

# Integrity Pacts to Prevent Corruption in Banknote Procurement

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**The Banknotes Ethics Initiative (BnEI) is an anti-corruption collective action initiative founded in 2013. It addresses the internal compliance standards of its members combined with a rigorous accreditation process administered by an external accreditation council. The objectives of BnEI are also supported by 38 central banks, and now, some five years after its inception, the BnEI is picking up on one of its driving themes – ensuring fair competition in the procurement of banknotes.**

In its next phase of work, BnEI is adopting a more pro-active approach to its customer base and plans to invite central banks to discuss their role in preventing bribery and using Integrity Pacts or similar arrangements to achieve this aim.

The Basel Institute on Governance is supporting the BnEI in its approach due to its long-standing experience in the practical aspects of collective action. In December 2015, the Basel Institute published the results of a learning review of recent experiences with Integrity Pacts. This study revealed important insights into how the pacts can be an effective tool to prevent procurement-related corruption, as well as the limitations of such approaches.

This article introduces the concept of Integrity Pacts and their potential use in banknote procurement as a means to promote ethical standards, transparency and efficiency, and to establish a level playing field for all bidders by ensuring that competitors are following the same rules of the game.

## What is an Integrity Pact?

An Integrity Pact (IP) is an agreement between a procurement authority and bidders to a public-sector contract and can be included as a clause within tender documents or as a separate contract.

The precise terms are developed according to the context, but usually include anti-corruption and fair competition obligations, sanctions, tools to report and resolve issues that may arise during the procurement, and the appointment of independent monitors to oversee the process.

Effective IPs also typically state the conditions and process under which monitors can withdraw from the IP if they believe their position is compromised.

Research shows that the role of the monitor is crucial and will often make or break an Integrity Pact. Projects involving complex technical issues may need several monitors with various skillsets. Their early and active involvement from the design stage of the tender development all the way through the process of implementation and post-contract is also important. Monitors should have powers to review all relevant materials related to the tender and contract process, and be sufficiently skilled and properly resourced so as to be able to detect 'red flags' or any potential breaches of the IP.

The concept of IPs was first pioneered by the anti-corruption NGO Transparency International (TI) in the 1990s. From the outset, TI has promoted three guiding principles for the design of an IP: transparency, stakeholder involvement, and accountability.

In many IPs, TI chapters have been instrumental in initiating these by proposing the concept to both government and private sector actors in various sector-specific tenders. Civil society organisations have also acted as the lead implementers or monitors, undertaken investigative tasks, or contributed to the selection of independent monitors in a number of IPs.

To date, IPs have been used as an anti-corruption tool in procurement processes in at least 20 countries in a wide array of sectors, and with varying degrees of success. But if lessons are learned from the early versions, then IPs can be an effective tool to help prevent bribery.

In some countries IPs are used in all public tenders above a certain value threshold, and since 2015, the Indian anti-corruption agency has ordered public-sector banks, insurance companies and financial institutions to employ IPs with independent external monitors for tenders after April 2016.

Currently, the European Commission is piloting a project with TI under which 17 major procurement projects in 11 EU member states will deploy IPs as a means to safeguard EU funds against fraud and corruption.

## Hallmarks of effective monitors

The Basel Institute's review of IPs reached a clear conclusion that having a proactive, engaged and knowledgeable monitor is imperative to an IP's success.

Additional elements that create the conditions for a strong IP include the independence of the monitors, which means they cannot be associated with any of the stakeholders – either financially or in any other way that could suggest that improper influence could be exercised. It is therefore important to conduct conflict of interest checks and publicise the monitors' profiles to earn stakeholder trust.

The selection process of the monitors must also be transparent. The more a contracting authority communicates regarding the IP from the outset, the better. Engaging and consulting with various stakeholders, including the private sector, even soliciting nominations for the monitors prior to a tender is ideal.

Sufficient resources, including time, ensure that monitors are able to investigate, report, and remediate or sanction any potential irregularities that might arise in a professional manner. To be able to fulfill their roles, monitors must have access to documentation related to the procurement process and contract implementation.

In turn, the bidders and procurement authorities must be obliged to collaborate and share information with the monitors as and when required to do so.

A corollary to these powers is the importance for the monitors to be in regular contact with all stakeholders and to report to the contracting authorities so as to promote an environment of trust.

IPs are sufficiently flexible to ensure that strong safeguards are put in place adapted to each country and industry. The greater the participation in the design of the IP, the higher the likelihood of an IP's success. If an IP is used in a tender without the hallmarks of an effective monitor, companies might be justified in thinking this is a tick-box exercise or mere anti-corruption window-dressing.

## Cost of an Integrity Pact

The costs of an IP will vary depending on the complexity of the procurement, as well as factors such as availability of local or international monitors and corresponding market rates for professional services.

Typically, the first question companies ask when confronted with an IP is: 'how much will this cost?'

There are many ways to fund an IP. For example, the public authority can dedicate resources through the public budget. Where major public projects are being funded by international financial institutions or donors, these funders can earmark appropriate resources to cover an IP.

Most frequently IP costs are covered through mandatory and equal fees paid for by the bidders; in some cases a percentage of the estimated contract value can be determined at the outset as a fixed cost for participating in a tender. A combination of the above fee structures can also be considered.

### The business case for IPs

Companies often exhibit some reluctance or hesitation to engage in, or otherwise support, an IP. Where IPs are mandatory, or monitors are pre-selected unilaterally by the contracting authorities, companies might sign an IP in order to submit a bid, but will lack an understanding, let alone conviction, about the usefulness of the IP.

The Basel Institute's review revealed a number of compelling factors that make a strong business case in favour of including IPs in public sector tenders and contracts. Foremost, IPs level the playing field among competitors.

Second, IPs help save money. This might seem counterintuitive, particularly given that monitors need to be paid. Yet the cost savings achieved with IPs with respect to reduced delays, especially those caused by an assumed or alleged breach of competition law, fewer contract amendments, and avoidance of price distortions resulting from unfair business practices more than make up for the actual costs related to an IP with strong monitors.

Third, IPs do not cause delays, but rather save time and secure other efficiencies in implementation of public-sector procurement and projects.

### Special considerations for the banknote industry

The banknote sector is among several industries that, for legitimate reasons, need to safeguard business secrets, in particular relating to technical specifications. In the defence sector, for example, national security is at stake, whereas in the banknote sector, confidentiality is needed to avoid risks of counterfeiting, amongst other criminal activities.

Despite national security considerations, IPs have been used in defence-related procurements in Colombia and India. The Indian defence ministry has been applying IPs since 2006 and as a result, procurement has been determined to be the 'lowest risk' area within the ministry.

In fact, in 2012, the defence ministry blacklisted six suppliers due to allegations of violations of a pre-contract IP and, in 2014, cancelled a supplier contract once evidence emerged through a foreign prosecution that the company had violated the terms of the pre-contract IP.

IPs can be designed to mandate that monitors respect strict confidentiality rules and foresee additional precautions, such as ensuring that documents shared with the monitors can be identified and traced at all times.

Furthermore, while technical specifications can remain confidential, non-sensitive information can still be reported on and communicated, promoting transparency that builds trust both among bidders, as well as the public.

In July 2017, the Reserve Bank of India issued a pre-qualification bid (PQB) notice for the supply of security features for Indian banknotes that required bidders to sign a pre-contract IP. The IP text was available to the public in the general PQB notice on the internet. It has also been reported that the Central Bank of Aruba included an IP in a banknote-related tender, although there is no publicly-available information on how that IP was designed.

In sum, despite special considerations that are unique to the banknote sector, IPs have the advantage of being a flexible tool that can be tailored on a case-by-case basis to the needs of specific public-sector tenders and projects.

### Additional corruption prevention options

The use of IPs to prevent corruption in public procurement was devised in the 1990s at a time when private sector anti-corruption compliance programmes were still being developed and in many industries were non-existent. International and national anti-corruption regulatory frameworks have also developed significantly since then.

Despite these advances, the persistence of corruption in high-value public-sector procurement underscores that IPs remain a useful mechanism to raise awareness of integrity standards and increase compliance with the law.

That said, IPs are one of several integrity-promoting tools for procurement that can be considered by central bank or other banknote-related procurement entities. For example, digital communication channels and other information and communications technologies (ICT) by governments, particularly transferring procurement onto digital platforms (e-procurement), have revolutionised information sharing and the environment where anti-corruption and compliance have advanced considerably.

Another preventive tool that involves the IP has been developed jointly by the Basel Institute and the Organization for Economic Cooperation and Development (OECD) and TI. The so-called High-Level Reporting Mechanisms (HLRM) is a tool that seeks to protect the public procurement process by preventing collusion or bribery or other forms of corruption through collaboration between the public and private sectors, with external experts tasked with resolving practical issues so that the tender is not disrupted.

An HLRM is independent but located in a high level of government and creates an early reporting channel through which companies can relate issues that might indicate corruption or unfair business practices. Like an IP, an HLRM is designed to provide a swift resolution of such allegations to ensure that a procurement process remains on track. The HLRM in Colombia also requires the parties to sign up to an IP as part of the mechanism.

Central banks are among the most independent branches of the public sector, with a high degree of autonomy. Where they express interest in developing integrity-enhancing measures in banknote-related procurement, it is advisable to take a whole-of-government approach to preventing corruption and consider how an IP can be used in each context.

IPs have the advantage in that they are best when tailored to a country's unique needs regarding each banknote-related tender, preferably through a participatory approach to ensure the greatest chances for success.

### Towards a pilot IP in the banknote sector

Companies with strong anti-corruption and antitrust compliance programs have been quick to see the virtues of IPs once introduced to the concept through a tender, and then spread the word within their industries to promote fair competition.

This is the case of BnEI. In a unique multi-stakeholder effort, BnEI and the Basel Institute are joining forces to raise awareness of the IP concept in the banknote sector and have prepared an IP proposal. With greater information about the IP tool, as well as its flexibility alongside other integrity measures, we hope to identify one or several countries who will be interested in piloting an IP in banknote procurement.

BnEI and the Basel Institute welcome any questions to further clarify the use of IPs and look forward to promoting collaborative pilot IPs in the banknote sector.

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