

Beyond the global crisis: the transparency imperative

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Anti-Corruption Assessment of the Global Crisis

More than one year after the onset of the global crisis, we are heartened that transparency has become the most important issue in the public agenda, but concerned that many concrete measures are still to be taken in order to ensure greater transparency and accountability in all aspects of economic and financial life, and prevent similar crises in the future.

A crisis largely caused by an integrity deficit is much more than a financial crisis. It is a moral crisis, hitting the political, socio-economic and socio-cultural foundations of our societies. Every technical answer to such a crisis has to be built on strong ethical principles, so that all action will be founded in transparency, accountability and integrity from the start. The conditions that led to the crisis are the same conditions that lead to the corruption we are fighting against. Our movement has to be at the forefront of the global campaign for long-term solutions to the crisis, which will be solutions for a sustainable, corruption-free economy.

1. Diagnosis: What went wrong and is still wrong

The current crisis has clearly established the dangers associated with the overemphasis on profit maximisation for shareholders. The wider interests of the community as well as the centrality of ethics have been overlooked. Corporations were solely concerned with creating value for the smallest number, and even for that number they failed to deliver, creating immense damages throughout the world economy.

Lack of transparency was at the onset of the crisis

Incentives to achieve short-term profits took precedence over prudent risk management within the corporations and on the markets, with the implicit consent of the regulators and the credit rating agencies.

Lack of a moral compass

- Deception had become a major issue in national and international financial transactions;
- Speculation was preferred over prudent risk management;
- Greed promoted huge cash incentives to attain short-term profits, while dismissing longer-term fundamental corporate performance goals;
- Conflicts of interest were often considered by individuals or even corporations as a normal way to do business;
- Multimillionaire traders were raised in the financial markets to celebrity status, while basic institutional obligations to investors and shareholders were increasingly ignored;
- Unbridled support for free markets by politicians encouraged regulatory abstinence in the belief that markets will curb excesses on their own, thus facilitating financial crime.

Lack of transparency within corporations

- Corporate whistle-blowing procedures, when available, have been poorly utilized, have had limited scope and have often led to retaliation against the whistle-blowers;
- Executive compensation, through stock options and bonuses, is almost always weighted in ways that reward high-risk taking with an emphasis on the short-term, while rarely levying a penalty for poor performance, creating a fundamental misalignment with the medium- and long-term interests of shareholders and the broader public;
- Some corporations have become black boxes with poor country-per-country communication on their operations.

 Lack of transparency in markets

- The lack of a central system of clearing houses for many transactions in derivatives added to market opacity – there simply was a massive lack of transparency about the scale of transactions, where trades were taking place and the exposure of individual firms;
- Off-shore financial centres were used by many financial institutions to avoid disclosure requirements;
- Financial institutions together with the national authorities of off-shore financial centres facilitated opacity of accounts, and sometimes tax evasion and other illicit actions, by corporations and individuals;
- Risk was transferred through complex financial instruments with no adequate disclosure to investors, with inadequate research by credit rating agencies, and by ineffective regulation.

 Lack of efficient government oversight

- Authorities charged with regulating and supervising banks had such a strong prejudice in favour of allowing free markets to operate with maximum freedom that they contributed to the speculative culture that reduced attention to prudent risk management;
- National governments, strongly supporting deregulation and free markets, failed to provide the resources to supervisory agencies to ensure they could pursue rigorous regulation, investigate reported abuse, and prosecute wrongdoers;
- Major gaps existed in many countries in regulatory frameworks so that many financial institutions that engaged in trading in complex derivatives and allied products outside of traditional banking institutions, such as insurance companies and hedge funds and investment banks, were very poorly regulated, if at all.

Lack of transparency in the North is causing immense damages in the South.

Hundreds of millions of people across the world are now suffering because of the poor management and greed of a few in powerful institutions. Whereas damages are very significant and long-lasting for the populations in the North, developing and poor countries in the South are the major casualties of the global crisis.

 Growth rates of most developing economies have fallen significantly

- Negative global growth is severely impacting fast-growing populations;

Anti-Corruption Assessment of the Global Crisis

- A sharp decrease in world trade worsens the impact on economies which had become strongly dependant on international division of labour;
- Subsidiaries of corporations headquartered in the North, when located in the South, often were among the first ones to be hit by shut-down decisions or redundancy programmes.
- ☉ Foreign currency inflows are dropping, making it much more difficult to meet external financing needs
 - Foreign direct investment has been significantly reduced as a result of a search for liquidity by international corporations;
 - Rising unemployment and declining consumption levels in the North are negatively affecting flows of workers' remittances to the South;
 - Resource-rich economies are strongly impacted by falling commodity prices;
 - Tourism revenue is declining;
 - Access to credit on global capital markets is much tighter.
- ☉ The effects of the global crisis are life-threatening in fragile countries
 - Weak states lack fiscal ability to introduce the counter-cyclical measures that were adopted in the developed or emerging economies;
 - Declines in tax revenue are cutting into much needed public spending in health, education and infrastructure;
 - In many countries, jobs have become unstable and insecure, and may quickly disappear;
 - Vast segments of the populations in the South were already close to, or much below poverty levels. The crisis will push such vulnerable groups further into poverty.

Lack of transparency is affecting efforts to overcome the crisis.

The immediate governmental response to the financial crisis has been a massive cash injection to institutions and markets. Significant tax collection efforts are also underway. Whereas those policies may provide adequate answers to emergency situations, they have to be monitored in a transparent manner, and they do not directly address the short-termism, the incentives to speculate and the excessive culture of deregulation.

- ☉ Lack of transparency in the rescue packages
 - In several countries, the size and composition of rescue packages for financial service providers and corporations have been decided without sufficient public oversight;

- Rescue packages are being managed in several countries without civil society involvement;
 - Enhanced transparency efforts have not been asked from the recipients of the rescue packages;
 - Governmental measures have in many instances stressed protection of national jobs and products, creating financial protectionism and thereby adding to the opacity of the financial system.
- 🌐 Lack of transparency in the fight against off-shore centres
- The exclusive tax recovery purpose of the governments' fight against off-shore centres hides the crucial role those centres play in grand corruption schemes, and contradicts the G20 pledge to end bank secrecy;
 - The quick promotion of OECD black-listed tax havens to the grey list raises doubts on the adequate scrutiny that should be exercised on those centres' concrete transparency achievements – and so far the pledges of action and reform have not been followed-up with action.
- 🌐 Lack of transparency in international cooperation against the crisis
- Increased lending by the IMF will largely fund general balance of payments and budget support which offers few assurances that it will not be misused; while increased World Bank support may well finance infrastructure projects, which are notorious in posing corruption risks;
 - The Financial Stability Board, renamed from the Financial Stability Forum by the London G-20 summit, is now set to be the leading international regulatory authority, yet does not appear to have strong procedures in place to enhance public transparency, to demonstrate public accountability and to involve civil society.
- 🌐 Lack of representation in global architecture
- Some political leaders are calling for a more democratic world order, but this order will not be built only on an increased governmental participation of developing countries in the governance of the international financial institutions. Civil society does not currently have adequate representation in those institutions, so that the voice of vulnerable groups is barely heard and short-term political interests often prevail over long-term public good.

2. The recommendations: What TI is asking for

Cash cannot be the alpha and omega of the financial crisis. Transparency, accountability and integrity have to be built into every answer to the crisis. A global sustainable economic model can only be built on value creation for the largest number of people. If an “Alliance for Change” is to create a more democratic world order, greater civil society participation only will allow this new order to be founded on solidarity and justice.

Enhanced government oversight and global fight against financial crime

- 🌐 Investigative and judiciary authorities engaged in the prevention of financial crime should have substantial budgets, granted to them on a long-term basis to prevent political pressures and in order to ensure they have the staff capability to pursue their mission;
- 🌐 The regulatory bodies of financial institutions and financial markets must be seen to be accountable. They must report regularly on complaints -including corruption cases- brought to their attention and explain how they have dealt with these coupled with reporting fully on their enforcement actions;
- 🌐 These regulatory bodies should be fully staffed with qualified employees and have the budgets they need for that purpose;
- 🌐 Sentencing guidelines may be considered depending on local law, so that companies clearly demonstrating that they had strong, effective and monitored anti-corruption systems would have smaller penalties, and corporations would be incentivised to adopt strong anti-corruption systems.

Enhanced transparency within corporations

- 🌐 Opportunities for whistle blowing have to cover excessive risk taking. Hotlines allowing confidential reporting have to be made mandatory above certain thresholds of revenue or staff number. Full whistle-blower protection has to be reinforced by law;
- 🌐 The nomination and approval of members of boards of directors should be open to shareholder ballot and contested elections may be supported;
- 🌐 The compensation of members of boards of directors should be subject to the annual shareholders meeting;
- 🌐 The full compensation packages of the most highly compensated executives in publicly listed financial institutions as well as the most senior management executives, should be fully detailed in corporate proxy statements published in advance of each annual shareholder meeting.

- Regulations should be put in place that ensure that longer-term corporate overall performance is the governing criteria for senior management compensation, which may require much of top pay be given in the form of stock options that cannot be renegotiated and that can only be exercised within a medium-term framework; and schemes through which top managers would have to personally invest a certain fraction of their annual remuneration in the securities of their corporations.

Enhanced transparency in the markets

- Offshore financial centres must be blacklisted if they do not open themselves to anti-corruption investigations and if they do not put adequate disclosure requirements on registered funds and financial institutions;
- Financial institutions should lose their operating licenses if they keep links with black-listed offshore centres;
- Every listed company should publish the list of all its subsidiaries with percentages of ownership and places of registration, so that activities in offshore centres can be identified by the authorities and the public;
- Companies should publish their key financial and legal data (net assets, revenue, pre-tax profit, tax, net profit, registered subsidiaries) openly in every country where they operate;
- Corporate reporting has to be enhanced by reporting on anti-corruption policies and systems so that corporate efforts towards transparency are meaningful and evident to the markets and all stakeholders.

Enhanced transparency in the rescue packages

- Rescue packages should be systematically designed to allow public oversight of the way in which they are distributed;
- Beneficiaries of rescue packages and recipients of rescue funds must be held accountable for the use of public funds, and they should specifically report in a separate section of their annual report on what they did with their public financing;
- The recipients of rescue packages have to publicly report on their anti-corruption systems.

Enhanced transparency in international cooperation to counter the crisis

- The Financial Stability Board (FSB) should include representatives of international NGOs;

This document was prepared by the Private Sector team at TI-S and in consultation with the anti-corruption movement. It is an attempt to respond to the global crisis that began unfolding in 2008.

For more information on TI's work on the private sector, please see:
www.transparency.org/global_priorities/private_sector.

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- ☉ The FSB should publish recommendations to fight corruption in the financial system;
- ☉ The FSB should monitor the use of the IMF increased lending capacity;
- ☉ Export credit agencies, and more generally International Financing Institutions, should increase due-diligence efforts and budgets, and require detailed anti-corruption commitments from their borrowers.

Bold action involving the South

- ☉ Developing countries' voice and representation should be strengthened in the governance of international financial institutions, especially in the light of the increasing economic globalisation, but more importantly, their own civil society organisations have to find adequate representation at the global level;
- ☉ Official Development Assistance (ODA) should be increased to compensate shrinking inflows of foreign currencies and help to counterbalance the downturn;
- ☉ Levels of ODA should be fully disclosed to the public, both in the country where it is decided and in the beneficiary country, in order to increase aid effectiveness and to fight misuse and corruption.

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