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Oct 27th, 11:00 AM - 12:30 PM

Panel 2: Corruption and the Private Sector: Is Money Laundering the New Corrupt Foreign Practices?

Richard Charlton
Federal Reserve Bank of New York

Janet Dine
Queen Mary University of London

Michael Malloy
University of the Pacific

André Odermatt
LGT Treuhand AG

Carol Van Cleef
Bryan Cave, LLP

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DE NEDERLANDSCHE BANK N.V.
AMSTERDAM, THE NETHERLANDS

UNITED STATES OF AMERICA
BEFORE THE
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C.

STATE OF ILLINOIS
DEPARTMENT OF FINANCIAL AND PROFESSIONAL REGULATION

NEW YORK STATE BANKING DEPARTMENT
NEW YORK, NEW YORK

In the Matter of ABN AMRO BANK N.V. Amsterdam, The Netherlands ABN AMRO BANK N.V. NEW YORK BRANCH New York, New York ABN AMRO BANK N.V. CHICAGO BRANCH, Chicago, Illinois	FRB Dkt. No. 05-035-B-FB Order to issue a Direction (in Dutch, *"Besluit tot het geven van een aanwijzing*"); Order to Cease and Desist Issued Upon Consent

WHEREAS, De Nederlandsche Bank ("DNB") is the home country supervisor of ABN AMRO Bank N.V., Amsterdam, The Netherlands ("ABN AMRO"), a Netherlands bank;

WHEREAS, the Board of Governors of the Federal Reserve System (the "Board of Governors") is the host country supervisor in the United States of ABN AMRO, which is both a foreign bank as defined in section 3101(7) of the International Banking Act (12 U.S.C. § 3101(7)), including its New York Branch and its Chicago Branch (collectively, the "Branches"), and a registered bank holding company;

WHEREAS, the Illinois Department of Financial and Professional Regulation, Division of Banking (the "IDFPR"), pursuant to the authority provided under Section 3 of the Foreign Banking Office Act, (205 ILCS 645/1 et seq.) supervises and has examination authority over the foreign banking office maintained by ABN AMRO in the state of Illinois;

WHEREAS, the New York State Banking Department (the "NYSBD") is the licensing agency of the New York Branch of ABN AMRO, pursuant to Article II of the New York Banking Law ("NYBL"), and is responsible for the supervision and regulation thereof pursuant to the NYBL;

WHEREAS, the Board of Governors, the NYSBD, the IDFPR (collectively, the "U.S. Supervisors"), DNB (collectively with the U.S. Supervisors, the "Supervisors"), and ABN AMRO have the common goal to ensure that ABN AMRO complies with United States federal and state laws, rules and regulations wherever they are applicable within the United States or across jurisdictional borders, that ABN AMRO fosters a strong commitment towards compliance and has adequate compliance systems which cover in an appropriate manner all activities concerning the United States, and that ABN AMRO effectively manages the financial, operational, legal, reputational, and compliance risks of its operations in the United States;

WHEREAS, the U.S. Supervisors and ABN AMRO have mutually agreed to the issuance of this combined Order to Cease and Desist Upon Consent against ABN AMRO and the Branches, and DNB has decided to issue the Direction laid down in this Order to ABN AMRO and the Branches (collectively, the "Order");

WHEREAS, on July 23, 2004, ABN AMRO and the New York Branch entered into a Written Agreement with the Federal Reserve Banks of New York and Chicago (collectively, the "Reserve Banks"), the IDFPR, and the NYSBD designed to correct deficiencies

at the New York Branch relating to anti-money laundering policies, procedures, and practices (the "Written Agreement"), and ABN AMRO and the New York Branch have taken substantial steps to rectify the deficiencies set forth in the Written Agreement and continue to take additional steps;

WHEREAS, after execution of the Written Agreement, and in response to its requirements, ABN AMRO discovered and provided additional information to the Supervisors regarding a pattern of previously undisclosed unsafe and unsound practices warranting further enforcement action. Specifically, based on the information submitted by ABN AMRO and other information gathered by the Supervisors:

A. ABN AMRO lacked adequate risk management and legal review policies and procedures to ensure compliance with applicable U.S. law, and failed to adhere to those policies and procedures that it did have. As a result, one of ABN AMRO's overseas branches was able to develop and implement "special procedures" for certain funds transfers, check clearing operations, and letter of credit transactions that were designed and used to circumvent the compliance systems established by the Branches to ensure compliance with the laws of the U.S. In particular, the "special procedures" circumvented the Branches' systems for ensuring compliance with the regulations issued by the Office of Foreign Assets Control ("OFAC") (31 C.F.R. Chapter V). ABN AMRO failed to adequately review such "special procedures" to determine whether the execution of the procedures was consistent with U.S. laws; and

B. ABN AMRO lacked effective systems of governance, audit, and internal control to oversee the activities of the Branches with respect to legal, compliance, and reputational risk, and failed to adhere to those systems that it did have, especially those relating to anti-money laundering policies and procedures, including the procedures to implement the Currency and

Foreign Transactions Reporting Act, 31 U.S.C. § 5311 *et seq.* (the Bank Secrecy Act (the "BSA")); the rules and regulations issued thereunder by the U.S. Department of the Treasury (31 C.F.R. Part 103); and the suspicious activity reporting requirements of Regulation K of the Board of the Governors (12 C.F.R. § 211.24(f)). As a result, ABN AMRO and the Branches: (1) failed to adequately document, report, and follow up on negative findings from certain internal audits; (2) failed to produce negative audit findings in a timely manner to the U.S. Supervisors, and to appropriate internal governing bodies; (3) failed to follow-up on inquiries referred to the New York Branch from overseas offices regarding compliance with U.S. law; (4) overstated to internal auditors, compliance personnel, and the U.S. Supervisors the extent of due diligence efforts undertaken by certain branches outside the United States with respect to high risk correspondent banking customers; and (5) failed to escalate the "special procedures" for review outside of the trade processing business or reporting line;

WHEREAS, to address the unsafe and unsound practices described above, ABN AMRO must continue to implement improvements in its oversight and compliance programs with respect to United States law in all countries in which ABN AMRO branches or affiliates do business that is in whole or in part governed by United States law, and must undertake specific additional measures to further improve oversight and compliance in the Branches and other U.S. offices of ABN AMRO;

WHEREAS, the unsafe and unsound practices described above also warrant the separate assessment of civil money penalties by the Board of Governors under section 8(i)(2)(B) of the Federal Deposit Insurance Act, as amended (12 U.S.C. § 1818(i)(2)(B)) (the "FDI Act"), the NYSBD pursuant to Section 44 of the NYBL, the IDFPR pursuant to the authority provided under Section 18 of the Foreign Banking Office Act, (205 ILCS 645/1 et seq.) and Section 48 (8)

of the Illinois Banking Act, (205 ILCS 5/1 et seq.), OFAC, and the U.S. Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN");

Laws of The Netherlands

WHEREAS, DNB is entrusted with the task of supervising financial institutions such as ABN AMRO pursuant to Section 4 of the Bank Act 1998 (in Dutch: "*Bankwet 1998*") and the Act on the Supervision of the Credit System 1992 (in Dutch: "*Wet toezicht kredietwezen 1992*");

WHEREAS, DNB has concluded that the unsafe and unsound practices referred to in A. and B. above also constitute failures to duly comply with the rules referred to in Sections 22 and 22a of the Act on the Supervision of the Credit System 1992 (in Dutch: *Wet toezicht kredietwezen 1992*) and warrant the issuance of a direction (in Dutch: *aanwijzing*) under Section 28 of such Act on the course of action to be pursued by ABN AMRO in respect of the matters specified in this Order; the course of action DNB requires ABN AMRO to take is set out in Paragraphs 1, 2, 6, 7, 8, 9, 10, and 11 of this Order;

WHEREAS, the measures required by the Supervisors have been discussed with ABN AMRO prior to the issuance of this Order, in conformity with the requirements of Netherlands law. By countersigning this document, ABN AMRO confirms (i) that the decision (in Dutch: *besluit*) to issue a direction (in Dutch: *aanwijzing*) has been sufficiently substantiated within the meaning of sections 3:46 and 3:48 of the Dutch General Administrative Law Act (in Dutch: *Algemene wet bestuursrecht*), (ii) that it is aware of and understands each of the measures it is required to take pursuant to this Order, and (iii) that none of the measures gives rise to any doubt as to its scope, substance or other aspects;

WHEREAS, the direction (in Dutch: *aanwijzing*) qualifies as a decision (in Dutch: *besluit)* within the meaning of section 1:3(1) of the Dutch General Administrative Law Act (in Dutch: *Algemene Wet Bestuursrecht*);

WHEREAS, the use of the English language in this Order is appropriate in accordance with Section 2:6 of the Netherlands General Administrative Law Act. By signing this document, ABN AMRO recognizes that the use of the English language is appropriate. In DNB's opinion the interests of third parties are not harmed by not using the Dutch language because the use of the English language is widely recognized as standard in similar matters;

WHEREAS, DNB must point out that every interested party (in Dutch: *belanghebbende*) is entitled to file an objection (in Dutch: *bezwaar)* against the decision (in Dutch: *besluit*) to issue a direction (in Dutch: *aanwijzing)* within the meaning of section 28 of the Act on the Supervision of the Credit System by sending in a writ of objections (in Dutch: *bezwaarschrift*) to DNB within six weeks after DNB having sent this decision to ABN AMRO. This decision has been sent to ABN AMRO on December 19, 2005; and

WHEREAS, by signing this document ABN AMRO confirms that it has informed DNB that it will not use its right to file an objection against this decision;

Laws of the United States

WHEREAS, the Board of Governors issues this Order pursuant to section 8(b) of the FDI Act (12 U.S.C. § 1818(b)); the IDFPR issues this Order pursuant to Section 18 of the Foreign Banking Office Act, (205 ILCS 645/1 et seq.) and Section 48 (6)(b) of the Illinois Banking Act, (205 ILCS 5/1 et seq.); and the NYSBD issues this Order pursuant to Section 39 of the New York Banking Law;

WHEREAS, on December 19, 2005, the Managing Board of ABN AMRO adopted a resolution:

A. authorizing and directing Rijkman W.J. Groenink, Chairman of ABN AMRO, and Joost Ch.L. Kuiper to enter into this Order, on behalf of ABN AMRO, the New York Branch, and the Chicago Branch consenting to compliance by ABN AMRO, the New York Branch, the Chicago Branch, and their institution-affiliated parties, as defined in sections 3(u) and 8(b)(4) of the FDI Act (12 U.S.C. §§ 1813(u) and 1818(b)(4)), with each and every provision of this Order;

B. waiving any and all rights that ABN AMRO, the New York Branch and the Chicago Branch may have pursuant to 12 U.S.C. §§ 1818 and 1847 or 12 C.F.R. Part 263, Section 25 of the Illinois Administrative Procedure Act, (5 ILCS 100/1-1 et seq.), or otherwise:

(i) to the issuance of a Notice of Charges and of Hearing on any matter set forth in this Order;

(ii) to a hearing for the purpose of taking evidence of any matters set forth in this Order;

(iii) to judicial review of this Order; and

(iv) to challenge or contest, in any manner, the basis, issuance, validity, terms, effectiveness or enforceability of this Order or any provision hereof;

NOW, THEREFORE, before the filing of any notices, or taking of any testimony or adjudication of or finding on any issues of fact or law herein, and without this Order constituting an admission or denial by ABN AMRO, the New York Branch, or the Chicago Branch of any

allegation made or implied by the Supervisors in connection with this matter, and solely for the purpose of settling this matter without a formal proceeding being filed and without the necessity for protracted or extended hearings or testimony and pursuant to the aforesaid resolution:

I. ENHANCED U.S. LAW COMPLIANCE PROGRAM

IT IS HEREBY ORDERED by the Supervisors that:

1. Within 90 days of this Order, ABN AMRO shall submit to the Supervisors an acceptable enhanced global regulatory compliance program ("U.S. Law Compliance Program") for all matters related to global compliance with the applicable state and federal laws of the United States ("U.S. Laws"), in particular, the laws and regulations set forth in this Order. The U.S. Law Compliance Program may include elements from existing or already proposed compliance systems.

Management and Governance

A. The management and governance structure of the U.S. Law Compliance Program shall include, at a minimum:

i. Designation of a committee of ABN AMRO's Supervisory Board (which could be a new committee or the existing Supervisory Board Compliance Oversight Committee)("Supervisory Board Compliance Committee") to be responsible for overseeing the U.S. Law Compliance Program; this committee shall ensure that periodic and other reports are provided to the Supervisory Board, and shall review all significant compliance incidents. The committee shall promptly receive information about significant compliance-related incidents, including how these incidents are resolved,

and ensure that information about such incidents is included in its periodic reports to the Supervisory Board;

ii. designation of a high ranking executive ("Chief Compliance Officer") to be responsible for the U.S. Law Compliance Program. The Chief Compliance Officer shall not have responsibility for any business line, and shall report to the Managing Board, as well as to the Supervisory Board Compliance Committee, with respect to the U.S. Law Compliance Program. The Chief Compliance Officer shall be given the authority and the resources necessary to meet these responsibilities. All decisions concerning the Chief Compliance Officer's hiring, appraisal, promotion, salary, and termination shall be approved by the Managing Board, with the explicit consent of the Supervisory Board;

iii. a systematic description of the organizational arrangements and control mechanisms of the U.S. Law Compliance Program, aimed at conducting the activities in a controlled and sound manner, including interfaces with non-U.S. offices and affiliates of ABN AMRO.

Integrated Compliance Activities

B. The U.S. Law Compliance Program shall include, at a minimum, the following elements designed to ensure that ABN AMRO complies with U.S. Laws, and to ensure that non-U.S. offices and affiliates do not engage in practices aimed at evading or circumventing ABN AMRO's compliance programs and controls in the United States:

i. A detailed analysis of the U.S. law compliance risks arising from ABN AMRO business conducted within or outside the United States;

ii. policies and procedures for obtaining and acting on, as appropriate, legal or any other technical advice;

iii. policies and procedures for reporting, as required, to the Supervisors, or, if relevant, another host country supervisor, or other government agency, sufficient to ensure compliance with U.S. Laws with respect to any business conducted by ABN AMRO that is governed in whole or in part by such laws. To the extent that reporting is limited or prohibited by the laws of the location where the activity takes place, the policies and procedures shall require that ABN AMRO use its best efforts to report to the Supervisors, another host country supervisor, or other government agency;

iv. the establishment of a compliance reporting system widely publicized within the organization and integrated into any other general reporting systems provided for by ABN AMRO that employees use to report known or suspected violations of law or bank policy concerning U.S. Laws, including a process for resolving or escalating the reported violations or apparent violations;

v. general guidelines that will specifically contain prescriptive criteria related to (a) compliance with U.S. Laws addressing cross-border payment processing procedures; and (b) due diligence concerning customers who directly or indirectly utilize the dollar clearing and other services,

including advising or confirming with respect to letter of credit transactions, of ABN AMRO in the United States;

vi. strategies for training employees in compliance issues appropriate to the employee's job responsibilities on an ongoing or periodic basis which will cover specifically, whenever appropriate, compliance with U.S. Laws;

vii. new product and process approval procedures designed to ensure that consideration is given to the applicability of U.S. laws and regulations, and that an adequate control infrastructure is developed and implemented to ensure compliance with any applicable U.S. laws and regulations;

viii. standards for employee performance appraisals (including compensation reviews) that take into account the employee's role in ensuring ABN AMRO's full compliance with U.S. Laws and the reporting of compliance incidents when discovered or suspected; and

ix. standards for and implementation of ongoing compliance testing and risk assessment procedures.

Global Compliance Audit and Ongoing Reviews

C. The U.S. Law Compliance Program shall also include, at a minimum:

i. An audit program that will require regular audits by internal auditors of ABN AMRO to identify and propose the correction of any deficiencies relating to U.S. Laws. The deficiencies may relate to violations of U.S. Laws or to procedures designed to circumvent the compliance systems of ABN AMRO's U.S. operations;

ii. a requirement that all internal audits under the U.S. Law Compliance Program be executed and delivered in accordance with industry standards, and result in written reports that will contain a formal rating and opinion on the effectiveness of internal controls and on compliance with applicable U.S. laws and regulations;

iii. systems and procedures to monitor the status and evaluate the effectiveness of corrective action taken to address weaknesses identified by audit and compliance personnel, or by the Supervisors. Such procedures shall include a mechanism to ensure that significant risk weaknesses identified are periodically brought to the attention of the Managing Board and the Supervisory Board Compliance Committee, together with accompanying management comments (plans for corrective action and timelines), as well as to be reported to the Audit Committee of the Supervisory Board;

iv. on at least an annual basis, in conjunction with audit(s) of the U.S. Law Compliance Program or otherwise, a review of ABN AMRO's policies and procedures and the implementation of changes that are appropriate to ensure that the U.S. Law Compliance Program is functioning effectively to minimize the incidence of compliance problems covered by this Order, and to effectively detect, correct, and report such problems when they occur; and

v. a regimen for the periodic and ongoing assessment by business areas of the effectiveness of U.S. Law Compliance Program implemented pursuant

to Part I of this Order, and reports to the Chief Compliance Officer of the results of such self assessments together with plans for addressing issues uncovered in such reviews, and oversight by the Supervisory Board Compliance Committee, which shall focus on the implementation and effectiveness of the plans proposed and implemented by business areas.

II. HEAD OFFICE OVERSIGHT

IT IS FURTHER ORDERED by the Supervisors that:

2. Within 60 days of this Order, ABN AMRO shall submit to the Supervisors an acceptable written plan to strengthen oversight of the management of the Branches within the structure of ABN AMRO's global operations. The plan shall, at a minimum, set forth:

   A. The actions that ABN AMRO's head office management and U.S. management will take to improve its oversight of the Branches and maintain effective control over and supervision of the Branches' senior management, operations, and activities, including obtaining information sufficient to assess management's adherence with applicable written plans, policies, procedures, and programs;

   B. the responsibility of ABN AMRO's head office management and U.S. management to ensure that the Branches' policies and procedures are tailored to its operations, and adequately address its activities;

   C. the responsibility of ABN AMRO's head office management to ensure that the Branches' operations are conducted in a safe and sound manner by enforcing adherence to the Branches' anti-money laundering policies and

procedures, particularly those relating to its compliance function, and by overseeing activities of the Branches; and

D. the responsibility of ABN AMRO's head office management to monitor exceptions to approved policies and procedures.

III. THE BRANCHES' ACTIVITIES AND OVERSIGHT

IT IS FURTHER ORDERED by the U.S. Supervisors that:

Continued Compliance with Existing Written Agreement

3. ABN AMRO and the New York Branch shall continue to implement the programs and plans required by the July 2004 Written Agreement that were submitted to the Reserve Banks, the NYSBD and the IDFPR with respect to Anti-Money Laundering Compliance (Paragraph 1), Independent Testing and Audit (Paragraph 2), Training (Paragraph 3), and Suspicious Activity Reporting and Customer Due Diligence (Paragraph 4) of the Written Agreement, as required by Paragraph 6 of the Written Agreement. In addition, ABN AMRO and the New York Branch shall fully implement additional recommendations and address the criticisms noted in the Examination Letter from the Federal Reserve Bank of New York and the New York State Banking Department to ABN AMRO, dated October 3, 2005, particularly those relating to ABN AMRO's customer due diligence program and transaction monitoring programs. If the Board of Governors, the NYSBD or the IDFPR request changes to those programs, ABN AMRO and the New York Branch shall submit an acceptable plan to implement those changes within 60 days of notification.
4. ABN AMRO and the New York Branch shall continue to submit reports as required by Paragraph 7 of the Written Agreement.

5. Except as incorporated by reference in Paragraphs 3 and 4 of this Order, upon the effective date of this Order, the Written Agreement is terminated and the terms of this Order are substituted in its place.

IT IS FURTHER ORDERED by the Supervisors that:

Management Plan

6. Within 60 days of this Order, ABN AMRO shall submit to the Supervisors a written plan to improve the effectiveness of the management structure of the Branches. The primary purpose of the management plan shall be to aid in the development of an effective management oversight structure and control environment for both business and compliance purposes. The management plan shall, at a minimum, include:

    A. An assessment of the effectiveness of the control infrastructure, corporate governance and organizational structure of the Branches within the structure of ABN AMRO's U.S. operations, including management supervision, internal controls, reporting lines, duties performed by each officer and employee, and compliance with applicable federal and state laws and regulations consistent with the U.S. Law Compliance Program set forth in Part I of this Order;

    B. an organization chart, reflecting both direct and indirect reporting lines, detailing the management structure for the ABN AMRO organization in the United States, including the Branches, that sets forth:

        i. the reporting lines within each of the Branches;

        ii. reporting lines to each of the Branches from other ABN AMRO offices or officials;

iii. reporting lines from the Branches to other ABN AMRO offices or officials; and

iv. the names and qualifications of the individuals in charge of each business line or control function in each of the Branches;

C. the development and adoption of escalation procedures relating to activities of the Branches designed to ensure that material issues are reported to appropriate committees and senior management of ABN AMRO outside of the respective business lines, and that appropriate corrective action is taken; and

D. the development of processes designed to ensure that any strategic or business line includes full due diligence and a sound strategic implementation plan that incorporates appropriate oversight, controls, compliance, and risk monitoring/reporting.

Internal Audit

7. ABN AMRO and the Branches shall continue to develop and improve the internal audit programs for the Branches. Within 60 days of the Order, ABN AMRO and the Branches shall jointly submit to the Supervisors acceptable enhanced written internal audit policies and procedures that shall, at a minimum, address, consider, and include:

A. Procedures to evaluate the Branches' compliance with applicable laws and regulations for each audit area consistent with the U.S. Law Compliance Program set forth in Part I of this Order;

B. policies and procedures for an ongoing program to provide quality assurance evaluations of the internal audit program;

C. procedures for the periodic submission directly to ABN AMRO's audit committee of all high risk audit issues or deficiencies, regardless of the format in which the issue or deficiency is documented;

D. procedures designed to ensure that Supervisors are given access to internal audit work products, including, but not limited to, all interim reports and final reports. For this purpose, interim reports include, at a minimum, any report that has been completed by Internal Audit for submission to management, regardless of whether subsequent reports are modified based on comments from management; and

E. procedures for the establishment of a process to monitor the status and designed to ensure effective follow-up of corrective action taken to address weaknesses identified by audit and compliance personnel, or the Supervisors, and establish procedures to conduct targeted audits to evaluate remedial action.

OFAC Compliance

8. Within 60 days of this Order, ABN AMRO shall submit to the Supervisors an acceptable written plan, consistent with the U.S. Law Compliance Program set forth in Part I of this Order, that includes:

A. Procedures designed to ensure that issues relating to compliance with OFAC regulations (31 C.F.R. Chapter V), or any guidelines issued or administered by OFAC, that arise in connection with operations of the Branches or other

U.S. offices of ABN AMRO, or that otherwise come to the attention of personnel of the Branches or other offices of ABN AMRO, are escalated to the appropriate compliance personnel;

B. procedures designed to ensure that any violations or apparent violations of regulations issued by OFAC are promptly reported and addressed;

C. the designation of a compliance official who has appropriate expertise in OFAC compliance for the Branches;

D. procedures designed to ensure that the compliance program of the Branches is adequately staffed and funded with respect to OFAC compliance; and

E. strategies for training of both U.S. and non-U.S. employees in OFAC issues appropriate to the employee's job responsibilities on an ongoing basis, especially with regard to cross border United States dollar payment processing procedures.

9. ABN AMRO shall continue to cooperate in providing information responding to any ongoing OFAC inquiries on the effective date of this Order, consistent with the cooperation it has provided to date in those inquiries.

MISCELLANEOUS

10. The program, plans, and policies and procedures required by Paragraphs 1, 2, and 7-8 of this Order shall be submitted to the Supervisors for review and approval. Programs, plans, and policies and procedures required by Paragraphs 1, 2, and 6-8 shall be submitted within the time periods set forth in this Order. ABN AMRO and the Branches shall adopt the approved programs, plans and policies and procedures within 10 days of approval by the Supervisors unless otherwise set

forth in a schedule of implementation included in the acceptable program, plan, or policies and procedures. During the term of this Order, the approved programs, plans and policies and procedures shall not be amended or rescinded without the prior written approval of the Supervisors, or U.S. Supervisors, as applicable.

11. Within 20 days of the end of each month following the date of this Order, ABN AMRO and the Branches shall jointly submit to the Supervisors written progress reports detailing the form and manner of all actions taken to secure compliance with the provisions of this Order, and the results thereof. The Supervisors may, in writing, discontinue the requirement for progress reports or modify the reporting schedule.

12. The provisions of this Order shall not bar, estop or otherwise prevent any of DNB, or any agency or department of The Netherlands, the Board of Governors, IDFPR, and the NYSBD or any other U.S. federal or state agency or department from taking any other action affecting ABN AMRO or any of its current or former subsidiaries, or affiliates.

13. Each provision of this Order shall remain effective and enforceable according to the laws of The Netherlands, the United States of America, and the States of Illinois and New York, until stayed, modified, terminated or suspended by DNB, the Board of Governors, the IDFPR, and the NYSBD, as applicable. ABN AMRO may apply to DNB, the Board of Governors, the IDFPR and the NYSBD to have this Order terminated, modified or amended.

14. No amendment to the provisions of this Order shall be effective unless made in writing by DNB, the Board of Governors, the IDFPR and the NYSBD, as applicable, and by ABN AMRO.

15. The provisions of this Order shall be binding on ABN AMRO, its institution-affiliated parties, as defined by 12 U.S.C. §§ 1813(u) and 1818(b)(4) of the FDI Act, and ABN AMRO's successors and assigns.

16. No representations, either oral or written, except those provisions as set forth herein, were made to induce any of the parties to agree to the provisions as set forth herein.

17. Notwithstanding any provision of this Order, DNB, the Board of Governors, the IDFPR and the NYSBD may, in their discretion, grant written extensions of time to ABN AMRO to comply with any provision of this Order.

18. The Board of Governors delegates to the Reserve Banks the authority to approve the programs, plans or policies and procedures submitted pursuant to Paragraph 10, above.

19. All communications regarding this Order shall be addressed to:

(a) Mr. Arnold Schilder
Executive Director
De Nederlandsche Bank N.V.
Westeinde 1
1017 ZN Amsterdam
The Netherlands

(b) Scott G. Alvarez, Esq.
General Counsel
Board of Governors of the
Federal Reserve System
20th & C Streets, NW
Washington, DC 20551

(c) Mr. Robert A. O'Sullivan
Senior Vice President
Federal Reserve Bank of New York
33 Liberty Street
New York, NY 10045

(d) Ms. Catharine Lemieux, Ph. D.
Senior Vice President
Federal Reserve Bank of Chicago
230 North LaSalle St.
Chicago, IL 60604

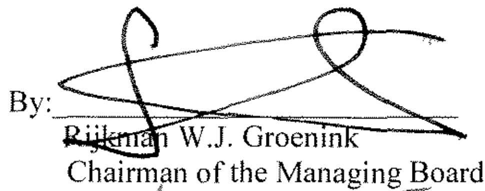
(e) Mr. Scott D. Clarke
Assistant Director
IDFPR, Division of Banking
500 East Monroe Street
Springfield, Illinois 62701

(f) Mr. Michael J. Lesser
Deputy Superintendent
New York State Banking Department
One State Street
New York, NY 10004

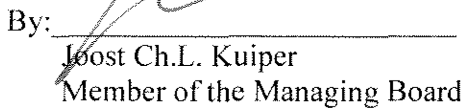
(g) ABN AMRO Bank N.V.
ABN AMRO Bank N.V. - - New York Branch
ABN AMRO Bank N.V. - - Chicago Branch
Carin Gorter
Group Compliance
Gustav Mahlerlaan 10, Amsterdam
P.O. Box 283 (HQ 9156)
1000 EA Amsterdam
The Netherlands

By order of De Nederlandsche Bank (with respect to all Paragraphs except Paragraphs 3-5), the Board of Governors of the Federal Reserve System, the Illinois Department of Financial and Professional Regulation and the New York State Banking Department, effective this 19th day of December 2005.

ABN AMRO BANK N.V.

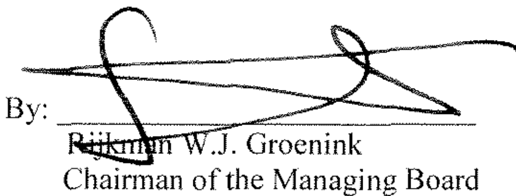


By:____________________________
Rijkman W.J. Groenink
Chairman of the Managing Board

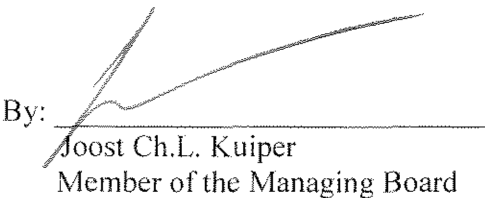


By:____________________________
Joost Ch.L. Kuiper
Member of the Managing Board

ABN AMRO BANK N.V.
New York Branch

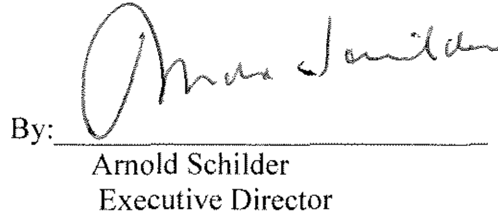


By: ____________________________
Rijkman W.J. Groenink
Chairman of the Managing Board



By: ____________________________
Joost Ch.L. Kuiper
Member of the Managing Board

DE NEDERLANDSCHE BANK N.V.



By:____________________________
Arnold Schilder
Executive Director

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

By:____________________________
Jennifer J. Johnson
Secretary of the Board

NEW YORK STATE BANKING DEPARTMENT

By:____________________________
Diana L. Taylor
Superintendent of Banks

ILLINOIS DEPARTMENT OF FINANCIAL AND PROFESSIONAL REGULATION

By: ____________________________
Scott D. Clarke
Assistant Director
Division of Banking

By order of De Nederlandsche Bank (with respect to all Paragraphs except Paragraphs 3-5), the Board of Governors of the Federal Reserve System, the Illinois Department of Financial and Professional Regulation and the New York State Banking Department, effective this 19th day of December 2005.

ABN AMRO BANK N.V.

By:________________________
Rijkman W.J. Groenink
Chairman of the Managing Board

By:________________________
Joost Ch.L. Kuiper
Member of the Managing Board

ABN AMRO BANK N.V.
New York Branch

By: ________________________
Rijkman W.J. Groenink
Chairman of the Managing Board

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DE NEDERLANDSCHE BANK N.V.

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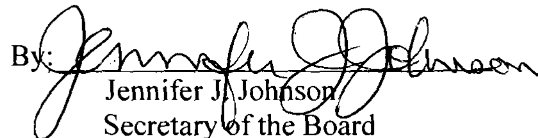
Arnold Schilder
Executive Director

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM


By: Jennifer J. Johnson
Secretary of the Board

NEW YORK STATE BANKING
DEPARTMENT

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Diana L. Taylor
Superintendent of Banks

ILLINOIS DEPARTMENT OF FINANCIAL
AND PROFESSIONAL REGULATION

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Scott D. Clarke
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Division of Banking

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Joost Ch.L. Kuiper
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ABN AMRO BANK N.V.
New York Branch

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FEDERAL RESERVE SYSTEM

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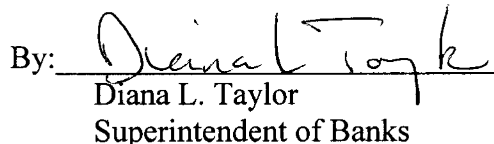
NEW YORK STATE BANKING
DEPARTMENT

By: 
Diana L. Taylor
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ILLINOIS DEPARTMENT OF FINANCIAL
AND PROFESSIONAL REGULATION

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Scott D. Clarke
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ABN AMRO BANK N.V.
New York Branch

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NEW YORK STATE BANKING DEPARTMENT

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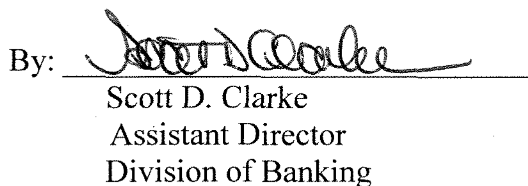
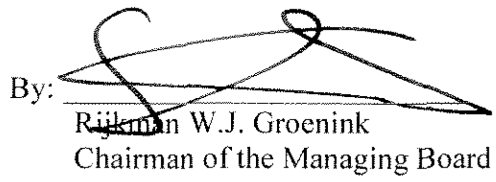
By: 
Scott D. Clarke
Assistant Director
Division of Banking

ABN AMRO BANK N.V.
Chicago Branch



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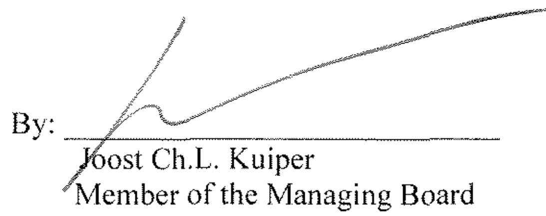

By: ______________________________
Joost Ch.L. Kuiper
Member of the Managing Board

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 97-19 (SUP)
June 30, 1997

TO THE OFFICER IN CHARGE OF SUPERVISION AT EACH FEDERAL RESERVE BANK

SUBJECT: Private Banking Activities

Private banking activities, which involve, among other things, personalized services such as money management, financial advice, and investment services for high net worth clients, have become an increasingly important aspect of the operations of some large, internationally active banking organizations. The Federal Reserve has traditionally reviewed private banking activities in connection with regular on-site examinations. In 1996 and 1997, the Federal Reserve Bank of New York undertook a comprehensive review of private banking activities at approximately 40 domestic and foreign banking organizations in the Second District in order to enhance the Federal Reserve's understanding about private banking operations. Examiners focused principally on assessing each institution's ability to recognize and manage the potential reputational and legal risks that may be associated with inadequate knowledge and understanding of its clients' personal and business backgrounds, sources of wealth, and uses of private banking accounts. In carrying out the reviews, examiners considered the parameters of an appropriate control infrastructure that is suited to support the effective management of these risks.

The reviews indicated that there are certain essential elements associated with sound private banking activities, and these elements are described in a paper, prepared by the Federal Reserve Bank of New York, entitled "Guidance on Sound Risk Management Practices Governing Private Banking Activities". A copy of the sound practices paper is attached for the use of your examiners, and we are requesting that you provide copies to each domestic and foreign banking organization in your District that conducts private banking activities. A suggested transmittal letter is also attached.

The sound practices paper provides banking organizations with guidance regarding the basic controls necessary to minimize reputational and legal risk and to deter illicit activities, such as money laundering. The essential elements associated with sound private banking activities are, in brief outline, as follows:

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- Management Oversight. Senior management's active oversight of private banking activities and the creation of an appropriate corporate culture are crucial elements of a sound risk management and control environment. Goals and objectives must be set at high levels, and senior management must be proactive in overseeing compliance with corporate policies and procedures.
- Policies and Procedures. All well run private banking operations have written "Know Your Customer" policies and procedures, consistent with guidance provided by the Federal Reserve over the past several years, that require banking organizations to obtain identification and basic background information on their clients, describe the clients' source of wealth and lines of business, request references, handle referrals, and identify red flags and suspicious transactions. They also have adequate written credit policies and procedures that address, among other things, money laundering-related issues, such as lending secured by cash collateral.
- Risk Management Practices and Monitoring Systems. Sound private banking operations stress the importance of the acquisition and retention of documentation relating to their clients, as well as due diligence regarding obtaining follow-up information where needed to verify or corroborate information provided by a customer or his or her representative. Inherent in sound private banking operations is the retention of beneficial owner information in the United States for accounts opened by financial advisors or through the use of off-shore facilities. Adequate management information systems capable of, among other things, monitoring all aspects of an organization's private banking activities are also stressed. These include systems that provide management with timely information necessary to analyze and effectively manage the private banking business and systems that enable management to monitor accounts for suspicious transactions and to report any such instances to law enforcement authorities and banking regulators as required by the regulators' suspicious activity reporting regulations.
- Segregation of Duties, Compliance, and Audit. Because private banking activities are generally conducted through relationship managers, banking organizations need to have an effective system of oversight by senior officials and by board committees, as well as guidelines pertaining to the segregation of duties to prevent the unauthorized waiver of documentation requirements, poorly documented referrals, and overlooked suspicious activities. Likewise, strong compliance and internal audit programs are essential to ensure the integrity of the risk management and internal control environment established by senior management and the board of directors.

Other Related Projects and Products

The lessons learned from the private banking reviews will be incorporated into a new examination manual for private banking activities. The manual will be in two parts: one which describes the examination procedures for a comprehensive, top to bottom review of a private banking operation; and the other, a set of "risk focused" guidelines aimed at assisting examiners in determining which procedures should be followed depending, for example, on the level of private banking activity, any noted deficiencies, management's responsiveness in implementing corrective action, and the sufficiency of the organization's internal audit program. We expect to start field testing these new procedures within the next

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three months.

In the next few weeks, the Federal Reserve will also distribute an updated Bank Secrecy Act examination manual. The updated version will include examination procedures relating to recent additions and changes to the Bank Secrecy Act, as well as updated sections related to anti-money laundering initiatives.

Staff is in the process of developing a draft regulation that would require banking organizations to establish "Know Your Customer" policies and procedures. The results of the private banking reviews will be incorporated into the proposed regulation. In moving forward with this initiative, the Federal Reserve will coordinate its efforts with the other federal banking agencies regarding the breadth and scope of the rules in order to ensure that all banking organizations in the United States operate under the same standards.

In the event you have any questions regarding the attached sound practices paper, please contact Ms. Nancy Bercovici, Senior Vice President, Federal Reserve Bank of New York, at (212) 720-8227, or Mr. Richard A. Small, Special Counsel, Division of Banking Supervision and Regulation, at (202) 452-5235. Other questions can be directed to Mr. Small.

Richard Spillenkothen
Director

Attachments

Suggested Transmittal Letter
to the Chief Executive Officer or General Manager of
Each State Member Bank, Bank Holding Company, and
U.S. Branch and Agency of a Foreign Bank
That Conducts Private Banking Activities

Subject: "Sound Practices" For Private Banking Activities

Dear ______________________:

Private banking activities, which involve, among other things, personalized

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services such as money management, financial advice, and investment services for high net worth clients, have become an increasingly important aspect of the operations of some large, internationally active banking organizations. The Federal Reserve has traditionally reviewed private banking activities in connection with regular on-site examinations. In 1996 and 1997, the Federal Reserve Bank of New York undertook a comprehensive review of private banking activities at approximately 40 domestic and foreign banking organizations in the Second District in order to enhance the Federal Reserve's understanding about private banking operations. Examiners focused principally on assessing each institution's ability to recognize and manage the potential reputational and legal risks that may be associated with inadequate knowledge and understanding of its clients' personal and business backgrounds, sources of wealth, and uses of private banking accounts. In carrying out the reviews, examiners considered the parameters of an appropriate control infrastructure that is suited to support the effective management of these risks.

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- Policies and Procedures. All well run private banking operations have written "Know Your Customer" policies and procedures, consistent with guidance provided by the Federal Reserve over the past several years, that require banking organizations to obtain identification and basic background information on their clients, describe the clients' source of wealth and lines of business, request references, handle referrals, and identify red flags and suspicious transactions. They also have adequate written credit policies and procedures that address, among other things, money laundering-related issues, such as lending secured by cash collateral.
- Risk Management Practices and Monitoring Systems. Sound private banking operations stress the importance of the acquisition and retention of documentation relating to their clients, as well as due diligence regarding obtaining follow-up information where needed to verify or corroborate information provided by a customer or his or her representative. Inherent in sound private banking operations is the retention of beneficial owner information in the United States for accounts opened by financial advisors or through the use of off-shore facilities. Adequate management information systems capable of, among other things, monitoring all aspects of an

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organization's private banking activities are also stressed. These include systems that provide management with timely information necessary to analyze and effectively manage the private banking business and systems that enable management to monitor accounts for suspicious transactions and to report any such instances to law enforcement authorities and banking regulators as required by the regulators' suspicious activity reporting regulations.

- Segregation of Duties, Compliance, and Audit. Because private banking activities are generally conducted through relationship managers, banking organizations need to have an effective system of oversight by senior officials and by board committees, as well as guidelines pertaining to the segregation of duties to prevent the unauthorized waiver of documentation requirements, poorly documented referrals, and overlooked suspicious activities. Likewise, strong compliance and internal audit programs are essential to ensure the integrity of the risk management and internal control environment established by senior management and the board of directors.

In the event you have any questions regarding the attached sound practices paper, please contact Ms. Nancy Bercovici, Senior Vice President, Federal Reserve Bank of New York, at (212) 720-8227, or Mr. Richard A. Small, Special Counsel, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, at (202) 452-5235.

Sincerely,

Enclosure

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Guidance on Sound Risk Management Practices Governing Private Banking Activities

Prepared by the

Federal Reserve Bank of New York

July 1997

Guidance on Sound Risk Management Practices Governing Private Banking Activities

This paper presents the observations of examiners of the Federal Reserve Bank of New York regarding sound risk management and internal control practices with respect to private banking activities. Findings are based on a year-long cycle of on-site examinations of the risk management practices of approximately forty institutions in the Second Federal Reserve District that are engaged in the provision of financial services to high net worth individuals, which is commonly referred to as private banking. These examinations represented a cross section of commercial banks, Edge Act corporations, trust companies, and U.S. branches of foreign banks. Our examiners found varying degrees of sophistication and depth in private banking activities. And, we recognize that what constitutes sound practice may vary according to the particulars of each organization's business.

The guidance presented in this paper is not a regulation and should not be interpreted as such. The sound practices reflect the type of information banks need to have to satisfy existing legal requirements as well as transactions testing performed by examiners, and the types of controls essential to minimize reputational and legal risk and deter money laundering. The goal of the paper is to ensure that banks are aware of the major issues currently under review by regulatory and legal authorities and to further the dialogue with institutions engaged in private banking.

Heightened supervisory interest in private banking activities primarily reflects market developments. Recently, domestic and foreign banking organizations have been increasing their private banking activities and their reliance on income from this business line. Several large institutions reported plans to increase sharply the net contribution of

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private banking to their organizations' earnings. Additionally, the target market for private banking -- high net worth individuals -- is growing and becoming more sophisticated and diverse with regard to product and service preferences and risk appetites. As the target market for private banking is growing, so is the level of competition among institutions that provide private banking services. Banking organizations are experiencing competition for private banking clients from non-bank financial institutions, including securities dealers, and asset management and brokerage firms. Accordingly, there are increased pressures on the relationship managers and marketing officers of banking organizations to obtain new clients, increase their assets under management, and contribute a greater percentage to the net income of their organizations.

The reviews underlying this paper focused primarily on assessing each banking institution's ability to recognize and manage the potential reputational and legal risks that may be associated with inadequate knowledge and understanding of the clients' personal and business background, source of wealth and use of their private banking accounts. Also considered were the essential characteristics of an appropriate control infrastructure that is suited to support the effective management of these risks.

To varying degrees, the sound practices identified here either are currently in place or are in the process of being implemented in most institutions, although it is recognized that practices observed in the United States may differ from global practices. The discussion is structured as follows: (I) management oversight, (II) policies and procedures, (III) risk management practices and monitoring systems, and (IV) segregation of duties, compliance and audit.

I Management Oversight of Private Banking

Senior management's active oversight of private banking activities and the creation of an appropriate corporate culture are crucial elements of a sound risk management and control environment. Senior management is responsible for identifying clearly the purpose and objectives of the organization's private banking activities. A statement that describes the target client base, the range of services offered to clients, and the financial objectives and risk tolerances should be approved by senior management and establish accountability for risk management and control functions. Well-developed goals and objectives not only describe the target client base in terms of factors such as minimum net worth, investable assets and the types of products and services sought, but specifically indicate the types of clients the institution will and will not accept, and establish multiple and segregated levels of authorization for new client acceptance. Institutions that follow such sound practices will be better positioned to design and deliver products and services that match their clients' needs, while reducing the likelihood that unsuitable clients will be accepted.

Senior management should be actively involved in strategic planning for the private banking operation. Sound strategic planning should involve not only setting targets such as revenue, assets under management, and the number of new accounts, but also include the establishment of control and risk management goals, such as satisfactory audit and

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compliance reviews. The most control-conscious institutions have passed these and other specific qualitative goals through to relationship managers. In some cases, they have included these factors in employee compensation schemes, thus promoting accountability and responsibility for risk management and control processes.

The culture that exists within the private banking operation invariably reflects senior management's level of commitment to controls and risk management. A focused, integrated, "top-down" approach to embracing risk management and control concepts will most effectively foster an environment in which managers and staff are knowledgeable and aware of the risks in their portfolio. This approach to private banking activities will help ensure that staff members apply consistent practices, communicate effectively, and assume responsibility and accountability for controls.

Each organization should ensure that its policies and procedures for conducting private banking activities are evaluated and updated regularly, and that there is a clear delineation of roles, responsibilities and accountability for implementing such policies and procedures.

II Policies and Procedures

As a private banking operation frequently functions as a "bank within a bank," there are different policies and procedures needed to govern its activities and operations. This paper focuses primarily on the significance of sound Know Your Customer ("KYC") policies and procedures in managing the reputational and legal risks inherent in private banking activities.

Know Your Customer Policies and Procedures

Nearly all of the institutions examined had written KYC policies and procedures -- most of which captured the spirit of sound KYC guidelines. These institutions have taken a reasonable approach to including essential components of a sound KYC policy in their written policies, such as: obtaining identification and basic background information on the clients, describing the clients' source of wealth and line of business, requesting references, handling referrals and identifying red-flags or suspicious transactions. Policies also should require that the clients' source of wealth and funds be corroborated and include specific guidelines on how to corroborate information provided by the client. Sound policies also define acceptable KYC information for different types of account holders, such as individuals, operating companies, personal investment companies ("PICs"), trusts, clients of financial advisers or other intermediaries, and financial advisers. These policies also should recognize that contact/visitation reports written by private bankers, which document their meetings with clients in their home countries and places of business, are an important component to the KYC process.

Additionally, sound policies require that the type and volume of transactions expected to be passing through the clients' accounts be documented, with actual flows

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monitored to assist in detecting suspicious or unusual transactions. Accountability for following up on suspicious activities and making such reports as may be required should also be clearly assigned.

Compliance with policies should be expected by senior management as a matter of course; waivers should be the exception, not the rule, and reasons for any exception should be documented. Moreover, all waivers should be handled by authorized personnel -- thus reinforcing senior management's oversight of the risk management process. Clearly, the best written policies and procedures will not work unless they are implemented effectively and modified appropriately to reflect changing industry practices.

Credit Policies and Procedures

Lending to high net worth individuals and their business concerns often takes on unique banking characteristics. The majority of private banking lending is fully secured -- often by cash, securities and other assets held by the private banking function. Thus, the extensions of credit to high net worth individuals on a secured basis should not result in compromising sound underwriting standards. If credit is extended based on collateral, even if the collateral is cash, repayment is not assured. For example, collateral derived from illicit activities may be subject to government forfeiture. Accordingly, when extending secured private banking loans, institutions should be satisfied as to the source and legitimacy of the client's collateral, the borrower's intended use of the proceeds and the source of repayment. Some institutions have appropriately recognized that, when lending to high net worth individuals, whether on a secured or unsecured basis, the creditworthiness determination is bolstered by a thorough and well-structured KYC process.

III Risk Management Practices and Monitoring Systems

Effective risk management practices and systems that carry out the KYC policies are the foundation of a sound risk management process. These practices should be well-integrated within the organization and reassessed on an ongoing basis. Additionally, relevant personnel should recognize their roles in the process, as well as their accountability.

Documentation and Due Diligence

Virtually all institutions perform more due diligence on relationships established currently than on accounts that were opened in the past. They are supplementing basic account- opening information, such as identification through passports and national identity cards and other basic personal and business data, including the client's mailing address, profession, and estimated net worth, with more detailed and substantive information. Sound practice requires institutions to obtain references on their clients from reliable, independent sources, such as other financial institutions, the client's business associates, attorneys or accountants. Independent references that describe the capacity in which the referring party knew the client and the nature of their relationship are important components of the KYC process, and institutions routinely should seek to obtain these references. Furthermore, if

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internal references from personnel that serve the client from an affiliated office are used, such references should be accompanied by detailed, well-supported documentation.

Institutions employ a wide array of sound practices to corroborate a client's source of wealth and business activities, in addition to obtaining references. For example, some institutions have obtained private credit agency reports on their clients' businesses, including those in foreign countries. Private bankers have also sought out public information on high profile clients in the press, periodicals and through standard database searches. Sound practice also suggests that private bankers obtain financial statements, marketing brochures, and annual reports of clients' businesses as additional corroboration sources.[1] Examinations have confirmed that there are relatively easy and unobtrusive ways to corroborate a private banking client's source of wealth, whether that client is from the United States or abroad.

A concerted effort should be made to embrace these due diligence practices with prospective and existing private banking clients to assure that a client's source of funds is legitimate. While most institutions emphasized the significance of documentation and due diligence during the client acceptance process, it is equally important to ensure that client profiles are appropriately updated throughout the relationship with the client.

Most banking institutions maintain and manage accounts for PICs in their U.S. offices; in fact, frequently PICs are established for the client -- the beneficial owner of the PIC -- by one of the institution's affiliated trust companies in an offshore secrecy jurisdiction. The majority of these institutions employ the sound practice of applying the same general KYC standards to PICs as they do to personal private banking accounts -- they identify and profile the beneficial owners. Most institutions had KYC documentation on the beneficial owners of the PICs in their U.S. files.

The beneficial owners of PICs have a legitimate right to protect their financial privacy, and some high net worth private clients may have a special and legitimate need for confidentiality -- because of their public prominence, for example. The needed confidentiality in these cases may be afforded by promulgating special protections as to access to the records revealing the identity of a beneficial owner of a PIC. However, the ability to make proper identification of the beneficial owner remains an important control within the banking organization. First, without this control, the banking organization cannot satisfy its compliance obligations with respect to legal process served on the banking organization, which might reach property owned or controlled by a particular beneficial owner, including the PIC itself. If the banking organization has structured its records in a way that makes it impossible to comply with such process, this could cause the organization serious compliance problems. Second, the lack of transparency may be an impediment to the banking organization's understanding of its overall relationship with a particular beneficial owner; and the existence of accounts for one or more PICs could confuse the organization about the nature and depth of the overall relationship if the identity of the beneficial owner is masked within management information systems. Finally, there is no legal impediment to maintaining appropriate records. The law in the foreign jurisdiction where the PIC is organized ordinarily should present no obstacle to recording the beneficial owner in a record

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that the banking organization maintains with respect to a PIC account in the United States.

KYC standards for the beneficial owners of PICs (and similarly for those of offshore trusts and foundations) should be no different from those of other personal private banking accounts. Further, institutions maintaining such accounts in the United States should be able to make available, within a reasonable period of time, the identities and full KYC profiles of the beneficial owners when requested by supervisors performing test-checks of their KYC programs.[2]

Use of "Omnibus" and "Concentration" Accounts

Sound practice calls for each private banking client to have its own account(s) at the bank, through which all of the client's transactions are directed. Private banking operations should have the policies and controls in place to confirm that a client's funds flow into and out of the client's account(s), and not through any other account, such as the organization's suspense, omnibus or concentration accounts. Generally, it is inadvisable from a risk management and control perspective for institutions to allow their clients to direct transactions through the organization's suspense account(s). Such practices effectively prevent association of the clients' names and account numbers with specific account activity, could easily mask unusual transactions and flows, the monitoring of which is essential to sound risk management in private banking, and could easily be abused.

Management Information Systems

The management information systems ("MIS") associated with private banking activities were reviewed with a focus on the utility, thoroughness, timeliness and accuracy of data reported to management and responsible individuals. While the size and complexity of the private banking operation at each organization will affect the resources devoted to MIS, private banking operations should make effective use of current technology to support their risk management framework. The level of MIS support given to private banking frequently was weaker than the support given to other areas of the same banking organization. In such cases, institutions should develop specific plans to change or upgrade their MIS.

MIS should be migrating towards providing management with timely information necessary to analyze and manage effectively the private banking business. The types of reports that may meet this objective are those that reflect each client's holdings, including those held through PICs and any affiliated accounts; any missing account opening documentation; transactions made through a client's accounts that are unusual; and the private banking function's profitability. Institutions that manage private banking activities on a decentralized, functional basis may face challenges in uneven implementation of policies and procedures and in aggregating a client's total relationship with the institution, as the client's account balances might be recorded on disparate systems. Institutions with integrated management of private banking activities have more success in capturing and reporting a client's complete relationship. Management's ability to measure and analyze each client's complete relationship with the organization is a key element for sound risk management, and

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MIS should support that objective.

MIS should be capable of monitoring accounts for unusual and potentially suspicious activities. Many institutions are developing or enhancing systems which will identify transactions that warrant explanation and evaluation because of their size, volume, pattern, source or destination. Systems that identify individual transactions on an exception basis, for example those that are above established thresholds in dollar amount and volume, are more appropriate in the detection of aberrations in transactional behavior than systems that only recognize net balance changes. There is a wide array of thresholds used to initiate exception reports -- some institutions use a dollar minimum for each transaction, regardless of the type of client or activity, while others segregate their client base and establish different dollar/volume thresholds for transactions pertaining to each client grouping or to each individual client account. Each institution should implement exception reporting that makes sense and provides appropriate information within the context of its particular business. It should recognize that the systems and reports are valuable only if there are individuals who are responsible for receiving, analyzing and acting on the information generated.

Reporting Suspicious Activity

Procedures established to investigate and, if necessary, report suspicious private banking activity also were reviewed. If legal, reputational, and other risks are to be controlled, there must be a heightened focus on preventing and detecting money laundering and other unlawful activity. Financial institutions clearly have a key responsibility in that process. The Federal Reserve's Suspicious Activity Reporting regulations, which became effective April 1, 1996, and are similar to regulations issued by the OCC, FDIC, OTS, NCUA and the Treasury, impose a duty to file a Suspicious Activity Report ("SAR") for any transaction that:

"has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the institution knows of no reasonable explanation for the transaction after examining the available facts including the background and possible purpose of the transaction."

Some institutions with global private banking activities have recognized the advantages in applying their suspicious activity monitoring procedures globally, as they will be better equipped to detect and analyze patterns and trends of suspicious transactions within their organizations. Private banking senior management should ensure that sound practices are being followed throughout their organization. Management should ensure there is a proactive approach and well-established procedures covering the SAR process and that accountability exists within their organization for the analysis and follow-up of internally identified suspicious activity, for the decision-making process as to whether or not to file a SAR, and for maintaining or closing an account. Because there is a legal requirement to report suspicious transactions, it is essential for banking organizations to maintain internal programs that ensure compliance.

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IV Segregation of Duties, Compliance and Audit

Ensuring effective implementation of established policies and procedures is a significant challenge to many private banking operations. Institutions that evidence ongoing progress towards conformity with stated policies and procedures are those that recognize the importance of segregation of duties and provide adequate attention, direction and support to the individuals responsible for compliance and internal audit.

Segregation of Duties

Adequate segregation of duties in the KYC process is of critical importance. Institutions should not rely exclusively on any individual relationship manager or immediate supervisor to, for example, waive documentation required to open an account, approve the client profile, authorize a new client relationship, fully identify (or "know") the client, and monitor client accounts for unusual transactions. The more control-conscious institutions ensure that an independent unit -- such as compliance, risk management or senior management -- also has responsibility for these functions. Some institutions have segregated KYC duties in a KYC committee comprised of relationship managers, compliance, and senior management to determine, prior to the acceptance of any new client, if the potential client's profile meets the institution's KYC standards. Many institutions have also introduced the concept of "back-up relationship managers" or "client teams" to minimize the risk of a single relationship manager having exclusive knowledge and control over individual relationships.

Segregation of duties clearly facilitates the private banking operation's compliance with policies and procedures and, consequently, minimizes reputational and legal risk. Institutions that have not already established independent control over the above-mentioned activities are urged to introduce such measures as soon as possible.

Compliance

Compliance functions are most effective if they are proactive in ensuring the integrity of the control infrastructure of the private banking operation, as opposed to being reactive to specific, isolated events. They should ensure that policies and procedures are being followed by conducting frequent *ad hoc* reviews and tests that measure how different groups within the private banking function are complying with the policies and procedures. Some institutions assign to compliance the responsibility for reviewing all prospective client profiles to determine if the relationship managers have satisfied the institutions' profiling requirements, obtained necessary documentation and taken appropriate action where problems arise. Compliance functions should also be in a position to recognize promptly any client activity that may be unusual, to question relationship managers about the nature of potentially suspicious activities, and to follow through on their inquiries and suspicions. Compliance functions work effectively only when they have senior management commitment and sufficient resources to accomplish their mission.

In creating a culture that follows best practices of risk management and internal

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control, institutions should conduct frequent training of personnel that is reinforced at regular intervals, particularly in providing the "how to" of client profiling, conducting due diligence, preparing customer call reports and detecting and responding to unusual activities. In some cases, KYC training has been incorporated into the overall marketing and sales training programs. This serves to integrate the concepts of knowing the client's personal and business background, and source and legitimacy of wealth with those relating to the selling of appropriate products and services that meet the client's needs and interests. The majority of institutions provide training on money laundering and documentation requirements for their compliance staff. Institutions also should incorporate this training into programs conducted for their relationship managers.

Internal Audit

Comprehensive private banking audit programs are based on risk ratings that apply an appropriate weighting to the major risks of the business, such as reputational and legal risk, and audits that are conducted with sufficient frequency and involve adequate transaction testing to determine the effectiveness of the internal control environment. KYC testing, for example should be a critical element.

As internal audit plays a crucial role in independently evaluating the risk management and controls, management should ensure that audit functions are staffed adequately with individuals who are well-versed in private banking. In addition, auditors should be proactive in following-up on their findings and criticisms.

Conclusion

The purpose of this paper is to provide sound practice guidance to institutions that are engaged in private banking, while at the same time contribute to the ongoing national and international discussion of the difficult challenges of implementing effective Know Your Customer policies and procedures. Banks face a major responsibility with their affirmative legal obligation to prevent money laundering. This is particularly true in light of the general expectation that private banking will grow significantly in size, complexity and diversity over the next several years, with the result that business practices, policies and procedures will need to be reviewed and revised to ensure effective risk management. We look forward to continuing our dialogue with banks engaged in private banking.

Footnotes

1. Note that dealings with certain types of entities -- pension funds or public entities such as municipalities -- require additional procedures. When dealing with a pension fund certain disclosure requirements of ERISA may apply, and a knowledge of relevant statutes or regulations may be required when dealing with public entities. Return to text

2. Similarly, KYC standards should be no different than those applicable to private banking

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accounts when the institution deals with a financial adviser or other type of intermediary acting on behalf of a client. In order to perform its KYC responsibilities, the institution should identify the beneficial owner of the account (usually the intermediary's client, but, in rare cases, the intermediary itself) and perform its KYC analysis with respect to the beneficial owner. The imposition of an intermediary between the institution and the counter party should not lessen the private bank's KYC responsibilities. Return to text

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The Capture of Corruption: Complexity and Corporate Culture

"Corruption is often discussed in the kinds of language and symbolism reserved for life-threatening diseases'[1]. This is problematic as no-one seems to have found a definition which is universally agreed. Nor is there absolute consensus on what types of behaviour within a loose definition are harmful. Johnson, however, argues that in some respects there is "*too much* consensus. The new wave of concern has been driven primarily by business and by international aid and lending institutions. While there is nothing inherently wrong with that, their vision of corruption, like any other, is partial."[2] Johnson points out that the major anti-corruption players (USAID, World Bank, OECD, UNDP and TI)[3] rarely address differences in the societies whose corruption they seek to cure. Noting the way in which corruption and ant-corruption has emerged on to the international agenda, Samson notes; "In the last five or six years, anti-corruption practices have diffused transnationally and have become organised globally. We have seen the emergence of a *world of anti-corruption* with its own actors, strategies, resources and practices, with its heroes, victims and villains"[4] Samson moots two possible explanations for this powerful recent emergence of the anti-corruption movement "The fight against corruption is virtuous, and those who form part of the anti-corruption community' are thus 'integrity warriors'. The second explanation focuses on the need to increase system rationality; fighting corruption, it is "argued, will make market economies more efficient, state administration more effective, and development resources more accessible."[5] Pointing out that when anti-corruption norms are applied to projects "'global morality' [becomes] . . . a social process. It is a process by which virtue is transformed into a specific activity called a project- one which includes formulating a funding strategy, approaching donors, analysing stakeholders, hiring consultants, developing NGOs, conducting project appraisals, making evaluations . . . Anti-corruptionism . . . is a stage in which moral projects are intertwined with money and power."[6] Because of this "Anti-corruption . . . is not innocent. It can be manipulated to serve the interest of even the most unscrupulous actors."[7]

Further, the interdependence of world economies makes the condemnation of certain behaviours one-sided; that is, the behaviour of one set of actors is condemned while those on the other side of the transaction are regarded with complacence. This paper argues that such a system operates in certain tax havens, and will spotlight the British Virgin Islands to put detail on a complex moral phenomenon.

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[1] M. Johnson' Political Corruption', Colgate University 2003.

[2] M. Johnson "Comparing Corruption" in Heffernan and Kleinig (Eds)*Private and Public Corruption*, p276.

[3] United States Agency for International Development, Organisation for Economic Development and cooperation, united Nations Development Programme, Transparency International.

[4] S. Samson "Integrity Warriors: Global Morality and the Anti-Corruption Movement in the Balkans" in D. Haller and C. Shore (eds) *Corruption,* p106 Italics in original.

[5] S. Samson "Integrity Warriors: Global Morality and the Anti-Corruption Movement in the Balkans" in D. Haller and C. Shore (eds) *Corruption,* p107.

[6] S. Samson "Integrity Warriors: Global Morality and the Anti-Corruption Movement in the Balkans" in D. Haller and C. Shore (eds) *Corruption,* p109-10.

[7] S. Samson "Integrity Warriors: Global Morality and the Anti-Corruption Movement in the Balkans" in D. Haller and C. Shore (eds) *Corruption*, p129.

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The British Virgin Islands are a tiny group of islands composed of the remains of a volcano. As such they are mountainous and have very poor soil. With 20,000 inhabitants in such a location making a living is extremely difficult. Moreover, the islands have a troubled history 'The English ousted the Dutch from Tortola in 1672, and from Anegada and Virgin Gorda in 1680. The new rulers introduced the two quintessential features of the colonial era in the Caribbean: sugar cane and slaves. At first, most of Tortola's 'planters' were more interested in piracy and smuggling than agriculture, but by the 18th century they were displaced by a new wave of experienced planters and a settlement of hard working Quakers. Between the mid-18th and early 19th centuries, the islands prospered, producing sugar, cotton, rum, indigo and spices. Slave unrest and ideological doubt brought an end to slave auctions in 1803. By the 1830s, slaves had been emancipated. Abolition and competing sugar production in Europe and the USA were disastrous for the islands: capital and settlers departed for more buoyant economies, and for the next 100 years the islands' economy stagnated'[8]

The islands were desperately poor. Following in the footsteps of other Caribbean Islands the Government established two industries which now earn 92% of the BVI's earnings split about equally between tourism and financial services. However, the BVI was put on to the OECD list of corrupt economies and only removed in 2002 having pledged to clean up money laundering. This paper raises issues thrown up by this partnership between the culture of companies which have established more than 400,000 'shell' companies on the BVI, using it as an offshore haven and the development aspirations of those living on the barren (but beautiful) rocks which make up the BVI. As we will see the 'public interest' is often held to be significant in definitions of corruption but the public interest is a complex phenomenon, especially where cross-border issues are at stake.

Definitions of Corruption

The World Bank insists that it 'has identified corruption as the single greatest obstacle to economic and social development'[9] One definition of corruption was put forward by Edward Banfield in 1975. He described corruption as a relationship between three parties: the public as principal, the public official as agent obligated to fulfil the wishes of the principal, and a third party seeking to have the agent work on their behalf instead.[10] This is a simple description of corruption but, interestingly it is apparently a bribe which takes place *within a single jurisdiction.* It contains an assumption that the public official is being bribed to act against the interests of his public. If we widen the description to take account of behaviour in (for simplicity)

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[8] Lonely Planet on-line guide
[9] http://www.worldbabkmmmmmmmmmmmmmmmmmmmmmm
[10] E. Banfield 'Corruption as a Feature of Governmental Organisation' Journal of Law and Economics 1975 18(3) 567-605.

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two jurisdictions we may have an instance where the definition does not bite; if the condemned behaviour is approved of by the public in both jurisdictions, does the corruption disappear? As a moral and legal issue the use of tax havens is problematic, some would say inherently corrupt since it is clearly contrary to the beneficiaries of taxation in the home state of the companies offshoring their activities However, it would seem to benefit one other 'public interest' within that same jurisdiction; the shareholders will receive greater profit and the share price will go up. This is at least to their *financial* benefit.The third 'public interest' resides in the tax haven. Especially on such unpromising volcanic soil as the BVI, how else to develop? Tourism has natural limits; financial skulduggery has none? If the scheme benefits two 'public' and disadvantages one, do we vote for majority rule? And if so, why was the BVI on the list of 'corrupt' tax havens when it was being used by many companies in rich jurisdictions to increase their profits? Definitions which restrict corruption to public officials run the risk of being accused of 'capture' of the concept, that is, used selectively to condemn behaviour in order to achieve particular policy outcomes. It misses altogether the institutional corruption which is to be found in the aggressive, deregulated corporate sector in scenarios such as that in Enron and Worldcom. It should be remembered that Arthur Anderson were indicted *inter alia* for 'knowingly, intentionally and corruptly' inducing employees to shred documents relating to Enron. Shore and Haller are clear that such financial scandals "remind us that Europeans and Americans cannot assume that grand corruption is something that belongs primarily to the non-western 'Other' or to public-sector officials in defective state bureaucracies: corruption (both massive and systemic) we should not be surprised to learn, can also be found in the very heart of the regulated world capitalist system."[11] This seems to have been missed by the World Bank whose definition is 'the abuse of public office for private gain'[12].

Corruption as a Moral Deflection Device?

Thomas Pogge explains the ability of rational humans to shape their thinking to suit their interests; "moral norms, designed to protect the livelihood and dignity of the vulnerable, place burdens on the strong. If such norms are compelling enough, the strong make an effort to comply. But they also, consciously or unconsciously, try to get around the norms by arranging their social world so as to minimise their burdens of compliance."[13] Pogge labels such avoidance techniques 'moral deflection devices'

There are strong reasons for believing that 'corruption is a 'moral deflection device'. It is certainly used as a 'persuader' by lobby groups with a particular agenda: "Most corruption involves agents seeking favours from public officials. The larger the

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[11] D. Haller and C. Shore (eds) *Corruption* Pluto Press , London, 2005

[12] World Bank 2002 The New Anticorruption Home Page www.worldbank-homepage.htm, accessed 6/10/2006

[13] Pogge *world Poverty*, p5

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realm of government, the greater the opportunity for such favours `to be granted. If the government regulates trade, the corruption can play a part in allocating export or import quotas. If the government does not regulate trade there are no such opportunities for preferment. . . But . . . certain enduring values seem to be more important than the amount of government intervention in determining the level of corruption (most notably personal honesty). What are we to make of the fact that there are some relatively uncorrupt countries with very intrusive governments, such as in Scananavia? . . . Can we create a virtuous `chain of events with less government leading to less corruption and then to a better functioning of the expanded domain of the market economy?"[14] No surprise that the right wing, free market Institute of Economic Affairs would like to argue de-regulation of companies and a smaller State if only the inconvenient evidence of the Scandanavians did not impede the argument. Neild takes a more balanced approach, examining the emergence of 'clean government' in northwestern Europe[15] in the eighteenth and nineteenth centuries which by no means went hand in hand with less government and pointing out the dangers of the reduction of government; "a policy of trying in a heavily governed country to reduce the scope of government, and hence the number of rules that have to be enforced, may be accompanied by denigration of the public service and by cuts in its pay and conditions of such severity that, in combination with an idealization of private gain, it may produce an increase rather than a decrease in the rate of corruption. Russia today is an example."[16]However, at least corruption can be used by such lobbyists as an argument to restrict aid; "The most effective way of putting international pressure on corrupt, pauper nations is for aid to be available only to those that are demonstrably rooting out corruption. Countries with corrupt governments should be excluded from all aid programmes and soft loans. Their international debts should not be cancelled"[17] As Haller and Shore note the main structural approaches to corruption have colonialist overtones; either by perceiving corruption as a social pathology of 'primitive' nations or by measuring corruption against concepts of 'good governance'.[18] "While advocates of this approach claim that the concept of 'good governance' is based on neutral, objective and a-cultural values, critics argue that it reinforces the hegemonic values of the West as universal- precisely by defining them as 'above' the realm of politics and culture"[19] A similar problem lies with the Banfield approach noted above, the concept of harm to the public interest being a notably slippery concept. In particular Haller and Shore point to the complex nature of the public-private distinction which is fundamental to many approaches to corruption; "In the conventional political science approach, as in neoliberal ideology and in Transparency International initiatives, it is the violation of this public/private distinction by individuals that fundamentally defines corrupt behaviour. Corruption is thus viewed as a measure of how well a society distinguishes between public and private spheres."[20] Further the distinction between gifts and bribes is an incoherent one in some cultures. Overall "Neoliberalism has set the frame for analytical models of corruption, particularly in its restrictive World Bank definition of

[14] P. Booth *Foreword* in I. Senior *Corruption- The World's Big C* Institute of Economic Affairs, London, 2006

[15] Although even these societies are subject to corruption, see M. Bull and J. Newell (eds) *Corruption in Contemporary Politics*, Palgrave, Basingstoke, 2003.

[16] R. Neild *Public Corruption,* Anthem Press, London, 2002, p6

[17] I. Senior *Corruption,* !EA 2006, p189

[18] For example by Transparency International.

[19] D. Haller and C.Shore, *Corruption,* p4.

[20] D. Haller and C.Shore, *Corruption* p5.

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corruption as the abuse of 'public' office. Stripped to its basics, the neoliberal thesis holds that since corruption is primarily a pathology of the public sector, the solution lies in reducing public spending and rolling back the frontiers of the state . Shrinking the public sector, so the argument goes, reduces the scope for public officials to engage in malfeasance. It also subjects public officials to the regulatory disciplines of the market, to cost-consciousness, and to entrepreneurial business ethics. To focus on corporate crimes and corruption within the private sector is simply not on the current agenda of the US government or the IMF."[21] However it is, in a limited sense, on the agenda of TI which, following the Enron scandal, expanded its operations and definition of corruption from 'abuse by public officials for private gain' to abuse of entrusted power' for private gain'. The limitations of this latter definition restrict the discussion to the 'bad apple' theory of corporate corruption, much favoured in the Barings and Enron cases which argued that it was identifiable, corrupt individuals which caused the problem rather than an underlying corrupt culture.[22]

As Thomas Pogge points out the belief that corruption is a 'pathology of primitive nations' is common to 'many citizens of the affluent countries' who hold that the global economic order is not to blame for severe poverty and increasing global inequality; rather "poverty is substantially caused not by global, systemic factors, but – in the countries where it occurs – by their flawed national economic regimes and by their corrupt and incompetent elites, both of which impede national economic growth and a fairer distribution of the national product."[23] This comforting belief is accompanied by demands that the poor countries must first help themselves by giving themselves respectable political regimes. Since, until imposition of regime change in Iraq, it is not the responsibility of rich nations to impose regimes on others, nothing can be done. Aid, if given, would only be lost to corrupt elites. However these comfortable beliefs "are nevertheless ultimately unsatisfactory, because it portrays the corrupt social institutions and corrupt elites prevalent in the poor countries as an exogenous fact: as a fact that explains, but does not itself stand in need of explanation."[24] The prevalence of bad regimes itself requires an explanation. By way of providing an explanation, Pogge focuses on the extraordinary double standards applied to a gang of thieves overpowering the guards at a warehouse and stealing the contents as opposed to a group overpowering an elected government. The latter (but not the former) become owners of the contents able to dispose of the natural resources of the country, transferring ownership to the buyers and are able to borrow freely (international resource privilege). Thus "Indifferent to how governmental power is acquired, the international resource privilege provides powerful incentives toward coup attempts and civil wars in the resource-rich countries. Consider Nigeria, for instance, where oil exports of $6-$10 billion annually constitute roughly a quarter of GDP. Whoever takes power there, by whatever means, can count on this revenue stream to enrich himself and to cement his rule. This is quite a temptation for military officers, and during 28 of the past 32 years Nigeria has indeed been ruled by military strongmen who took power and ruled by force. Able to buy means of repression abroad and support from other officers at home, such rulers were not dependant on popular support and thus made few productive investments towards stimulating poverty eradication or even economic growth."[25] The failure to alter the prevalence of

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[21] D. Haller and C.Shore, *Corruption*, p18.
[22] For a further discussion of this see below, especially the work of MacLennan.
[23] Pogge *World Poverty,* p110
[24] Pogge *World Poverty*, p112
[25] Pogge *World Poverty* p113

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corruption under Olusegun Obasanjo "has provoked surprise. But it makes sense against the background of the international resource privilege: Nigeria's military officers know well that they can capture the oil revenues by overthrowing Obasanjo. An expose of the way in which companies, states, Codes of conduct and explanatory nationalism all work together has been provided by Global Witness.[26] They report that in Congo Brazzaville, Angola and Equatorial Guinea huge sums of oil and extractive revenues have vanished from sight, paid as bribes by the companies to the local elites. This is despite the voluntary disclosure code launched by the UK Government in 2003. A UK Government spokesperson explained that it was for the governments of these countries to stamp out corruption. Global witness had suggested preventing parent companies from listing on the FTSE , Dow Jones or Bourse (or any powerful country's Stock Exchange) unless companies were transparent about these sums of money. The UK Government spokesperson explained that this was not possible since laws would have to be passed in all the countries where the mining companies were registered.[27] This is a manifest inaccuracy, since EU rules and US rules would cover most of the operations and the stock exchange of Angola has, to say the least, a low profile in world affairs, but it displaces the burden to act on to the corrupt governments. Manifestly a recipe of appeasement of the companies by smoke and mirrors while apparently 'tackling the problem'.[28] It is noteworthy in this context that 'corruption indices' always rate countries by the frequency of receipt of bribes, never the source of the bribes[29]. It takes two to be corrupt and in this instance the bribes were coming from the west. It is therefore necessary to consider much more carefully the definitions of corruption that we use. Rejecting the orthodox definition of corruption, Kleinig and Heffernan argue that "it relies on the superficial clarity of a private/public destinction and an unexamined view of what counts as proper use"[30] Arguing that corruption is by nature "essentially contestable" both as to its definition and its desirability, they make the important point that "Corruption is not the exclusive failing of public officers; there may also be personal corruption, corrupt institutions, and corrupt cultures"[31]It is suggested here that the culture which has grown up in some of our largest and most powerful multinationals is a corrupt culture which merits as much attention as 'public' corruption and may often be a contributory factor in the development of other corruptions including illegal or marginally legal offshore financing. Euben argues from the basis of the *Oxford English Dictionary* which associates corruption with a cluster of words-decay, degeneration, disintegration, and debasement."[32] This much wider definition opens up an investigation into corporate culture. We need to investigate what has changed about corporate culture which can be so described.

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[26] Time for Transparency: Coming Clean on Oil, Mining and Gas Revenues, www.globalwitness.org, March 24th 2004.

[27] BBC Today Programme 24th March 2004

[28] In Angola one in four children die of preventable disease under 5 years old while $1.7 billion goes missing each year. Companies involved in the scandal in the three states include Elf, Mobil and Chevron.

[29] For a detailed examination of comparative indices see M. Johnson "Comparing Corruption" in

[29] Heffernan and Kleinig (eds) *Public and Private Corruption,* p275 et seq.

[30] W. Heffernan and J. Kleinig in W. Heffernan and J. Kleinig (eds) *Private and Public Corruption,* Rowman and Littlefield Inc, Lanham, 2004, p3

[31] Heffernan and Kleinig (Eds)*Private and Public Corruption,* , p3

[32] J. Euben in Heffernan and Kleinig (Eds)*Private and Public Corruption,*p54.

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Companies and Corruption

. MacLennan traces the rots of the current waves of corporate corruption in America to early industrialisation; the inevitable and fundamental conflict between the emergent values of market capitalism and democratic goals to protect the public interest."[33] MacLennan argues that this conflict was met by a network of regulations creating an American 'welfare state' which "not only provides a social safety net for the disadvantage in the economy, but also welfare for the very rich and their corporations.[34] Examining why this system seems to have failed so spectacularly over recent years, MacLennan advances the argument that, while the regulatory system is based on the idea that regulation is needed only during "*moments of business failure"*[35]*,* the clash of values runs deeper as "Market values, which have their root in a pre-industrial, liberal society based upon democratic citizenship and agrarian, small business enterprises , have morphed into a new ethic of corporate capitalism which no longer resembles the business culture of the past.. . . Corporate behaviour in the US has become increasingly 'corrupt' and the behaviour of officials in the Enrons and Worldcoms is not isolated. . . . it is pervasive and institutionalised. That means, it is more than criminal behaviour by a few bad actors in an otherwise clean enterprise. It is institutionalised in the everyday world-view and processes of corporate action."[36] MacLennan's study is into the close networks which link the political and economic elites but also notes that " Definitions of morality, public interest and personal responsibility in corporate board rooms and executive offices may in fact be quite different from those of the rest of the middle, working and poor classes."[37] An interesting example of this is Skilling's belief that he is entirely innocent of wrongdoing. This is unlikely to be mere denial and may well stem from an unholy mixture of the 'Alpha male entitlement' syndrome which leads powerful people (not *always* males to refuse to believe that the rules of ordinary life apply to them and by the fact that by constantly driving up the share price he believes that he was doing precisely the job that the company required in accordance with its aggressive market forces culture. MacLennan insists that "corruption implies something systematic, institutionalised and perhaps endemic to an organisation or culture. It is pervasive, infused or embedded in the system.. . Corrupt or criminal *behaviour* is individual. If an alleged crime occurs, individuals are held responsible and receive punishment through the courts. But *corruption* is institutional, patterened – perhaps criminal and unethical from outside, but not necessarily perceived as such by insiders All of the attention to the individual criminal executive is a detaour from figuring out how corruption works. An example is the coverage of the prosecution of Enron's executives, CEO Jeffery Skilling and Chief Financial Officer Andrew Fastow. All eyes are on the courtroom . . . and on possible jail sentences – thus isolating the executive as the criminal. The corporate culture that bred corruption, and the social

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[33] C. MacLennan "Corruption in Corporate America: Enron-Before and After" in D. Haller and C. shore (eds) *Corruption ,* p156.

[34] C. MacLennan "Corruption in Corporate America: Enron-Before and After" in D. Haller and C. shore (eds) *Corruption*, p157-8

[35] [35] italics in the original

[36], C. MacLennan "Corruption in Corporate America: Enron-Before and After" in D. Haller and C. shore (eds) *Corruption*, p158

[37] C. MacLennan "Corruption in Corporate America: Enron-Before and After" in D. Haller and C. shore (eds) *Corruption*, p163

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expectations of the elite that ruled the organisation, have escaped scrutiny"[38]Let us look at some instances of the Enron culture as translated into action by Skilling; "Skilling introduced a rigorous employee performance assessment process that became known as 'rank or yank' under this system the bottom 10 per cent in performance were shown the door. There was heavy pressure to meet targets, and remuneration was linked to the deals done and profits booked in the previous quarter."[39]

"One thing the traders all loved about Enron was the sense they had of operating in the purest environment that had ever been created in corporate America. By pure, they meant that the trading floor operated strictly by the dictates of the free market. The company's credo had always been that free markets worked best, of course. But the traders grabbed on to that belief with a cult-like fierceness. . . Maximising profit was not inconsistent with doing good, they believed, but an inherent part of it. . ."[40]

"And always, hovering over everything and everyone at Enron, was Wall Street. . . . In the Skilling era, the stock became . . . Enron's obsession. A stock ticker in the headquarter's lobby offered a constant update on the price of Enron shares. TV monitors broadcast CNBC in the building elevators. . . for Skilling himself . . . 'the stock price was his report card'. When it rose, he was exultant; when it dropped , he was glum"[41]
"Skilling's methods of arriving at Enron's quarterly and annual targets was downright perverse. Instead of going through a rigorous budget process and arriving at a number by analyzing all the business units and their prospects for the coming year as Kinder used to do, he would impose a number based solely on what Wall Street wanted. He would openly ask the stock analysts "What earnings do you need to keep our stock price up?" And the number he arrived at was the number Wall Street was looking for, regardless of whether internally it made good sense. . . . Invariably, as the quarter drew to a close, Enron's top executives would realize that they were going to fall short of the number they'd promised Wall Street. . .. when the realisation took place that the company was falling short, its executives undertook a desperate scramble to fill the holes in the company's earnings."[42]

A similar corruption was evident in the fall of Barings. The lack of supervision of Nick Leeson was attributable in a substantial degree to the feeling that he was 'the goose' laying the golden eggs so that stringent enquiries into his activities or limitation of them should be avoided at all costs.

In a brief investigation of corporate culture, MacLennan notes the prevalence of "shared corporate values predicated on the rights of property and the rule of

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[38] C. MacLennan "Corruption in Corporate America: Enron-Before and After" in D. Haller and C. shore (eds) *Corruption*, pp164-165, italics in original
[39] S. Hamilton and A. Micklethwait *Greed and Corporate Failure,* Palgrave, Basinkstoke, 2006, p36
[40] B. McLean and P.Elkind *The Smartest Guys in the Room,* Viking, London 2003, p219.
[41] B. McLean and P.Elkind *The Smartest Guys in the Room,* Viking, London 2003, p125.

[42] B. McLean and P.Elkind *The Smartest Guys in the Room,* Viking, London 2003, p127

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the market"[43] Let us look more carefully into property rights and market assumptions.

The US/UK model of companies and corporate law has shareholders as the primary focus; the company must serve the interests of shareholders and directors are appointed and dismissed by shareholders. Nevertheless directors are to act in the interest of the company and usually owe no direct duties to shareholders. This structure does not necessarily equate shareholders with the company nor does it equate shareholder interests with 'profit maximisation' and impose a duty on directors to achieve such a goal. Nevertheless recent discourse has imposed the concept of profit maximisation on the assumption that this is what shareholders require and the second assumption that shareholders and the company are one and the same thing. Such an understanding of corporate aims has wide implications for their behaviour since all considerations other than profit are seen as 'negative externalities' to be adhered to or to be bargained away if possible. There is no doubt that this philosophy was one of the underlying causes of spectacular bankruptcies such as Enron and WorldCom (see further discussion of this below). In terms of moral responsibility such a construct of corporations means that they become another method of moral deflection: because the purpose of corporations is to make as much money as possible those who tolerate and profit from their existence have no responsibility for the methods they pursue. This ignores the fact not only that companies are structured by national laws but also that those who profit from an activity have a responsibility to prevent that activity harming others. However, offshore financing muddies the water since, as noted above we have at least three different competing interest groups which may each claim to represent the 'public interest'.

'Free Markets' and neo-classical economics

The Enron vision of free markets was based on neo-classical economics. It is therefore important to examine closely foundation concepts of this thinking to understand how norms have emerged from the analysis. A key concept is 'efficiency', a term which also has emotive power. Who has ever heard of a government asking advisers to formulate an inefficient economic policy? However, notions of the measurement of efficiency vary. Pareto efficiency requires that someone gains and no one loses. However, the Kaldor-Hicks test accepts as efficient "a policy which results in sufficient benefits for those who gain such that potentially they can compensate fully all the losers and still remain better off"[44]

The neo-classical economists believe that rational actors utilising perfect information will produce maximum allocative efficiency by making choices which exploit competition in the market. In plain English that means that everyone is assumed to be equally rational, have equal bargaining power and that there is no asymmetry of information. Stiglitz explains the theories thus: "One of the great intellectual achievements of the mid-twentieth century . . . was to establish the conditions under which Adam Smith's 'invisible hand' worked. These included a

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[43] C. MacLennan "Corruption in Corporate America: Enron-Before and After" in D. Haller and C. shore (eds) *Corruption*, pp165

[44] explanation given by Ogus, *Regulation*, 24, who immediately points out that there is no requirement for the gainers to compensate the losers, see below in criticism section.

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large number of unrealistic conditions, such as that information was either perfect, or at least not affected by anything going on in the economy, and that whatever information anybody had, others had the same information; that competition was perfect; and that one could buy insurance against any possible risk. Though everyone recognised that these assumptions were unrealistic, there was a hope that if the real world did not depart too much from such assumptions – if information were not too imperfect, or firms did not have too much market power – then Adam Smith's invisible hand theory would still provide a good description of the economy. This was a hope based more on faith – especially by those whom it served well – than on science. My research, and that of others, on the consequences of asymmetric information . . . has shown that one of the reasons that the invisible hand may be invisible is that it is simply not there."[45]

Since the invisible hand is not to be fettered, State regulations should be removed so that a 'free market' is permitted to reach maximum efficiency. However, de-regulation distorts the concept of freedom by removing regulation which seeks to protect the vulnerable; trade union law, employment regulation, environmental legislation. Freedom to trade in this sense becomes someone else's lack of freedom. It is notable that he slave traders defended their practices on the basis that they must be allowed 'free trade'.

It must be noted that any identified defect in the underlying assumptions tends to have a cumulative effect, each building block contributing to a picture which emphasises the necessity for a market free of regulatory interference, disguising the reality of imbalances of power which might be addressed by regulation. The basis of the theories on a pseudo-scientific notion of efficiency and the claim that creating wealth is beneficial for society as a whole means that the end result is a picture where interference with the freedom of markets needs to be justified by anyone who argues for any regulation of market behaviour. It is important to note that Enron rose in the context of de-regulation of the utilities industries and of the accountancy profession.

Take first the Kaldor-Hicks notion of efficiency. The concept that net gains and losses need to be calculated and any net gain to any party is equivalent to efficiency is open to "several powerful objections, at least as a conclusive criterion of social welfare"[46] Ogus points to the coercive imposition of losses on individuals, the assumption that one unit of money is of equal value whoever owns it and its hostility to the notion of distributive justice. Ogus gives the following example;[47]

"Suppose that the policymaker had to choose between (A) a policy that increased society's wealth by $1million and benefited the poor more than the rich, and (B) a policy that increased its wealth by $2million, the bulk of which devolved on the rich? Many would argue for (A) on the grounds of fairness[48] but (B) would be considered to be superior in Kaldor-Hicks terms.[49]

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[45] J. Stiglitz *The Roaring Nineties: Seeds of Destruction*, Allen Lane, London, 2003.

[46]ibid, 25.

[47]ibid, 25.

[48] Ogus *Regulation* and see J. Rawls *A Theory of Justice* Oxford University Press, 1972.

[49] This argument has powerful resonance when the operation of transnational and global corporations is under scrutiny.

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Now, if we see this argument in the light of Marx's views on equality and the concept of freedom we can see how the approach is based on the idea of "notional equality" of the Kantian and Hegelian kind and how clearly Marx saw the reality that given real inequalities which pre-date the time of the transaction, inequalities will not only persist but become more and more accentuated. The Pareto-Hicks formula does not insist that the winning individuals and the losing individuals should be different in different transaction; in practice the powerful become more powerful, the poor more poor and disadvantaged. O. Lange writes[50] "let us imagine two persons: one who has learned his economics only from the Austrian School, Pareto and Marshall, without having seen or even heard a sentence of Marx or his disciples; the other one who, on the contrary, knows his economics exclusively from Marx and the Marxists . . . Which of the two will be able to account better for the fundamental tendencies of the evolution of Capitalism?" resolving the question in favour of the Marxists.[51] Lange also makes the contrast between Marx's theory of economic "evolution" and the fact that "for modern 'bourgeois' economics the problem of economic evolution belongs not to economic theory but to economic history"[52]. This static nature may be seen as flowing from the essentially moral emptiness of current economic theory; unlike Marxism it is not driven by a desire to achieve freedom and fulfilment of a spiritual nature. [53]

Deregulation, Market failure, corporate governance and failures to fulfil human rights

The call for regulatory structures to re-balance the company's focus on shareholders so that it serves to deliver a more just economic outlook is in line with an understanding of human rights which moves away from a traditional focus on limiting the behaviour of the state and its officials and focuses instead on human rights as imposing duties on individuals to build institutions which lead to as full a delivery of human rights as possible.[54] One of these institutions is the capitalist market. There is a good case for applying the concept of institution building to situations where there is market failure and making the case for regulations to try to correct the market failure so far as possible.

"But for the market economy to function well, there is a need for laws and regulations – to ensure fair competition, to protect the environment, to make sure that consumers and investors are not cheated."[55] Stiglitz examines the ways in which deregulation in the United States in the 1990s was instrumental in assisting the economic 'bubble' to grow and then burst and the spectacular bankruptcies and revelation of fraud that followed. "Regulations help restrain conflicts of interest and abusive practices, so that investors can be confident that the market provides a level

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[50] "Marxian Economics and Modern Economic Theory" in *Marx and Modern Economics",* S. Horowitz (ed), Macgibbon & Key, London 1968.

[51] ibid at p71.

[52] ibid, 73.

[53] A. Van Leeuwen *Critique of Heaven,* Lutterworth, London 1972, especially chapter IV "Human self-consciousness as the highest divinity"

[54] Pogge *World Poverty*, p50
[55] J. Stiglitz *The Roaring Nineties,* Allen Lane, London, 2003, p91

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playing field and that those who were supposed to be acting in their interests actually do so. But the flip side of this is that regulation restrains profits and so deregulation means more profits. And in the nineties, those who saw the larger profits that deregulation would bring were willing to invest to get it – willing to spend megabucks in campaign contributions and lobbyists."[56] So far as corporate governance is concerned, market failure occurred by failure to regulate competition adequately, by permitting banks and accountancy firms to merge and take on tasks which inevitably involved conflicts of interest and by using perverse incentives as part of the rewards packages for Chief Executive Officers (CEOs).[57] Competition regulation failure came partly from the argument that the 'New Economy' had arrived, that it provided new conditions where innovations would keep competition healthy so regulation was not necessary. Stiglitz was not convinced. Analysing the telecommunications market he writes; "There were two reasons that I was suspicious of those who simply said 'Let competition reign'. The first [was] . . . everyone talked about the importance of being the first mover into a market. In doing so, they were, in effect, admitting that they did not anticipate *sustained* competition. There would be competition *for* the market, but not competition in the market. That, in fact, was why those who had a head start in the race were lobbying so hard: they thought they had the inside track, and the payoff, if they won, would be enormous. . . But secondly, why, if the local phone companies really thought that competition would break out, were they so resistant to efforts to make sure that there was strong anti-trust oversight?"[58]

The second significant failure lay in permitting accountancy and banking firms to merge into huge giants carrying out activities which were clearly in conflict of interest. Thus accountants were making huge profits by carrying on consultancies for firms whose accounts they were supposed to be auditing and banks were simultaneously lending money to firms such as Enron, while also undertaking the placing of Initial Public Offers (IPOs) of shares with the public. The independent assessment of the lending branch of the bank as to the creditworthiness of the firm was likely to be undermined by the wish of the investment branch to do business issuing shares for the firm. This removed an important device for monitoring the solvency of the company and gave false signals. If the bank is still lending investors would believe that the firm was still solvent. Loans were granted to Enron until the last moment before the scandal broke and such loans only increased the size of the eventual shortfall for employee pension schemes as well as investors.

A third significant failure was "the strange corporate practice of giving corporate executives stock options – the right to buy company stock at below market prices – and then pretending that nothing of value had changed hands."[59] These transactions were not adequately disclosed. The importance of this is clear to Stiglitz: "As a longtime student of the role of information in a well-functioning economy, I [understood that] . . . the executives are being paid too much partly because *it isn't widely known exactly how much they are really being paid*. And if no one knows how much the CEOs are being paid, that means no one knows how much profit (or loss) the company is making. No one knows how much the firm is really worth. Without this information, prices cannot perform the roles they are supposed to in guiding investment. As economists put it somewhat technically 'resource allocations will be

[56] Stiglitz *Roaring Nineties* p90
[57] Stiglitz *Roaring Nineties* chapter 4
[58] Stiglitz *Roaring Nineties* pp97-98, italics in the original
[59] Stiglitz *Roaring Nineties* p115.

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distorted."[60] Further, compensation packages for CEOs ran out of control with boards accepting huge increases and shareholders unable to prevent the packages going through. "While senior executive compensation rose 36 percent in 1998 over 1997, the wages of the average blue-collar worker rose just 2.7 percent in the same period. . . . Even in 2001, a disaster year for profits and stock prices, executive CEO pay increased twice as fast as the pay of the average worker."[61] And you can be sure that it was not a percentage calculated from equivalent pay at the outset. Stiglitz understands the cause of the downturn of the US economy as being significantly caused by these factors which were all brought on by deregulation and a failure to understand the correct role of regulation in preventing or minimising market failures. And, market failures impact most significantly on the poorest in the community and are likely to directly cause non or underfulfillment of human rights. The imperative is to prevent perverse incentives and competition failures from so distorting the market that it fails. We must be on guard against the simplistic economic viewpoint which is analysed above since it is still endemic in many policy think-tanks and government advisors all over the world. Deakin argues that "We have acquired a framework of perverse incentives that rewards most those managers who are best at shifting risks and liabilities on to the under-represented within the corporation (mainly employees) and in society at large. This is the result of entrenching a particular version of the "shareholder value" norm, associated with short-run share price maximisation, in corporate culture and practice.[62]

Companies as Property

Paddy Ireland has made it clear that companies fit with difficulty into the property rights discourse.[63] This is because the traditional 'take' on companies is that they are 'the property of the shareholders' or " in the 'nexus of contracts' or 'agency' theory of the company, in what amounts to the same thing, that the shareholders own not 'the company' but 'the capital', the company itself having been spirited out of existence.[64] Ireland also shows that there is considerable convergence between the property rights of creditors and those of shareholders, each can be seen as essentially 'outsiders' having contractual rights against the company, rather than 'insiders' with membership rights. The remaining 'insider' rights of shareholders are relics of the time when joint-stock companies were run by members and of an even earlier time when lending for interest was banned but partnership for profit was not. An investment as a 'sleeping partner' was a convenient way to circumvent this rule.

The shareholder value norm itself rests on the 'myth of shareholder ownership', that this 'myth' is a rhetoric appealing to the concept of 'property' as an important right which has distorted our understanding of companies and of directors' duties by accepting that the gap between 'ownership and control' should be plugged by duties designed to align the interests of directors with those of shareholder-owners. Because this structure is based on the myth of ownership it is unhelpful and distorting, leaving out of account many of the real risks which companies run, risks of damage to the company by poor treatment of employees, the environment and consumers leading

[60] Stiglitz *Roaring Nineties* p118, italics in the original.
[61] Stiglitz *Roaring Nineties* p124
[62] S. Deakin Squaring the Circle? Shareholder Value and Corporate Social Responsibility (2002)70 Geo Wash LR 976at 977
[63] P. Ireland "Company Law and the Myth of Shareholder Ownership" 1999 MLR 62, See also J. Hill "Visions and Revisions of the Shareholder" (2000) American Journal of Comparative Law 39.
[64] Ireland, Myth of Shareholder Ownership.

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to leading not only to loss of reputation but to the real danger of collapse from striving for a short-term goal of shareholder value maximisation at the expense of sustainability and long-term goals. As we have seen, although greed motivated some of the fraud which was important in the downfall of Enron, one of the most important motivating factors was a desire to keep the share price rising. "I don't want us ever to be satisfied with a stock price; it should always be higher . . . Indeed, we still think that over the next several months that there's a good chance that the stock price could be up as much as 50 percent, and I think there's no reason to think that over the next two years we can't double it again"[65]

There is, however, room for optimism; "For almost a quarter century, beginning in the early seventies, the *rational expectations* school of economic thought dominated economic thinking. This portrayed the individual not only as a rational being, making consistent choices, but as someone capable of processing complex information and absorbing all the relevant knowledge. Its advocates focused on models in which everyone had the same information – there were no asymmetries. In fact, few people know enough math to process even the range of knowledge bearing on the simplest investment decision. (the rational expectations theorists conceded as much, yet asserted that, somehow, individuals acted *as if* they had processed it all. Not content with upholding the rationality of individuals, they portrayed the economy itself as a rational mechanism – one in which, miraculously, prices reflect instantaneously everything that is known today, and prices today reflect a consistent set of expectations about what prices will be *infinitely far into the future.* The political agenda of this work often seemed barely beneath the surface: if the rational expectations school was right, markets were inherently efficient, and there would be little if any need, ever, for government intervention. The heyday of the rational expectations movement has ended, I am pleased to report."[66] It is most notable that the most fervent believers of this creed have profited from it (at least until they have gone to prison), a clear example of Pogge's understanding that human beings prefer to take comfort from beliefs that will favour themselves. The analysis also makes it plain that building the market as an institution which will best deliver human rights is itself a human rights responsibility.

New Uses for Concession Theory

Nowhere is there complete adherence to the theory that companies ought to be permitted to function free of all regulation: all states operate a 'mixed' system of market freedom and regulatory control.[67] However, traditional discussions of corporate governance give little weight to the web of regulation which surrounds every corporate operation and, in particular; the impact of regulations on corporate culture has not been examined in its legal context. Is the way in which companies actually work reflected in discussions of corporate governance and an adequate legal framework?

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[65] Kenneth Lay speaking at a n Enron meeting, 1st December 1999, cited by B. McLean and P. Elkind *The Smartest Guys in the Room*, Viking, 3003, p242, see also B. cruver *Enron, Anatomy of Greed,* Arrow, 2003

[66] Stiglitz *Roaring Nineties* p151-2, italics in the original

[67] J. Dine *Governance of Corporate Groups*

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The imposition of regulations may easily be justified by traditional concessionary approaches: in its simplest form this approach views the existence and operation of the company as a concession by the state, which grants the ability to trade using the corporate tool, particularly where it operates with limited liability. In return this concession implies the right to impose limits on a company's freedom.[68] The imposition of regulations inevitably identifies those at most risk from particular corporate decisions and seeks to protect from or minimise that risk. Thus, environmental regulation identifies whole communities as at risk, financial regulation protects shareholders and health and safety regulation principally targets employees.

As Teubner rightly says:

"Putting it quite bluntly, a corporate enterprise does not exist simply as a self serving and self-realizing institution for the unique benefits of its shareholders and workers, but rather exists, above all, to fulfil a broader role in society."[69]

Indeed, large companies have a huge on influence our social, economic and political lives. In the words of Chayes, "[T]hey are repositories of power, the biggest centers of nongovernmental power in our society."70 In the UK the influence of companies is just as evident as in the USA. The food we eat is dependent on how it is grown, processed, packaged, advertised and sold to us. Every one of these stages is determined or influenced by companies. Increasingly companies are involved in the provision of public services with the government having created mechanisms such as private finance initiatives, and more recently the proposals for community interest companies. Such mechanisms are recognition of the influence of companies and their role in society. In such a context it seems that the two company law assumptions that share the structure of company law and corporate governance are not only anachronistic but in fact wholly inaccurate in their representation of the character of companies today. Teubner argues for a proceduralization of fiduciary duties that enables non shareholder interest groups to participate in the monitoring and decision-making functions. The role of the law, in Teubner's view should be to control indirectly internal organizational structures, through external regulation. The role of the law is external mobilisation of internal control resources.[71] The organisational structures should allow for "discursive unification processes as to allow the optimal balancing of company performance and company function by taking into account the requirements of the non-economic environment." In short, Teubner advocates a constitutionalization of the private corporation to make the corporate conscience work "if that meant to force the organization to internalise outside conflicts in the decision structure itself in order to take into account the non-economic interests of workers,

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[68] ibid and S. Bottomley 'Taking Corporations Seriously: Some Considerations for Corporate Regulation' [1990 19 *Federal Law Review* 203, W. Briton jnr 'The New Economic Theory of the Firm; Critical Perspectives from History' 1989 *Stanford Law Review* 1471.

[69] Gunther Teubner, "Corporate Fiduciary Duties and their Beneficiaries: A Functional Approach to the Legal Institutionalization of Corporate Responsibility" in Hopt and Teubner (eds) *Corporate Governance and Directors' Liabilities* (1987, de Greuter, Berlin) 149, at p. 157.

[70] Chayes, noted above, at p. 25.

[71] Teubner, noted above, at p. 160.

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consumers, and the general public."[72] Teubner highlights the role of disclosure, audit, justification, consultation and negotiation and the duty to organise. He emphasises the need to proceduralise. Ultimately the point is to ensure that the decision-making processes allow participation by those affected by the decisions, whether in terms of profit, consumer choice, working conditions or environmental impact of corporate activities. If the decisions are made jointly with the directors the monitoring role ought to reduce. Teubner's proceduralisation would mean a complete change in conceptualisation of the company and directors' duties. The following tries to put some flesh on the bones' in the context of a new look at UK company law.

As we have seen, Berle and Means identified the separation of ownership and control in the 1930s[73], showing that, with dispersed ownership of shares, control of corporations lay less with shareholders and more with the professional managers of large companies. This led to corporate governance being discussed primarily as involving antidotes to such a separation, and, in particular with implementing mechanisms to align the managers' interests with those of shareholders. Today there is a second shift in the governance of companies, this time strengthening the degree of separation between ownership and control and also shifting the focus and perhaps the power centre of decision making to a lower level in the company. This second shift calls into question the reality of the vision of a company exclusively directed by the 'controlling minds' of managers but by acknowledging that directors still have the ultimate decision making power is in line with the reconceptualisation of a company as owner; the directors are exercising their property rights powers on behalf of the company. Limits on their decision making, however, appear by way of providing them with information from throughout the organisation and insisting that the focus of their decision making should be an assessment of risks to the organisation. This new understanding would reject the idea of the company being composed solely of its organs but, in some ways embrace the 'organic' view of companies.[74] The organic analysis is borrowed from the analysis of States. Wolff[75] cites John Caspar Bluntschli who 'found something corresponding in the life of the State not only to every part of the human body but even to every human emotion, and designated e.g. the foreign relations of a State as its sexual impulses!' In fact the organic theory is remarkably wide in its vision, many current theories would omit the inclusion of the 'hands' at all, regarding employees as 'negative externalities' rather than as an integral part of the company's existence.

There are a multiplicity of regulations that companies must implement and within companies, systems are set up to implement them. A simple example (and the most obvious) is the systems which must be set up to ensure financial control. In the Barings collapse, one of the problems that was clearly identified was the lack of knowledge of the derivatives operation which was displayed by the directors. They were eventually disqualified as directors as being 'unfit' following their failure to put in place proper systems of financial control. However, in order to create effective systems they needed to fully familiarise themselves with the functioning of the derivatives operation. It is argued here that, because detailed knowledge of the operation of the systems which make up a functioning company are to be found elsewhere than at board level and that proper systems of control cannot be designed without this detailed knowledge, it is incumbent on the eventual decision makers to

[72] Teubner, noted above, at p. 165.
[73] A. Berle and G. Means *Modern Corporation and Private Property* (New York, Macmillan 1962)
[74] M. Wolff 'On the Nature of Legal Persons' (1938) *Law Quarterly Review* 494
[75] 'Nature of Legal Persons', 499.

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take account of the knowledge and experience of those most intimately involved in the systems necessary to control the risks which are the subject matter of the regulations.

This is not to say that the power to take the eventual decision has moved, but that proper decisions cannot be made without wide consultation. This, in turn, gives the consultees standing to influence the decision making process and, in particular, change the culture of the company from focussing on shareholder profit alone.

The example of financial controls is just a single example of the regulations which impinge on decision making within companies. The company must remain within the criminal law and must have systems which ensure that this happens. This may extend to ensuring consistency between methods of working and achievable targets. For example if time targets for repairs to electric signals on a railway cannot be achieved without electricians working excessively long hours, the inconsistency may in future be identified as a reason for holding the company (and its directors) criminally responsible for an ensuing disaster. Similarly proper systems for implementation of health and safety and environmental regulations must rely on detailed knowledge of the 'way things actually work'.

In effect, the imposition of regulations which must be implemented, gives the company a greater degree of autonomy from the shareholders. As we have seen, the 'shareholder property rights' model led to a narrow definition of what is meant by 'Corporate Governance' with most commentators concerned only with the methods by which management action can be controlled in order to ensure management behaviour 'for the benefit of the company', meaning in the vast majority of situations, for the financial benefit of shareholders. This tendency has been reinforced by the 'legal boxes' which have been constructed, particularly in common law jurisdictions. 'Company law' is seen as a separate discipline from 'labour law', ignoring the fact of enormous proportions that the huge majority of employees work for companies and that companies cannot work without employees. Similarly, other regulatory structures impinge on corporate decision making so that it is no longer open to the shareholders to insist on profit at the expense of compliance with health and safety standards, environmental regulations[76] or consultation with employees. Nor can systems to ensure compliance with criminal law be neglected.

In the recent US scandals, particularly those like ENRON and WORLDCOM which involve manipulating accounts in order to maintain inflated share prices we see a conflict between the old fashioned view of 'corporate governance' which sought to create mechanisms for aligning the governance of the company with shareholders' interest in profit maximisation and the vision described here which seeks, by regulation, to make sure that companies have proper systems in place to ensure their compliance with the requirements of society generally. Although it is true that directors of these companies stood to gain personally from inflated share prices, the primary motive for the 'creative accounting' was the pressure to do better than competitors so far as a continuously rising share price was concerned. The system of corporate governance which relies primarily on shareholder enforcement is shown not only to be inadequate but counterproductive, imposing pressures which are destructive of both the company and the wider interests of society, both in loss of faith in markets and destruction of, e.g. pension benefits.

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[76] See on this point M. Blecher "Environmental Officer: Management in an Ecological Quality Organisation " in G. Teubner (ed) *Environmental Law and Ecological Responsibility: The Concept and Practice of Ecological Self-Organisation,* John Wiley, London, 1994.

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Conclusion

However, even if such reforms were to lead to a more sustainable, socially responsible and less corrupt corporate culture this will not solve the conundrum of the 'corruption' of offshore tax havens. If reformed companies decided that shareholder value was not the sole determinant of their behaviour would they desert offshore financing? And if so, what would happen to the development potential of the ex-slave colonies which currently rely on it? Pogge would undoubtedly point to a duty to support the development of previously exploited peoples. What should replace the easy income from invisible companies?

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The Capture of Corruption: Complexity and Corporate Culture

Dine

Definition of Corruption?

- International aid and lending institutions
- Integrity Warriors
- One-sided condemnation

British Virgin Islands

- Tax haven/money laundering
- 400,000
- OECD black list
- How else to make a living?

Pogge: Moral Deflection Devices

- Corruption as a moral deflection device?
- Primarily State Officials
- Small State, Less Corruption?
- Scandinavian countries
- Withholding aid

Poverty and Corruption

- Poverty caused by corruption?
- Pathology of primitive nations
- but: corrupt regimes demand an explanation.

Gang of Thieves v Coup D'Etat

- International resource privilege
- International borrowing privilege
- Debt burden for incoming democratic regimes

Companies and Corruption

- Clash between market values and democratic public interest goals
- De-regulation and aggressive capitalism
- Moments of business failure or institutionalised corruption, MacLennan

ENRON

- Corruption as acts of individuals
- Skilling’s belief in innocence
- Alpha male syndrome +
- Doing the company’s bidding: share value maximisation

All pervasive companies

- Reforming corporate culture
- Internalising externalities via internalising regulation
- Systems of risk control

Complexity of Corruption

- Acting against the public interest
- BVI public?
- Shareholders?
- Recipients of the benefits of taxation?
- Which public interest counts?

Socially Responsible Companies

- Death of Tax Havens?
- Death of development aspirations of the BVI

Countering bribery in Switzerland

Andre Odermatt

Countering international and national bribery is a primary issue for Switzerland as Switzerland actively participated in the evaluation of the conventions of the OECD, the European Council and UNO and actively promotes its implementation and application. Moreover, countering bribery is important for Switzerland in terms of international cooperation and development.

In Switzerland, active and passive bribery as well as the acceptance or the offer of improper benefits, e.g. gifts, are criminal offences.

Active bribery is the offer of a bribe to induce a public officer to carry out a particular action while passive bribery is a request for or acceptance of bribery for a certain action by a public officer. In addition, the Swiss Criminal Code covers the offer and acceptance of improper benefits (such as gifts) both for as yet undefined actions as well as for anticipated actions that are possibly to be taken by officials in future.

A public official is defined as a member of a tribunal or other public authority, a public servant, an expert in public office, a translator, an arbitrator or a member of the army as well as a private person serving in public office.

Natural persons are primarily liable for bribery and they are then prosecuted for committing a criminal offence. If a bribe is committed by an enterprise, it is not only management that is liable but also all those persons who represent the enterprise. According to legislation, enterprises that fail to maintain a proper form of organisation in order to avoid charges of bribery are liable and can be penalized.

In 2006, new legislation under the "Law against unfair competition" came into force according to which the bribing of private persons (and not only of public officials) is a criminal offence. Whereas any persons offering a bribe are liable, the victim of a bribe is only legally responsible if he or she has a particularly confidential relationship with an enterprise. Therefore, that person must either be an employee, an assignee, a shareholder of an enterprise or a person otherwise closely related to an enterprise.

It goes without saying that corruption, once established, is also subject to the Swiss law against money laundering because money involved and transferred in connection with bribes has its origins in a "crime" and will thus be pursued by law.

In turn, the fight against bribery not only requires a legal framework. It clearly needs the commitment of enterprises working together to combat bribery. These companies must establish good corporate governance and a clear code of conduct, which not only give guidelines but also address the issue of sanctions.

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In cooperation with Transparency International (TI), leading international banks such as ABN AMRO, Barclays, Chase, Citibank, Deutsche Bank, HSBC, Credit Suisse and the UBS, among others, found common agreement regarding the countering of money laundering and corruption. Q.v. www.wolfsberg-principles.com .

One major initiative has been started by large industrial companies together with TI at the World Economic Forum with Principles against Corruption (PACI). Q.v. www.weforum.org . The vision is zero tolerance where bribery and corruption are concerned.

Achieving zero tolerance on the part of all the persons involved requires total commitment. A practical test might help, such as:

- Would my supervisor agree to such an action, once he heard about it?
- Would I agree to have such actions reported in the news?
- Is my counterpart who accepts any benefits acting in accordance with his employer's "code of conduct"?

If all these questions can be answered positively, then you can have your actions approved by your supervisor and you can file the facts relating to this action. You should desist if any question receives a negative answer.

Or follow Sir Peter Ustinov's statement: "If I tip a waiter after the meal, then it's not bribery. If I tip him before the meal, then that's bribery."

André Odermatt, LGT Trust Limited, Vaduz, Principality of Liechtenstein
andre.odermatt@lgt.com

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