EXPERT TALK

Third-party risk management: Spotlight on oil and gas

The oil and gas sector operates in a complex and dynamic risk environment, and firms active in the industry need to ensure that they take adequate steps to identify and mitigate different types of risk that may be present within their global third-party networks.

The need for third-party risk management

Companies in the oil and gas sector operate against a complex and high-powered environment. They are customarily located in countries at times characterised by political instability, environmental, social and governance (ESG) failures and elevated levels of corruption. Moreover, supply chains within the sector are typically large and spread across multiple jurisdictions.

Whilst these factors are not always present, the risk environment within which oil and gas companies operate remains challenging – and industry participants therefore need to fully understand the range of risks to which they could be exposed.

Specifically, companies active within this space should ensure that they identify and actively manage potential third-party risk that may be present within their supply chains, since any links to illicit activity – even unwitting – can have serious financial and reputational consequences.

Drilling down: components of the oil and gas supply chain

Oil and gas sector supply chains are typically multi-faceted and can be divided into three parts:

– Upstream, encompassing exploration and production
– Midstream, covering transportation
– Downstream, including refining and distribution to end users

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Each stage presents different challenges for suppliers and involves different risks for oil and gas sector participants:

Upstream

The upstream stage comprises both the exploration and the production of crude oil and gas, and is the most regulated section of the supply chain.

Oil and gas producing countries are often located in regions that are politically unstable and further, exploration and production companies are often owned and managed by the governments of these countries.

Possible risks within this stage include bribery and corruption, political exposure, environmental crime risk and the threat of social unrest that may disrupt supply. When supply is disrupted, this has a knock-on effect on prices, which in turn could affect the financial stability of the entire chain.

These risk factors mean that the upstream segment of the supply chain is often subject to more sanctions than other stages.

Midstream

The midstream component of the supply chain incorporates all aspects of the transportation of oil and gas, whether this involves pipelines, railroads, trucks or vessels. This segment covers, inter alia, logistic companies, oil tankers and freight forwarders.

From a risk perspective, transporters can be exposed to risks originating from both suppliers and end users. Moreover, these companies can introduce risk to other sections of the supply chain – ranging from reputational and ESG risk to delivery delays, with attendant financial and operational consequences for other supply chain participants.

Downstream

Refineries are exposed to potential risk from suppliers further up the supply chain, in both the up and midstream sections of the chain. There can be various risks, and can include third-party, sanctions, ESG or bribery and corruption risk.

At the same time, refineries may also introduce risk – including reputation, legal, quality or financial – that affects their suppliers and clients.

Regulation within the sector

Faced with this situation, different countries have introduced legislation to govern and regulate the sector.

For example, in the United States, the Environmental Protection Agency (EPA) actively promotes its mission of protecting human health and the environment[1], and legislation in force includes the Oil Pollution Act (OPA) and the Spill Prevention, Control and Countermeasure (SPCC).

Worldwide, the International Maritime Organization (IMO) MARPOL Annex I (Prevention of Pollution by Oil) is in effect.

Despite these efforts, fraud and irregularities have been identified throughout the sector. Some examples include:

Hiding Environmental and Safety Liabilities	False Statements, Financial Statement Fraud and Corruption
Falsifying or misrepresenting safety permits for offshore drilling rigs	Overstating the value of oil and gas assets
Illegally releasing pollutants from ships into national and international waters	Overstating estimates of proved oil and gas reserves
Covering up toxic pollution from drilling rigs	Understating climate change-related losses
Falsifying safety mechanisms for pipeline applications	Misleading shareholders about climate-related risks
Concealing pollution risks from shareholders	Underpaying royalties for drilling offshore and drilling on public lands
	Falsifying customs declarations
	Manipulating oil and gas futures
	Engaging in bribery or bid-rigging

1 https://www.epa.gov/aboutepa/our-mission-and-what-we-do

It is important to remember that if any form of illicit activity, including but not limited to the examples above, is detected in any part of the supply chain, there could be significant consequences for all associated companies, even if they were not aware of the activity.

Therefore understanding the different types of potential risk that exist, and taking adequate steps to mitigate these risks are both of the utmost importance.

Understanding different types of risk

A range of diverse risks can impact the oil and gas sector, and a brief discussion of some of the most common risks follows, specifically in the context of the Russian-Ukranian war:

Integrity risk

The range of sanctions imposed on Russia by different countries in the aftermath of the February 2022 war means that purchasing and transporting Russian oil and gas is now largely prohibited. Sector participants therefore need to conduct adequate due diligence to verify that no third parties within their supply chains are engaging with sanctioned companies or PEPs included on any active sanctions lists.

Identity risk

Both transporters and refiners need to verify that the resources they are handling do not originate from Russia. Refiners must verify that the ultimate beneficial owners (UBOs) of the vessels providing transportation are not included on any sanctions lists. All sector participants should perform rigorous KYC checks to verify the identities of all suppliers and other third parties.

ESG risk

The conflict in the region could potentially damage gas or oil pipe infrastructure, increasing the risk of an oil spill or similar environmental tragedy. This means that industry players need to know exactly where all suppliers and other third parties work in order to mitigate the risk of being associated with any environmental crime.

Reputational risk

In the wake of the latest round of sanctions, any connection to any Russian supplier or other third-party now carries heightened reputational risk. Sector participants need to be aware of any Russian connections or affiliations within their wider networks.

Operational risk

Russia has already announced the cessation of gas supply to their pipeline providing natural gas to Poland and Bulgaria. In addition to impacting the final users in both countries, the refineries connected to the Russian pipelines will not be able to provide energy. Disruptions such as these are already creating shortages and leading to increased oil and gas prices. The take-away for sector participants is that thorough knowledge of all suppliers and their operations is crucial for contingency planning.

Financial risk

Financial risk is always present, especially where different exchange rates are involved in the purchase and sale of goods or services, but robust information allows market participants to assign monetary value to that risk and incorporate this into financial decisions.

Holistic risk management

LSEG offers a range of market-leading solutions to help assess, manage and mitigate risks in your supply chain and distribution network, so your company can be protected against reputational damage and financial loss.

Our solutions help safeguard your reputation and meet regulatory obligations throughout your third-party relationship lifecycle – from onboarding and continuous monitoring to renewal.

Data: LSEG World-Check

Our industry-leading global database LSEG World-Check delivers unsurpassed depth and breadth of data to enable efficient screening to pinpoint potential risk.

Research, analysis and reporting solutions: LSEG due diligence reports

Our due diligence reports are designed to provide deep intelligence, tailored to your use-case and situation – whether you require quick, affordable data-driven reports or detailed integrity and advanced background on known high-risk customers, vendors or business interests.

Technology: LSEG Due Diligence Centre

Our proprietary workflow LSEG Due Diligence Centre is an industry-leading platform that centralises third-party risk management across the lifecycle of the relationship from initial assessment, onboarding, ongoing monitoring, renewal or end of life.

Outsourcing: Managed services

Our third-party managed services solutions can help reduce your compliance burden and maximise your existing staff resources. Our knowledgeable support staff can help decrease the overall cost of your third-party risk management programme, speed up processes and reduce the potential for error.

Find out more

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