DFC U.S. International Development Finance Corporation

Report of the

U.S. International Development Finance Corporation

On

Anti-Corruption

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Introduction

DFC was created pursuant to the Better Utilization of Investments Leading to Development Act of 2018 (the "BUILD Act") to partner with the private sector to finance solutions to the most critical challenges facing the developing world today, providing financially sound alternatives to state-directed initiatives that can leave the developing countries worse off.

The Corporation understands integrity risk as the risk of working with entities or individuals that might be engaged in serious financial misconduct or improper activity, including bribery and money laundering, as well as terrorist financing, fraud, theft, abuse, tax evasion, lack of transparency, and undue political influence, all of which are often generally referred to as "corruption."

DFC seeks out partners who incorporate values of honesty and integrity into their business practices. Collaborating with stable and reputable private sector entities ensures that financial resources are used in accordance with their intended purposes, development objectives are met, and investments succeed. DFC includes policies, procedures, and tools within its risk management framework to manage integrity risk and the reputational impact that corruption and similar practices might have on DFC's projects.

Developing countries and development projects are, by their very nature, more exposed to corruption as a global threat, and DFC takes into account how corruption could adversely impact the attainment of program objectives. As noted by the *United States Strategy on Countering Corruption, pursuant to the National Security Study Memorandum on Establishing the Fight against Corruption as a Core United States National Security Interest* (December 2021):

> In today's globalized world, corrupt actors bribe across borders, harness the international financial system to stash illicit wealth abroad, and abuse democratic institutions to advance anti-democratic aims. Emerging research and major journalistic exposés have documented the extent to which legal and regulatory deficiencies in the developed world offer corrupt actors the means to offshore and launder illicit wealth. This dynamic in turn strengthens the hand of those autocratic leaders whose rule is predicated on the ability to co-opt and reward elites.

The discussion below responds to the following questions:

(i) What are DFC's policies and procedures to mitigate risks of corruption and money-laundering, especially in Central America?

(ii) What challenges does DFC face in implementing projects in countries with high degrees of known corruption?

(iii) What recommendations does DFC have for improving implementation of projects in countries with high degrees of known corruption?

I. What are DFC's policies and procedures to mitigate risks of corruption and money-laundering, especially in Central America?

DFC established a Risk Committee in accordance with 22 U.S.C. §9651(a). The committee's responsibilities include, under 22 U.S.C. §9651(b)(5), overseeing the development of "policies and procedures for assessing, prior to providing, and for any period during which the Corporation provides, support to any foreign entities, whether such entities have in place sufficient enhanced due diligence policies and practices to prevent money laundering and corruption to ensure the Corporation does not provide support to persons who are (A) knowingly engaging in acts of corruption; (B) knowingly providing material or financial support for terrorism, drug trafficking, or human trafficking; or (C) responsible for ordering or otherwise directing serious or gross violations of human rights."

DFC policies and procedures designed to address these concerns are set forth primarily in the "Know Your Customer" (KYC) Policy Manual (KYC Manual), which are reinforced by the provision of advice and training through the Office of the General Counsel.

A. KYC Manual

The KYC Manual is applicable to all of DFC's transactions (loans, guaranties, insurance, equity investments and technical assistance and grants), and sets forth DFC's KYC due diligence policies and procedures, defines key provisions to be included in legal documentation and includes specific requirements for financial intermediaries.

The KYC Manual provisions related to KYC due diligence are intended to ensure DFC has adequate knowledge of the projects it supports, their direct and indirect owners and any other parties relevant to the transaction. Such knowledge is essential to prevent DFC from supporting entities that lack policies and practices to prevent money laundering and corruption or persons knowingly engaging in acts of corruption.

The KYC Manual explains in detail who is responsible for conducting KYC due diligence, what parties are subject to it, the issues that are relevant to KYC due diligence,[1] the sources of information that should be used to gather information on such parties,[2] and how material KYC issues must be elevated to the appropriate decision makers, including in certain instances, the CEO.

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[1] These include, among others, possible involvement in terrorism, corruption, or money laundering and criminal history.

[2] Including open-source data, commercial databases, Terrorist Screening Center, Treasury's Office of Intelligence and Analysis and State Department through U.S. Embassies, whose personnel have in depth knowledge of conditions in the field.

The KYC Manual also includes the representations and covenants that DFC should generally use in the legal documentation for DFC supported transactions to ensure that clients adhere to DFC's integrity standards and that DFC has appropriate remedies to respond to any instances of fraud, corruption, money laundering, sanctions violations or terrorist financing. Among others, these refer to compliance with applicable corrupt practices and anti-money laundering laws, compliance with all applicable requirements of OFAC regulations and other U.S. economic sanctions laws and commitment to maintaining management and accounting policies and controls sufficient to provide reasonable assurances of compliance with corrupt practices laws, prevention of bribery and the financing of terrorism. The KYC Manual further explains that additional certifications, covenants, and representations and warranties may be used in applications, commitments, and legal documentation, as appropriate, to mitigate specific risks.

DFC often partners with financial intermediaries, providing financing for or guaranteeing portfolio facilities that on-lend to multiple borrowers and projects, where it would be inefficient for DFC to offer direct support. DFC may also provide financial intermediaries with needed liquidity and capital that allows them to remain operational during times of crisis, thereby fulfilling a countercyclical role.

As gatekeepers of the financial systems in which they operate, financial intermediaries play a key role in combating corruption and money-laundering and DFC ensures that those it works with have robust systems in place to prevent and respond to such risks.

To do so, as required by the KYC Manual, prior to providing support to financial intermediaries, DFC must review their anti-money laundering and know your customer (AML/KYC) policies and reach a determination that these are well-developed or, alternatively, condition DFC's support on the adoption and implementation of appropriate modifications. In making its assessment, DFC considers international best practices.

The effectiveness of DFC's policy framework to manage integrity risk requires project teams to receive adequate training. As part of DFC onboarding, relevant staff receive KYC training. Additional training may be provided on a periodic basis to strengthen staff's ability to identify, assess and avoid or mitigate risks.

Also, to ensure consistency in the management of integrity risk across all of DFC's transactional work, DFC has established within the Office of the General Counsel an advisory function on integrity matters, responsible for providing expert advice to project teams, DFC's management, and DFC's Board on the assessment of risk indicators and possible mitigation strategies. This function may also develop integrity risk management tools and mechanisms to support the adequate implementation of the KYC Manual.

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B. Country Status Policies

DFC's country status policies guide DFC as to whether it may support investments in a given jurisdiction, or whether U.S. laws and regulations or foreign policy considerations prohibit or prevent DFC from providing such support.

A country's systems and efforts to combat corruption are considered in the determination of the country status. First, U.S. laws and regulations may take into consideration the prevalence of corruption within a country through the imposition of sanctions or other restrictions. Second DFC's management regularly references corruption indicators, sanctions affecting prominent individuals within a country, corruption investigations or convictions, and other information obtained through interagency consultations and public sources.

With respect to Central America, particularly the Northern Triangle countries and Nicaragua, DFC is prepared to support new projects in El Salvador, Guatemala, and Honduras, in each case subject to its policies and procedures – including the conduct of integrity due diligence pursuant to the KYC Manual's requirements. Because of political considerations and corruption concerns, DFC has stopped work on new projects in Nicaragua.

II. <u>What challenges does DFC face in implementing projects in countries with high degrees of known corruption?</u>

Managing corruption and money laundering risk in the development context presents many challenges. As stated, corruption is a world-wide phenomenon that is more deeply rooted in developing countries where institutions are weaker. Corruption and money laundering are also hidden practices, not easily identifiable, as corrupt actors seek to disguise the illicit origin of their wealth through diverse mechanisms, such as complex corporate structures that obscure ultimate ownership or the commingling of ill-gotten gains with legitimate business. State capture by corrupt leaders results in protection and impunity for them and their accomplices and, silences or discredits investigative journalists and other members of civil society that seek to expose corruption. Private sector entities may engage in bribery and other forms of corruption under the false pretext that no other form of business is viable in the environment in which they operate.

The lack of investigations and convictions results in asymmetries of information and requires DFC to consider, in the context of its due diligence, rumors and unofficial information to which it is difficult to react. Sound judgment calls are necessary when assessing risks to avoid arbitrary or capricious decisions without ignoring significant red flags.

In countries with high degrees of known corruption it may be difficult to identify investments that adhere to the integrity standards that DFC requires. Whereas investments should not be made in the face of grave concerns, it is also important to avoid *de-risking* measures as a solution. *De-risking* may deprive development assistance to countries that require it most.

DFC seeks to overcome these challenges through prevention and detection of risks. From a preventive perspective, DFC implements the above-described policies and procedures, which require an understanding of the conditions prevalent in the host country and the analysis of multiple sources of information to assess the character of DFC's counterparties and the integrity of the project it seeks to support. DFC's thoroughness in conducting KYC and assessing integrity risk requires time and resources, which may affect how quickly DFC can offer alternatives to state directed investments by authoritarian governments that do not adhere to DFC's best practices with respect to integrity and transparency.

From a detection perspective, DFC's portfolio monitoring officers are attentive to the materialization of integrity risk to ensure DFC reacts promptly and appropriately. Furthermore, information on how to contact the Office of the Inspector General is made available to DFC staff and external stakeholders, so that whistleblowers may come forward with allegations of corruption that may affect DFC's projects.

III. **What recommendations does DFC have for improving DFC's implementation of projects in countries with high degrees of known corruption?**

In carrying out DFC's development mandate, DFC predominantly provides support in countries where corruption is a serious concern. DFC's policies are designed to appropriately manage integrity risk in such environments and while DFC does not recommend substantive changes to their scope, it is important that DFC keeps abreast of how corruption, a changing phenomenon, materializes, so that its staff is well prepared to identify and respond to red flags and alerts.

Also, as DFC's pipeline and portfolio continue to grow and new staff is recruited, DFC's recommendation is to allocate resources to appropriately, periodically train, and advise staff on how to implement the KYC Manual and assess risks consistently across the agency, both during project preparation and project implementation. Similarly, DFC should seek to continuously improve its processes to gain efficiency in conducting KYC, without sacrificing quality or increasing its appetite for integrity risk.

Lastly, DFC has started to conduct knowledge sharing activities to strengthen the governance and compliance practices of financial intermediaries and other private sector entities that operate in environments exposed to corruption risk. DFC should continue to further this effort, as it helps raise the bar and increase the number of players that contribute to the fight against corruption.

In closing, DFC reemphasizes its commitment to prevent and mitigate the risk of corruption. Corruption erodes DFC's mandate, it "…carries enormous costs, whether one measures in dollars, livelihoods, or faith in accountable governance. The scale of the problem is formidable. But so too is the global commitment to preventing and otherwise combatting it, which brings together governments, frontline activists, researchers, investigative journalists, members of the business community, and everyday citizens. Together with these partners, the U.S. Government will lead in advancing the fight against corruption…".[3] DFC contributes to this effort by seeking to support investments that adhere to the highest integrity standards.

[3] United States strategy on Countering Corruption pursuant to the National Security Study Memorandum on Establishing the Fight against Corruption as a Core United States National Security Interest. December 2021.