

Whistleblowing in the financial industry:

The right means to curb illicit flows from developing countries?

Information provided by insiders can contribute to the goal of reducing illicit capital flight from developing countries. It helps address one of the most difficult aspects in investigating such flows (the secrecy of the banking industry) and makes accepting illicit money a riskier endeavour for banks.



- A bank employee learns that one of his clients - a company based in a developing country - moved money from the company's account with the local bank to another account with a foreign bank in a lower tax jurisdiction. The bank employee realizes that money was moved by paying for invoices for goods that were not calculated at market price, and that the inflated invoices must have been forged.
- A city mayor in a developing country receives USD 1 million in cash for securing a large construction contract for a foreign company. The foreign company establishes a trust in which the mayor's children are designated as beneficiaries. A lawyer acts as a trustee and opens a bank account into which the foreign company transfers USD 1 million. A bank employee becomes aware of the connection between the contract and the money transfer.
- In a developing country, a drug trafficking organization generates millions of USD in cash every year and moves these assets to a secrecy jurisdiction. An employee of a bank located in this jurisdiction, receiving the money, learns that these assets do not come from legal business activities.

Introduction

At a time when the issue of whistleblowers in the financial industry has gained international attention¹, this brief aims to evaluate whether information provided by insiders of the banking sector may contribute to the overall goal of reducing illicit capital flight from developing countries. It has been established that illicit capital flight out of the developing world has a devastating effect on poor countries (Reed and Fontana 2011). Such flows hinder a country's sustainable development, negatively affect the stability and credibility of a state's domestic financial system and institutions, and undermine international efforts to eliminate poverty². Measures addressing illicit capital flight have focused primarily on anti-money laundering, in particular on the identification of politically exposed persons (PEPs) and the reporting of suspicious transactions involving them. However, these measures have been criticized for not achieving a large reduction in the volume of illicit flows.

Current requirements in the financial industry

By asking banks to identify their customers and to file suspicious activity reports (SAR) to relevant authorities when there is suspicion of dirty money, anti-money laundering laws are already asking banks to maintain systems of "institutionalized whistleblowing". In the following examples, financial institutions both in rich and developing countries are already required to report these transactions to financial intelligence units:

Challenges to current requirements

Nonetheless, though banks in all countries are required to report the above transactions, several challenges arise in practice. For one, SAR requirements create some tension between different departments of a financial institution: the compliance unit (responsible for ensuring due diligence and reporting suspicious activity) and the dealmakers in the same bank (who want to complete a profitable business transaction). Whenever compliance staff want to report a suspicious transaction, the success of the dealmaker is in jeopardy. Further conflicts may arise between what the country's legislation has to say about the limits between employees' obligations and loyalty to employers and about his/her duty to report irregularities to an authority external to the company. Finally, labour regulations may also differ between someone who is an employee to those who work as management staff whose jobs are sometimes protected by different labour law provisions.

Addressing the challenges

To address some of these issues, extra support to compliance units within banks and to the employees making suspicious activity reports should be provided. For compliance units, such support requires more than proper financial and human resources: it needs backing from the board and management in order for them to do their job properly. Reporting directly to the board and not to the management is also one of the necessary requirements to strengthen these units. For the employees of such institutions, support must come through the right to submit their suspicions without fear of retaliation both internally (for example to a Compliance Officer) and to external authorities. In some cases the circle of those “in the know” is small and it is easy to deduce who the whistleblower was. This is why it is important that employees can report anonymously, also externally. Appropriate technical tools can help ensure anonymity at least technically (Schultz et al 2010) although that alone is not sufficient to protect the informant if other elements of protection systems are not functioning. Existing international SAR regulation and compliance requirements for banks are probably not enough in many circumstances and strong regulatory oversight is required to ensure that compliance work is properly implemented (Global Witness 2009)

What can be done to promote whistleblowing in the financial industry both in rich and developing countries?

The United Nations Convention against Corruption (UNCAC) is a good starting point to support whistleblower protection legislation. Articles 6, 13 and 39 recommend ensuring the existence of an independent body (or bodies) that prevent corruption, which are known to the public and have the capacity to receive anonymous reports. It further recommends, in Article 33, enacting appropriate legislation to provide protection for persons reporting those incidents. Even though the UNCAC targets corruption broadly and not specifically in relation to the banking sector, the mechanisms envisaged in the Convention, if effectively implemented, would benefit informants in that sector. The following measures should be considered as enabling steps to implement the principles expressed in UNCAC and promote a culture where *bona fide* whistleblowers in the financial industry and in other sectors are safely enabled to come forward with concerns. The first two measures are relevant across sectors while the third speaks directly to the financial industry:

Promote the enactment of legislation

An effective legislative framework should protect the whistleblower against any disadvantages suffered as a result of coming forward with information about misdeeds. This includes dismissal, sanctions, salary reduction, punitive transfers, lack of promotion, promotion delay, harassment and other detriments for employees in the

public and private sector. The law should provide for a full range of remedies with a focus on the recovery of losses. The informant should have the right to ask for compensation for injury and moral and material damage. This should include compensation for any pain and suffering incurred, compensation for loss of past, present and future earnings and status, mediation and attorney fees. The law shall also consider establishing a fund for compensation in cases of respondent insolvency (Transparency International 2009). Given the existing problems with implementation of laws in developing countries coupled with the fact that vast proportions of funds embezzled and misappropriated in developing countries end up in banks located in the rich world, these laws are particularly necessary in developed countries where whistleblowing is likely to take place.

However, this should not work as a disincentive for developing countries to pass such laws. In the case where there is a lack of engagement from the public administration on this issue, actors outside the government can also have an influence on a legislative process. In Lebanon, for example, civil society organizations and the private sector have taken the lead in promoting debates to influence good governance and transparency legislation. With the support of the international donor community, the National Network for the Right of Access to Information, a multi-sectoral group formed in 2008, drafted an excellent whistleblower protection law. The draft law has been submitted to Parliament but not yet been voted upon (Almadhoun 2010).

In addition, legislation stipulating financial incentives for whistleblowing might encourage those who have information about wrongdoing to come forward, to some extent reproducing in the opposite direction the incentives found in the financial industry (which reward closing profitable deals regardless of suspicious clients and without proper identification of sources of money).

In Malawi, for example, an informant scheme of the Revenue Authority encourages citizens to report suspected cases of tax fraud, evasion and smuggling by rewarding with amounts of USD 1,500 those that provide information leading to the recovery of tax revenue. In Nepal, the Prevention of Corruption Act allows the anti-corruption agency to issue an appropriate reward to the person assisting with inquiries, investigations and the collection of evidence. The United Kingdom and the United States, countries on the receiving end of illicit outflows from developing countries, also offer financial compensation to whistleblowers. In the UK, the Public Interest Disclosure Act envisages compensation for lost and future earnings. The US False Claims Act and the Dodd–Frank Wall Street Reform and Consumer Protection Act, a law passed in 2010 as a result of the financial crisis, go further: they allow whistleblowers to keep a portion of the amount recovered by the US government in the case of crimes against the state. Nonetheless, financial incentives should be used sensibly as ‘icing on the cake’ and not as a basic requirement for whistleblower protection.

Shooting the messenger

It is often not the guilty party who will be dismissed if wrongdoing is exposed but, instead, the person blowing the whistle. Studies note that the most common reaction to whistleblowing is to ignore the message and shoot the messenger (Rothschild and Miethe 1999; De Maria and Jan 1997). A good example of the risks of whistleblowing is that of a banker who blew the whistle on his employer, a Swiss financial institution, in 2007. The information provided to various US authorities set off cascading criminal and civil investigations involving the Swiss financial institution. Within two years, these investigations brought down the bank's entire US banking division and compelled intensive negotiations between the American and Swiss governments. The bank admitted to intentionally subverting US tax laws and defrauding the US government — a fraud hiding as much as USD20 billion in secret undeclared accounts and earning the bank up to USD200 million a year. To avoid criminal prosecution the bank agreed to pay a USD780 million fine and to turn over names of thousands of American account holders to the US Internal Revenue Service. The whistleblower was sentenced to 40 months in prison, in part because he failed to disclose his own involvement and that of a prominent client in the process.

Another famous example is that of an employee at the Central Bank of Kenya (CBK) who helped to expose one of the most complex financial scandals in Kenyan history, the Goldenberg affair. It is said that as much as USD 850 million—a fifth of Kenya's gross domestic product—was looted from the country's Central Bank in the 1990s. The whistleblower, David Munyakei, a clerk at CBK, noticed that a company called Goldenberg International was receiving unusually large sums of money for the alleged export of gold and diamonds. He raised questions and was advised to let the matter drop. Instead, he smuggled out documents and handed them over to opposition members of parliament. The documents revealed illegal transactions between the CBK and Goldenberg International and their disclosure eventually ended the scheme. The courage to disclose these corrupt practices resulted in Munyakei's arrest and dismissal from his position at the CBK. He spent the rest of his life poor and frequently unemployed, until dying in 2006, leaving three daughters and a widow (Starafrika.com 2009).

While these examples demonstrate that whistleblowing is still risky particularly in developing countries, in the case of banks located in rich countries, where the proceeds of corruption tend to be most commonly hidden, whistleblowing in the financial industry is particularly beneficial. It allows detection of criminal money flows and supports rich and developing countries in identifying and eventually repatriating the proceeds of crime.

Support the introduction of an independent body to receive complaints

Legislative measures are a first step. However, supporting institutions equipped with sufficient capacity and know-how to handle whistleblowing complaints, from the financial industry or elsewhere, are also needed. If there are no independent bodies to which informants can turn, many potential sources of information about corruption or illicit flows will not voice their concerns. Reporting levels are further affected by the capacity of an agency to process reports, determine which matters should be handled by the investigating authorities, and impose relevant standards. The absence of such procedures increases the risk that reports are lost or "filtered" before reaching the relevant investigative or prosecutorial agencies (OECD 2006). As with other anti-corruption bodies, a sufficient degree of independence is needed both to ensure that guarantees of protection can be delivered and to ensure that cases of reported corruption are acted upon effectively and not compromised (UNODC 2004).

When the independence of state agencies is compromised, a possibility is to establish support centers operated by representatives of private sector and/or civil society organizations to inform potential whistleblowers about relevant legislation and how it can impact them in case they report wrongdoing outside their companies. This informative role does not exempt the state from its responsibility to inform citizens about the law. Currently, several countries have established independent

organizations to assist whistleblowers. In the UK, Public Concern at Work is an independent charity offering free, confidential advice to people concerned about wrongdoing. Another example comes from Azerbaijan, where the local Transparency International chapter operates five regional legal advice centres that provide a mechanism for citizens to pursue corruption complaints. Similar arrangements, organized by NGOs, could be promoted focusing on providing support to informants in the financial sector in countries affected by illicit outflows of money.

Encourage whistleblowing procedures in the financial industry

As requested by the Financial Action Task Force 40 recommendations, banks and other financial institutions in rich and developing countries should establish internal reporting mechanisms. Employees should be able to address their concerns anonymously to an independent body within the institution, or to an ombudsperson's office or other similar external authority. Critical to the success of reporting mechanisms is the awareness of potential whistleblowers that such mechanisms exist. People should know about the different reporting channels available and how to use them. Then, it should be made known that reporting in good faith and on reasonable grounds will not trigger reprisals. Furthermore, easy access to legal advice should be provided to reduce misunderstandings (Banisar 2009). Finally, people will be less likely to report if they do not believe that the committee receiving reports will not protect confidentiality of their identity. The best way to protect an informant is to keep his or her identity, as



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well as the content of their disclosure, confidential for as long as possible and to explicitly allow anonymous reporting. To this end, financial institutions should use dedicated hotlines or electronic whistleblowing systems that similarly assist in receiving and classifying the reports.

Conclusion

Although whistleblowing should not be considered the only tool for dealing with illicit flows, enabling individuals in the financial industry to come forward with relevant knowledge is an important measure that can contribute in curbing these flows. Whistleblowing helps address one of the most difficult aspects in investigating such flows: the secrecy of the banking industry that makes initiation of legal proceedings to recover assets very difficult since interested parties first need to know where the assets are before they can begin investigations. Whistleblowing in the financial industry, in rich and developing countries, has the potential to contribute

to a reduction of illicit flows over time by making it a riskier endeavour for banks to accept illicit money. In addition, there has been recognition that whistleblowing is often a promising means to detect wrongdoing, in particular with regard to corruption and white collar crimes. Research conducted in 106 countries by the Association of Certified Fraud Examiners³ indicates that employees are the most common source of disclosure of fraud and wrongdoing and that tips by employees are by far the most prevalent means to detect unwanted activities (ACFE 2010). That is one of the reasons why over the past five years, many countries have started enacting whistleblower legislation. However, if more individuals are to come forward with their concerns, legislation is not enough and real protection should be ensured. This is an important consideration for not ruling out efforts to nurture the plans for whistleblowing incentives. Because the banks that mostly receive illicit flows from developing countries tend to be located in the developed world and this is where the individual blowing the whistle will require protection.

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Notes

1. In early 2011 Rudolf Elmer, a former senior Swiss banker, blew the whistle to Wikileaks on more than 2,000 prominent individuals and companies that he contends were evading taxes.
2. It is estimated that between USD 1 trillion and USD 1.6 trillion of illicit funds circulate globally per year, with around half originating from developing countries (Baker 2005; Christensen 2009). In contrast, in 2006, the 22 member countries of OECD Development Assistance Committee provided USD 103.9 billion in aid.
3. The ACFE is the world's largest anti-fraud organization and provider of anti-fraud training and education.