

The Practical Who, What, When, Why and How's of Third Party Due Diligence & Monitoring

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Agenda

- Overview of the FCPA & Associated Third Party Risks
- Data Analytics & Risk-Based Sampling
- Third Party Due Diligence in Practice
- French Anti-Corruption Law - Developments

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Overview of the FCPA & Associated Third Party Risks

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The Foreign Corrupt Practices Act (“FCPA”)

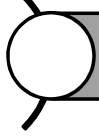
Anti-bribery provision: Makes it unlawful to offer or make a corrupt payment to a foreign official in order to influence any act or decision of the foreign official in his or her official capacity or to secure any other improper advantage in order to obtain or retain business.

Books & Records provision: Requires corporations to:

- Make and keep books and records that accurately reflect the transactions of the corporation; and
- Devise and maintain an adequate system of internal accounting controls.

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Anti-Bribery Provision – Third Party Relationships

The FCPA prohibits **knowingly** making corrupt payments through **third parties, agents, and intermediaries**, including subsidiaries and joint venture partners.

- “*Knowing*” includes conscious disregard, willful blindness, and deliberate ignorance.
- “Knowledge” exists where one is aware of a *high probability* a bribe would be offered or paid.

- **Requires “*due diligence*” in dealing with third parties** and knowledge of *red-flag* issues.

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DOJ Guidance & Corporate Enforcement Policy

In February 2017, DOJ published its *Evaluation of Corporate Compliance Programs* guidance outlining how it evaluates the effectiveness of a corporate compliance program, specifically outlining its expectations in such areas as -

- Ethical Leadership from Senior and Middle Management
- Autonomy and Resources of the Compliance Function
- Compliance Policies and Procedures
- Risk Assessment & Third-Party Management
- Training and Communications
- Compliance-related Incentives and Disciplinary Measures
- Continuous Improvement, Periodic Testing and Review

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Updated Guidance re: Evaluation of Compliance Programs

- In April 2019, DOJ updated its “Evaluation Guidance,” and highlighted the following “fundamental questions” that a prosecutor should ask when evaluating a compliance program:
 - Is the Compliance Program Well-Designed?
 - Is the program being applied earnestly and in good faith? In other words, is the program being implemented effectively?
 - Does the Program Work In Practice?

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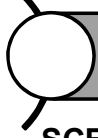
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Can't Live With Them, But... Can't Live Without Them?

- Companies face liability for third parties acting on their behalf
- 90%+ of reported FCPA cases involve third-party intermediaries
- 2019 FCPA Cases Involving Third Parties
 - ✓ *Microsoft* (July 2019): Subsidiary in Hungary allegedly violated the Foreign Corrupt Practices Act by providing discounted software licenses to its resellers, distributors, and other third parties
 - ✓ *Walmart* (June 2019): Subsidiaries in Brazil, China, India, and Mexico allegedly employed third-party intermediaries who made payments to foreign government officials without making sure those payments were not used as bribes and, when the company learned of corruption risks, it did not sufficiently investigate the allegations or mitigate them.
 - ✓ *Fresenius Medical Care AG & Co KGaA (FMC)* (March 2019): FMC allegedly made improper payments in Saudi Arabia, Morocco, Angola, Turkey, Spain, China, Serbia, Bosnia, Mexico, and eight countries in the West African region through a variety of schemes, including funneling bribes through a system of third party intermediaries, and, despite known red flags of corruption, devoted insufficient resources to compliance.
- Use of third-party intermediaries is a business necessity

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Only Show in Town

SCENARIO:

- Your company is bidding on a public contract in a high-risk emerging market.
- The law on public procurement consists of a single statute established a complex public bidding process plus a variety of government decrees, circulars and official guidance letters.
- Due to the detailed and complex legal process, you determine the company needs assistance navigating the public procurement process.
- A local contact familiar with the process strongly recommends a specific consultant to help avoid problems commonly encountered by foreign companies.
- The local consultant seems established, has a reputation for “getting things done” and appears to have a good relationship with the procuring agency’s procurement director.
- You have been unable to find any adverse information in public database or media searches.
- You cannot identify any other recommended consultants to use in that country.

Any concerns or red flags?

Recommendations to get comfortable?

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Who’s On First?

SCENARIO:

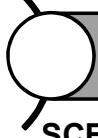
- You have been offered a deal in an emerging market with a joint venture company consisting of JV Partner #1 (the operating partner) and JV Partner #2 (the operating partner’s funder).
- JV Partner #2 is a venture capitalist that JV Partner #1 (the operating partner) has declined to give you further information on, claiming they are a passive investor who insists on anonymity.
- Amounts owed to you by the joint venture will be paid to your U.S.-based bank through a special fund created by JV Partner #2 in their own local bank.
- JV Partner #2 will also directly pay other companies involved in the deal any amounts owed to them by the joint venture.
- JV Partner #1 (the operating partner) explains that JV Partner #2’s anonymity and this payment arrangement are conditions of the funder’s investment in the joint venture.
- No adverse information has been discovered on the identified companies, although this emerging market has a high risk CPI rating per Transparency International.

Do you need to know the full identify of JV Partner #2 (the funder)?

What other controls or measures, if any, can you take if you do not know who the funder is?

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Corruption History v. Mere Politics

SCENARIO:

- You discover that the principal of your strategic partner in a certain emerging market was convicted of “corruption against the people” and tax fraud several years ago.
- Your partner has a long history of conducting business with political opponents of the country’s ruling party and claims the charges and conviction were politically motivated.
- The country’s ruling party has been known to trump up charges against political opponents, but this country also is also considered high-risk for corruption.
- Your business leaders insist that the partner is trustworthy and is simply the victim of political fighting.

What can you do to help assess whether the past convictions were politically motivated or evidence of actual corruption?

How can you manage situations where the local business leaders do not agree with your risk assessment? Who makes the final decision?

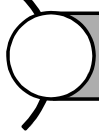
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Data Analytics & Risk-Based Sampling

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Data Analytics & Risk-Based Sampling

Use data analytics to make risk-based judgmental samples over three years of disbursement data (~60K transactions).

- ❑ Manual review is time consuming, requires too many resources, and can be ineffective.



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Risk-Based Approach

1. Focus on the appropriate period to test whether controls are effective.
2. Select the right locations.
3. Look at trends on an analytical basis – make sure the trends match the books!
4. Understand customs & practices and assess reasonableness.
5. Judgmentally select a sample of transactions for high-risk contracts / payment recipients.
6. Sometimes the books may be correct, even when you find something.
7. Follow through with interviews.

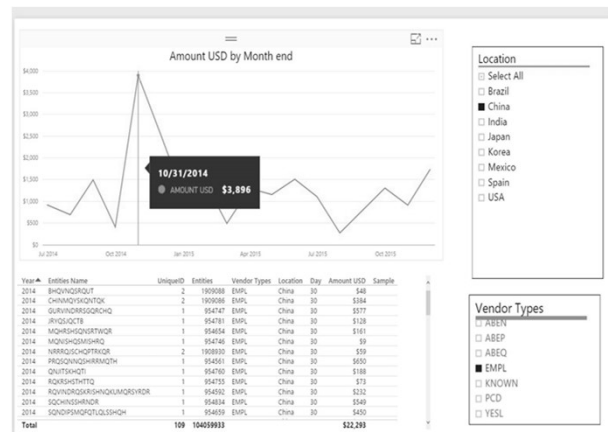
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Risk-Based Approach (cont.)

1. Selection of 80 disbursements for testing, with a focus on high-risk areas such as payments to / for:
 - a. High-risk vendors
 - b. Vendors not on approved list
 - c. Employees
 - d. Travel & entertainment expenses / Consulting fees
 - e. Seminar / conference / training expenses

Focus on Employees



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You Need More Than Technology

SCENARIO:

- A global company, in the business of building power stations, sold a 25% stake in a South African subsidiary (“Sub”) to a company called Front in 2014 for \$200K.
- In 2015, Sub was awarded \$6B in power station contracts in South Africa.
- In late 2016, Company repurchased 25% share of Sub from Front for \$4MM.
- In reviewing the books & records of the South African subsidiary, you noticed a consulting fee of \$1.5MM to Front in 2015, plus dividend payments of \$1MM to Front in 2016.

How would you proceed to determine the legitimacy of the consulting fee, dividend payments, and repurchase of shares?

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Third Party Due Diligence in Practice

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Third-Party Relationships: Assessment of Risk

DOJ's FCPA Resource Guide provides:

- “Risk-based due diligence is particularly important with third parties and will also be considered by DOJ and SEC in assessing the effectiveness of a company’s compliance program.”
- “Performing identical due diligence on all third party agents, irrespective of risk factors, is often counterproductive, diverting attention and resources away from those third parties that pose the most significant risks.”

The Bribery Act 2010 Guidance, directs organizations to take a “proportionate and risk based approach, in respect of persons who perform or will perform services for or on behalf of the organisation, in order to mitigate identified bribery risks.”

What does this mean in practice for global organizations?

- Reasonable Risk Based Approach
- Higher the Risk = Higher Level of Due Diligence
- Consistent Application of Process, Periodic Review & Audit Trail

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Third-Party Relationships: “The Standard?”

World Economic Forum Good Practice Guidelines on Conducting Third-Party Due Diligence (2013)

- “I am confident that my agent, reseller, supplier etc. does not make corrupt payments, and that our business relationship is a normal, legitimate one. I can explain to, and convince others why my confidence is justified.”
- “This means making appropriate inquiries to determine whether an organization’s existing or prospective third parties are honest and can be reasonably expected to refrain from corruption. The higher the risk, the broader and deeper the third-party due diligence should be.”

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Mitigating Measures

SCENARIO:

- Your screening of a potential new reseller discovers media reports of an ongoing government corruption investigation involving a 15% owner of the reseller company.
- This 15% minority owner had other business dealings with the local government through a separate company, and is alleged to have conspired with government officials to purchase prime public land at below-market values.
- In addition to being a minority shareholder, the 15% owner is also one of the corporate directors of the reseller company.
- You are not sure what role that 15% owner has in directing or overseeing the reseller’s business.

What further due diligence would be prudent to do, and on whom?

Are there any mitigating measures that might get you comfortable with doing business with the reseller company?

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How Much Due Diligence Is Enough?

SCENARIO:

- You have a potential distribution deal with a local partner in a high-risk emerging market where local law requires foreign businesses to partner with a local company.
- You have no experience with the potential new partner, so decide to conduct due diligence.
- Public database and media screening reveals commercial disputes by the partner's shareholders in other countries involving claims of counterfeiting by one claimant and breach of contract by another claimant.
- Enhanced due diligence reveals a complex ownership structure, with no single person or company owning the majority of the potential partner company.
- You learn that the potential partner company was only formed in this emerging market a year ago and does not have a established business history in this market.
- You learn that the potential partner has a local office in the country, a legal requirement for this type of business venture.

Is further “boots on the ground” diligence appropriate?

If so, what type of “boots on the ground” diligence would you recommend?

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Sapin II – French Anti-Corruption Law – Developments

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Sapin II – The French Anti-Corruption Law

- Companies (groups) with operations in France, over 500 employees and more than €100 million in revenue (consolidated)
- Issued in December 2016, in regard to a number of provisions since June 2017
- Decrees issued:
 - March – Functioning of the Agence Française Anti-corruption (“AFA”)
 - April – Implementation of whistleblower provisions

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Sapin II – DPA “a la française” - CJIP in Full Swing

- Convention Judiciaire d’Intérêt Public
- The Parquet National Financier (Financial Arm of the French Dpt. of justice) and the AFA issued guidelines concerning CJIPs on June 29, 2019
- Without the CJIP
 - Penalties up to 30% of average revenue over the past 3 fiscal years
 - Monitorship imposed and supervised by the AFA including review of implementation of remediation steps
 - Compensation to victims of the actions, if it/he/she can be identified (may include the government)
- Benefits of the CJIP
 - For moral persons, only
 - Cooperation should result in factors reducing the penalties and even absence of monitoring
 - No admission of guilt
 - Coordination with foreign enforcement agencies
- Six since October 2017 (last one in June 2019, includes HSBC, the first one and publicized Société Générale that involved the DOJ) – not just French companies
- An example: EDF contractor and review of factors considered by the PNF

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Sapin II – First Audit Referred to the Enforcement Body of the AFA

- First case of a company that did not meet the requirements under Art. 17 of the law
- Referred to the enforcement body of the AFA (Commission des Sanction)
- Sonepar is a French private company
- Decision was rendered on July 10, 2019
- AFA violations of Art. 17:
 - Cartography of the risks too generic
 - No code of Conduct
 - Lack of integration of anti-corruption risk in ICFR
 - Lack of internal assessments
- Factors considered by the Commission
- Take aways

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Sapin II – Whistleblower Provisions

“A physical person who reveals or signals, without personal interest and in good faith, a crime or misdemeanor regarding, or a grave and flagrant violation of which he or she became aware, of an international commitment ratified or approved by France, [...], the law or regulation, or the threat of a grave prejudice to the public.”

- Anti-corruption AND other violations.
- Effective date to implement whistleblower internal reporting process – 6/1/2017
 - Reporting is a 3 step process:
 1. Internal first - required (could be a hotline firm/lawyers)
 2. Authorities - if no action is taken within a “reasonable delay” (judiciary, AMF, ACPR)
 3. Third the press/the public – if all else fails, after a 3-month period, if no action has been taken
- No financial incentives for whistleblowers to report wrongdoing; in fact, the whistleblower should act without any self-interest.
- Anonymity and confidentiality must be provided
- Personal data governed and authorized by CNIL
- In case of wrongful termination, the State may financially support the whistleblower

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Whistleblower / Lanceur d'alerte?

SCENARIO:

Your company is a U.S. manufacturer of airplanes with operations in the U.S. and in France.

- You know it is subject to the new French anti-corruption law called "Sapin II."
- You were awarded a large contract with an African nation, and received a tip through new established hotline from a whistleblower located in France concerning possible commissions paid to government officials of that country through an intermediary, with the issuance of false invoices concerning a fictitious project.

What should you do? How much time do you have internally to get back to the whistleblower?

Assume the French authorities get involved, what should you do in regard to the U.S. authorities (SEC/DOJ?)

If an investigation bears out the allegations and a settlement can be reached, is there a risk for management?

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COMMENTS OR QUESTIONS?

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