ANNEX 5: PRESENTATIONS FROM WORKING SESSION 2 –

INTEGRITY AND ETHICS IN BUSINESS AND PROMOTION OF INVESTMENT

"*OECD guidelines on corporate governance of state-owned enterprises*"

Mr. Arto Honkaniemi, Prime Minister's Office, Government of Finland

"Creating Conditions for Sustainable Economic and Social Development in Eastern Europe and Central Asia: Fighting Corruption and Promoting Good Governance",

16-18 September 2009

Astana, Kazakhstan

OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES

- A GLOBAL BENCHMARK
- A VERSATILE TOOL

Arto Honkaniemi
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Ownership Steering Department
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MEMBER OF THE OECD WORKING GROUP ON PRIVATISATION AND CORPORATE GOVERNANCE OF STATE-OWNED ASSETS

OWNERSHIP STEERING
GOVERNMENT OFFICE

WHAT IS MEANT BY ”CORPORATE GOVERNANCE”?

NO UNIVERSAL DEFINITION

AN EFFORT TO GIVE A DEFINITION:

“BEST PRACTICES FOR THE ORGANS OF A COMPANY (SHAREHOLDER’S MEETING, BOARD OF DIRECTORS, CEO, MANAGEMENT)

TO WORK, IN THE BEST INTEREST OF THE COMPANY AND ITS SHAREHOLDERS,

WITH EACH OTHER AND WITH THE VARIOUS STAKEHOLDERS OF THE COMPANY (SHAREHOLDERS, FINANCIAL MARKETS, INVESTORS, LENDERS, AUTHORITIES, MEDIA, EMPLOYEES)”

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WHAT MAKES CORPORATE GOVERNANCE IMPORTANT

- CORPORATE GOVERNANCE MEANS GOOD CORPORATE CITIZENSHIP
- TRANSPARENCY FACILITATES COMMUNICATION WITH STAKEHOLDERS
- CORPORATE GOVERNANCE LEADS TO MORE EFFICIENT WAYS OF WORKING
- TRANSPARENCY DECREASES IRREGULARITIES AND BRINGS THESE FASTER TO DAYLIGHT
- CORPORATE GOVERNANCE INCREASES ACCEPTANCE ON FINANCIAL MARKETS
  - HIGHER SHARE PRICE
  - CHEAPER BORROWING

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PARTICULARLY IMPORTANT FOR SOE'S

- SOE'S MORE VULNERABLE THAN PRIVATELY HELD COMPANIES
  - VITAL UTILITIES OR OTHER INFRASTRUCTURE
  - LOCAL IMPORTANCE
  - OBJECTS OF PUBLIC INTEREST
  - BUSINESS VS. PUBLIC POLICY
- UNDUE POLITICAL INTERFERENCE OFTEN A PROBLEM OF SOE´S
- SOE'S "HONEYPOTS" FOR IRREGULAR PRACTICES WHICH MIGHT LEAD TO CORRUPTION
- CORPORATE GOVERNANCE FACILITATES PRIVATISATION

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THE RECENT FINANCIAL CRISIS HAS EMPHASIZED THE IMPORTANCE OF CORPORATE GOVERNANCE

- LACK OF CORPORATE GOVERNANCE SEEN AS A REASON OF VARIOUS EXCESSES THAT HAVE LED INTO AND AGGRAVATED THE FINANCIAL CRISIS

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OECD WORK ON CORPORATE GOVERNANCE

- DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
  - CORPORATE AFFAIRS DIVISION
- STEERING GROUP ON CORPORATE GOVERNANCE
  - SPECIALIST GOVERNMENT REPRESENTATIVES
- WORKING GROUP ON PRIVATISATION AND CORPORATE GOVERNANCE OF STATE-OWNED ASSETS
  - SOE SPECIALISTS
- NON-MEMBER COOPERATION
  - REGIONAL ROUNDTABLES
  - GLOBAL NETWORK

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OECD PRINCIPLES OF CORPORATE GOVERNANCE

- **DRAFTED BY THE STEERING GROUP**
  - **EXTENSIVE HEARING OF INTERNATIONAL SPECIALISTS AND PRACTITIONERS**
  - **SHARED EXPERIENCE OF COUNTRIES**
  - **PARTICIPATION BY A LARGE NUMBER OF NON-OECD COUNTRIES**
- **FIRST EDITION ENDORSED BY OECD MINISTERS IN 1999**
- **REVIEWED IN 2004**
- **HIGH-LEVEL GENERAL BENCHMARKING**
  - **APPLIED BY LEGISLATORS AND POLICYMAKERS**
  - **NOT NECESSARILY DIRECTLY APPLICABLE BY COMPANIES**
  - **BASIS OF NUMEROUS NATIONAL CORPORATE GOVERNANCE CODES**
- **ONE OF THE TWELVE KEY STANDARDS FOR SOUND FINANCIAL SYSTEMS BY THE FINANCIAL STABILITY FORUM**
- **WORLD BANK/IMF REPORTS ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)**

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SIX PRINCIPLES AND ANNOTATIONS TO EACH OF THEM:

1. BASIS FOR AN EFFECTIVE CORPORATE GOVERNANCE FRAMEWORK
2. THE RIGHTS OF SHAREHOLDERS AND KEY OWNERSHIP FUNCTIONS
3. THE EQUITABLE TREATMENT OF SHAREHOLDERS
4. THE ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE
5. DISCLOSURE AND TRANSPARENCY
6. THE RESPONSIBILITIES OF THE BOARD

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OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES

- DRAFTED BY THE WORKING GROUP AT THE ASSIGNMENT OF THE STEERING GROUP
  - LIKEWISE EXTENSIVE HEARING OF INTERNATIONAL EXPERTS AND PRACTITIONERS
- MADE PUBLIC 2005
- A COMPLEMENT TO THE PRINCIPLES
- NON-BINDING GUIDELINES AND BEST PRACTICES

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LIKEWISE SIX CHAPTERS AND COMPLETING ANNOTATIONS:

1. ENSURING AN EFFECTIVE LEGAL AND REGULATORY FRAMEWORK
2. THE STATE ACTING AS AN OWNER
3. EQUITABLE TREATMENT OF THE SHAREHOLDERS
4. RELATIONS WITH STAKEHOLDERS
5. TRANSPARENCY AND DISCLOSURE
6. THE RESPONSIBILITIES OF THE BOARDS OF SOE'S

EFFECTIVE LEGAL AND REGULATORY FRAMEWORK

- **SOE'S SHOULD OPERATE ON A LEVEL PLAYING FIELD WITH COMPETING PRIVATELY OWNED COMPANIES**
  - SEPARATION OF OWNERSHIP FUNCTION AND REGULATION
  - SIMPLE LEGAL FORM AND OPERATIONAL PRACTICES FOR SOE'S
    - CREDITORS' RIGHTS TO BE HONOURED
  - ANY OBLIGATIONS TO PROVIDE PUBLIC SERVICES BEYOND REGULAR COMMERCIAL ACTIVITY TO BE MANDATED AND DISCLOSED IN A TRANSPARENT MANNER
  - SOE'S NOT EXEMPT FROM APPLICATION OF GENERAL LAWS
    - STAKEHOLDERS' RIGHTS TO BE MAINTAINED
  - LEGAL FRAMEWORK TO ALLOW ADJUSTMENT OF CAPITAL STRUCTURE WHEN NEEDED
  - ALSO FINANCING OF SOE'S ON COMPETITIVE BASIS
    - NO SPECIAL BENEFITS FROM STATE-OWNED BANKS

THE STATE ACTING AS AN OWNER

- **THE STATE SHOULD BE AN ACTIVE OWNER WITH A CONSISTENT OWNERSHIP POLICY ENSURING TRANSPARENT AND PROFESSIONAL GOVERNANCE OF SOE'S**
  - OWNERSHIP POLICY TO DEFINE THE OBJECTIVES OF STATE OWNERSHIP AND THE STATE'S ROLE IN GOVERNANCE OF SOE'S
  - OPERATIONAL AUTONOMY TO THE SOE'S
  - SOE BOARDS TO EXERCISE THEIR RESPONSIBILITIES IN AN INDEPENDENT MANNER
  - THE STATE BODY EXERCISING THE OWNERSHIP RIGHTS TO BE CLEARLY DEFINED
  - OWNERSHIP ENTITY TO BE ACCOUNTABLE AND AUDITED
  - THE STATE SHOULD EXERCISE ITS SHAREHOLDER'S RIGHTS
    - SHAREHOLDERS MEETINGS
    - BOARD NOMINATION
    - REPORTING SYSTEMS, ASSESSMENT OF SOE PERFORMANCE
    - CONTACT WITH EXTERNAL AUDITORS
    - LONG-TERM REMUNERATION SCHEMES

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EQUITABLE TREATMENT OF SHAREHOLDERS

- **BOTH THE STATE AND THE SOE'S ARE TO RECOGNISE THE RIGHTS OF ALL SHAREHOLDERS IN ACCORDANCE WITH THE OECD PRINCIPLES**
  - ENSURANCE OF EQUITABLE TREATMENT IS A DUTY OF THE OWNERSHIP ENTITY AS WELL AS THE SOE'S
  - A HIGH DEGREE OF TRANSPARENCY SHOULD BE OBSERVED TOWARDS ALL SHAREHOLDERS PROVIDING EQUAL ACCESS TO CORPORATE INFORMATION
  - THE SOE'S SHOULD HAVE AN ACTIVE POLICY OF COMMUNICATION AND CONSULTATION WITH ALL SHAREHOLDERS
  - THE PARTICIPATION OF MINORITY SHAREHOLDERS IN SHAREHOLDERS' MEETINGS SHOULD BE FACILITATED

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RELATIONS WITH STAKEHOLDERS

- **THE SOES' RESPONSIBILITIES TOWARDS THE STAKEHOLDERS SHOULD BE RECOGNISED BY THE STATE OWNERSHIP POLICY**
  - THE GOVERNMENT, THE OWNERSHIP ENTITY AS WELL AS THE SOE'S ARE ALL RESPONSIBLE FOR THE RECOGNITION AND RESPECT OF THE STAKEHOLDERS' RIGHTS IN ACCORDANCE WITH THE OECD PRINCIPLES
  - PARTICULARLY LISTED SOE'S AND THOSE PURSUING IMPORTANT PUBLIC POLICIES SHOUD REPORT ON STAKEHOLDER RELATIONS
  - THE SOES' BOARDS SHOULD, ON BASIS OF COUNTRY NORMS, DEVELOP INTERNAL CODES OF ETHICS AS WELL AS THEIR COMPLIANCE PROGRAMMES

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TRANSPARENCY AND DISCLOSURE 1/2

- **THE SOE'S SHOULD OBSERVE HIGH STANDARDS OF TRANSPARENCY IN ACCORDANCE WITH THE OECD PRINCIPLES**
  - THE OWNERSHIP ENTITY SHOULD DEVELOP A CONSISTENT AND AGGREGATE REPORTING ON SOE'S AND PUBLISH ANNUALLY AN AGGREGATE REPORT
  - THE SOE'S SHOULD HAVE EFFICIENT INTERNAL AUDIT SYSTEMS REPORTING DIRECTLY TO THE BOARD OR ITS AUDIT COMMITTEE
  - THE SOE'S SHOULD BE SUBJECT TO ANNUAL, INDEPENDENT, EXTERNAL AUDIT ACCORDING TO INTERNATIONAL STANDARDS. STATE CONTROL PROCEDURES ARE NOT A SUBSTITUTE

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THE RESPONSIBILITIES OF THE BOARDS OF SOE'S 1/2

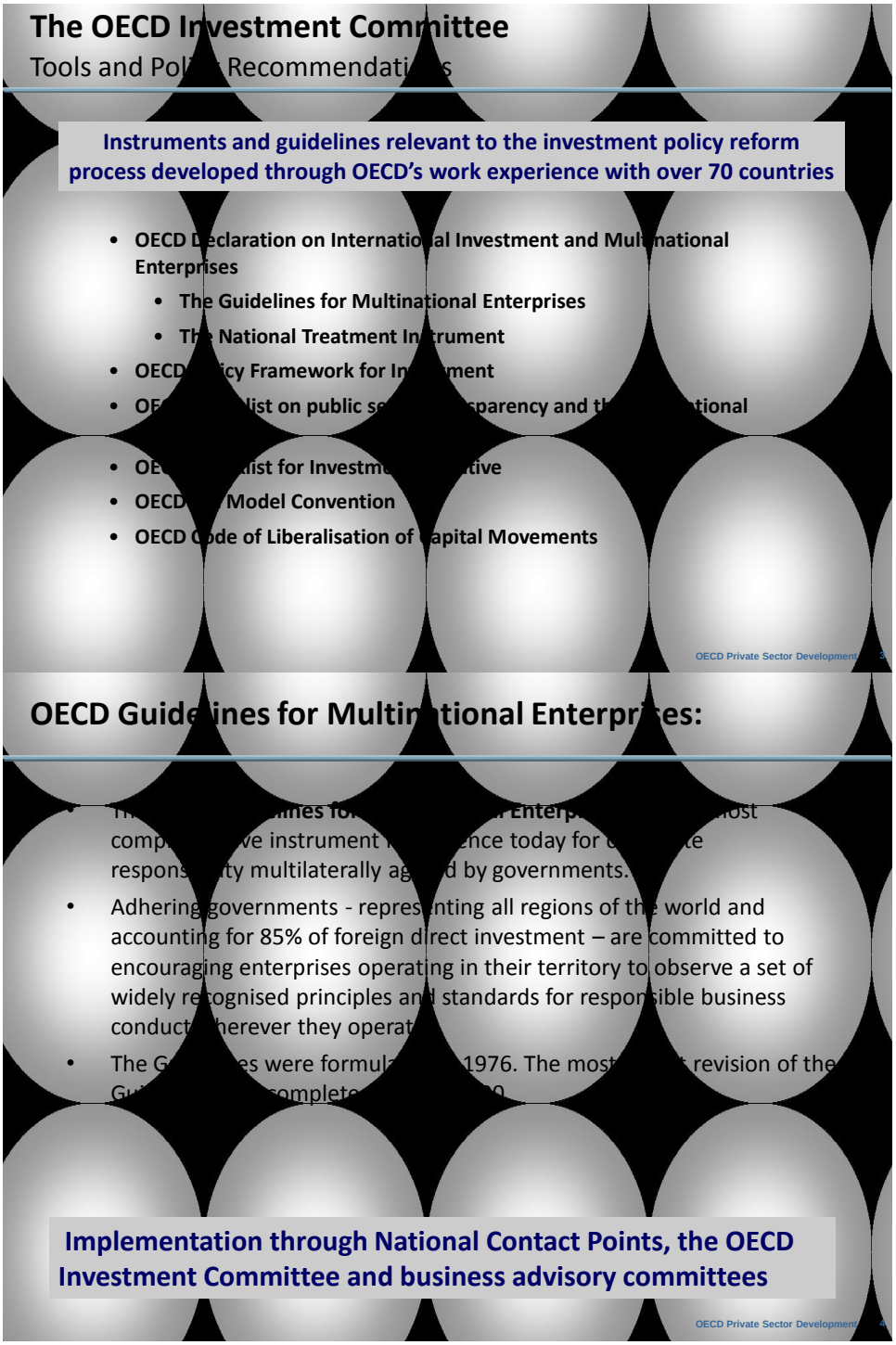
- **THE BOARDS OF THE SOE'S ARE RESPONSIBLE FOR THE STRATEGIC GUIDANCE OF THE COMPANY AND THE MONITORING OF ITS MANAGEMENT. FOR THIS TASK THEY SHOULD HAVE THE NECESSARY AUTHORITY AND COMPETENCIES. THEY SHOULD ACT WITH INTEGRITY AND BE HELD ACCOUNTABLE FOR THEIR ACTIONS AND OMISSIONS**
  - THE BOARD SHOULD HAVE A CLEAR MANDATE AND ULTIMATE RESPONSIBILITY FOR THE COMPANY'S PERFORMANCE. THE BOARD SHOULD BE ACCOUNTABLE TO THE OWNERS, ACT IN THE BEST INTEREST OF THE COMPANY AND TREAT ALL SHAREHOLDERS EQUITABLY
  - THE BOARD SHOULD CARRY OUT ITS FUNCTIONS FOLLOWING THE OBJECTIVES SET BY THE OWNERSHIP ENTITY. THE BOARD SHOULD BE EMPOWERED TO APPOINT AND TO DISMISS THE CEO

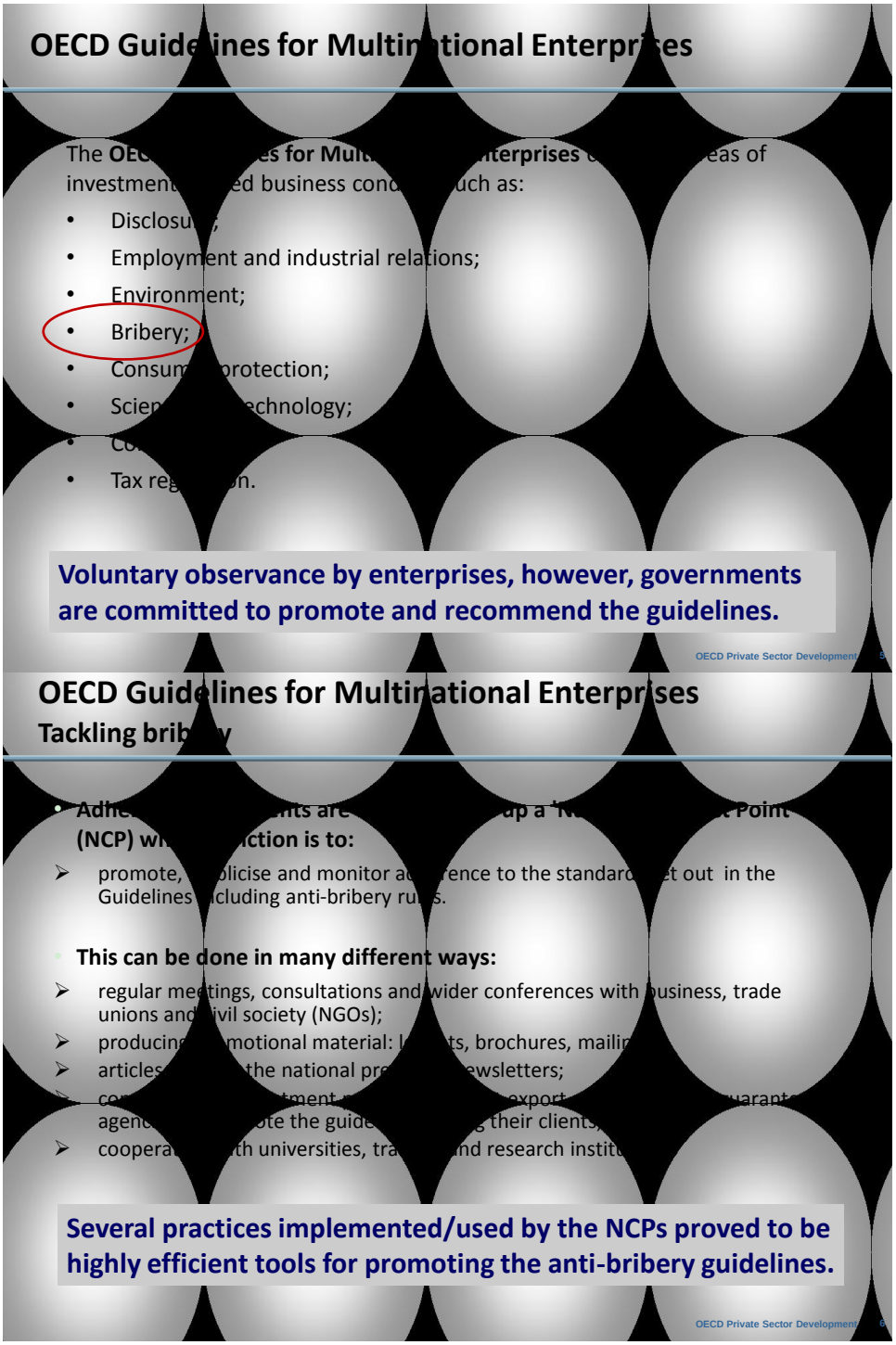
THE RESPONSIBILITIES OF THE BOARDS OF SOE'S 2/2

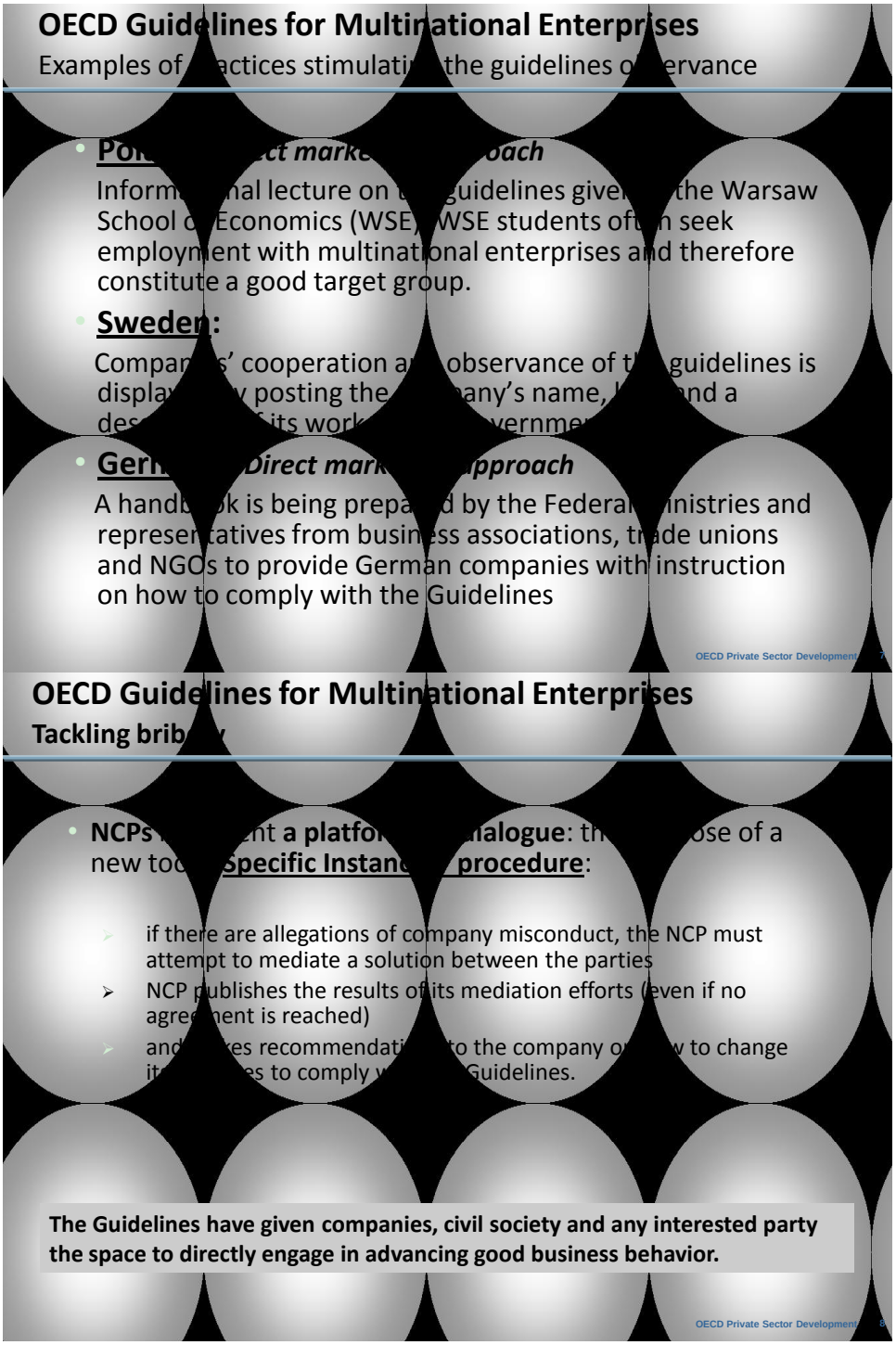
- THE COMPOSITION OF THE BOARD SHOULD ALLOW OBJECTIVE AND INDEPENDENT JUDGEMENT. THE CEO CANNOT BE THE CHAIRMAN OF THE BOARD.
- IF EMPLOYEE REPRESENTATION IS MANDATED, IT SHOULD BE EXERCISED EFFECTIVELY AND ENHANCING THE COMPETENCIES OF THE BOARD.
- WHEN NECESSARY THE BOARD SHOULD SET UP SPECIALISED COMMITTEES TO SUPPORT THE WORK OF THE BOARD
  - AUDIT
  - RISK MANAGEMENT
  - REMUNERATION
- THE BOARD SHOULD CARRY OUT AN EVALUATION OF ITS PERFORMANCE ANNUALLY

"OECD guidelines on corporate governance of state-owned enterprises"

Mr. Joachim Steffens, Ministry of Economics and Technology, Germany


The OECD Investment Committee
Tools and Policy Recommendations
Instruments and guidelines relevant to the investment policy reform process developed through OECD's work experience with over 70 countries
• OECD Declaration on International Investment and Multinational Enterprises
• The Guidelines for Multinational Enterprises
• The National Treatment Instrument
• OECD Policy Framework for Investment
• OECD Checklist for Investment Incentives
• OECD Model Convention
• OECD Code of Liberalisation of Capital Movements
OECD Private Sector Development
OECD Guidelines for Multinational Enterprises:
• The Guidelines for Multinational Enterprises is the most comprehensive instrument in existence today for corporate responsibility multilaterally agreed by governments.
• Adhering governments - representing all regions of the world and accounting for 85% of foreign direct investment – are committed to encouraging enterprises operating in their territory to observe a set of widely recognised principles and standards for responsible business conduct wherever they operate.
• The Guidelines were formulated in 1976. The most recent revision of the Guidelines was completed in 2000.
Implementation through National Contact Points, the OECD Investment Committee and business advisory committees
OECD Private Sector Development


OECD Guidelines for Multinational Enterprises
The OECD Guidelines for Multinational Enterprises cover areas of investment and expected business conduct such as:
• Disclosure;
• Employment and industrial relations;
• Environment;
• Bribery;
• Consumer protection;
• Science and technology;
• Competition;
• Tax reporting.
Voluntary observance by enterprises, however, governments are committed to promote and recommend the guidelines.
OECD Private Sector Development
OECD Guidelines for Multinational Enterprises
Tackling bribery
• Adhering governments are required to set up a 'National Contact Point' (NCP) whose function is to:
➢ promote, publicise and monitor adherence to the standards set out in the Guidelines including anti-bribery rules.
• This can be done in many different ways:
➢ regular meetings, consultations and wider conferences with business, trade unions and civil society (NGOs);
➢ producing promotional material: leaflets, brochures, mailings;
➢ articles in the national press, newsletters;
➢ contacting investment promotion, export guarantee agencies to promote the guidelines to their clients;
➢ cooperation with universities, trade and research institutes.
Several practices implemented/used by the NCPs proved to be highly efficient tools for promoting the anti-bribery guidelines.
OECD Private Sector Development


OECD Guidelines for Multinational Enterprises
Examples of practices stimulating the guidelines observance
Direct market approach
Information lecture on the guidelines given at the Warsaw School of Economics (WSE). WSE students often seek employment with multinational enterprises and therefore constitute a good target group.
Sweden:
Companies' cooperation and observance of the guidelines is displayed by posting the company's name, logo and a description of its work on the government
Direct market approach
A handbook is being prepared by the Federal Ministries and representatives from business associations, trade unions and NGOs to provide German companies with instruction on how to comply with the Guidelines
OECD Private Sector Development
OECD Guidelines for Multinational Enterprises
Tackling bribery
NCPs implement a platform for dialogue: the purpose of a new tool Specific Instance procedure:
if there are allegations of company misconduct, the NCP must attempt to mediate a solution between the parties
NCP publishes the results of its mediation efforts (even if no agreement is reached)
and makes recommendations to the company on how to change its practices to comply with the Guidelines.
The Guidelines have given companies, civil society and any interested party the space to directly engage in advancing good business behavior.
OECD Private Sector Development

OECD Guidelines for Multinational Enterprises

Tackling brib[illegible]y

Two exa[illegible] NCP "sp[illegible]tances" n[illegible]e

NCP Nethe[illegible]s: Dutch oil depo[illegible]e Philippines.

"In 2006 Du[illegible] and Philippine NGOs [illegible]cused Royal Dutch Sh[illegible] of violating the Guidelines' [illegible]nti-bribery, environmen[illegible]al and information-disc[illegible]sure standards at an oil depot in a densely populated part of Manila. The Dutch NCP has held mediation meetings with Shell and the NGOs, and has organized a fact-finding mission to Manila. The Netherlands is pursuing the complaint despite a separate legal case in the Philippines involving the same depot."

NCP UK: U[illegible]ural resource com[illegible]ies in the Congo.

"Based [illegible]lings of a UN [illegible]D (a British NG[illegible]omplaint aga[illegible]nesses [illegible]the UK[illegible]panies bribe p[illegible]illegal exploita[illegible]ural resources [illegible]mocratic Republic [illegible]go. RAID was large[illegible]uded from the enq[illegible]unched in 2004 but the co[illegible]nies were made to co[illegible]ont the bribery allega[illegible]ns. A political debate on t[illegible]e NCP's performance en[illegible]ued, which ultimately l[illegible]d to improvements in the structure and operations of the British NCP."

Source: Transparency International, Working paper, March 2008 "Using the OECD Guidelines to Tackle Corporate Corruption"

The Policy Framework for Investment

A key OECD policy instrument

In 2003, OECD countries together with some non-member participants developed a "***Policy Framework for Investment***" (PFI) proposing guidance in critically important policy fields for improving the quality of a country's environment for investment.

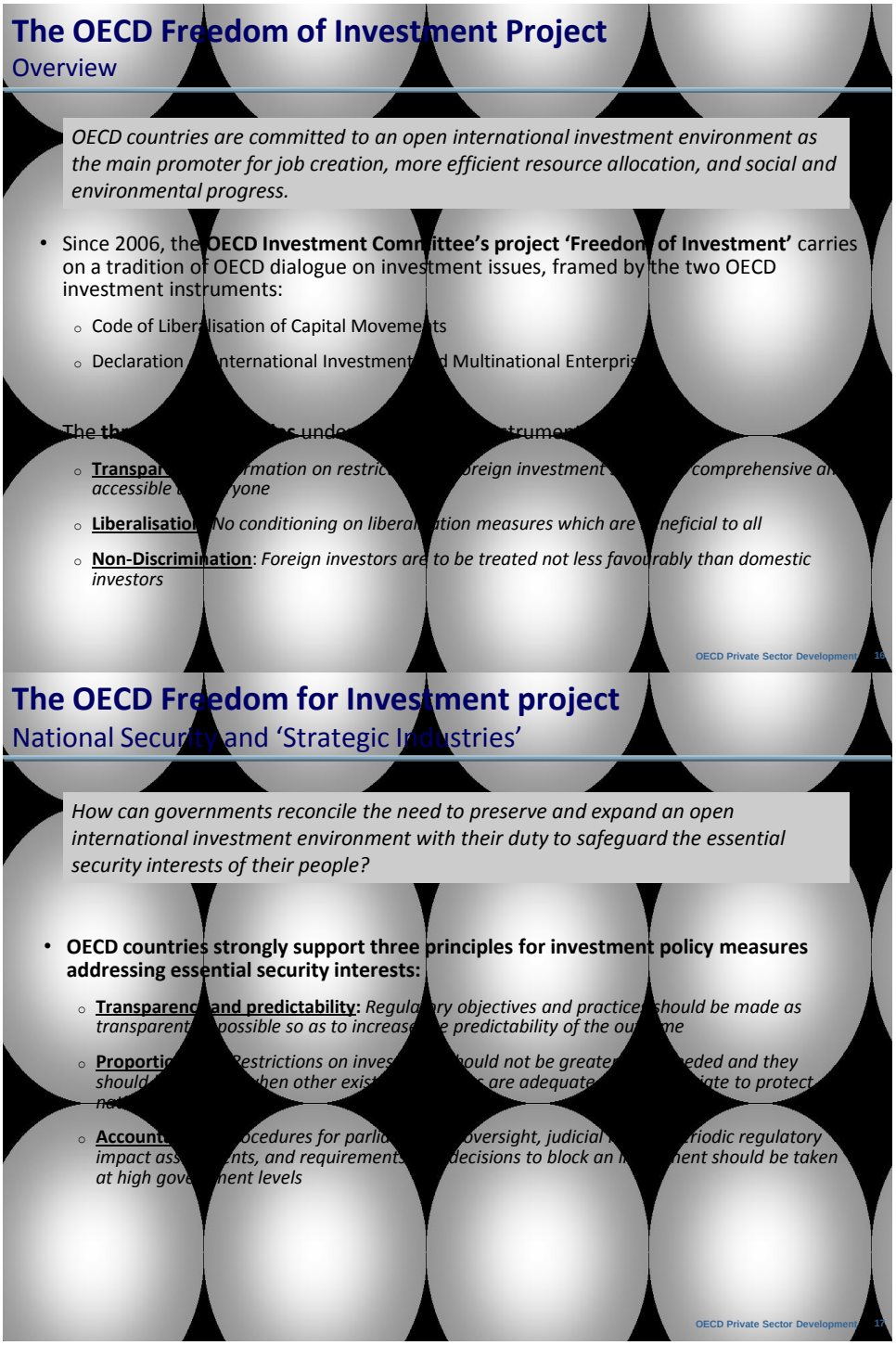
✓ A **comprehensive and systematic approach** for improving investment conditions ever developed.

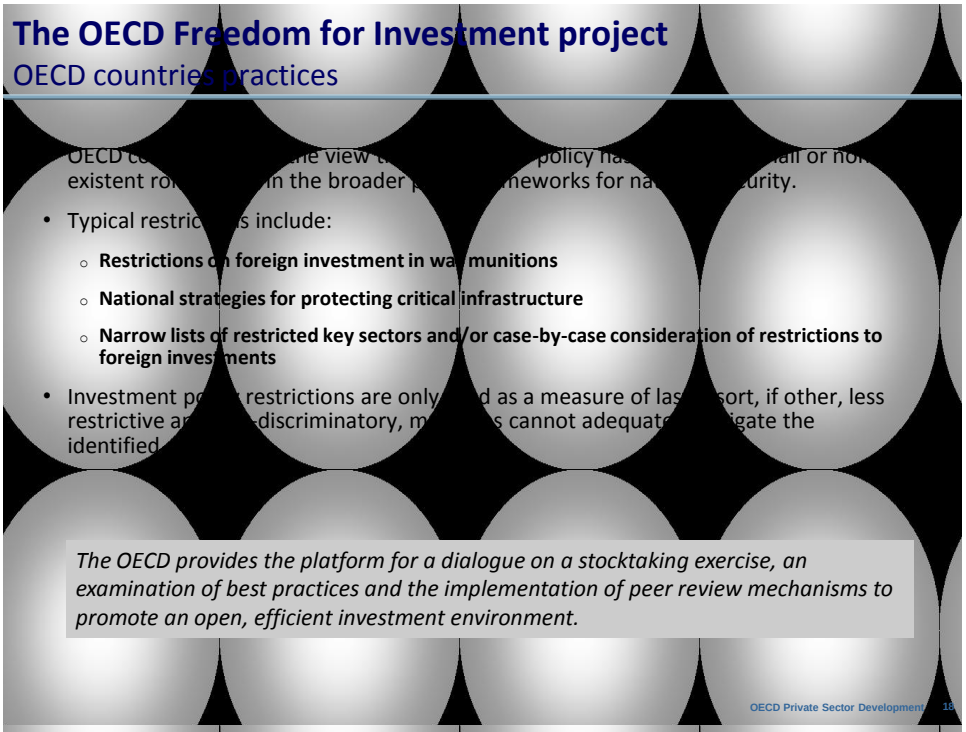
✓ Covers **10 policy areas** and addresses some 82 questions to governments to help them design and implement policy reform to create a truly **attractive, robust and competitive environment for domestic and foreign investment.**

Policy Framework for Investment

- **Investment**
- **Investment promotion and facilitation**
- **Trade**
- **Competition**
- **Tax**
- **Corporate Governance**
- **Responsible business conduct**
- **Human resource development**
- **Infrastructure and financial sector development**
- **Public governance**

Source: *Policy Framework for Invest[illegible]* OECD, 2006.


The OECD Freedom of Investment Project
Overview
OECD countries are committed to an open international investment environment as the main promoter for job creation, more efficient resource allocation, and social and environmental progress.
Since 2006, the OECD Investment Committee's project 'Freedom of Investment' carries on a tradition of OECD dialogue on investment issues, framed by the two OECD investment instruments:
Code of Liberalisation of Capital Movements
Declaration on International Investment and Multinational Enterprises
Transparency: Information on restrictions to foreign investment should be comprehensive and accessible to everyone
Liberalisation: No conditioning on liberalisation measures which are beneficial to all
Non-Discrimination: Foreign investors are to be treated not less favourably than domestic investors
OECD Private Sector Development
The OECD Freedom for Investment project
National Security and 'Strategic Industries'
How can governments reconcile the need to preserve and expand an open international investment environment with their duty to safeguard the essential security interests of their people?
OECD countries strongly support three principles for investment policy measures addressing essential security interests:
Transparency and predictability: Regulatory objectives and practices should be made as transparent as possible so as to increase the predictability of the outcome
Proportionality: Restrictions on investment should not be greater than needed and they should be lifted when other existing laws are adequate or appropriate to protect national security
Accountability: Procedures for parliamentary oversight, judicial review, periodic regulatory impact assessments, and requirements that decisions to block an investment should be taken at high government levels
OECD Private Sector Development


The OECD Freedom for Investment project
OECD countries practices
existent ro
n the broader
neworks for na
urity.
Typical restric
s include:
Restrictions on foreign investment in war munitions
National strategies for protecting critical infrastructure
Narrow lists of restricted key sectors and/or case-by-case consideration of restrictions to foreign investments
Investment po
restrictions are only
d as a measure of las
sort, if other, less
restrictive a
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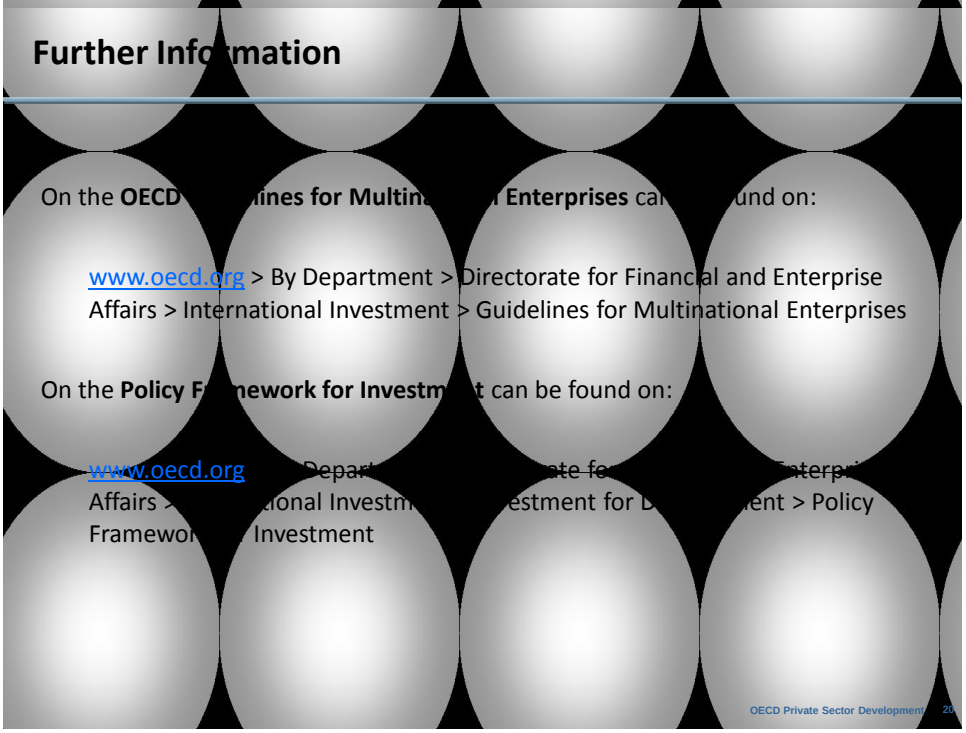
identified
The OECD provides the platform for a dialogue on a stocktaking exercise, an examination of best practices and the implementation of peer review mechanisms to promote an open, efficient investment environment.
OECD Private Sector Development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www.oecd.org > By Department > Directorate for Financial and Enterprise Affairs > International Investment > Guidelines for Multinational Enterprises
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Investment
OECD Private Sector Development

"Integrity Due Diligence: Why it is important to Know Your Customer"

Ms. Enery Quinones, Chief Compliance Officer, European Bank for Reconstruction and Development

Yesterday, we heard an interesting presentation from *Statoil* explaining their integrity due diligence process when looking at potential agents or representatives (third parties). For Banks such as EBRD, Integrity due diligence is also very important and is one of the most effective ways to prevent fraud and corruption in our investment activities.

As an institution that is meant to assist countries in the transition to market economies by setting standards of good corporate governance, we cannot afford to invest our money with clients, or firms, that do not share our ethical values.

My comments today reflect 5 years experience with the EBRD as the Chief Compliance Officer. One of my principal responsibilities is to protect the Bank from reputational damage which may arise from our investment activities in countries which, for the most part, are still in the bottom half of Transparency International's Corruption Index.

This is indeed a very challenging responsibility. How do you ensure that the companies, sponsors, or owners of the companies are reputable? How do you ensure that they share the same ethical and good business practices that the Bank itself must follow?

The answer is to conduct strict integrity due diligence. The first principle of the Bank's integrity guidelines stipulate that we will not make an investment if we do not know who is the ultimate beneficial owner of the entity that is seeking our involvement. Know your customer, or "KYC", has long been the corner-stone for combating money laundering and terrorist financing. But it is also the most useful weapon to ensure that the Bank's funds are not diverted to purposes for which they were not intended.

Knowing your customer however is easier said than done. Often you will try to determine who is the ultimate owner of a company but in examining the shareholding structure you will not always be able to see behind the different layers of off-shore companies and trusts. There may sometimes be legitimate reasons for off shore structures, but sometimes there are not, for example when these structures hide the identity of the real owners or when they are intended as a means to evade taxes.

Knowing who is the real owner is our first priority. Let me give an example. In Russia, we were once looking to invest with a private company. One of the owners (a non-Russian national), claimed to own 25% of the company but he held his shares in very opaque structures using companies with nominee directors and bearer shares and could not produce any legal proof of his claim. There were unconfirmed rumors that this individual was holding shares on behalf of a minister in the Russian government in addition to allegations of money laundering. In fact, there were legal disputes over this 25% share in different jurisdictions. We could not be sure and although otherwise if was a very good opportunity, the Bank decided not to invest because of this

uncertainty and several months later an arbitration court made a finding that in its opinion the minister was very likely the real owner of the disputed 25%.

What is the process of integrity due diligence?

From Statoil, you heard about the importance of having processes which respect basic criteria but which are adapted to one's own particular environment and needs. The EBRD has developed a process which allows us to make a critical assessment of all the risks associated with any given transaction, in particular the integrity risks.

The first step in assessing risk is to gather as much information as possible with respect to our potential clients. If the information from different sources raises concerns then it is often good practice to hire specialized firms that have local networks and sources of information not available to those of us further away. Like Statoil, we spend millions of euros every year on these integrity reports by private companies.

The next step is to examine the information collected in light of specific risk factors which are particular to the institution; for the EBRD, certain countries, sectors, or persons are considered higher risks than others. For example, there is less risk in countries that are now part of the European Union because there is strong legal framework in place while there is more risk in countries like Mongolia or Turkmenistan, where the Bank is not very present. There are also higher risks in working in sectors such as real estate and extractive industries such as oil and gas and mining because of the need for permits and licenses.

Once we have gathered the information and analyzed it with respect to risk factors, we may still have not have complete certainty about whether or not to invest. In which case, we must then assess what is the likelihood that the information we have is accurate and what would be the impact on the bank's reputation if that information proved to be wrong. This is where we must make difficult judgment decisions knowing that if in the worst case, we have made a wrong decision, at least we will have fully respected our process.

From our years of experience, we have developed very detailed integrity red flag checklists that the bankers are obliged to fill out, sometimes with the assistance of the specialized firms. The checklist is reviewed by our credit department and in case they identify serious integrity issues, they refer the matter to us for advice, the office of the chief compliance officer.

These checklists are intended to identify concerns with respect to the customer, or in other words the ultimate beneficial owner, as well as other matters such as the business history and the treatment of minority shareholders, for example. We must also understand the sources of wealth of the individuals. Many wealthy individuals acquired their assets in periods of non-transparent semi-legal transfers; sometimes these were state assets that were acquired for less than their real value. Or perhaps they were associated with criminals or criminal activities.

There are cases where we discover that a potential client has had a criminal conviction or he might be under investigation for criminal acts. Sometimes these individuals will tell us that their conviction is politically motivated, or that a business rival has paid to spread false information about them. We don't know for sure so it is best to stay away from these individuals.

There are also concerns when we are working with someone who is or was involved in political affairs; politically exposed persons or "PEPs". They may be owners or managers of businesses but because of their pubic status they may be able to influence laws or regulations in favour of their private business interests.

All of these concerns are thoroughly discussed and debated by senior management. If the collective view is that the Bank cannot effectively mitigate the risks associated with a particular transaction or investment, then the Bank will not make the investment.

Ultimately, we must use our best judgment when making investment decisions and at the same time take every measure to ensure that our customers, or our clients, will uphold good standards of integrity and anti-corruption.

I hope I have provided you with some understanding of why it is so important for Banks such as the EBRD to know who they are lending their money to and what the processes are procedures are that help us make these very difficult decisions.

"*Role of Business Associations in Protecting Interests of Small Businesses Facing Corruption"*

Ms. Elena Mironova, Deputy Director General, City of Perm Chamber of Commerce and Industry, the Russian Federation

Perm is an important industrial center in the Western Ural, in Russian Federation, with the population counting about one million people. Perm Chamber of Commerce and Industry (Perm CCI) was set up in 1991. Advocacy of businesspeople's interests is a priority of the Perm CCI. Leading anti-corruption efforts in the region is one of the forms of entrepreneurship protection. Today the CCI heads the Coalition of Business Associations and Entrepreneur Associations. One of the key directions the Coalition has scheduled to follow is to combat corruption.

What is corruption?

In most cases when it comes to corruption, people mean offering a bribe to an official to facilitate reaching a target. Yet the "corruption" notion extends far beyond that, and bribing is just one of the corruption forms which is most popular.

Corruption means an abuse of political powers to gain personal advantages and benefits, and corruption forms can be diverse.

Where does corruption come from?

One of the most evident reasons to my mind is shortcomings of the Russian law, vague wordings and sometimes willfully obscured wordings, and points of law lobbied for a change in the law to officials' advantage.

As an example I can say that a great deal of attention is shown to the support of small business and entrepreneurship in general lately in Russia, what is explicitly and clearly seen in RF President's Decree # 797 dd. May 15, 2008, and later federal laws which should seem to facilitate business development.

The practice shows the opposite.

For instance, the long expected Federal Law # 159-FZ, which entitles tenants to buy municipal premises, was issued on July 22, 2008. Let me give explanations. For a long time many small businesses could afford to rent municipal premises at good prices, and they would invest their funds in repair and construction of the said sites. All of a sudden the rent rates increased 3 to 4 times. The deadline to vacate the premises or to buy them is before start of 2010.

It is beyond doubts that any businessperson would prefer to buy an office and to make it his property, and, what is more, the Law entitles to do so. But it is not so simple to do as it looks.

Firstly, the Law does stipulate that only a *bona fide* businessperson can buy the premises, but the Law never describes who a *bona fide* businessperson is. Hence, officials developed their own

interpretation of the notion to their benefit, and this was a reason for them to give a no-answer to a businessperson willing to buy an office. It took almost one year to cancel this shortage.

Secondly, every region was entitled to set forth own terms and conditions and time frames of buying. Local governments started playing for the time and offered such buying terms and conditions that no businessperson would ever be happy with and accept. Our Business Association Coalition was fast to react. We involved mass media and local community in handling the issue, and we succeeded in changing the deputies' mind, and the buying terms and conditions amended in favor of entrepreneurs before the regional law had been passed.

But this is by far not happening in all regions.

Thirdly, what price level should be set for businesspersons to buy their premises? The Law provides that local authorities should find and select real estate appraisers to fix the price, and it took 10 months for the local government to find and make selection of real estate valuators.

Businesspersons had to face with a lot of similar bottlenecks in their attempts to comply with the Law in effect. As a result, no premises were bought as of May 1, 2009 although there were more than 300 businesspeople who were willing to get a title to his/her own office. This is only one particular case I described to you. Unfortunately we can not limit the number of such cases to one or two.

Most comfortable environment for the corruption to flourish is businesses which are subject to multiple inspections and controls by government inspection agencies. As per unofficial data around 20% of the small business profit was paid to oil the palm.

Companies were under inspection, or audit, or control with or without cause. There were cases when a company was inspected by two or three inspecting or controlling entities at a time. When is the company supposed to work?

And finally, Law # 294 was passed on December 26, 2008 which provides protection of businessperson's rights during official inspections and audits and limits the number of inspections to minimum, and unscheduled inspections can be permitted only by the public prosecution office.

It seemed that entrepreneurs had a chance of breathing a sigh of relief. But it is not as much simple as it seems to be. The Law should become effective in half a year from July 1, 2009, and officials decided to make use of this half a year and to catch up with advantages they missed and to cover up their financial gap in full. The number of inspections jumped up to 3-4 times only for three months of 2009.

The State Duma had to amend the law and to change the effective date from July 1 to May 1, 2009.

May 1st, 2009 brought a still period for inspections. Despite of that the prosecution office continued getting inspection applications on a regular basis, but it would issue denials in 60% of the cases finding no reason for inspection. This gave a ray of hope.

The Law happened to have no effect for the militia (the police), the tax office, etc. You can not get a clear understanding of this provision in the Law because the wording is so intricate that lawyers and judges fail to present an unambiguous interpretation to this point still today. The result is that inspections continue, and entrepreneurs suffer from problems, the environment favors the corruption growth.

Of course, we, business associations, do not sit twiddling thumbs, we do our best to help businesspersons find the truth via courts, we offer an initiative to amend the laws and hold public arrangements. But any effort we make takes time, to change the law is not a matter of a second.

In cooperation with the Prosecution Office of Perm Krai and in association with CIPE (USA) we prepared methods for corruption verification in draft laws, and two representatives of the Business Association Coalition joined the Perm Krai Commission which focuses on the draft law examination. I do hope this measure will help stop wordings which may evolve a corruption possibility when the law enters into force.

The second problem, as I see, which may launch corruption is a businessperson no matter how incredible it may seem.

There is a reputable business which complies with the law without making tries to find a way to avoid the law; there is a business which gets stuck to "the state purse", makes money on low quality services, makes supplies at increased prices, builds dacha community in rest (recreation) area or residential buildings in historic zones under protection, or bribes mineral resources. This business is not interested in elimination of corruption, the stake is too high. That is why this type of businesspeople use any and all means to hold power, to become a deputy to affect the law-making process and to prevent anti-corruption laws. This type of business is a small part in the total business pattern and, if we consolidate our efforts, we can easily cause this business type to extinct.

There are businesspeople who operate in good faith and meet the law, but administrative and governmental barriers keep them away from the legal way of getting permits and licenses (see above) and push them to make a deal with officials otherwise they will loose their business.

When talking with entrepreneurs you can often hear: "It is easier to give money to get a document you need than to waste half a year in this or that institution or authority", and their budget has got a line stipulating contingent expenses, and it is much harder to prevent this situation.

We have to change entrepreneur's psychology, and administrative orders and regulations and laws should make entrepreneurs believe that a legal way is better, faster and more reliable.

Corruption is a problem, which can not be solved *in solo*. It needs a shared solution and a joint effort.

If an enthusiastic entrepreneur decides to fight corruption by co-operating with law-enforcement bodies or going against an officials taking bribes, he will bear alone consequences of these actions. At the same time this entrepreneur by facing this difficult situation contributes to improving the general climante. If he meets someone likeminded, they can join their efforts in

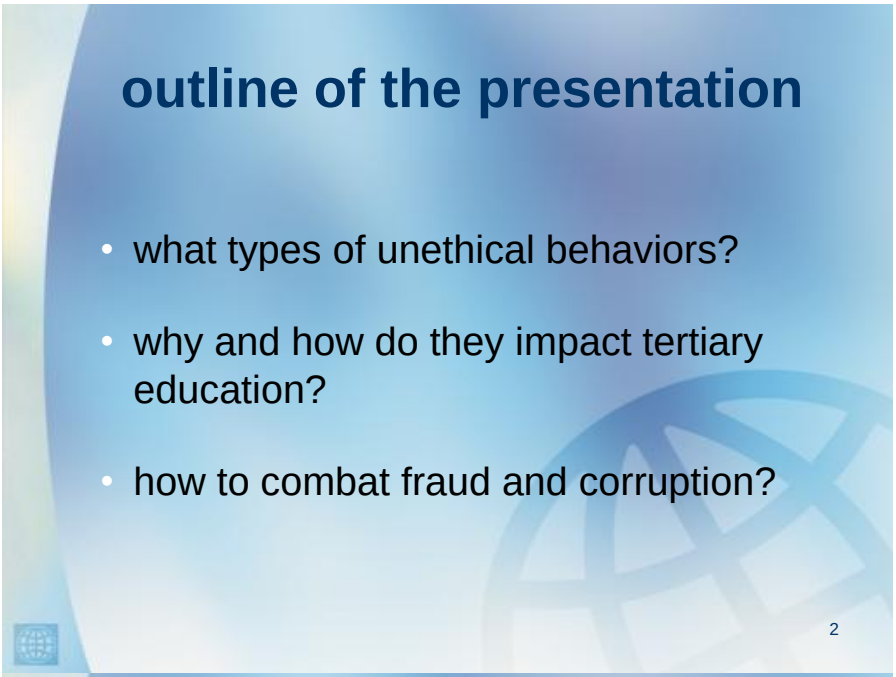
unmasking corruption together, and they will be able to agree on common goals and evenly distribute their efforts, and coming to a shared solution will already be not that impossible.

Business associations, Chambers of Commerce and all those who *de facto* defend business interests, play invaluable role in combating corruption. Only joint efforts will help us stop corrupt officials and resist corruption.

ANNEX 6: PRESENTATIONS FROM WORKING SESSION 3 – *CORRUPTION IN EDUCATION*

"Combating Unethical Behaviour in Tertiary Education"

Mr. Jamil Salmi, World Bank



financial fraud and mismanagement

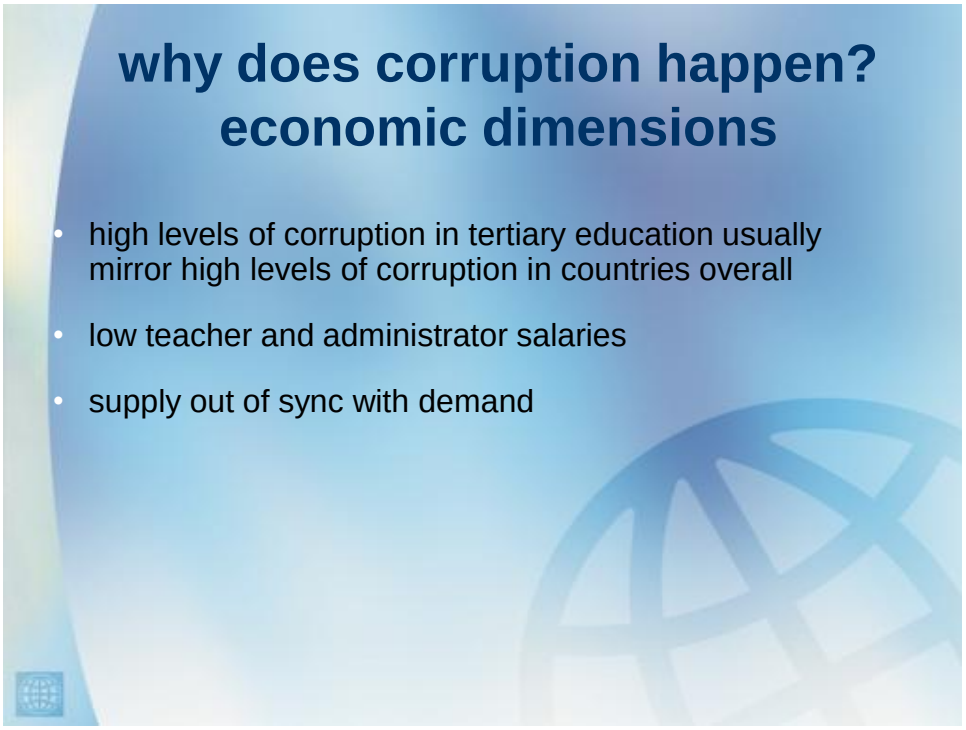
- profiteering
- theft
- embezzlement
- financial mismanagement
- student loan fraud

- institutional administrators, government officials, and outside parties

outline of the presentation

- what types of unethical behaviors?
- **why and how do they impact tertiary education?**

16


why does corruption happen?
economic dimensions
high levels of corruption in tertiary education usually mirror high levels of corruption in countries overall
low teacher and administrator salaries
supply out of sync with demand

why does corruption happen?
political dimensions
lack of oversight and accountability
managerial capacity
political tolerance

negative impact

- contrary to basic purpose of education
  - ethical values
  - academic merit
  - loss of trust in system and outputs
    - teachers (role models)
    - students (code of conduct)
    - institutions (reputation)
- misuse of limited resources

outline of the presentation

- what types of unethical behaviors?
- why and how do they impact tertiary education?
- **how to combat fraud and corruption?**

20

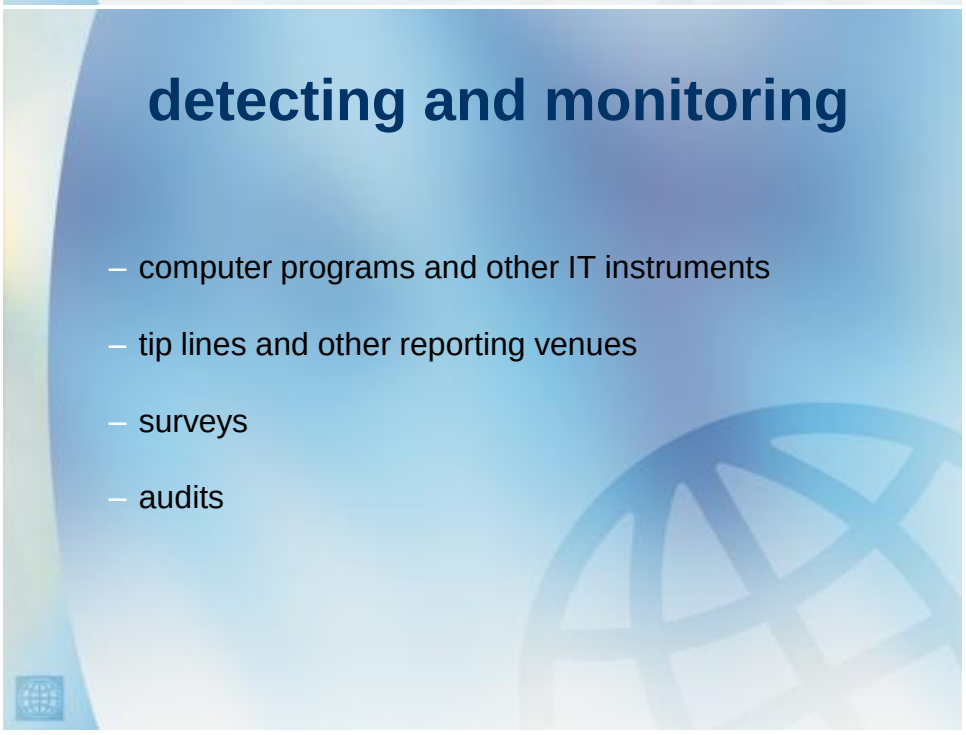
what can be done?

- four types of interventions:
  - preventative measures
  - measures for detecting and monitoring
  - punitive measures
  - multiple purpose measures

preventive measures

- standardized / automated procedures
- legislation and other government policies
- institutional policies and governance arrangements
  - diversified, independent Board
  - strong leadership

preventive measures
– standardized / automated procedures
– legislation and other government policies
– institutional policies and governance arrangements
• diversified, independent Board
• strong leadership


detecting and monitoring
– computer programs and other IT instruments
– tip lines and other reporting venues
– surveys
– audits

punitive measures
– protests and violence
– legal action
– career/status sanctions
– academic/professional sanctions

multi-purpose measures
– accreditation systems
– education / awareness raising
– publicity

conclusion
27

the integrity imperative
• social justice (moral dimension)
• trust in the meritocratic process
• proper use of public resources
• potential loss of talent
28

the way forward
• more documentation and closer monitoring (surveys, reporting mechanisms)
• more systematic assessment of which policies and instruments work
29

"Assessment of Institutions and Education Sector – Experience in Kyrgyz Republic"

Mr. Sadir Zhaparov, Director of the National Agency of the Kyrgyz Republic on Corruption Prevention

Dear Chairman, Dear colleagues,

First of all I would like to welcome all participants of our working session and would like to thank for the provided opportunity to speak to you.

Today the National Agency of the Kyrgyz Republic on Corruption Prevention acts as the body implementing the uniform state policy in the field of prevention of corruption and being authorized to detect, eliminate and prevent corruption in the Kyrgyz Republic.

According to the data of the "Methodology of Research of the Corruption Level" developed by our agency, the educational system is regularly rated as the most corrupted area. On the basis of the performed research and analysis it has been decided to perform random inspection of the leading higher educational institutions of the republic.

In the course of that inspection there have been analyzed relevant documents regulating activities of the offices of admissions and admission examinations and also there has been performed a random inspection of 2778 personal files of the students of the National University.

The commission has detected the following violations:

- lack of expert conclusion on how the tests relate to the school program and on correctness of the answers;
- the tests do not vary by complexity depending on the category of the applicants. Thus, nearly the same tests with similar levels of complexity have been used at the admission examinations both in the law college based on the 9th form of the school as well as in the law institute based on the existing higher education;
- the provided decisions on enrollment show violation of the enrollment terms established by the admission rules. Certain orders have been issued in the end of September and in the beginning of October. The terms of additional admission examinations being beyond the established standards have not been agreed with the Ministry of Education and Science of the Kyrgyz Republic;
- the templates of tests and answer sheets have not been encoded;
- it is impossible to identify which answer sheets and blanks of tests pertain to which applicants;
- it is possible that a blank of test is checked by a technical employee which reduces the liability of the examiner;
- the tests are signed by technical employees, while the examiner signs for the marks in the examination lists, which contradicts to the logic of liability of persons for giving marks;
- the examiners sign tests without indication of their last and first names although the established rules require to do so.

All these comments could have been explained by the specifics of technology of holding test examinations, however we have detected gross facts of forgery and falsification of the examination results whereby the answer sheets have been filled in by the examiners instead of the applicants and also the calculation of marks in the answer sheets has been incorrect. All these facts prove the systematic nature of violations.

Following the results of inspection the National Agency has seized 374 personal files of the students with the detected facts of falsification of the test results and sent them to the General Prosecutor's Office of the Kyrgyz Republic for initiation of criminal cases.

At our proposal the Board of the Ministry of Education and Science of the Kyrgyz Republic has released rectors of two leading higher educational institutions of the republic of their posts due to "negligence and lack of control over the activities of the offices of admissions".

All rectors of the higher educational institutions of the republic have been instructed to work out internal rules regulating the procedures of conducting admission examinations. All higher educational institutions have established the commissions for prevention of corruption comprising of students, their parents and public members besides professors.

Taking into account the systematic nature of abuses in the inspected higher educational institutions and also implementing the order of the Kyrgyz Republic President K.S. Bakiev that it is necessary to take certain measures for realization of the principle of equal access of the citizens to the secondary and higher education and that most importantly the population should get proper education without corruption elements from the side of school teachers, professors and heads of the educational institutions, the National Agency of the Kyrgyz Republic on Corruption Prevention together with the Ministry of Education and Science of the Kyrgyz Republic have established supervisory commissions for participation in the admission examinations.

The supervisors have been authorized to be present in classes during examinations and checking of examination tests of the applicants as well as to perform random re-checking of the checked tests in the amount up to five percent.

Currently the results of the said initiative are being summarized, however, already now one may note many positive moments. Due to the joint systematic anticorruption work performed by the Agency together with the Ministry of Education in the course of inspection for 2008/2009 academic year there have been dismissed 21,320 students, without taking into account the results of the summer session. 52 percent of the dismissed students are the students of the extension department, 48 percent are full-time attendance students. Since the total number of students is currently 250 thousand, then the number of the dismissed students amounts to approximately 10% of their total number.

Besides that we are constantly engaged in preventive activities not only in the field of professional education but also in the field of school education. Thus every year on 9 December (International Anticorruption Day) in all schools of the republic there is conducted a contest of compositions and drawings on the topic "Children's Life without Corruption" and demonstrational burning of a scarecrow "Corruption". The best works of children are demonstrated at a mobile exhibition in all state administration bodies. This arrangement is of great educational importance.

Also currently in parallel with the said actions we are finalizing anticorruption expertise of the legal acts in the field of education and we are preparing particular recommendations on changes thereto.

Of course, today there are talks almost at all levels about necessity of reforming the educational system. The importance and urgency of this problem is obvious for everybody.

It is pleasant that the management of the Ministry of Education and Science of our country has got certain vision of the main directions of the necessary changes, has developed and adopted several conceptions and strategies of development of the educational system.

Finally I would like to note that it is necessary to start carrying out relevant reforms in the field of education already today as we are dealing with our future represented by the students. The existing situation strongly requires further efforts of all state administration bodies and civil society.

"Integrity challenges in the Romanian Education System"

Ms. Laura Stefan, Romanian Academic Society, Romania

Coalition for Clean Universities

- **14 coalition members** from the civil society, including students' and professors' associations
- **42 public universities** reviewed
- **Aim**: monitor and rank public universities vis-à-vis integrity and transparency standards
- Employ a **"naming and shaming"** strategy, as well as publicize **best practices** so that peer-pressure is created in this field
- Duration of the project: May 2007 – May 2009

Evaluation criteria

- **Administrative probity:** transparent institutional practices
- **Academic probity:** professors' performance and meritocracy in career management
- **Democratic governance:** enforcement of codes of ethic (plagiarism, nepotism, cronyism), students' participation to the decision-making process
- **Sound financial practice:** transparent and fair public procurement practices, transparent budget

Evaluation tools

- Public information requests
- Analysis of existing data (including available reports from controlling institutions and media reports)
- Analysis of information from whistleblower
- Interviews with the stakeholders – including students, professors, as well as the management of the respective universities

Methodology

- 20 evaluation teams
- Each team – 2 members: one teaching staff and one student (all teaching staff had teaching experience abroad). To avoid conflicts of interests, the evaluators could not evaluate universities from their own city.
- One faculty from each of the 42 universities was randomly selected for academic probity issues
- Each report was reviewed by a reviewer external to the evaluation teams
- The final ranking was reviewed by external reviewers and by the Coalition for Clean Universities

Information requested

- By-laws
- Activity reports
- Code of ethics and activity of ethics commissions
- University Charta
- Budget
- Wealth and interests statements
- Teaching positions and salary lists, including bonuses
- ISI publications and international patents
- Students' evaluations of professors and courses
- List of public acquisitions exceeding 10.000 Euros

Scoring sheet

TOTAL – 100 POINTS:

- **Administrative probity – 30 points**
- **Academic probity – 20 points**
- **Democratic governance – 35 points**
- **Sound financial practice – 15 points**

Penalties – 10 points each

- The University has lost trials on issues of fairness
- More than one prosecuted case of corruption, sexual harassment, discrimination, etc in the past 4 years.
- Negative reports by controlling institutions in the past 4 years.
- Existing proofs of serious acts of forgery in the past 10 years (ex. false diplomas)

Results per criteria

Administrative probity – mean = 20.2/30:

- Only 38% of state universities are transparent as regards to administration
- Out of the 42 universities, 16 have all assets statements published and updated, 13 published them in an incomplete form, and 13 plainly refused to make them public

Academic probity – mean = 12/20:

- Evaluators found a total lack of enforcement of any basic rules at 70% of the universities.

Results per criteria

Democratic governance – mean = 10/35:

- 60% of the universities are equal or below the mean.
- 95% of the universities, a great number of families were identified within faculty and administrative staff.
- Only 20% comply with the conditions of participation of student representatives in the decision making process

Sound financial practice – mean = 8.8/15:

- 38% of universities either refused to provide evaluators with the necessary financial documents, or provided incomplete documentation

Ranking

Universities were separated into 6 categories, from 5 stars to 0

- No university received 5 stars
- 3 universities received 4 stars
- 18 universities received 3 stars
- 10 universities received 2 stars
- 5 universities received 1 star
- 6 universities received 0 stars

Criminal cases in court

Oradea Public University – sending false information regarding the number of students:

- Finance for public universities is dependent upon the number of state-budgeted students enrolled per year
- Between January 2000 and January 2004 the university reported between **17.000 and 33.000** state-budgeted students, while only **14.000** students were actually enrolled
- The approximate damage to the state budget was 24,3 million euro
- Movable and immovable property was seized to cover the damage
- The National Anticorruption Directorate case was sent to court in March 2008

Criminal cases in court

Serious fraud baccalaureate - private high-school:

- The students, in cooperation with the director, bribed the baccalaureate commission and supervisors in order to be allowed to copy during the exam and get satisfactory marks
- The director offered the answers to the exam questions to the students during the exam
- The total bribe amounted to approximately 30.000 euro
- The National Anticorruption Directorate sent the case to court in October 2008

"***Measures to promote good governance in higher education in Slovenia"***

Ms. Duša Marjetič, Undersecretary, Ministry of Higher Education, Science and Technology, Slovenia

THE REPUBLIC OF SLOVENIA

MINISTRY OF HIGHER EDUCATION, SCIENCE AND TECHNOLOGY

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Main features of Slovene HE in last decade

- joint Bologna process in 1999
- implemented curriculum reform and 3-cycle structure in period 2004-2009
- in 2004 HEIs got bigger financial autonomy
- 1,2% GDP – public expenditure (0,94% GDP for institutions)
- dual-track tuition system (limited number of State financed places): 73% of all HE students (98.128) have publicly funded places
- public universities enrol 92% HE students – 25% are paying tuition fee

27.1.2010 2

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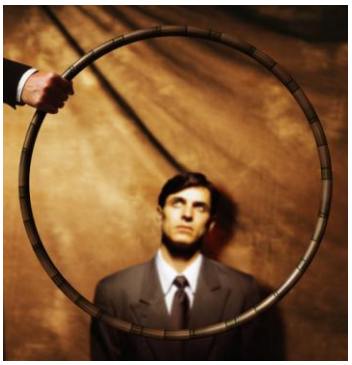
Public funding



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Mechanisms promoting good governance

- Accreditation
- National register of HEIs
- Evaluation
- Matura (*ticket to HE)*
- Public tender for enrolment places *(for public institutions with Government's consent)*
- National enrolment office *(for all publicly financed undergraduate studies)*
- Annual work programme *(unified form set by the ministry)*
- Annual report
- Administrative board
- Concessions are given to private HEIs based on public tender by the Government (for a fix period of time with restrictions)
- Involvement of HEIs in EU financed projects

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Mechanisms promoting good governance

- Obligatory annual internal audit for public institutions
- Budget Supervision Office of the Ministry of Finance
  - Risk management – documented risk assessment
- Court of auditors of the Republic of Slovenia (independent by Constitution and law)
- Labour Inspectorate of the Republic of Slovenia
- Anti-corruption commission
- Examples of good practice