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Behavioural Integrity Testing and Proactive Risk Assessments: Toward an Industry Based Compliance Defense

IACSA - International Anti-Corruption Academy

Publication 2012
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Introduction

It is said that 20 years ago it was somewhat of an experiment by the U.S. government; one that was a cause of concern at the time when it put into motion a “stick and carrot” strategy for getting corporations to become good corporate citizens. After two decades of hoping that organizations would aspire to become good corporate citizens this wish has instead been usurped by a rival concern. Many CEOs are clamoring to know, “How can we put this problem of compliance behind us so we can concentrate on the business of making money?” With this attitude, some fear that the implementation of the US Foreign Corrupt Practices Act (FCPA) is not working as planned. How did it come to this?

This attitude has been propelled as much by the absence of an organizational model and paradigm for benchmarking compliance with FCPA as by strong-minded Department of Justice (DOJ) prosecutors determined to leverage their legal tools for punishing and rehabilitating corporations that bribe foreign public officials. The disenchantment and resentment of a few companies comes from what some now see to be derived from a mistaken belief; specifically, that they could avoid facing jail time and heavy penalties if they showed it had an effective programme aimed at complying with anti-bribery measures. These motivations, and not becoming a good corporate citizen, were contrived incentives.

The U.S. Sentencing Commission reports that in the 20 years since the Federal Sentencing Guidelines for Organizations (FSGO) were promulgated 3,433 organizations have been sentenced – but only five have received credit for having a compliance and ethics programme. Who are these five and what did they have that was so great? Regrettably, the Commission cannot make publicly available data on which organizations received credit. The Ethics Resource Center (ERC) in 2012 reports that prosecutors have
trouble pointing to any evidence that an “effective compliance and ethics programme” has ever played a role in the outcome of a real case. This is in spite of evidence that companies with ethics and compliance programmes are more law abiding and engage in less misconduct than those without. The ERC notes that a “Conference Board study in 2009 found very few cases where DOJ acknowledged granting credit for – or even carefully assessing – a pre-existing compliance/ethics programme” (ERC, 2012:12).

For years executives, legal counsel, compliance officers, and academics have been asking for clear answers about how DOJ makes decisions on giving credit for effective compliance programmes. But these too have not been forthcoming. Koehler, a frequent contributor to this dialogue states that given this lack of specificity about DOJ’s decision-making process, organizations are hesitant to submit to the DOJ’s “opaque, inconsistent, and unpredictable practices”. Understandably, with the goal of staying out of the courtroom, companies are starting to worry that making good faith compliance efforts to abide by the law may all be for nothing if DOJ will not recognize these efforts (Koehler, 2012).

Can it be that the Commission’s strategy 20 years ago on FSGO has turned out to be an experiment that failed? It has been recalled that William Wilkins Jr., Commission chairman at the time, was unsure of the success of this initiative and speculated that if organizations did not take up the challenge to take up the fight against corporate crime by adopting effective compliance and ethics programmes on their own it is doubtful this FSGO “carrot and stick” approach would endure (Wilkins, 2010, in Ethics Resource Center, 2012). It behooves everyone today to continue trying to make this experiment work. To this end we propose that corporations blaze a fresh trail in becoming a good corporate citizen, launch their own experiment, and stop relying on DOJ to give them the elements of an effective compliance programme. It is time for a fresh paradigm, one that could potentially win a battle in the courtroom and at the same time benchmark with social science tools what it takes to be a good corporate citizen.

Consider that the matter of compliance programme effectiveness seems always to be posed “after the fact”, after enforcement action has revealed that a bribery offense has been committed. This post hoc trigger for adducing pre-existing effectiveness is reactive and inefficient. By then it is too late. The act has left a footprint and cannot be “erased.” Moreover, enforcement officers and regulators are on the scene. Later, prosecutors frame the questions, make their observations, and fit facts into their bounded legal universe of deterrence, punishment and rehabilitation.

Now consider the same bribery offense this time detected by inserting, before the fact, the potential offender into a simulation of the real world where the offense was to take place. Testing integrity by offering the person the same opportunity to commit an offense in a simulated world, and observing the offense being committed in a simulated world now gives the compliance officer more options. This kind of covert probe of human intentions can identify high risk persons and see if they are not disposed to comply with regulations. Findings from these probes would prompt corrective action, retraining, company sanctions, serve as deterrence for others, and importantly, by avoiding a real offense from being committed, remove the basis for enforcement action. An early detection system like this may be the effective tool sought by CEOs for staying out of the courtroom. In this paper we make a case for a proactive risk assessment paradigm based on covert probes of real world work environments. The paradigm reduces the risk of enforcement activity, while documenting the effectiveness of a compliance programme. Properly conceived and executed this before the fact evidence based proactive model of compliance risk is potentially superior to the current singular use of after the fact enforcement of the FCPA.

Part I of this paper summarizes the wide ranging demands for data to support claims of programme effectiveness, highlighting the problem of measurement and the need for evidence-based conclusions. Part II looks at the increasing use of covert probes by banks and securities commissions to gather intelligence on compliance, and outlines the elements of Integrity Tests as an information gathering methodology. Part III presents a case example of Integrity Testing within a financial institution. Part IV shows how Integrity Testing can provide the necessary data for programme evaluations, how these tools
can form a new framework for measuring risk of compliance failure and build the foundation for a new discourse with prosecutors in cases of a rogue employee.

1 Demands for data to evaluate effectiveness

Guidance manuals for complying with national anti-corruption, money laundering and bribery legislation include a requirement that the compliance effort be evaluated. DOJ does not prescribe specific programme requirements for prosecutors in examining effectiveness, so we are left to wonder how they make these assessments. There is no formal knowledge base or general methodology that is used by prosecutors. Because of this, the ERC has urged DOJ to augment the legal education and practice of prosecutors, and stated that this should include, “...providing training to key DOJ personnel on compliance/ethics programme best practices.... (and that) this training process might include dialogue with the private sector about emerging best practices.” (ERC, 2012:9). The Center is not the only one demanding upgrading competence to support claims of effectiveness.

1.1 FSGO Advisory Group to the Commission, 2003

A decade after FSGO came into effect an Advisory Group to the Commission (2003) undertook to examine the criteria used in assessing how the FSGO programme ensures an organization’s compliance with the law. The Advisory Group recommended that FSGO guidelines be updated to reflect the learning and progress in the compliance field since 1991, and to give organizations greater guidance regarding the factors likely to result in effective programmes.

1.2 UK Bribery Act, 2010

The UK Guidance is general but insists on an internal review of financial control mechanisms, staff surveys, questionnaires, feedback from training and, “some form of external verification or assurance of the effectiveness of anti-bribery procedures (to) provide an important source of information... to inform continuing improvement of anti-bribery policies” (p.31).

1.3 OECD Good Practice Guidelines, 2009

The Working Group on Bribery (WGB) presents a dozen guidelines for companies to consider in preventing and detecting bribery of foreign officials. Added to the list is a 12th guideline stating that companies should conduct: “...periodic reviews of the ethics and compliance programmes or measures, designed to evaluate and improve their effectiveness in preventing and detecting foreign bribery, taking into account relevant developments in the field, and evolving international and industry standards” (p.14).

1.4 Government Accountability Office (GAO), 2009

After studying FCPA enforcement efforts a GAO (2009) report concludes that DOJ cannot demonstrate the extent to which their primary enforcement tools, Non Prosecution Agreements (NPA) and Deferred Prosecution Agreements (DPA), contribute to combating corporate crime. DOJ, it found, has no measures to assess the effectiveness of their efforts. The report concludes that it could be difficult for DOJ to justify its increasing use of these tools if it cannot show through measurable, quantifiable indicators and
performance measures that these DPAs and NPAs promote corporate reform, deter future violations and prevent recidivism.

1.5 OECD USA Phase III Report, 2010

In evaluating the U.S. anti-bribery efforts recently the WGB also notes that the reasons for the impressive FCPA enforcement record lies in the use of NPAs and DPAs by prosecutors. But again, the WGB goes on to state that the actual deterrent effect of this type of enforcement has not been quantified and that this raises the question of whether these NPAs and DPAs make any difference on corruption and bribery whatsoever. The WGB report underscores the importance of collecting data to link programme activities to results, and recommends the U.S. make public any information about the impact of NPAs and DPAs on deterring the bribery of foreign public officials.

1.6 Ethics Resource Center (ERC), 2012

The Independent Advisory Group of this highly regarded organization published a review of the progress of the FSGO over the past 20 years. The ERC Group recommends that DOJ establish standards to govern how ethics and compliance programmes are to be judged and that manuals for prosecutors include clear directions, and that prosecutors use these programme standards when assessing a company’s compliance and ethics programme. Another key recommendation by the ERC is that companies should have the burden of demonstrating not only that they have a comprehensive and well-designed ethics and compliance programme but that they also evaluate it to examine the extent to which that is the case.

1.7 Pretexting to gather real world data

It is possible to collect the evidence sought. For example, the World Bank (Carozza, 2009) has used a “mystery shopper” methodology to gather real time data in a study of sending fees and exchange rates by firms engaged in transactions involving remittances. In this case it involved “pretending” to be a customer and conducting real transactions with a remittance firm in order to document their actual practices. Likewise, the mystery shopping exercise can also be used as a tool for regulatory bodies to assess their industry’s compliance with relevant requirements.

For example, recently the Securities and Futures Commission and the Hong Kong Monetary Authority teamed up in a covert exercise to identify risks of compliance failures before the fact. (Securities and Futures Commission, 2011). In Hong Kong ten licensed corporations comprising investment advisory firms and brokerages were approached by a “potential client”. The probe focused on collecting information on the selling practices involving unlisted securities and futures investment products. The probe looked into how intermediaries collected required information from each client. Altogether, 150 interactions with intermediaries were documented. Real world covert interactions revealed significant gaps in customer information collection, explanation of product features to customers, and risk suitability assessments. These data identified risks of non-compliance by individuals and firms before the fact and served in planning more detailed inspections to be carried out.

2 Multifaceted Integrity Tests: Covert probes to access hidden data

Corruption and bribery are offenses committed in private. A defining element of these offenses is the belief by offenders that they are not being observed. Since these misdeeds are done in secret detection and
prevention methods can only be effective if these acts are observed through covert means such as undercover. Observations must indeed be covert or the data gathered from individuals cannot be said to represent the real universe where crime is committed. When law enforcement uses covert means it is for gathering court admissible evidence to prosecute. When non-law enforcement use similar covert methods it is to gather information for developing theory, or gather data about commercial practices, or assess efficiency of a system, or test employee compliance with internal rules and regulations.

Simple Integrity Tests identify a behavioural response required in a specific work function. The options in the test allow for only two outcomes: pass or fail. The test must allow for a failure to manifest itself as much as compliance to be shown. Used in a law enforcement context a simple integrity test is predicated upon reasonable suspicion and can involve:

- A covert operative handing in a wallet containing cash to officers at the police desk and witnessing that correct handling protocols are observed;
- Leaving valuable goods at a simulated crime scene or suspected shipping container to test whether an officer steals the item;
- A covert operative offering an officer a bribe; and
- Putting false information in a database to catch a person suspected of unlawfully disclosing information.

2.1 A proactive risk assessment paradigm

A proactive compliance paradigm refers to a commonly shared approach for collecting information about the risk of compliance failures. This paradigm includes standards for information gathering, criteria for accepting observations as evidence, logic for drawing conclusions, and oversight of the methodology.

Multifaceted Integrity Tests comprise activities aligned with a developing paradigm. They have a number of distinguishing characteristics. First, they involve collecting information on more than a simple pass/fail basis. They involve testing the presence or absence of a set of predetermined criterion behaviours. Second, while the scenario may be straightforward the staging of opportunities that invite a target response is sequenced and conditioned by the target’s own behaviour as the test unfolds. Third, the interaction may involve having more than one contact with the target over a specified period. Fourth, the scenarios and interaction sequences are standardized and executed by trained agents. Finally, and most importantly, there are clear metrics imposed for measuring the outcome of a multifaceted integrity test.

2.2 What can Multifaceted Integrity Tests measure?

The measurements can index:

- the behavioural outcomes of training;
- the degree of compliance with company policy, rules, and regulations;
- the severity of any rule violation;
- confidence in the imputed future intentions of the target; and,
- predispositions in the target to commit a criminal offense.
Assigned values index the adequacy of an expected compliant/integrity response or rate the severity of a failed compliant/integrity response. The behavioural risk assessment paradigm is based on the assumption that the scenario reflects real world situations expected in the employee’s environment, that the executed scenario by the agent is a realistic simulation of the interaction process, that the behaviour observed would likely be repeated given another similar opportunity. The test and its results allow for a reasonable inference to be made in regard to the employee’s predisposition to engage in such misconduct given an opportunity in the future. In some cases, where there is a need to support the assumptions of predisposition, the test can be repeated on the same target through an equivalent scenario.

3 A practical application of a proactive Multifaceted Integrity Testing paradigm

3.1 Objectives

The following case illustrates the staging of a multifaceted integrity test scenario and summarizes the interactions between agent and target. In this real world case, a large financial institution was concerned with the risks that, in spite of training in Anti Money Laundering (AML) and Counter Terrorist Financing (CTF), employees might not align their conduct with the training when confronted with a suspicious customer. The geographical location selected for these integrity tests coincided with a high risk environment for potential money laundering operations. Four branches of the bank in the same area were selected.

The building of the scenario\(^1\), training of covert agents, behavioural triggers and metrics were carefully pre-planned for fairness (Girodo, 1998) and to meet the prerequisites for a valid and ethical integrity test. Agent role playing reliability, storage of a record of the test, erasing any “footprint” left by the test, and a detailed discussion with executives of how the results would be managed was part of the Integrity Testing protocol. The test aimed to:

- assess the risks that an employee will fail to identify potential money laundering customers;
- assess the risks that an employee will fail to comply with the AML training received when encountering instances of suspicious activity by a customer;
- assess the risk that an employee’s behaviour will be at variance with established policy and procedure;
- assess the risks that an employee will exercise unauthorized and/or inappropriate discretion in dealing with a customer;
- assess the risk that the employee might engage in criminal conduct.

The covert interactions lasted from 10 minutes to 1.5 hrs. Below is a narrative reconstructing of the actual Multifaceted Integrity Testing with select verbatim taken from audio-video records in four separate tests. Note the various types of failures by two targets, including their willingness to conspire to commit a criminal offense. Real names are not used.

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\(^1\) The contribution of Kevin J. Ford to building the AML scenario is gratefully acknowledged.
### 3.2 Narrative reconstruction of the case

Richard Wong is legal counsel and deputy chief financial officer and emissary for the CEO of a private Asian financial institution. Wong has planned this meeting with a bank official for three weeks. He has received training for this role and is confident he can surreptitiously approach a targeted bank official and persuade him of his intentions. Wong is to meet the branch accounts manager of the bank’s foreign office, a certain Mr. Jonathan Yew, to ask for a special favour. Yew, 36 years old, racket ball champion, raised in a middle class environment and now married into a wealthy upper socialite family, is a rising star.

Wong does not hesitate to reveal that he represents the financial interests of a wealthy client, owner of a billion dollar International Trading Company. The purpose of this initial meeting Wong says is “to ascertain if it would be worthwhile for my client to do business with you and your branch.” He continues, “My client is very particular about who he deals with. Discretion is of utmost importance. He is looking for a discrete and mutually beneficial relationship with the bank, if this is possible.” Yew nods in understanding. “My client, whom I would prefer not to name at this time, wants to know if the bank might be able to give my client special attention.” Yew listens, and quietly probes into the kind of business Wong represents.

Over the discussion Wong hints of his client’s origins, identity, and eventually reveals his banking intentions. Innocuously, Wong inquires of Yew about such matters regarding any limits the bank might have regarding cash transactions and wire transfers, and later about the possibility of opening trust accounts in foreign countries, receiving transfers from the Bahamas, and other banking activity. At an appropriate moment Wong leans forward and says softly “it might be difficult to supply all the needed original documentation, but we do have notarized photocopies of the originals.” Wong states that his client would only be interested in this bank if a special “trusting” relationship could be developed. Yew cautiously probes into what he means by this.

Wong replies, “My client might want to access the bank services off hours, or maybe on a Sunday with only a few hours notice. Some of our transfers must be acted upon immediately, and there can be no delay.” He expounds on other special services his client might request. As an example he suggests a typical USD 5,000,000 transfer might be the very first transaction from the Bahamas, and that some of these instruments might be in cash. Wong immediately assures the associate accounts Manager that any extra work or dedication in regards to his account would be amply recognized – usually quarterly when one of the client’s representatives will meet discretely with the proper bank official. The precise amount and modalities for this compensation would be agreed to in due course before any undertakings are begun.

Wong cautions and reassures Yew at the same time, “We don’t want to draw any unnecessary attention here. We know how we can work with you as closely as possible to do everything by the books ... but my client would like something more than a distant business relationship”. Wong describes other types of transactions – the type Yew recognizes from AML presentations made by a compliance consultant 6 months ago. “This is an important proposition and cannot be rushed into by either party. You would need to give this some thought. If this is a commitment that you cannot make, best you let me know. I have a meeting this afternoon with another bank and my client wants a preliminary report on potential service providers tomorrow noon his time. Mr. Yew, I know I may be imposing however, may I suggest we meet for tea later... around 11:30? Where would you suggest we can talk more privately?”

Two blocks from the bank Wong, holding a cup of Teh tarik, continues “… my client would insist that all transactions go smoothly and experience no interruptions of any kind. I understand that other parties may take an interest in your customers and want to look at their accounts more closely. We understand that. We are accustomed to dealing with that and we are ready for that. We want to cooperate fully to assist the bank and to protect the bank’s interests.” Yew nods several times acknowledging he understands.

Wong comes to the point. “To help us here we would need to receive advance notice of any outside inquiry so that we can prepare how to assist in the examination of our account activity, and to make sure there is
as little interruption in our business and our customers. My client would show his gratitude in a very measurable way. Could your branch provide this advance notice to my client if the case arose?"

Yew whispers, "No problem, we can come to some kind of an arrangement. No one will know about this. There is extra work and risk for me. I help you ... you help me."

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At the very same hour, a few miles away at another end of the city, an identical interaction is underway at a second branch of the same bank. Another potential customer is exploring the possibility of a special relationship with the bank. There, a Mr. Chan Man Wai, who had presented himself as an executive and general counsel of a private firm, is meeting with mid-level banking officer Mr. Megat Nikah to ask about opening a private account for a client who, “at this time prefers not to be named.” The scenario is the same, an outlining of the need for a special relationship with the bank, the gradual introduction of those familiar red flags inserted in passing as if they were normative for all wealthy businessmen and a natural part of a customer getting to know his bank.

The invitation for coffee turns into a lunch where Mr. Megat from the bank is led to consider the advantages of developing a special discrete arrangement that would be mutually beneficial. “We know how to mitigate the risks without leaving a trail”, Mr. Chan confides in familiar code. The accounts executive is cautious with his words, but clearly shows an eagerness to hear more about a confidential arrangement. Twenty minutes into lunch Mr. Chan raises the matter of receiving an alert of impending inspections. Mr. Megat peers around, leans forward and, just audibly enough to be picked up by Mr. Chan’s tiny vest button microphone, says “As soon as we hear anything about an upcoming inspection ... you’ll know too.”

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At precisely the same hour matching covert probes are underway in two other branches with the same invitation by two other “business representatives” to test the waters for a secret cooperation by bank officials. An accounts manager in a third branch bank and a senior front line staff in a fourth listen to the same delivery both had rehearsed with Richard Wong and Mr. Chan Man Wai during an Integrity Testing training programme for anti-corruption agencies given three weeks earlier.

This time, bank officials are less obliging. Within the first 5 minutes both refuse to entertain any such special relationship and utter, with balanced assurance and poise, their ingrained mantra, “We must follow our ‘Know Your Customer’ regulations and what you are asking will not be possible. We will have to know the name of the person whose name will bear the account. I am sorry, but I am very busy and will not be able to meet you for coffee.”

That refrain, drummed into front line staff and managing bank employees during AML training sessions, here stakes a claim for integrity, the compliance regime, and for keeping bank executives out of the courtroom.

4 Benefits of proactive behavioural integrity test paradigm

4.1 Identifying risks and specifying compliance standards

One of the strengths of Australia’s anti-corruption initiatives for organizations lies in the framework it has created for its ethics and compliance regime. It operationalizes compliance and adopts a country wide business ethics code with clear compliance standards (Australian Standards, 2006). These include recommendations for using specific behavioural measurement instruments to put these standards into effect and to test their effectiveness.
The Australian Standards aim to enable compliance but the Standards are also concerned with compliance failure for this is where the risk lies. It defines compliance failure as “an act or omission whereby an organization has not met its compliance obligations, processes, or behavioural obligations” (AS 3806-2006, p. 5). Within the list of critical measures for collecting data on compliance failures and “near misses” the measurements include data obtained from Integrity Testing.

4.2 Measuring compliance training outcomes

Training followed by a practical test in the field to verify competencies applies to getting a driver’s permit, Scuba certification, and a pilot’s license. Ethics training and followed by competence testing with covert behavioural tests is a way of verifying effectiveness. A framework for implementing these tests has been described (Girodo, 2004, 2010). Full knowledge and agreement by employees to be randomly tested is obtained. Here, they agree to have their knowledge and skills tested by external agents and to receive feedback on their individual results and from those of employees as a group.

Our case example obtained behavioural science evidence that at least for two employees the content of their training could be applied effectively. What we do not know is the impact of this training on employees who attended the training. Documenting the effectiveness of compliance training by the behavioural testing of a properly selected sample of employees would allow for a generalization about effectiveness as a whole. This behavioural data is a more accurate and valid measure of effectiveness than counting the number of employees taking the course, or keeping track of the number of email reminders sent concerning a regulation. Deficiencies in behavioural outputs in simulated encounters allows for improvements and documenting the results of these changes.

4.3 Impact on general deterrence

Deterrence aims at impact the mind of the would-be violator. Deterrence follows from the subjective probability that misconduct will be detected or more precisely over the actor’s uncertainty that he will get away with it. Police organizations that use integrity testing often emphasize their deterrence effects. The Minister for Home Affairs and Minister for Justice (2011) of Australia, Jason Clare, introduced legislation to conduct targeted integrity tests on officers suspected of corruption. He states, “Where we find corruption we have to weed it out. This will help weed it out. …The power of integrity testing is that it puts fear in the mind of people thinking of acting corruptly… They will need to think twice before accepting a bribe from a criminal because that criminal could be an undercover police officer.”

Organizations’ annual reports should present data on misconduct, ethical failures and internal rule violations obtained through Integrity Testing. This would communicate to all employees of an organization that various capabilities of effective covert detection are in place. Experience suggests that in large organizations at least, advertising one or two successful proactive cases every now and then is sufficient to keep the uncertainty of risk outcomes and thus the deterrence effect alive. Communication within the company about proactive tests and their consequences sends the message to all employees and to DOJ that management is serious about complying with company policy.

Conclusion

From the perspective of developing industry owned standards for becoming a good corporate citizen, Multifaceted Integrity Testing can be a useful tool. These probes can furnish objective and quantifiable data for prevention, for identifying vulnerabilities, and for measuring the results of programme modifications. They can be adapted to a range of industry interests. The scenario based staging follows
social science standards of the ethical use of deception in data gathering, and law enforcement best practice for fair and objective covert probes of integrity.

From a government perspective, the power of the "stick" from penalties in not complying with instruments to combat cross border crimes will have a stronger compliance effect if regulators join with companies in accepting objective data for documenting the effectiveness of compliance efforts. As companies move closer to paradigms using objective results-based measures like the ones provided by Multifaceted Integrity Tests the business community will raise the bar on industry benchmarking practices. In proving their claims of effectiveness within their own industry, compliance officers will compel prosecutors to enter the world of social science evidence and engage them in a discourse on this new terrain.

References


