

The Financial Industry in the 21st Century

**Transnational Commercial Bribery and Corruption:
a Challenge for the Financial Industry,
Regulators and Supervisors**

**Introductory remarks by Kurt Hauri,
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**Basel, Switzerland
21 September 2000**

General remarks

Dear colleagues

It is a great honor for the Swiss Federal Banking Commission and for myself as its chairman to co-host the ICBS in Switzerland and to welcome such a great number of distinguished experts in the field of banking supervision. I know that already 6 heavily digestible topics are on the agenda of this workshop day. Therefore, it is not without a certain degree of unease that I am going to address another rather delicate issue instead of just making some easygoing hints about the beautiful Swiss nature scenery or jokes about our common job as supervisors and regulators. I am afraid the following remarks will not deliver this, they will not be humorous but at least, I hope, they will be within the time limit given to me.

The Swiss Federal Banking Commission was founded 65 years ago as an answer to Switzerland and its banks suffering from a deep economic crisis. Since that time it has been the task of the Swiss Federal Banking Commission to prevent bank failures and, thereby, to avoid distress of banks' creditors and the Swiss economy as a whole. However, since the beginning of the 1980s an additional target came into the focus of the Swiss Federal Banking Commission adding another dimension to the traditional goal of protecting the public from financial losses and to prevent systemic risk. Since that time the Commission has regularly been addressing the issue of preventing the financial industry from being abused for criminal purposes.

During this period a proliferation of international minimum standards for ethical behavior of all kind has occurred. Many different international fora have been involved and the standards are covering various and sometimes overlapping areas. But if one looks at all these initiatives from a little distance, a common driving idea can be identified: the financial industry (as other industries as well) has to respect increasingly higher standards for ethical behavior, and more and more banks have to assume responsibility not only for their own correct business conduct, but also for that of their customers. There has been a significant regulatory trend towards higher ethical standards and – at least this is my assessment – this trend will persist in the 21st century. From this background I would like to address one particular aspect of unethical or even illegal behavior, namely *the misuse of international financial centers in transnational commercial bribery and corruption*. By using the term “transnational commercial bribery and corruption” I intend to show that the focus is not “petty corruption” meaning small cash payments to subordinate government officials. Our concern is “grand corruption” involving substantial international money flows being wire-transferred across all international financial centers.

Key steps in the Swiss supervisory practice

Before I do what this public coming from all over the world is expecting me to do, that is to address the topic with a more international view, please let me summarize a few key steps that the Swiss Federal Banking Commission has taken in developing the present supervisory framework in this field:

- During the 1980's the Swiss Federal Banking Commission started to oversee more closely the implementation of the banking industry's self regulatory rules on customer identification, including the duty to know the identity of beneficial owners hiding behind straw-men or off-shore domicile companies with no commercial activity.

- During the same time, standards were developed on a case-by-case-basis requiring the financial institutions to pay special attention to all complex or unusual transactions with no apparent economic or visible lawful purpose.
- In 1985, the Swiss Federal Supreme Court upheld a decision of the Federal Banking Commission formally prohibiting a back-to-back loan with the only purpose to deceive a foreign authority.
- In 1991, the Swiss Federal Banking Commission devised rules requiring the supervised institutions to establish the names of beneficial owners represented by financial lawyers.
- In 1987, following the decision of the Swiss government and the Banking Commission to freeze the assets of the Marcos Clan in spring 1986, the Swiss Federal Banking Commission developed a practice requiring that the decision to enter into a business relationship with high-ranking public officials, such as heads of states or members of a government, be taken on the financial institution's highest management level.
- In 1993, the Swiss Federal Banking Commission declared that it would no longer consider the management of a supervised institution to be "fit and proper" if the institution accepted corruption proceeds for deposit.
- In 1998, the preceding two measures were codified in the Banking Commission's guidelines against money-laundering.
- In 1998, the Swiss Federal Banking Commission issued an industry ban against the chairman of the board and a director of a supervised institution on the ground that they had accepted roughly 300 Mio Deutschmark to be paid as commission ("provision") on an account belonging to the son of the former President of Nigeria Abacha.
- Finally, in September 2000, the Swiss Federal Banking Commission published the results of an investigation at 19 banks being involved in accepting in total about 600 Mio US Dollars on behalf of the entourage of Nigeria's former president Abacha. All funds had been reported by the banks to the Swiss money laundering reporting office and frozen by Swiss law enforcement authorities. The Swiss Federal Banking Commission publicly blamed 6 banks for not handling the customer relationship with the necessary diligence. So far, it has issued no industry bans since none of the responsible individuals are any longer being employed at a senior level in the financial industry.
- This year the Swiss Federal Banking Commission will be further amending its guidelines against money laundering to take into account the lessons drawn from the Abacha-case as well as recent legislative changes, which declare bribery of domestic or foreign officials a predicate offense for money laundering in Switzerland.

The result of this long way is a policy of the Swiss Federal Banking Commission which could be summarized in five points:

1. Whenever a supervised institution is not observing anti-money laundering provisions, including "know your customer rules", prohibitions of the acceptance of corruption proceeds or rules on persons with public functions, this is clearly a supervisory issue that is not tolerated by the supervisor.

2. Every single case of a serious offense against an important rule is investigated independently and as quickly as possible by the supervisor, even if other law enforcement agencies are investigating at the same time.
3. All persons responsible for breach of rules or for organizational failures at management level risk an industry ban issued by the supervisor.
4. The supervised institutions have to address deficiencies in systems and controls with regard to legal and compliance efficiently, thoroughly and speedily and under tight supervisory control.
5. Supervised institutions unwilling or unable to bring their compliance systems to a satisfactory standard take the risk of their license being withdrawn.

International context

As promised, let me come to the international context. As the Abacha-investigation of the Swiss Federal Banking Commission clearly showed, very substantial amounts of money have been wire-transferred to and from Switzerland, from and to banks in various respectable financial centers. As an always increasing number of financial institutions are acting globally they become a global target for abuse. No doubt that this is a very demanding challenge for international banks, for international regulatory bodies as well as supervisors in all countries.

International banks have to make sure that their compliance standards are on the highest level worldwide. Otherwise they may not effectively monitor and manage their reputational, operational and legal risks. The banks are well advised if they address in these compliance standards also the issue of proceeds from corruption even though not all jurisdictions where the international bank is carrying out its business have identical, or even comparable, standards. To avoid regulatory arbitrage it would be highly desirable if the major international players in private banking could agree upon a common set of rules to be complied with on a worldwide basis

International regulators become more and more aware that they cannot limit their focus on tracing and chasing proceeds of drug-trafficking. Over the last ten years the international regulatory community has made considerable progress in developing instruments to reduce international commercial corruption. The newly developed policies by the International Financial institutions, such as the World Bank and the IMF, new recommendations, resolutions and conventions of international organizations like the OECD, and the work done by private non governmental organizations like Transparency International have put the issue of corruption on the political agendas of all relevant international bodies. Still, it seems to me that on a international level, there is a need to address adequately various issues related to the abuse of the financial sector by corrupt politicians and government officials. The “potentate risk” is truly global. One of the objectives would be an internationally coordinated understanding that banks should not accept proceeds from corruption. So far, rules on how financial institutions should handle business relations with politically exposed persons are lacking on the international level. “Know your customer” rules need to be harmonized to avoid regulatory arbitrage. Difficult questions would have to be addressed, for instance: should funds stemming from corruption be frozen? Who should be entitled to request such freezes on an international level? Another question is whether and how and to whom these funds may be restituted. All this work is extremely difficult for legal, cultural and political

reasons. In spite of these difficulties I believe that this work should be undertaken and coordinated internationally.

And although all these issues go far beyond our normal tasks as *financial supervisors* I *believe* that we will probably be asked to contribute in this process. I am quite sure that financial supervisors will be asked to contribute in this field, which is at best loosely connected with our primary objectives. There is little hope that this won't happen as supervisors are traditionally suffering from a "Christmas tree" effect, in which government offices are gradually divesting themselves by adding new decorative tasks to our already widespread functions.

I thank you for your attention and wish you a stimulating workshop day.