OECD RISK MANAGEMENT TOOL FOR INVESTORS IN WEAK GOVERNANCE ZONES

Draft text for public consultation

Deadline for comments: 23 November 2005

The OECD Investment Committee is seeking the public's views on its draft Risk Management Tool for Investors in Weak Governance Zones through an online consultation.

Comments may be sent to Kathryn Gordon, Senior Economist, OECD Investment Division [Kathryn.gordon@oecd.org]. In order for comments to be reflected in the draft to be considered by the Investment Committee in December 2005, they must be received by 23 November 2005.

Comments will be posted on the OECD website (www.oecd.org/daf/investment). It is the policy of the OECD to publish all responses, and anyone not wishing to have his/her response published, or anyone wishing to remain anonymous, should say so explicitly. The purpose of the consultations is to provide inputs of generic interest for the Investment Committee's consideration – they are not intended for use as a forum for lodging accusations or waging campaigns. Likewise, they should not be used for self–promotion by organisations or individuals unless such self promotion contributes to enhancing understanding of generic issues. The OECD Secretariat reserves the right to remove references to individuals or organisations that are not in the spirit of the consultations.

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OECD RISK MANAGEMENT TOOL FOR INVESTORS
IN WEAK GOVERNANCE ZONES:

DRAFT TEXT FOR PUBLIC CONSULTATION

I. Introduction

1. The mission of the OECD Investment Committee is to enhance the contribution of investment to growth and sustainable development. The Committee recognises that attracting private investment -- both domestic and international -- and creating effective institutions of public and private governance will lay the groundwork for durable improvements to the well being of citizens in weak governance zones.

2. Creating the conditions that permit this to happen is primarily the responsibility of governments[1]. A recurrent theme of the OECD Investment Committee's work on the OECD Guidelines for Multinational Enterprises ("the Guidelines") – a government-backed, voluntary code of conduct for international business – is that corporate responsibility goes hand-in-hand with government responsibility. 'Weak governance zones' are defined as investment environments in which governments cannot or will not assume their roles in protecting rights (including property rights), providing basic public services (e.g. social programmes, infrastructure development, law enforcement and prudential surveillance) and ensuring that public sector management is efficient and effective. These "government failures" lead to broader failures in political, economic and civic institutions that are referred to as weak governance.

3. As companies themselves often note[2], weak governance zones represent some of the world's most difficult investment environments. In addition to the usual financial and business risks encountered in all investment environments, weak governance zones present risks for business that stem directly from government failure – e.g. widespread solicitation, extortion, endemic crime and violence, abuses by security forces, and violations of the rule of law. Through its development of this risk management tool,[3] the OECD Investment Committee seeks to help investors in weak governance zones deal with these risks by calling to their attention the guidance contained in OECD integrity instruments and the findings of the broad-based consultations the Committee has conducted on this issue[4].

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1 Most of the work of the OECD Investment Committee is addressed to governments. It aims to help them create better enabling environments for investment. A description of a major aspect of this work – the Investment for Development programme -- can be found at: www.oecd.org/daf/investment/development.

2 See survey of public statement by extractive industry companies operating in weak governance zones that can be found in: "Multinational Enterprises and the Quality of Public Governance: A Case Study of Extractive Industries." OECD International Investment Perspectives. 2002.

3 Risk management can be defined as the systematic application of management policies, procedures and practices to the tasks of identifying, analysing, evaluating, treating and monitoring risk.

4 Numerous consultations have been held by the OECD Investment Committee since investments in weak governance zones were first raised in issue was first raised in early 2001. They have included consultations with business, trade unions and NGOs from the OECD and non-OECD regions. They also

4. International instruments – e.g. declarations, conventions and guidelines -- provide various types of guidance that is of potential interest to many actors, including governments and companies. In particular, these instruments can help investors by setting forth agreed concepts and principles for business conduct. The evolving framework of international instruments provides guidance in such areas as respecting human rights, combating corruption, disclosing information and protecting the environment. In some cases, these instruments are addressed directly to companies (as with the OECD Guidelines for Multinational Enterprises). In others, they create obligations for signatory governments to translate the concepts and principles into national law (as with the OECD Convention on Combating Bribery), which in turn alters the legal obligations of companies. Investors will want to obey the law and to observe established international concepts and principles in their global operations, including in weak governance zones. Some instruments deal with public sector management issues. Indeed, OECD instruments of this type cover a wide range of public sector issues (e.g. management of budget systems or of conflict of interest in the public service). While addressed to governments, these instruments may nevertheless be useful for investors in weak governance zones as aids for identifying and understanding risks that arise from government failures. It is in this spirit – helping companies understand their investment environment -- that the present risk management tool makes use these public sector instruments.

5. The principal distinction between investments in weak and in stronger governance host countries lies not in differences in the concepts and principles that apply to managing them, but in the amount of care required to make these concepts and principles a reality. The "heightened risks" encountered in weak governance zones (e.g. in relation to corruption and human rights abuses) create a need for "heightened care" in ensuring that the company complies with law and observes relevant international instruments.

6. The OECD Investment Committee aims to help companies to do this by proposing a risk management tool for investments in weak governance zones. There is clearly a demand for such a tool and the business sector itself supports such work[5]. The issue of such investments has been raised many times with the OECD Investment Committee and the National Contact Points[6] (NCPs) in the context of implementing the OECD Guidelines on Multinational Enterprises. Support for an OECD initiative in this area has come from the G8 – the 2005 G8 Gleneagles Summit Communiqué calls for "developing OECD guidance for companies working in zones of weak governance."[7] The draft risk management tool presented in this report is to be used as a basis for consultation with business and other stakeholders and will be subject to further revision by the Investment Committee.

7. The Committee recognises that its efforts are only one of many international initiatives seeking to help people living in weak governance zones to get on the path of successful economic development[8]. The

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involved other OECD bodies and international financial institutions. A summary of the most recent series of consultations can be found at: www.oecd.org/daf/investment/guidelines.

5 See, for example, Chair's Report for the 2005 Annual Meeting of the National Contact Points. Section VIII of the Report notes that BIAC stated that it would "focus its support" on two projects, one of which was the development of the risk management tool to help investors in weak governance zones. See also written submissions by companies to the consultations.

6 National Contact Points are government offices (sometimes involving participation by business, trade union and NGO representatives) that located in each of the 39 countries adhering to the OECD Guidelines for Multinational Enterprises. They are charged with promoting the OECD Guidelines among multinational enterprises operating in or from the country in question.

7 The 2005 G8 Gleneagles Summit Communiqué, paragraph 10c of the African Statement).

8 For example, other initiatives are being undertaken in the OECD, the United Nations and adhering governments. The Development Assistance Committee is developing the DAC Principles of Good International Engagement in Fragile States working to improve international engagement in "fragile states" – defined as countries in which there is a lack of political commitment and/or capacity to develop and

Committee aims to add value by basing its contribution on its experiences with the OECD Guidelines and on established OECD expertise. The tool is non-prescriptive and consistent with the objectives and principles of the Guidelines.

8. The tool also reflects the results of consultations conducted by the Committee between December 2004 and March 2005. The consultations included: 1) face-to-face discussions with invited experts; 2) an electronic discussion open to all interested parties; 3) an international conference held in Addis Ababa (jointly sponsored with NEPAD, Transparency International and the UN Global Compact) that involved more than 70 participants representing African business, trade unions, NGOs and governments.[9]

9. The tool proposes a list of questions that companies might ask themselves when considering actual or prospective investments in weak governance zones. The questions cover the following topics:

I. Obeying the law and observing international standards

II. Heightened managerial care

III. Political activities

IV. Knowing clients and business partners

V. Speaking out about wrongdoing

VI. Business roles in weak governance societies – a broadened view of self interest

10. Further commentary on terms appearing in bold type can be found in the Annex (*Glossary of Selected Terms)*.

II. Obeying the law and observing international standards

11. Companies have the same broad responsibilities in **weak governance zones** that they do in other investment environments – they are expected to obey the law and to observe **relevant international instruments** covering such areas as human rights, the fight against corruption, labour management and environmental protection. Because legal systems and political dialogue in weak governance zones often do not provide reliable guidance to companies, international standards are particularly useful in these contexts. Companies will want to reflect carefully on what law and relevant international instruments mean for their operations, accounting for the specificities of their sector, operating environments and business strategy.

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implement pro-poor policies. The UN Global Compact has published the *Business Guide to Conflict Impact Assessment and Risk Management* (June 2002). The Extractive Industries Transparency Initiative, which promotes transparency on the revenue side of budget systems so as to facilitate more effective use of extractive industry revenues in weak governance host countries, is closely related to this risk management tool.

[9] A summary of the findings of the consultations can be found in the Chair's Report for the 2005 Annual Meeting of the National Contact Points.

12. In thinking about these issues, investors in weak governance zones might wish to consider the following questions:

General

- Is the company confident that, in this investment environment, it will be able to put in place business policies and processes that will allow it to obey applicable laws and to observe **relevant international instruments**, including the *OECD Guidelines for Multinational Enterprises*? If the answer to this question is no, what conclusions does the company draw for its investment strategy?

- Does the company inform itself about and analyse how its investment may impact on existing problems (e.g. conflict, corruption in state-owned enterprises)? Does the company seek to involve stakeholders, especially local actors, in this process?[10]

Human rights and management of security forces

- Does the company respect the human rights of those affected by its activities consistent with the host government's international obligations and commitments?[11]

- Is the company well-informed about the host country's human rights situation? [12] In particular, can it provide answers to such questions as:

  - Do the host government and other important political bodies respect human rights?[13]
  - What do external evaluations of the country's human rights record say? [14]
  - What steps is the host government taking to improve the human rights situation? [15]

- What steps has the company taken to guard against extortion attempts and to protect employees and physical assets from threats related to violent conflict? [16]

- Governments have the primary role in maintaining law and order, security and respect for human rights. Nevertheless, companies have an interest in ensuring their security management practices are consistent with the protection and promotion of human rights. Do company policies reflect good practice in the management of relations with public[17] and private[18] security services (as set forth, for example, in the *Voluntary Principles on Security and Human Rights*[19])? In particular:

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10 The Development Assistance Committee (DAC) Guidelines on Helping Prevent Violent Conflict. Page 24 (Be transparent and communicate intentions) and page 69 (Roles of business in conflict situations).

11 OECD Guidelines recommendation II.2.

12 The DAC Guidelines on Helping Prevent Violent Conflict. Page 69.

13 BIAC written consultation inputs.

14 BIAC written consultation inputs.

15 BIAC written consultation inputs.

16 The Development Assistance Committee Guidelines on Helping Prevent Violent Conflict. Page 69.

17 See two UN instruments: the Basic Principles on the Use of Force and Firearms by Law Enforcement Officials and the Code of Conduct for Law Enforcement Officials. Companies may also wish to consult the Voluntary Principles for Security and Human Rights. Under the heading "interactions between companies and public security", the Principles recognise that "governments have the primary role of maintaining law

- Does the company manage security in ways that also protect and promote human rights?[20] Is the company confident that its management of security for employees and physical assets is not at the expense of the security of local populations?[21]
- Has the company evaluated the security risks that may exist in its operating environments?[22] Does it follow good practice in making conflict impact assessments (possibly using tools developed by various international initiatives)?[23]
- Is the company confident that its management of security for employees and physical assets does not inadvertently support or finance armed groups who may be responsible for human rights abuses?[24]
- Does the company keep itself informed about and contribute to the development of international standards for strengthening accountability in management of security?[25]

• What actions does the company take, to assess and, where appropriate, mitigate the social and environmental impacts of its activities (for example, when a project affects local peoples' means of livelihood or creates large movements of people)? [26]

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and order, security and respect for human rights" and that companies have an interest in ensuring that actions taken by governments, particularly public security providers, are consistent with the protection and promotion of human rights. Voluntary principles are proposed on: security arrangements, deployment and conduct of public security; consultation and advice and responses to human rights abuses.

18 The UN instruments cited in the previous footnote contain much guidance of relevance to private security services. Companies may also wish to consult the Voluntary Principles for Security and Human Rights, under the heading "interactions between companies and private security", the Voluntary Principles recognise that it may be necessary to engage private security providers as a complement to public security where governments are unable or unwilling to provide adequate security. The Principles provide guidance for companies in their management of private security.

19 The Voluntary Principles on Security and Human Rights provide guidance for companies in three areas: risk assessment, interactions between companies and public security and interactions between companies and private security. Four countries have adhered to the principles: Netherlands, Norway, United Kingdom and the United States. Many companies and NGOs also adhere to the Principles.

20 RAID written contribution. 7 October 2005.

21 The DAC Guidelines on Helping Prevent Violent Conflict. Page 69. See also the UN instruments: Basic Principles on the Use of Force and Firearms by Law Enforcement Officials and the Code of Conduct for Law Enforcement Officials.

22 RAID written contribution. 7 October 2005.

23 A number of such resources are available to companies: they include the Global Compact Business Guide for Conflict Impact Assessment and Risk Management; and material provided by the Conflict Prevention and Reconstruction Unit of the World Bank. www.worldbank.org/conflict

24 The DAC Guidelines on Helping Prevent Violent Conflict. Page 69.

25 DAC Guidelines on Helping Prevent Violent Conflict. Page 74. Companies might also wish to consult the Voluntary Principles for Security and Human Rights.

26 Text proposed by DAC Secretariat based on the Conflict and Peace Development Cooperation Network the conflict prevention community. See also, the UN Global Compact's *Business Guide for Conflict Impact Assessment and Risk Management* (2002), page 26.

Combating corruption and money laundering

- Does the company refrain from, directly or indirectly, offering, promising, giving or demanding a bribe or other undue advantage to obtain or retain business or other improper advantage?[27]

- Are employees aware that business that cannot be conducted without recourse to corruption or money laundering should not be conducted at all?[28]

- Does the company refrain from using subcontracts, purchase orders or consulting agreements as a means of channelling payments to public officials, to employees of business partners or to their relatives or business associations?[29]

- Does the company ensure that remuneration of agents is appropriate and for legitimate services only? Are lists of agents employed in connection with transactions with public bodies and state-owned enterprises kept and made available to competent authorities?[30]

- When relevant, does the company comply with **international standards for combating money laundering**? In particular, does the company observe the Financial Action Task Force's recommendations on customer due diligence and record keeping; reporting of suspicious transactions and compliance; other measures to deter money laundering and terrorist financing?[31]

III. Heightened managerial care

13. Business responsibilities are broadly the same in **weak governance zones** as in other countries – they are expected to identify and develop investment opportunities, obey home and host country laws and observe the international instruments that are relevant for their operations. However, the heightened risks encountered in weak governance zones create a need for **heightened managerial care** – covering information gathering, internal procedures, relations with business partners (including agents, joint venture partners and subsidiaries) and use of external legal, auditing and consulting services -- in order to ensure compliance with legal obligations and observance of international standards.[32]

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[27] Chapeau of Chapter VI, OECD Guidelines for Multinational Enterprises.

[28] See the Summary of the 2003 Roundtable on Corporate Responsibility (page 117) published in the 2003 Annual Report on the OECD Guidelines for Multinational Enterprises).

[29] OECD Guidelines Recommendation VI. 1; last half of recommendation.

[30] OECD Guidelines Recommendation VI. 2.

[31] The Forty Recommendations of the Financial Action Task Force on Money Laundering contain, *inter alia*, recommendations for financial institutions and non-financial businesses (e.g real estate and casinos) and professions (e.g. legal and accounting). See http://www.fatf-gafi.org/dataoecd/7/40/34849567.PDF

[32] The concept of "heightened care" used here draws on the DeBeers written submission to the consultations. Related concepts were developed in the submission from the International Association of Oil and Gas Producers. Written submissions can be accessed at www.oecd.org/daf/investment/guidelines.

14. In thinking about what **heightened managerial care** means, investors might wish to consider the following questions:

Policies

- Are the concepts and principles that underpin relevant home and host country laws and **relevant international instruments** embedded in the company's business culture?[33]

- Does the company have policies that promote these concepts and principles and provide guidance on what they mean for the company's business? Do its policies adequately communicate the implications for the company's business practices of relevant laws and international standards? Is more detailed guidance provided to employees that are likely to be directly confronted with difficult situations?

- Does the company encourage, where practicable, business partners, including suppliers and sub-contractors, to apply principles of corporate conduct compatible with the *OECD Guidelines*?[34]

- Does the company encourage the application of these principles to the company's subsidiaries and joint ventures in weak governance zones?[35]

Management systems

- Are senior management and members of the Board of Directors visibly and actively committed to ensuring that investments in weak governance zones are managed in accordance with company policies?[36]

- Does the company exercise heightened care in putting in place the management systems and **adequate internal company controls** in order to manage the heightened risks of operating in weak governance zones? In particular, has the company taken steps to ensure that:

  - Employees at all levels – from senior executives to field workers – are aware of company policies, their legal obligations and of the international standards relevant for their work?[37]
  - Management practices (e.g. hiring, promotion, compensation, employee evaluation, disciplinary actions and **internal audit**) create incentives for employee compliance with company policies and the law and for observance of **relevant international instruments?** [38]

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33 OECD Investment Committee consultations (December 2004 to March 2005) and the 2003 Roundtable on Corporate Responsibility (see, for example, text on management systems in the Summary of the Roundtable published in the 2003 Annual Report on the OECD Guidelines for Multinational Enterprises).

34 OECD Guidelines Recommendation II.10.

35 OECD Investment Committee consultations (December 2004 to March 2005).

36 OECD Investment Committee consultations (December 2004 to March 2005).

37 Employee awareness is covered in Guidelines recommendation II.8.

38 See the "Summary of Roundtable Discussions – Enhancing the Role of Business in the Fight Against Corruption" published in the 2003 Annual Report on the OECD Guidelines for Multinational Enterprises. This summary describes the need "to embed anti-corruption policies more deeply in the management process of the company." (page 122)

- Employees are confident that, if they lose business because they comply with company policies, **relevant international instruments** or with home or host country law, they will be supported by their supervisors and by senior management and will not suffer adverse consequences?[39]
- Employees know where to turn to for help when dealing with situations in which they are under pressure to violate the law or to not observe company policies and **relevant international instruments**?
- Does the company refrain from discriminatory or disciplinary action against employees who make bona fide reports to management or, as appropriate, to the competent authorities, on practices that contravene the law, the OECD Guidelines or company policies?[40]

Reporting and disclosure of information

- Does the company ensure that timely, regular and reliable information is disclosed regarding its activities, structure, financial information and performance? Is the information disclosed for the enterprise as whole and, where appropriate, along business lines or geographic areas?[41]

- Does the company apply high quality standards for disclosure, accounting and audit for its operations in weak governance zones?[42]

  - Does the company exercise heightened care in ensuring that its financial statements are subject to **adequate independent external audits?**[43]
  - Does the company use heightened care to ensure that the **arm's length principle** is used in valuing transactions with **related companies?**[44]

- Does the company provide easy and economical access to published information? Does it take appropriate steps, when necessary, to make information available to communities that do not have access to print or electronic media?[45]

- Does the company support the development of international principles of transparency that are relevant for its operations?[46]

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[39] OECD Investment Committee consultations (December 2004 to March 2005).

[40] OECD Guidelines Recommendation Chapter II.9.

[41] OECD Guidelines Recommendation Chapter III. First paragraph.

[42] OECD Guidelines Recommendation Chapter III. Second paragraph.

[43] OECD 1997 Revised Recommendation V.

[44] OECD Guidelines Chapter X asks companies to conform transfer pricing practices to the arm's length principle. The Democratic Republic of Congo case study underscores the importance of properly accounting for transactions between related companies.

[45] See Commentary on OECD Guidelines Chapter III (Disclosure), paragraphs 17 and 18.

[46] The Extractive Industries Transparency Initiative (EITI) is one example of such an initiative. The OECD Investment Committee has twice associated itself with the EITI. See Archive Document 1 in the 2005 Chair's Report of the Annual Meeting of the National Contact Points and Archive Document 1 of the 2003 Chair's Report.

IV. Political activities

15. In all societies, business can play legitimate and useful roles in the political process. However, if investors use political activities to gain access to improper advantages, they might violate home or host country laws or fail to observe international standards.

16. **Weak governance zones** are characterised by institutional shortcomings that prevent the public and private sectors from playing their respective roles effectively. These shortcoming include: absence of workable systems for promoting public and private sector ethics; excessive discretionary powers for public officials at all levels of government; absence of rules-based frameworks for investment protection; and lack of adequate tendering procedures and of financial and managerial controls in all parts of the public sector (including state-owned enterprises).

17. Investors in **weak governance zones** often find it necessary to forge political alliances with **high level governmental and political figures** in order to protect their investments from heightened threats of direct or indirect expropriation.[47] These threats arise from inadequate checks on the powers of political actors – in effect, investors, through their political activities, create an informal system of investment protection that compensates for the lack of rules-based protection of their rights.

18. In thinking about these issues, investors might wish to consider the following questions:

Involvement in local politics

- Does the company abstain from **improper involvement in local political activities?**[48]
- Does the company refuse to make illegal contributions to candidates for public office or to political parties or to other political organisations? Do its contributions fully comply with public disclosure requirements?[49]
- Does the company exercise heightened care to ensure that its political activities in weak governance zones do not aid and abet criminal and/or corrupt activities or exacerbate conflict?[50]
- Does the company exercise heightened care in managing relations with **high level governmental and political figures** (e.g. by providing for board-level approval for and monitoring of these relations)?[51]
- Does the company exercise heightened care in ensuring that charitable contributions and sponsorship programmes are not used for illegitimate purposes?[52]

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47 DAFFE/INV/WP(2004)1REV1. Conducting business with integrity in weak governance zones: issues for discussion and a case study of the Democratic Republic of Congo. This case study documents a number of instances of expropriation that occurred under the rule of Laurent Desiré Kabila.

48 OECD Guidelines for Multinational Enterprises, recommendation II.11.

49 OECD Guidelines for Multinational Enterprises, recommendation VI.6.

50 DAC Guidelines on Helping Prevent Violent Conflict – adapted from ideas developed in Chapter 7 (Working with business) and Chapter 8 (Countering negative economic forces).

51 DAFFE/INV/WP(2004)1REV1. Conducting business with integrity in weak governance zones: issues for discussion and a case study of the Democratic Republic of Congo.

52 OECD Investment Committee consultations (December 2004 to March 2005).

- Does the company refrain from seeking or accepting exemptions not contemplated in the statutory or regulatory framework related to environmental, health, safety, labour, taxation and financial incentives among other issues?[53]
- Does the company take steps to enhance the transparency and perceived legitimacy of its political activities (e.g. through partnerships with legitimate citizens groups or business associations)? [54]

Dealing with public officials with conflicts of interest[55]

- Does the company have a policy for dealing with the business risks (e.g. of damage to reputation) associated with its political and business relations with **public officials** that may give rise to **conflicts of interest**? [56]
- Does the company exercise heightened care in identifying **conflicts of interest** associated with **public officials** with whom it has political or business relations?
- Does it exercise heightened care in managing **"at risk" situations for conflict of interest**?

V. Knowing clients and business partners

19. In **weak governance zones**, investors face heightened risks of entering into relationships with employees, clients or business partners that might damage business reputations or give rise to violations of law. Investors in weak governance zones have an interest in using heightened care in managing these risk and several business associations have issued guidelines for helping companies to do this[57].

20. In thinking about these issues, investors might wish to consider the following questions:

- Has the company taken adequate steps to inform itself about possible roles in host country criminality, **corruption** and conflict of people with whom it may have business or political relations?[58]
- Does the company exercise heightened care to ensure that it does not, through its business relations, aid and abet criminal and/or corrupt activities nor exacerbate conflict?[59]

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53 OECD Guidelines recommendation II.5; See also paragraph 6 of Commentary.

54 OECD Investment Committee consultations (December 2004 to March 2005).

55 As defined in the *OECD Recommendation on Guidelines for Managing Conflict of Interest in the Public Service.*

56 See the *OECD Guidelines for Managing Conflict of Interest in the Public Service,* 2.4.2.

57 For example, see the Wolfsberg Principles (described during the December 2004 Investment Committee consultation). See also the Guidelines on Reputational Due Diligence published by the International Association of Oil and Gas Producers. The Association's written contribution to the electronic consultation for a statement on how its Guidelines relate to the Investment Committee's weak governance zones project.

58 Adapted from Development Assistance Committee Guidelines on Helping to Prevent Violent Conflict, page 73-74. See also the Introduction to the Guidelines on Reputational Due Diligence published by the International Association of Oil and Gas Producers.

59 Adapted from DAC Guidelines on Helping to Prevent Violent Conflict, Chapters 7 and 8. See also the Guidelines on Reputational Due Diligence published by the International Association of Oil and Gas Producers. The Guidelines provide information on all aspects of managing relationships with employees and business partners (e.g. collection of information, selection, contracting practices, assessment and resolution, documentation and monitoring).

- Does the company exercise heightened care to not be party to misuse of transactions channelled through off-shore financial centres and/or involving corporate vehicles (corporate forms that allow individuals or organisations to hide their identity and their involvement in transactions)?[60]

VI. Speaking out about wrongdoing

21. Information about wrongdoing (including crimes and **abuses** such as human rights violations, solicitation of bribes and extortion[61]) is especially valuable in weak governance host countries, which have few institutions (e.g. a free press, well developed legal and auditing institutions, active and free trade unions and civil society) that can collect and channel information (since, in the absence of protection of basic rights, these activities are risky). Companies sometimes come across such information and share it with home or host governments, international organisations or the media. Although foreign companies may be more capable of protecting themselves than most citizens in weak governance zones, the risks of speaking out in such environments are serious and real – they include threats to the physical security of employees and assets and threats of expropriation.

22. In thinking about these issues, companies might wish to consider the following questions:

- If a company envisages making an investment that is likely to put it in a position of frequently knowing of and having to remain silent about wrongdoing, has it considered associated **risks** of damage to its reputation; damage to internal business culture)?[62]
- Is it possible for the company to share with the public or with relevant government authorities or international organisations information about wrongdoing that it might acquire in the course of managing its investment? Does the host government have a whistle-blowing or ombudsman facility?[63] Could the company use whistle-blowing and ombudsman facilities made available to it by some home and host governments and by international organisations?[64]
- What risks would this involve for the company's owners, employees and other stakeholders?
- Could the company envisage forming partnerships with other companies, business associations, international organisations, trade unions or civil society organisations in order to lower the risks of reprisals for passing on information about wrongdoing?[65]

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[60] See *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes (OECD 2001)* for a detailed discussion of this issue.

[61] Solicitation of bribes differs from extortion in that extortion involves actual or threatened violence or fear, whereas solicitation involves a request for a bribe. When a country responds to solicitation by offering, promising or giving a bribe, it has engaged in bribery. On the other hand, extortion involves wrongdoing only by the party that extorts the payment, since the other party does not have the intent to commit bribery.

[62] OECD Investment Committee consultations (December 2004 to March 2005).

[63] BIAC Written Comments; 28 September 2005.

[64] Consultations and Summary of 2003 Corporate Responsibility Roundtable. See pages 121 and 123 of summary of 2003 Annual Report on the Guidelines. See also the BIAC Position on Solicitation of Bribes, Document 5 of the Archive of Documents, 2004 Annual Report on the Guidelines.

[65] OECD Investment Committee consultations (December 2004 to March 2005).

VII. Business roles in weak governance societies – a broadened view of self interest

23. The business costs of "government failures" and of associated problems of rights violations (including investors' rights), violence and corruption are large – they include direct costs and missed opportunities.[66] Individual companies and the business sector as a whole might therefore find it in their broad self interest to help weak governance host societies to get on the path of institutional reform. However, the roles they can usefully play in this area are not always well defined and there may be risk associated with business engagement in this area.

24. A durable exit from poverty and insecurity will need to be driven by the leadership and people of the countries concerned[67]: host country actors – including citizens, politicians and civil servants – have the primary responsibility for reforming institutions in weak governance zones. International organisations and home country governments can play important supporting roles. [68]

25. OECD consultations on possible roles for companies in promoting institutional reform in weak governance countries revealed mixed views. While welcomed by some, others feared that such activity would inevitably deteriorate into inappropriate involvement in local politics. Nevertheless, consultation partners generally agreed that multinational enterprises can help by working in partnership with host country business associations and NGOs.

26. In thinking about these issues, investors might want to consider the following:

- Does the company use its influence on political actors positively, not only to negotiate immediate conditions for their investment, but also to avert conflict and to promote broader reform?[69] In particular, where possible, does the company promote:
  - Observance in host country law and policies of **relevant international instruments**?[70]
  - The development of the rule of law and the protection of rights (including property rights)? [71]
  - Improvements in public security in line with internationally agreed principles?[72]

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66 DAC Guidelines *Helping Prevent Violent Conflict*. page 69. third paragraph. See also Consultations and Summary of 2003 Corporate Responsibility Roundtable (section on *Is corruption good for business*?).

67 Adapted from first sentence of the Preamble of the DAC *Principles for Good International Engagement in Fragile States.*

68 The *DAC Principles for Good International Engagement in Fragile States* contain principles for donors and other external actors. The Principles were made available for discussion and consideration at the OECD's High Level Meeting (HLM) of Development Ministers and Heads of Agencies in March 2005. It was agreed there that the draft Principles (as currently drafted and referred to in our comments) should be piloted in a number of countries over the next 2 years. Following these pilots, the DAC will decide whether to amend them.

69 Adapted from Development Assistance Committee Guidelines on Helping to Prevent Violent Conflict, page 69.

70 Based on BIAC written submission. 28 September 2005.

71 Based on BIAC written submission. 28 September 2005. See also the OECD Policy Framework on Investment – Chapter 1 (Investment Policy).

72 Internationally agreed principles include the United Nations Code of Conduct for Law Enforcement Officials and UN Basic Principles on the Use of Force and Firearms by Law Enforcement Officials.

- The adoption of public sector ethics programme covering such areas as solicitation, conflict of interest and campaign finance?[73]

- The development of laws and policies that promote free and fair competition (including the development of competition policy, competitive tendering and appropriate reform of regulation and of the state-owned enterprise sectors)?[74]

- Transparency and consultation in the adoption and implementation of law and public policy and in the political process? Does this include easy and economical access to government information that impacts business or other parties? [75]

- Companies should comply with the tax laws and regulations of all countries in which they operate[76]. In weak governance zones, **weak fiscal systems** are one symptom of broader government failures. Companies that make large tax payments into governments with **weak fiscal systems** may want to assess possible **risks** (e.g. of damage to reputation) associated with making payments into fiscal systems that cannot control revenues or channel expenditures in a financially and politically accountable way. If such **risks** are deemed to be substantial, the company might want to ask itself the following questions:

  - Is it possible for the company to engage constructively with host country institutions with a view to encouraging reform in this area?

  - What are the benefits, costs and risks associated with engagement on this issue for the company's owners and for other people affected by its operations?

- If the company does engage on this issue, how can it organise its activities so as to maximise benefits and reduce risks of reprisals (e.g. by forming partnerships with host country, regional or international civil society organisations? by forming partnerships with home governments and international organisations for promoting more transparent and accountable fiscal policy)?

- Does the company encourage capacity building through close cooperation with the local community, including business interests, consistent with the need for sound commercial practices?[77]

  - In managing its relations with host country business partners – including state-owned enterprises -- does the company support and uphold good corporate governance principles and apply good governance practices?[78]

  - Does the company participate in and support development of host country professional and business associations, chambers of commerce and other institutional supports for a constructive role for business in host societies?[79]

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73 See the Revised Recommendation of the OECD Council on Combating Bribery in International Business Transactions and Chapter 10 (Public governance) of the OECD Policy Framework on Investment.

74 See Chapter 4 (Competition Policy) of the OECD Policy Framework on Investment.

75 See the OECD Policy Framework for Investment, Chapters 1 (Investment Policy), 4 (Competition Policy), 6 (Corporate Governance) and 9 (Infrastructure and Financial Services).

76 OECD Guidelines Chapter X (Taxation). Second sentence.

77 OECD Guidelines recommendation II.3

78 OECD Guidelines recommendation II.6. Phrase about state-owned enterprises added.

Annex – Glossary of Selected Terms

Abuses. Abuses are acts that are excessive or improper when evaluated using widely accepted international concepts and principles for business conduct (see **Relevant international instruments**). Such abuses might not be offences (criminal or otherwise) in all jurisdictions.

Adequate internal company controls. According to the OECD Revised Recommendation on Combating Bribery (Article V) these practices should include:

- the development of standards of conduct;
- the company's management processes and controls are subject to adequate **internal audit** procedures, including the creation of monitoring bodies, independent of management, such as audit committees of boards of directors and supervisory boards;
- provision of channels from communication of and protection for, persons not willing to violate professional standards of ethics under instruction or pressure from hierarchical superiors.

Adequate independent external audit. External auditors lend credibility to published financial statements and are fundamental to public confidence in the reliability of these statements. In this context, independence means that auditors are free of any influence, interest or relationship that might impair professional judgement. Adequate standards for ensuring the independence of external auditors permit them "to provide an objective assessment of company accounts, financial statements and internal controls" (quote from OECD Revised Recommendation on Combating Bribery; V. B.ii.).

Arm's length principle. This valuation principle is commonly applied to commercial and financial transactions between **related companies**. It says that transactions should be valued as if they had been carried out between unrelated parties, each acting in his own best interest. This is an important concept in the *OECD Transfer Pricing Guidelines*.

"At risk" situations for conflicts of interest. The *OECD Guidelines for Managing Conflict of Interest in the Public Service* identify "at risk situations" as:

- "Outside" appointments – The appointment of a public official on the board or controlling body of, a community group, a professional or political organisation, another government entity, a government-owned corporation, or a commercial organisation which is involved in a contractual, regulatory, partnership or sponsorship arrangement with their employment organisation.
- Contracting – The preparation, negotiation, management or enforcement of a contract involving a public organisation.
- Gifts and other forms of benefits – Offering of traditional or new forms of gifts or benefits.
- Additional employment – Public officials engage in ancillary ("outside") employment while retaining their official positions.
- Activity after leaving public office – A public official who is about to leave public office may negotiate an appointment or employment or other activity which creates a potential for conflict of interest with their employing organisation.
- "Inside information"— Using information collected or held by public organisation which is not in the public domain or information obtained in confidence in the course of official functions.

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[79] OECD Investment Committee consultations (December 2004 to March 2005).

Conflict of Interest involves a conflict between the public duty and private interests of a public official, in which the public official's private capacity interests could improperly influence the performance of their official duties and responsibilities. Source: *OECD Guidelines for Managing Conflict of Interest in the Public Service*.

Corruption is the act of a public official or person with a fiduciary duty or other position of trust who wrongly or unlawfully uses his position to procure some benefit for himself or for another person[80].

Heightened managerial care. Heightened managerial care is a variant of the risk management term – 'due care'. Its use of the word "heightened", recognises that companies need to make additional efforts to manage the heightened risks encountered in weak governance zones. Due care can be defined as the effort that an ordinarily reasonable and prudent person would use under the same or similar conditions to avoid harm to his or her company or to another party. In view of the heightened risks encountered in weak governance zones, companies will want to reinforce and to be more vigilant in using the same risk management techniques that they use in other investment contexts. Heightened care would normally consist of extra efforts in: gathering information about the investment environment, verification and follow-up, record keeping and documentation, assessments, decision making, building in safeguards, training and other management practices for relevant staff, associates and business partners (e.g. selecting appropriate staff, associates and business partners for at-risk positions and providing them with appropriate incentives and guidance), monitoring and possible remediation.

High-level governmental and political figures are individuals who are or have been entrusted with prominent public functions in a foreign country. These include, for example, Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state-owned corporations, important political party officials. Business relationships with family members or close associates of high-level political figures involve business risks similar to those with the political figures themselves. The definition is not intended to cover middle ranking or more junior individuals in the foregoing categories. [This definition is adapted from the definition of 'politically exposed persons' in the *Financial Action Task Force's Glossary of Terms*.]

High quality accounting practices. The OECD Revised Recommendation (Article V) and the OECD Convention on Combating Bribery (Article 8) defome "adequate accounting practices" as:

- Maintaining adequate records of the sums of money received and expended by the company; identifying the matters in respect of which receipts and expenditures take place. Companies should not make off-the-book or inadequately identified transactions or keep off-the-book accounts.
- Companies should disclose in their financial statements the full range of material contingent liabilities and should adequately sanction accounting omissions, falsifications and fraud. They should prohibit the recording of non-existent expenditures or liabilities with incorrect identification of the object. They should not use false documents.

Improper involvement in local political activities. Clarification of the meaning of improper political activity is a subject of ongoing relevance with respect to OECD anti-corruption instruments.[81] At a

80 Corruption includes, for instance, the bribery of a foreign public official, which pursuant to the OECD Convention means the intentional offer, promise or gift of any undue pecuniary or other advantage, whether directly or through intermediaries, to a foreign public official, for that official or for a third party, in order that the official act or refrain from acting in relation to the performance of official duties, in order to obtain or retain business or other improper advantage in the conduct of international business.

minimum, political involvement is deemed improper in a foreign country if is illegal in a company's home or host country. For instance, under the legal systems of some countries, an advantage promised or given to any person, in anticipation of his or her becoming a foreign public official, is illegal; under the legal systems of many countries it is considered technically distinct from the offense of bribery[82]. More generally, in thinking about this issue, investors might want to ask themselves whether their political activities are transparent; whether they would feel comfortable if these activities were described in detail in the media; and whether their activities are in the best interests of the host country (see also **legitimate political activity**).

Internal audit is an independent objective assurance and consulting activity designed to create value and to improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control and governance processes[83].

International standards for combating money laundering. These standards include the *Financial Action Task Force's 40 Recommendations* and the Basel Committee on Banking Supervision's *Customer Due Diligence for Banks*. The *Wolfsberg Standards* provide have been developed by a group of international banks – they provide guidance on various aspects of bank responsibilities and roles in the fight against money laundering.

Legitimate political activity. The following characteristics of legitimate political activity were proposed by participants in OECD consultations conducted as part of the development of this risk management tool:

- The purpose of the activity is to promote better participatory processes and a competitive market environment;
- The company is acting in good faith – its intention is candid, *bona fide* and in the best interest of the host country;
- The company is well informed about the local political situation and understands the national, regional, local and ethnic dimensions of host country politics;
- The company works in partnership with legitimate civil society actors and with international organisations. Such partnerships allow organisations to pool their competencies and to enhance co-ordination and transparency.

Public officials. These include people who hold a legislative, administrative or judicial office (either appointed or elected); any person exercising a public function, including for a public agency or a public enterprises (e.g. a state-owned enterprise); any official or agent of a public international organisation. (This definition is based on the definition of 'public sector representative' provided in Article 1 of the OECD Convention on Combating Bribery).

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81 See, for example, DAFFE/IME/BR(2000)24 ("Status Report on Five Issuing Relating to Corruption"). Two of the five issues relate to clarifying the relationship between companies' political contributions and bribery.

82 Description of legal systems' treatments of transactions made in anticipation of a person becoming a public official is from Commentaries on the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. Paragraph 10.

83 Text provided by OECD Auditor General's Office. It is based on material produced by the Institute of Internal Auditors.

Related companies. Related companies are companies that do not have an arm's-length relationship (e.g., a relationship involving independent, competing interests). This could be due to both companies being part of the same business group or could stem from family or personal ties between officials of two companies. Accounting for transactions between related companies is particularly difficult (see **Arm's length principle**). For this reason managerial, regulatory and tax arrangements often provide for greater scrutiny of transactions between related companies.

Relevant international instruments. Many international instruments provide useful guidance for evaluating risks and identifying appropriate business conduct. This is especially true in weak governance zones, where host country sources of information and guidance may be lacking. In some cases, the instruments create binding obligations on States, which can, in turn, create legal obligations for companies. For instance the OECD Convention on Combating Bribery requires that State parties criminalise bribery of foreign public officials, making bribery a criminal offence for companies and individuals. Companies will need to evaluate their particular business situations in order to decide which instruments are relevant for their operations and how they should be reflected in company policies. The international instruments cited in the OECD Guidelines for Multinational Enterprises are (by issuing organisation):

- *United Nations*: Universal Declaration of Human Right*;* Copenhagen Declaration for Social Development; ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy (1977 Tripartite Declaration); ILO Declaration of Fundamental Principles and Rights at Work (1998 Declaration); ILO Convention 29 of 1930 and C.105 of 1957 (Elimination of all forms of compulsory labour); ILO convention 111 of 1958 (Principle of non-discrimination with respect to employment and occupation); ILO Recommendation 94 of 1952 (Concerning Consultation and Co-operation between Employers and workers on the Level of Undertaking); Rio Declaration on Environment and Development, Agenda 21; Convention on Access to Information, Public Participation in Decision-making, and Access to Justice in Environmental Matters (Aarhus); UN Guidelines on Consumer Policy. [The United Nations Convention against Corruption was adopted by the UN General Assembly in October 2003 and subsequently opened for signature by State parties.]
- *OECD*. Convention on Combating Bribery of Foreign Public Officials in International Business Transactions; Revised Recommendation of the Council on Combating Bribery in International Business Transactions; Principles of Corporate Governance; Recommendation of the Council on the Tax Deductibility of Bribes to Foreign Public Officials; Guidelines for Consumer Protection in the Context of Electronic Commerce; Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.
- *Private*. ISO 14000 Series of Standards on Environmental Management Systems; the International Chamber of Commerce Report on Extortion and Bribery in Business Transactions.

Risks. Risks stem from changes in the company's external environment (e.g. a change in regulation) or from the actions of employees (e.g. a rogue employee deciding to violate company policy by paying a bribe) that give rise to changes in the value of the company. (Changes may involve increases in company value, in which case, the risk is an opportunity). Companies run risks of many types (financial, operating, political, etc) in the course of routine business activities – in weak governance zones additional risks stem from failures of government. The main sources of risks that are relevant to consideration of investments in weak governance zones are:

- Unfavourable developments in law, policy or practice -- The legal, regulatory and political context may evolve in a manner that is unfavourable (or favourable) for the company (e.g. actual or threatened expropriation, solicitation, threats related to the absence of the rule of law). Since

there are relatively few formal constraints on public sector actors in weak governance zones, this risk is a particularly important one.

- Legal non-compliance -- The company may be unable to control its operations or employees so as to comply with home or host country laws.
- Non observance of international standards -- The company may be unable to control its operations or employees so as to observe international standards.
- Close association with external events – The company may be closely associated with external events that do not reflect well on it (e.g. violence in the immediate vicinity of its operations; alliances with high level political officials that are widely viewed as corrupt).

These can lead to the following sources of value loss for the company:

- Direct and indirect legal costs.
- Loss of reputation -- A company may sustain losses in the value of an intangible asset – business reputation. This may make it more difficult to conduct business in the future or to compete in capital or labour markets.
- Reductions in brand value -- A company that operates in brand-sensitive segments of retail and business-to-business markets may sustain losses in the value of its brands.
- Reductions in employee morale and integrity (damage to internal business culture) -- A company may suffer from loss in the effectiveness of internal value creation and control processes due to lack of employee motivation and growth of cynicism and of the belief that ethics do not matter.

Weak fiscal system. The following questions, based on the OECD Best Practices for Budget Transparency, may help interested parties to evaluate fiscal systems:

- Are the accounting policies that underpin the budget (including any deviations from these policies) publicly available?
- Has the government put in place a system of internal financial controls, including internal audit, in order to assure the integrity of information provided in the reports?
- Do the finance minister and senior officials responsible for producing budget reports effectively assume their responsibilities?
- Is the budget report audited by a “Supreme Audit Institution” in accordance with generally accepted auditing practices?
- Are the audit reports scrutinised by Parliament?
- Does Parliament have the opportunity and the resources to effectively examine any fiscal report that it deems necessary?
- Are all fiscal reports made publicly available (including the availability of all reports, free of charge, on the Internet)?
- Does the finance ministry actively promote understanding of the budget process by individual citizens and non-governmental organisations?

Weak governance zones are defined as investment environments in which public sector actors are unable or unwilling to assume their roles and responsibilities in protecting rights (including property rights), providing basic public services (e.g. social programmes, infrastructure development, law enforcement and prudential surveillance) and ensuring that public sector management is efficient and effective. These "government failures" lead to broader failures in political, economic and civic institutions that are referred to as weak governance. Weak governance zones can be identified by:

- extremely low "human development" indicators (published by the United Nations Development Programme, these indicators measure welfare performance outcomes such as infant mortality, literacy, life expectancy and various measures of material standard of living; and inputs such as health and education spending);
- widespread and serious corruption and lawlessness;
- extremely weak evaluations of the country's public sector management and performance in economic and policy reviews conducted by international financial institutions or other international organisations.