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Implementing a consistent and efficient third party due diligence process

Third party due diligence hasn't always been amongst the first priorities considered by businesses implementing 'adequate procedures' to tackle bribery & corruption. As a consequence many organisations struggle to put in place effective and proportionate due diligence processes aligned to their markets. However, the increase in regulatory scrutiny of ABC procedures and the expectations from US agencies that "Comprehensive due diligence demonstrates a genuine commitment to uncovering and preventing FCPA violations." and from the UK Ministry of Justice that "The commercial organisation applies due diligence procedures" means this task is getting more attention.

These issues were touched on at the recent C5 Anti-Corruption Event in London where LexisNexis Business Information Solution's Due Diligence Segment Leader, Mark Dunn, hosted a workshop entitled 'Implementing Compliance Procedures in Your Joint Venture Partners and Subsidiaries'. The event brought together anti-corruption professionals including; senior officials from government, international financial institutions and NGOS; as well as in-house business leaders, counsel, ethics and compliance executives, and internal auditors from around the globe to network and discuss issues around bribery, corruption and compliance.

Implementing an efficient process

One of the main purposes of the workshop was to emphasise the importance of having in place a robust due diligence process. Regulatory, financial and reputational drivers are all vital, but importantly, the discussion focussed on how to build a due diligence process that aligns to strategic business objectives. Many companies are implementing ad hoc processes that lead to inconsistent and cumbersome procedures. As a consequence, the ability for the business to execute strategic decisions and monitor ongoing risks involving third parties are being hampered.

Often, those markets that attract the greatest investment are perceived by Transparency International as posing the greatest risk and it is vital sufficient controls are put into place to effectively manage that risk.

Another issue facing larger organisations implementing due diligence controls has also been what to do about existing processes? There may already be due diligence resources in place that historically have focused on key projects such as mergers & acquisitions and patent protection. However, it is important for businesses to consider whether such resources are fit for purpose and sufficiently scaleable to tackle the increased demands, volumes and ongoing monitoring activities associated with a third party ABC due diligence programme.

Mark also emphasised the importance of fundamental risk assessment. Risk assessment forms the foundation on which an ABC policy is created and reviewed over time. The risk assessment will also determine how much due diligence is conducted on certain entities, how frequently entities are monitored and how often this due diligence is refreshed. Ultimately, implementing and managing a robust risk assessment process will also enable the company to better apportion budgets where they are most needed and streamline due diligence tasks.

Risk assessments usually focus on common factors such as jurisdiction, entity type, industry and the nature of the transaction. However, internal risks are often overlooked and firms should consider factors such as the third party's compensation schemes, financial controls, their own anti-bribery messaging and business conduct in their local market.

Managing resources

As referenced above, an important consideration for companies is how they align due diligence resources to business risk. As many companies in sectors such as construction, pharmaceuticals and aerospace & defence amongst others often have tens of thousands or more third party relationships in place, a high proportion of which will be deemed high risk, it is unrealistic to apply legacy processes where the default position would be to outsource all due diligence to a specialist risk advisor. Instead, more of the initial due diligence checks conducted against public sources are being brought in house and risk advisors are only being called upon where such due diligence uncovers a potential red flag that needs further investigation. Alternatively, the level of transaction risk from the outset is deemed so high that escalating due diligence out to a risk advisor for more specialist surveillance or other investigative tasks is considered necessary.

Ultimately, a simple due diligence process model is increasingly being applied that may start with in house searches conducted against free web and more specialist subscription tools and only escalated onto outsourced services where applicable. This way, all the resources complement each other and align to the risk based approach: the message is never to rely on a single source.

There are several considerations to make when looking for resources and working with third parties. What benefit will the tools offer the business? Will they be cost effective? What content will those resources provide? Are they scalable and flexible to adapt to changing business requirements? Are local requirements covered such as language capabilities? Is there a dependency to cover IT support in house or can this be managed by the provider?

Identifying and verifying beneficial owners

One of the key issues impacting the due diligence process in jurisdictions deemed a higher risk is the ability to identify and verify the beneficial owners behind an existing or prospective third party agent or joint venture partner. However, difficulties in locating publicly available information to identify and verify the identity of beneficial owners is not unique to higher risk markets. This issue has long been a problem for regulated entities tackling customer due diligence requirements under anti-money laundering legislation. Ongoing efforts by the Financial Action Task Force and more recently the G8 to mandate the collection of beneficial ownership data and to make this publicly available are slowly beginning to get results. The latest announcement by the UK on an initiative to "establish a public register of company beneficial ownership" was made in June.

To date, in terms of both anti-money laundering and anti-bribery & corruption due diligence, due to the lack of such data in the public domain, companies have made the disclosure of beneficial owners a mandatory requirement as part of their pre-engagement process when working with third parties. Once the names of beneficiaries are disclosed, a company will proceed in verifying what they have been told by applying risk based due diligence as appropriate.

Other considerations concerning due diligence are how far to go to verify information and check reputational risk? How to get third parties to cooperate whilst being mindful of cultural mismatches? Defining the criteria that leads to a company deciding to decline or exit a third party relationship? There is an expectation that firms will be able to demonstrate robust procedures to reflect the above along with a clear audit process outlining why, when and how certain decisions were taken along the way.

To be as effective as possible, the Compliance department or designated team needs to get involved at an early stage. The business needs to reflect the tone from the top, buy into the ABC process and the benefits this delivers. Inevitably, on occasion, this may mean deals are restricted or declined but ultimately the business risks are managed. Realistically, companies need to have their own people on the ground to protect local interests and uncover evidence. Investing in a high risk jurisdiction and then taking a hands off approach is a recipe for disaster – it is imperative the company is actively involved. When conducting forensic due diligence, a tick box approach cannot be relied upon. As referenced earlier, if the risk is deemed high enough, a business needs to send experienced experts to investigate on the ground and have its contractual relationships tied up. When managed effectively, embedding Compliance personnel works and improves risk mitigation.

Local advice

In many jurisdictions, both legal and cultural issues need to be addressed. It may be common sense, but it is essential to understand local customs and culture.

In jurisdictions that do not have transparent societies and government structures, there will almost always be challenges securing due diligence. When dealing with such issues, particularly where local suppliers or partners are expected to be involved, recognising and mitigating heightened risks is key.

Companies have to become familiar with local law and regulations, including perceived minor nuances and the different perspectives adopted to corporate liability. So while globalisation has brought the world a lot closer together and in a sense smaller, potential compliance issues and inherent risks have become much broader.

Many companies may call on the resources of their global law firm or consultants but this may not always be sufficient if the staff are perhaps unfamiliar with the local nuances within a market. The legal team will no doubt be very knowledgeable, but at some point there may be a need to balance this approach with resources that have grown up in the country, attended local law schools, understand the cultural differences and network.

8 key points to consider

1. Implement criteria to help assess red flags and define the point at which the business may walk away from an opportunity, backed by a clear audit trail reflecting the decisions taken and why.

2. Take a risk based approach to due diligence. Know when to investigate further and assess whether a potential red flag is an isolated issue or a systemic problem within the third party.

3. Know when to escalate due diligence and deploy more specialist advisors backed by a tailored consulting agreement.

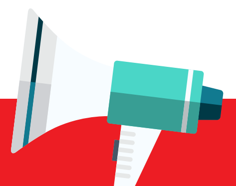
4. Set out a communications process to ensure Compliance is able to apply clear and consistent procedures when escalating potential issues to senior management or seeking further approval.

5. Make sure everyone (staff and third parties) are aware of the consequences of non-compliance, both personally as well as for the business.

6. Be aware of local legislation and any inherent nuances or interpretations in local law.

7. Even if there is no perceived risk from breaching high profile, extraterritorial UK or US anti-bribery legislation, is there still a danger of damaging the company's reputation or curtailing future projects in other markets?

8. Ensure ABC policies and procedures, the tone from the top and staff training correctly message the dangers of letting what may be perceived as the obvious commercial benefits of a significant business opportunity outweigh the regulatory and reputational risks to the business.



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