THE ROLE OF THE FINANCIAL SECTOR IN PREVENTING CORRUPTION

The Anti-Corruption Implementation Plan adopted at the Brisbane Summit, November 2015 commits the Anti-Corruption Working Group “to consider the role of the financial sector in preventing and detecting the inflows of corrupt funds”.

ENHANCED DUE DILIGENCE FOR POLITICALLY EXPOSED PERSONS

Corrupt individuals often turn to banks and other financial institutions to legitimise their monies, bringing them into the formal financial system. Financial Institutions might be a critical part of the solution if they prevent these flows from entering the system. They can do this by effectively identifying prospective investors and clients as “Politically Exposed Persons” (PEPs) and applying Enhanced Due Diligence (EDD).

While banks and other financial intermediaries currently have a duty to take such a step, they often fail to fulfil it. Many banks continue to provide the corrupt with a place to put their money. This loophole is due to both overall lax enforcement of anti-money laundering regulations and the way that banks currently undertake due diligence on PEPs. As of 2010, out of 124 assessed jurisdictions only two per cent were fully compliant with Financial Action Task Force (FATF) recommendations on PEPs. According to a 2011 report by the UK’s financial regulator, more than a third of the banks inspected lacked effective measures to identify customers as PEPs and over half of them did not apply meaningful enhanced due diligence in high risk situations.

The identification of PEPs is complicated by the lack of consistent terminology for who is a PEP or who should be included among “family members” and “close associates.” Potentially high-risk categories such as prominent political party officials, diplomats and sub-national politicians are not universally included. UNCAC includes in the definition of “close associates” both natural persons and companies, while the FATF and the EU only mention the former. In the definition of “family members,” the EU focuses on immediate families, while the FATF and the UNCAC leave the exact definition open to interpretation.

Moreover, most international standards require Enhanced Due Diligence mechanisms to be automatically applied only to foreign PEPs. FATF has expanded enhanced due diligence recommendations to include domestic PEPs yet they are only treated as “high-risk” after an internal bank-led assessment; if they are deemed low or normal risk, no EDD is done when they are taken on as customers.

The G20 should work with the financial sector and other stakeholders to align and broaden existing definitions of PEPs and eliminate the distinction between foreign and domestic PEPs. The definition should be expanded to include public functions considered high risk.

---

ANTI-MONEY LAUNDERING COMPLIANCE

One of the key shortcomings of the current AML compliance system in banks is that it is not incentive-driven. In order to promote a greater culture of integrity in the banking sector the incentive system of banks should include ethical and risk-based criteria in the performance management system and remuneration. Furthermore, senior managers should demonstrate clearly and unambiguously to middle management and employees that ethical and risk aware behaviour is expected from them. Sanctions for unethical behaviour should be clearly communicated and consistently applied.

The G20 should work with the financial sector to incentivise compliance and hold individuals accountable for unethical behaviour. To strengthen accountability lines the G20 should consider mandating each bank to nominate one Board member who is responsible for all aspects of reputational risk, including anti-money laundering and conduct risk.

*Please also see our Position paper on Beneficial Ownership transparency.*