational companies. We have developed guidelines to help governments improve transparency and accountability in the public service. We are helping our members get corruption out of the export credit business and development aid.

Of course, and fortunately, the OECD is not alone in its efforts. The leaders of the G8, at their last summit committed to work with international financial centres and their private sectors to deny safe haven to illicit assets gained through high-level corruption. They said they would take concrete steps to ensure that financial markets are protected from criminal abuse, including bribery and corruption, by pressing all financial centres to attain and implement high standards of transparency and exchange of information. In another development, the World Bank has announced a new strategy to eliminate corruption from its own projects and to be stricter in dealing with countries where corruption makes it unlikely that grants or loans will be used for the purpose they are intended. Bilateral donors working in the OECD Development Assistance Committee developed principles on anti-corruption in aid-funded procurement and recommendations on how to support developing countries' own anti-corruption programmes.

Civil society will also play a crucial role in pushing anti-corruption to the top of the global agenda. Transparency International has built a worldwide coalition to raise awareness and lobby for change. The business community is answering the call to rise up against corruption. A few examples are the International Chamber of Commerce's ongoing efforts to alert businesses to the risks of bribery and to provide guidance on reinforcing company controls against corruption and on resisting bribe solicitation. The World Economic Forum is pursuing its initiative "Partnering against Corruption". The Extractive Industries Transparency Initiative is a coalition of donor governments and resource-rich developing countries as well as companies and industry associations that are committed to transparency – full publication and verification of company payments and government revenues from oil, gas and mining.

Furthermore, organisations are taking steps to "join up" these multiple efforts. Bilateral donors in the OECD Development Assistance Committee are co-ordinating anti-corruption policies related to aid with the World Bank. We are engaging interested countries in the Asia-Pacific region, in Eastern Europe and more recently in Africa, with the support of the regional development Banks. All these institutions are committed to helping the United Nations turn its anti-corruption convention into a strong instrument. And we all work closely with business organisations and with Transparency International.

We seem to be witnessing a rising global momentum against corruption. The efforts of these many actors - international organisations, donors, companies, and civil society - will generate the essential ingredient for success: political will. And it can be done. There are not many examples of quick turn around – but there are some. In Hong Kong, in the 1960s and 70 corruption was rampant. Bribes were necessary for even the most basic services. Finally public outcry pushed the government to respond. The Independent Commission Against Corruption was created in 1974 and has since had remarkable success. Creating wide-spread success will require a broad effort.

And so, I am led to ask: What should be the role of bank supervisors?

The risk environment for the financial sector is becoming more complex. This is not unusual since one of the fundamental jobs of the financial sector is to buy, sell, package and manage risks – financial risks. But other kinds of risks are also growing and becoming more complex. Banks serve more customers, from a more diversified customer base, including international customers. The volume of banking activity has increased and new technologies have revolutionised the banking industry. Fortunately, expertise is growing as well within banks and among financial supervisors.

Banks will face increased risk associated with a stronger fight against corruption. Treaties will increase international co-operation in law enforcement. Law enforcement officials are becoming more skilled and more practised, and investigations and prosecutions are becoming more frequent and more successful.

As a result we expect that there will be more requests for mutual legal assistance in corruption cases, more requests to banks to open their financial records and more cases seeking asset recovery. This will result in more public scrutiny of financial institutions, more publicity about banks' involvement in corruption cases and greater demands for clean business practices. Banks will need to take active measures to protect themselves from dealing with corruption money, not only in response to society's expectations, but also as a element of sound risk management.

Financial supervisory bodies can help to prevent the misuse of the financial sector for corrupt ends. I have four suggestions:

First, know-your-customer rules are the single most important shield to the entry of the proceeds of corruption into the financial system. You are probably aware that, because of the OECD Anti-Bribery Convention, in OECD countries and the six others that are part of the Convention, corruption is a predicate offence for money laundering. The anti-money laundering and counter-terrorism financing campaigns led by the Financial Action Task Force, better known as FATF, have raised "know-your-customer" practices substantially since the Basel Committee's 1999 survey. However there are still areas that need more attention.

- Some supervisory bodies have already developed audit tools to ensure that know-your-customer rules are being implemented effectively. These audit tools can be further developed and used more rigorously and on a broader basis.
- Regulations allow financial institutions to rely on due diligence conducted by another bank when they welcome a new customer. This information and its sources should be verified, and further inquiries into customer identification should be conducted if there are grounds for any doubt.
- Politically exposed persons, (or PEPs as they are called) present special challenges - in terms of managing reputational risk and the resource implications of responding to criminal investigations. Typical due diligence may prove insufficient for politically exposed persons; and it is senior level managers who should oversee investigations and make the decisions to open accounts for them.
- E-banking brings new challenges in verifying a customer's identity. Financial institutions need reliable procedures to authenticate the identity of account beneficiaries, especially in cross-border e-banking transactions.

Second, the practice of testing the integrity of financial institution directors and managers is expanding. There should be real consequences when directors or managers fail to uphold best practices, for example if they knowingly or negligently accept the proceeds of corruption for deposit to their bank.

Third, a recent OECD study found that only a few countries have developed guidelines and typologies on money laundering transactions related to bribery. Without such tools, it will be very difficult, if not impossible for financial institutions to detect these transactions. This is something that the OECD can help develop, but we will need co-operation of financial institutions to do this.

Finally, unless banking systems in all countries fully participate in anti-corruption measures, the corrupt and the proceeds of corruption will simply make their way to the lowest point, the weakest link in the system. This is why I am especially pleased to be able to alert this audience to the issue of corruption and the banking system. I predict that anti-corruption efforts will grow and banking systems will increasingly be implicated. The International Conference of Bank Supervisors should also be able to make a contribution.

Fighting corruption presents unprecedented challenges to bank supervisors, and to us all. Indeed, these may be among the toughest challenges we face today.

At the swearing in ceremony for William or "Bill" Taylor in 1991, George Bush (senior) said "one of America's toughest jobs, is Chairman of the FDIC". What's more, Bill Taylor took this job at an extremely difficult time in US banking history. Bill is remembered for his integrity, his tenacity, and his professional dedication. As Alan Greenspan aptly recounted in 1996, Bill "understood that a safe and sound banking system was essential to a healthy market system, and he was committed to maintaining such a system."

If Bill Taylor were among us here today he would no doubt be a visionary in understanding the menace of corruption to modern banking. We will have to lead this battle without him. But we can follow the example of his commitment and his determination to find the ways to work together to stop the exploitation of financial systems as vehicles and havens for corruption.