

# Unique Markets, Responsible Investing

*IFC's Integrity Due Diligence Process*





# CBR Business Risk and Compliance

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IFC, a member of the World Bank Group, creates opportunity for people to escape poverty and improve their lives. We foster sustainable economic growth in developing countries by supporting private sector development, mobilizing private capital, and providing advisory and risk mitigation services to businesses and governments. This work was prepared by IFC's Business Risk & Compliance Department.

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# Integrity Due Diligence Process



IFC, a member of the World Bank Group, is the largest global development institution focused on the private sector in emerging markets. Working with more than 2,000 businesses worldwide, we use our capital, expertise, and influence to create markets and opportunities in the toughest areas of the world. IFC was established in 1956 pursuant to

its Articles of Agreement which have been signed by more than 180 member countries. The nature of IFC's business means it works with a diverse range of development partners: from multi-nationals to small local companies, and from government institutions to NGOs, in both investment and advisory services projects.

IFC conducts integrity due diligence ("IDD") on its business clients and partners. This is similar to the "Know Your Customer" process used in the financial industry. IDD is critical to ensure that IFC works with reputable and sustainable business partners so that its investments are successful, its resources are used effectively, and its development objectives are met.



IFC has policies and procedures in place for conducting IDD to:

**IDENTIFY** integrity risks related to a project and the entities and persons involved, utilizing open sources of information and IFC's network of staff in over 100 countries;

**EVALUATE** and assess integrity risks, including review by an independent risk function within IFC's Business Risk & Compliance Department; and

**MONITOR** for new issues and changes in integrity risk over the life of its projects.

## Why does IFC do IDD?

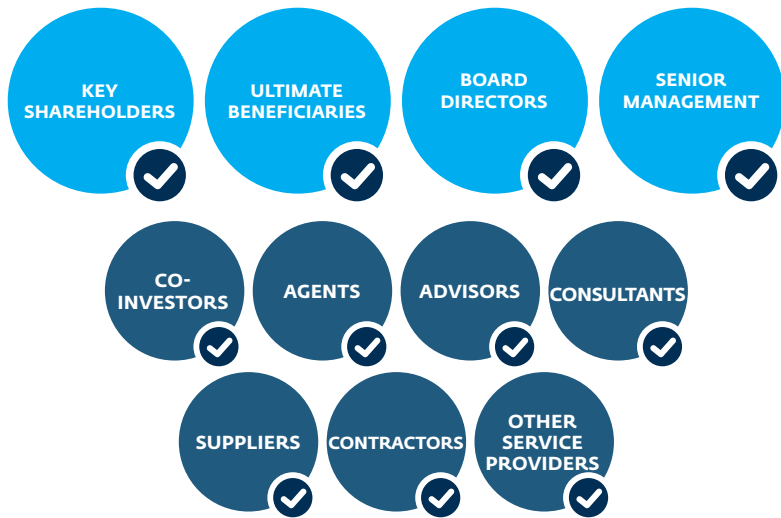
IFC is committed to integrity, high ethical standards, and good business practices. It expects its project sponsors, clients, partners, co-financiers, and counterparties to meet similar standards. IFC promotes good business practices and sustainability amongst its clients and partners.

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*Early identification of integrity risks along with financial, legal, corporate governance, environmental and social, and compliance-related due diligence is an essential component of IFC's risk management.*

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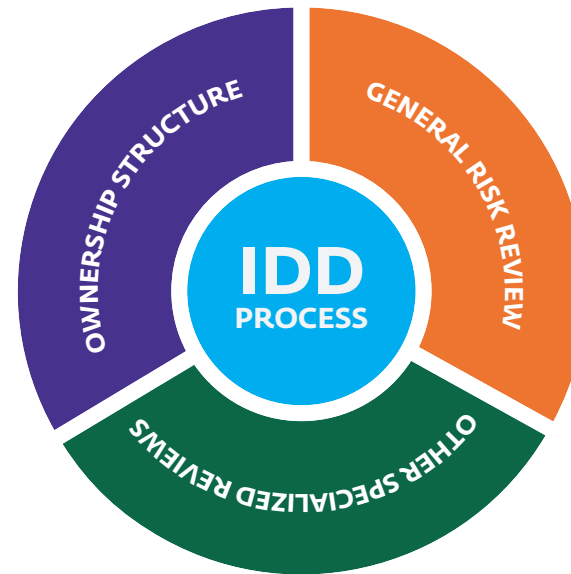
IFC defines integrity risk as the risk of engaging with external institutions or persons whose background or activities may have adverse reputational and, often, financial impact on IFC. **Integrity risks include, but are not limited to, corruption, fraud, money laundering, tax evasion, lack of transparency and undue political influence.** In order to safeguard its investments, IFC pays close attention to potential integrity risks as they may undermine IFC's development mandate and adversely impact IFC's ability to carry out its business effectively.



## Who/what is subject to IDD?

IFC’s IDD process applies to all IFC engagements from short-term advisory projects to long-term debt financing and equity investments. Entities and individuals whose role in a project could potentially have a material adverse impact on IFC’s reputation are subject to the IDD process.

**This typically includes the key shareholders and their ultimate beneficiaries, board directors and senior management. To be prudent, it is often necessary to conduct IDD on other parties, including co-investors, contractors, agents, advisors, consultants, suppliers, and other service providers.**



## How does IFC conduct IDD?

IFC takes a risk-based approach to identify, assess, and document integrity risks in potential and existing relationships.

The IDD process is comprehensive and includes the following components: (i) general risk review, (ii) ownership structure review, and (iii) other specialized reviews for financial institutions and private equity funds.

## General Risk Review:

Operations staff conduct thorough research using various internal and external sources to identify integrity risk issues such as criminal activities, civil proceedings and political influence, and remain fully engaged throughout the IDD process.

### The IDD process for each project typically includes:

- Input from IFC's country offices that provide market intelligence and insights.
- Open source research in English and other languages using internet search engines, media sources and websites of regulatory bodies.
- Daily screening of individuals and entities against various sanctions, watch, regulatory, and law enforcement lists, such as the United Nations sanctions lists and the World Bank Listing of Ineligible Firms & Individuals, using an industry standard tool.
- External reference checks using IFC's network of industry contacts.
- Hiring independent external risk consultants and local counsel in circumstances where important integrity-related information is either missing, difficult to obtain or particularly sensitive.

As a member of the World Bank Group, IFC also has privileged access to governments and authorities who can provide valuable inputs to the IDD process where appropriate.

## Ownership Structure Review:

Fundamental to any relationship is knowing who owns and controls a client by identifying the ultimate beneficial owner. IFC will not invest if it does not know the identity and reputation of its clients, or if it believes that a client may be controlled by an undisclosed third party. Opaque structures may be used to evade taxes, hide ownership and wealth, facilitate criminal activity and launder the proceeds of crime. For all of these reasons, as part of its IDD process, IFC is required to conduct due diligence to understand the structures used by its clients.

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*Enhanced due diligence is required for investments involving "intermediate jurisdictions" (broadly defined as jurisdictions other than those of transaction sponsors or project companies and sometimes referred to as offshore financial centers (or "OFCs")). The domicile of a private equity fund is considered "per se" an intermediate jurisdiction.*

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Where there is an intermediate jurisdiction, IFC may undertake an investment only after it is satisfied that the structure of the transaction is legitimate and not designed to be used for tax evasion, tax abuse or other illegitimate purpose.

In conducting this assessment, IFC takes into account the standards on tax transparency promulgated by the Global Forum on Transparency and Exchange of Information for Tax Purposes (the "Global Forum"). Offshore structures with a controlling interest in IFC projects must be domiciled in an intermediate jurisdiction that is compliant or largely compliant with the Exchange of Information on Request tax transparency standard of the Global Forum standards for tax transparency.

## Other Specialized Reviews for financial institutions and private equity funds:

Money laundering and terrorist financing are significant challenges not only to the integrity of the global financial system, but also to IFC projects. Financial institutions are inherently susceptible to these risks and therefore need to maintain robust procedures and controls to prevent and detect them.



**For financial institution and certain non-financial clients, IFC assesses their anti-money laundering and combating the financing of terrorism ("AML/CFT") processes to determine the following:**

- Whether AML/CFT processes are in compliance with relevant national AML/CFT laws and regulations.
- Whether there are AML/CFT processes that are appropriate for the relevant business and operating environments.
- Effectiveness of the implementation of the AML/CFT processes.

In conducting this assessment, IFC takes into account the countries listed by the Financial Action Task Force on Money Laundering<sup>2</sup>.

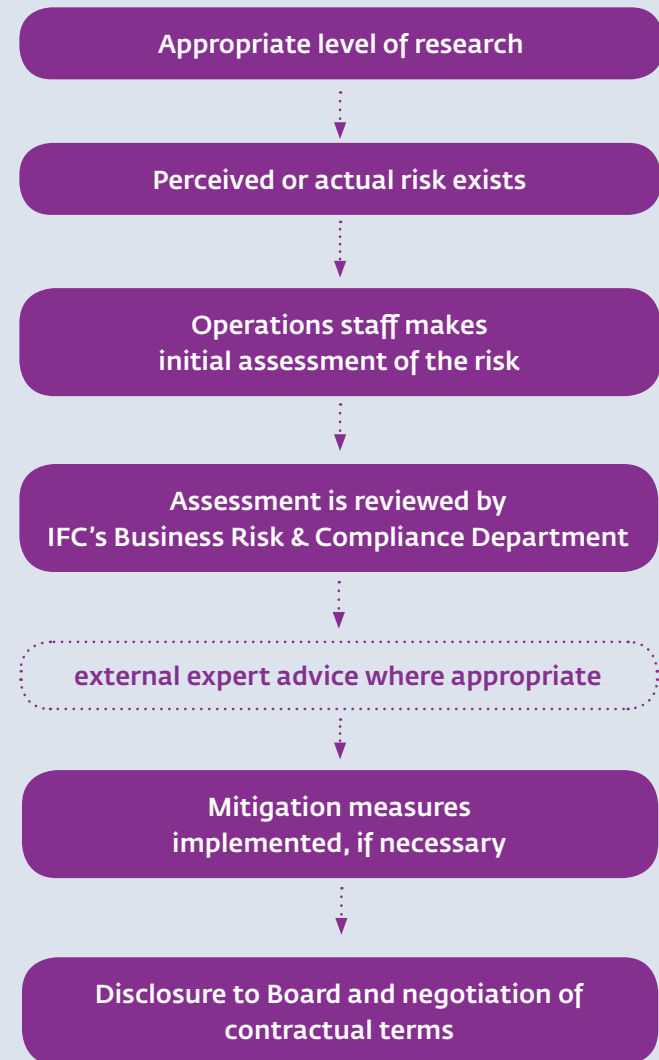
For a private equity fund, IFC assesses the fund manager's IDD process to ensure it identifies, assesses and manages integrity risks to appropriate standards. As a condition of its investment in a fund, IFC requires the fund manager to ensure that it has an appropriate IDD process in place as regards investee companies.

1. Refer <http://www.oecd.org/tax/transparency/>  
2. Refer <http://www.fatf-gafi.org>

## What if IFC operations staff identify integrity risk?

Each IFC project presents unique risks depending on factors such as the identity of the owners of the client or the control structure. If after conducting the appropriate level of research, integrity issues are determined to present a perceived or actual risk to IFC's reputation, operations staff are required to make an initial assessment of the risk. This assessment is then reviewed by an independent integrity specialist in IFC's Business Risk & Compliance Department. IFC may seek external expert advice where appropriate to understand, assess or mitigate any integrity risks identified. In some cases, IFC may implement measures to mitigate them. Mitigation measures may include a reputational "put option" in the case of an equity investment where there are significant unresolved issues subject to ongoing investigation and/or litigation. Other mitigation measures may include requiring a change of ownership or change in governance or compliance arrangements.

Ultimately, the assessment of integrity risk is a careful judgment call based on thorough research, the type of risk identified, possible mitigation measures, the context and other circumstances surrounding the project. If appropriate, an integrity risk issue is escalated to IFC's management to decide whether to accept the risk. In determining which projects to pursue, IFC balances potential adverse reputational or economic risk with potential development impact and other factors such as financial return. Material integrity





issues and risks are disclosed to IFC's Board. IFC investment agreements include standard and negotiated contractual covenants and protections to endeavor to safeguard both IFC and the transaction against integrity risks.



### Portfolio monitoring

IFC's IDD process requires staff to conduct IDD in IFC's projects throughout the project cycle.

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*Monitoring existing relationships is important to identify early warning signs of emerging risks and to develop appropriate responses.*

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IFC operations staff update IDD as parties change, projects are restructured, business interests are sold, there are changes in management, litigation occurs, regulatory issues arise, or there are new developments as regards existing risks. As noted above, IFC continues to conduct screening of clients throughout the project cycle against various sanctions, watch, regulatory or law enforcement lists using an industry standard tool.

## IFC's Business Risk & Compliance Department - Role and responsibilities

IFC's corporate risk management policies define the types and amounts of risk that IFC's management is willing to assume, via delegated authority from the Board. IFC's operations staff are responsible for conducting IDD and monitoring integrity risks throughout the life of a project and are overseen by line management. The Business Risk & Compliance Department, headed by the Chief Compliance Officer, has responsibility for overseeing compliance with IFC's IDD, AML/CFT and OFC programs and providing corporate-wide guidance on these matters.

IFC's Business Risk & Compliance Department consists of specialist risk staff with expertise in specific regions. They have backgrounds in risk, legal, compliance, operations, information technology, data analysis and project management. The Department provides operations staff with guidance, tools, and training programs on the key aspects of the IDD process. All IFC operations staff are required to take training on IDD.

## WBG sanctions and debarment

The WBG's sanctions and debarment system is an independent sanctions system through which the WBG sanctions entities that have engaged in sanctionable practices in a WBG financed transaction.<sup>3</sup>

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*If IFC receives an allegation of fraud, corruption, collusion, or coercion in relation to an IFC financed project, that allegation must be submitted to the WBG's Integrity Vice Presidency ("INT"), which is the WBG's independent investigative arm.*

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INT<sup>4</sup> evaluates the allegations of wrongdoing and may open a formal investigation. Based on the outcome of the investigation, the WBG's independent sanctions system may consider whether sanctionable misconduct was committed



**A sanction may be imposed, including debarment of an entity or individual from future WBG financing.**

through a two-tiered sanctions review, whereupon a sanction may be imposed, including debarment of an entity or individual from future WBG financing.

If the debarment exceeds one year, cross debarment by other major multilateral development banks may also occur, affecting future financing. The debarments and other sanctions are published on a public list, readily accessible electronically and searchable.<sup>5</sup>

After a debarment is imposed, the World Bank's Integrity Compliance Office normally works with eligible companies to monitor their integrity compliance programs and evaluate whether they have made sufficient progress to lift the debarment.

All WBG staff members have a duty to report suspected fraud or corruption in WBG-supported operations and projects or in the administration of WBG business to IFC management or INT.

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3. Refer <http://www.worldbank.org/en/about/unit/integrity-vice-presidency/sanctions-compliance>

4. Refer <http://www.worldbank.org/en/about/unit/integrity-vice-presidency>

5. Refer <http://www.worldbank.org/debarr>



