

Sanctions Reform: Expansion of Sanctions Regime Beyond Procurement and Sanctioning of Obstructive Practices

Information Note for Borrowers

The purpose of this Note is to inform borrowers of the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA, the IBRD and IDA being hereinafter collectively referred to as the “World Bank” or the “Bank”) that the Executive Directors of the Bank, at their August 1, 2006 session, unanimously approved a package of reforms of the Bank’s sanctions regime.

The Reforms. The reforms included the following:

- Expansion of the sanctions regime beyond procurement to cover more generally fraud and corruption that may occur in connection with the use of Bank loan proceeds in the preparation and/or implementation of Bank-financed investment projects. This has been accomplished, in part, through the adoption of new definitions of corrupt, fraudulent, collusive, and coercive practices.
- Adoption of “obstructive practices” as a separate sanctionable offense, covering both non-compliance with the Bank’s third-party audit rights and deliberate obstruction of Bank investigations into fraud and corruption.

A. Expansion of the Sanctions Regime.

Rationale. Under the World Bank’s sanctions process prior to these reforms, the Bank imposed sanctions for corrupt, fraudulent, collusive, and coercive practices, as defined under the Bank’s Procurement Guidelines¹ and the Consultants Guidelines,² in the context of the procurement of works, goods, and services, the selection and employment of consultants, and the execution of contracts resulting from such procurement or selection. Corrupt, fraudulent, collusive, or coercive practices³ that may have occurred in the preparation or implementation of a Bank-financed project, but outside the procurement or selection processes or contract execution (such as fraud and corruption by NGOs and financial intermediaries that were not selected through procurement) were not subject to sanctions.⁴ The expansion of the sanctions regime is essentially intended to ensure consistency of treatment of cases of such practices by expanding the sanctions regime to cover more generally fraud and corruption occurring in Bank-financed investment operations, to better fulfill the Bank’s fiduciary duty under its Articles of Agreement to ensure the proper use of all loan proceeds.

¹ 2004 Guidelines on Procurement under IBRD Loans and IDA Credits dated May 2004.

² 2004 Guidelines on Selection and Employment of Consultants by World Bank Borrowers dated May 2004.

³ These practices are sometimes referred to collectively in this Note as “fraud and corruption”.

⁴ Such practices, however, whether or not in the procurement/selection context, are normally subject to contractual remedies under the Bank’s legal agreements (including the General Conditions).

The move to encompass fraud and corruption committed outside the procurement context required the coverage of fraud and corruption committed without the involvement of public officials. The financial intermediaries and NGOs mentioned above are private parties and interact with other private parties in the course of project implementation. In addition, private parties may engage in fraud and corruption while assisting the project implementation units (PIUs) in the preparation, implementation and the supervision of the projects.

Moreover, the former definitions did not adequately cover acts in furtherance of an offense (even where the act is not completed, possibly due to discovery by relevant authorities or other fortuity) or agreements to undertake a prohibited course of conduct. Because the coverage of attempts and conspiracies is common in a wide range of national jurisdictions, the Bank has decided to include such acts within the scope of its sanctions regime.

Expanded Definitions. The new definitions read as follows:

A “corrupt practice” is the offering, giving, receiving or soliciting, directly or indirectly, of anything of value to influence improperly the actions of another party.⁵

A “fraudulent practice” is any act or omission, including a misrepresentation, that knowingly or recklessly⁶ misleads, or attempts to mislead, a party to obtain a financial or other benefit or to avoid an obligation.

A “collusive practice” is an arrangement between two or more parties designed to achieve an improper purpose, including to influence improperly the actions of another party.

A “coercive practice” is impairing or harming, or threatening to impair or harm, directly or indirectly, any party or the property of the party to influence improperly the actions of a party.

An “obstructive practice” is (i) deliberately destroying, falsifying, altering or concealing of evidence material to the investigation or making false statements to investigators in order to materially impede a Bank investigation into allegations of a corrupt, fraudulent, coercive or collusive practice; and threatening, harassing or intimidating any party to prevent it from disclosing its knowledge of matters relevant to the investigation or from pursuing the investigation, or (ii) acts intended to materially impede the exercise of the Bank’s contractual rights of audit or access to information.

⁵ Typical examples of corrupt practice include bribery and “kickbacks”.

⁶ To act “knowingly or recklessly”, the fraudulent actor must either know that the information or impression being conveyed is false, or be recklessly indifferent as to whether it is true or false. Mere inaccuracy in such information or impression, committed through simple negligence, is not enough to constitute fraudulent practice.

The main changes from the former definitions include (i) the elimination of procurement-specific references, (ii) the introduction of an element of improper purpose, and, in the case of fraudulent practice, a requirement that the perpetrator have misled “knowingly or recklessly”, and (iii) the allowance that the “target” of the practice may be any other party and not just a public official (i.e., encompassing so-called “private-to-private” fraud and corruption). The matrix attached as Annex A provides a graphic word-by-word comparison of the new definitions of these terms with those previously set out in the Procurement and Consultant Guidelines.

Scope of expansion. The new sanctions regime covers fraud and corruption committed (or attempted) by recipients of loan proceeds in connection with the use of Bank loan proceeds in all Bank-financed investment projects.⁷ The terms “recipients of loan proceeds” and “use of loan proceeds”, however, are to be interpreted broadly. The regime covers fraud and corruption not only in the direct diversion of loan proceeds for ineligible expenditures, but also fraud and corruption engaged in for the purpose of influencing any decision as to the use of loan proceeds. All such actions are deemed “use of loan proceeds”. Similarly, recipients of loan proceeds include all persons or entities which either receive loan proceeds for their own use (e.g., “end users”), persons or entities such as fiscal agents which are responsible for the deposit or transfer of Loan proceeds (whether or not they are beneficiaries of such proceeds), and persons or entities which take or influence decisions regarding the use of loan proceeds.⁸

It is expected that most non-procurement-related sanctions cases would typically involve an NGO or financial intermediary responsible for the implementation of a particular component or subcomponent of a project and which has been found to have engaged in sanctionable practices. The Bank does not sanction government officials or employees, or government-run agencies and entities other than those autonomous state-owned enterprises that are eligible to participate in procurement processes.⁹ Any cases involving government officials, employees, agencies and entities will be addressed, as has been the case, by the Borrower taking timely and appropriate action, failing which the Bank would have the right to exercise its contractual remedies. As has been the case in the procurement context, the list of sanctioned individuals and entities will be publicly disclosed by posting on the Bank’s website.

Anti-Corruption Guidelines. The expanded definitions of “corrupt practice”, “fraudulent practice”, “coercive practice” and “collusive practice” are included in a new framework

⁷ The expanded sanctions regime does not apply to development policy lending (DPLs) except in cases where the Bank agrees with the Borrower on specified purposes for which loan proceeds may be used.

⁸ These categories are not mutually exclusive. Certain persons or entities may fall under more than one category. A financial intermediary, for example, may receive payment for its services, will transfer funds to end users and will make or influence decisions regarding the use of loan proceeds.

⁹ State-owned enterprises, referred to as Government-owned enterprises in paragraph 1.8 (c) of the Procurement Guidelines and paragraph 1.11 (b) of the Consultant Guidelines, are eligible to participate in their own country if they are legally and financially autonomous, operate under commercial law, and are not dependent agencies of the Borrower. In addition, Government-owned universities and research centers may participate under certain conditions in Bank-financed consulting assignments as per paragraph 1.11 (c) of the Consultant Guidelines.

document entitled “Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants” (the Anti-Corruption Guidelines). These Guidelines will be included as part of the package of normative documents, such as the Procurement Guidelines and the Consultant Guidelines, that apply to Bank-financed investment projects. Like those other Guidelines, the new Anti-Corruption Guidelines will be incorporated by reference into the legal agreements for each project. The Borrower will be expected to distribute the Guidelines to all project participants with which it enters into a contract and to ensure project participants’ awareness of their contents. For this purpose, the Guidelines will be translated from English into the five other official United Nations languages. The text of the Anti-Corruption Guidelines is attached as Annex B.

In addition to the expanded definitions, the Guidelines set out the basic actions that borrowers and other recipients of loan proceeds are required to undertake to prevent and combat fraud and corruption in Bank-financed projects. These include taking all appropriate measures to prevent fraud and corruption, distributing the Anti-Corruption Guidelines to project participants, informing the Bank of allegations of fraud and corruption, taking timely and appropriate action when cases of fraud and corruption arise, cooperating with Bank investigations, and taking all necessary and appropriate action to give full effect to Bank-imposed sanctions. The Guidelines also set out the actions that the Bank may take against persons and entities that engage in fraud and corruption, including the imposition of sanctions against the corrupt party (which would, with appropriate adjustments,¹⁰ be similar to those available in the procurement context).

Changes to General Conditions. In addition, the following amendments to the IBRD and IDA General Conditions¹¹ to enhance the legal tools at the Bank’s disposal to prevent and combat fraud and corruption have been adopted:

- Two new events of suspension enable the Bank to suspend the loan: (a) if the loan were to a Borrower that is not a member country, and the Borrower has been declared ineligible to participate in Bank-financed projects for having engaged in fraud or corruption in another project; and (b) if the Bank determined that fraud or corruption¹² has occurred in connection with the use of Bank loan proceeds without timely and appropriate action having been taken by the Borrower to address such practices when they occur. In addition, a breach of the undertakings in the Anti-Corruption Guidelines permits the Bank to suspend the loan under the existing event of suspension for nonperformance.¹³

¹⁰ Formerly, debarment only operated prospectively—i.e., the sanctioned party could continue to perform under any ongoing contracts but could not bid for future contracts. This makes sense in the context of procurement, where contractors generally perform specific, time-bound activities. But, since outside the procurement context, sanctioned parties may be “fixtures” that are part of the implementation arrangements for the duration of a project or for an indefinite period, sanctions may cause the interruption of current arrangements as well as the exclusion from future arrangements.

¹¹ *IBRD General Conditions for Loans*, dated July 1, 2005 and *IBRD General Conditions for Credits and Grants*, dated July 1, 2005.

¹² “Obstructive practices” are not covered by this new remedy.

¹³ Section 7.02(b) of the IBRD General Conditions; Section 6.02(b) of the IDA General Conditions.

- The former cancellation remedy for fraud or corruption, which is tied to the procurement/selection context, has been broadened to cover any instance of fraud and corruption that occurs generally in connection with the use of loan proceeds. This remedy is linked to the amount of the loan that has been tainted by fraud or corruption.
- The refund remedy for IDA grants have been expanded to enable IDA to seek refund of amounts tainted by fraud and corruption in both procurement and non-procurement contexts.

The text of these amendments is attached as Annex C.

B. Obstructive Practices

New Definition of “Obstructive Practice”. Obstruction of Bank investigations into allegations of fraud or corruption is now itself sanctionable. A new sanctionable offense defined as “obstructive practice” applies both in procurement and non-procurement contexts. This definition is included in the Anti-Corruption Guidelines (as noted above), the Procurement and Consultant Guidelines, and the Procedures of the Bank’s Sanctions Board.

“Obstructive practice” is defined in the Anti-Corruption Guidelines as “(i) deliberately destroying, falsifying, altering or concealing of evidence material to the investigation or making false statements to investigators in order to materially impede a Bank investigation into allegations of a corrupt, fraudulent, coercive or collusive practice; and/or threatening, harassing or intimidating any party to prevent it from disclosing its knowledge of matters relevant to the investigation or from pursuing the investigation; or (ii) acts intended to materially impede the exercise of the Bank’s contractual rights of audit or access to information”. This definition requires deliberate commission of specified acts designed to materially impede Bank’s investigation of fraud and corruption. Small delays or mere inefficiencies do not constitute “obstructive practices”.

Rationale. Under the former sanctions process, which had no separate sanction for obstruction of investigation, parties under investigation had a perverse incentive to destroy evidence or intimidate witnesses. If the Bank was investigating a firm for bribery of a staff member in relation to a Bank-financed project and the firm destroyed evidence which could prove their guilt, under the former rules the destruction could only be used as an aggravating factor in the determination of sanctions, and only if the Bank were able to prove the underlying offense of corruption. A firm could attempt to avoid sanction by preventing the Bank from gathering sufficient evidence to prove the underlying allegation of corruption.

Recognizing obstruction of investigation as a separate sanctionable offense encourages firms to act responsibly, and deter them from destroying evidence, harassing witnesses or otherwise obstructing the Bank's investigations. It provides a means for enforcing the Bank’s third-party rights and a mechanism for discouraging firms from non-cooperation in circumstances where there are no contractual rights or where those rights have lapsed.

It should be noted that obstructive practices do not form a basis for the Bank's exercise of contractual remedies under the General Conditions.

C. Procurement

Cases of fraud and corruption specific to procurement/selection of consultants matters will continue to be subject to the fraud and corruption-related provisions of the Procurement and Consultant Guidelines. The Procurement and Consultant Guidelines ineligibility provisions have been modified to include new ineligibility grounds stemming from sanctions imposed pursuant to the Anti-Corruption Guidelines. The Guidelines incorporate the expanded definitions, appropriately clarified for the procurement context, as well as the expansion of the definitions of fraud and corruption to encompass obstructive practices. The change in definitions is not expected to have a substantive impact on the sanctions regime as it applies to procurement and consultants. The texts of the amendments to Procurement Guidelines are attached in Annex D; equivalent amendments have been made to the Consultant Guidelines.