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EXAMINING ANTI-BRIBERY AND ANTI-CORRUPTION PRACTICES IN THE SUPPLY CHAIN

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Statement of intent

One of the key considerations for any anti-bribery/anti-corruption (ABC) compliance program is how to think about the risk of third parties that may enter into a contractual relationship with your company via the Supply Chain (SC). In many companies the SC function is a stand-alone discipline, which is siloed from other functions. This article will highlight the need for companies to implement or review existing approaches to third party risks in supply chains.

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In the October 2010 issue of the Harvard Business Review (HBR) there is a Spotlight article on “The Transparent Supply Chain”. In this article, author Steve New discusses the evolution in Supply Chain (SC) from opaqueness to transparency and focuses on the “quality, safety, ethics and environmental impact” of SC on the triumvirate of companies, customers and government. New terms this information as “Provenance” and this is relevant both up and down the SC.

New points out that customers are becoming increasingly concerned with not only the authenticity of the goods they purchased but also the ethics of how the goods were manufactured. Companies have long been concerned with the quality of goods and services they receive from their SC vendors and tracking this information can provide assurances of high quality control. Increasingly the third prong of the triumvirate, the government, is now requesting such information and such transparency in the area of anti-corruption and anti-bribery compliance. Both US and UK regulators have specifically called out the management of vendors in a company’s SC as key components for compliance under the US Foreign Corrupt Practices Act (FCPA) and UK Bribery Act (UKBA).

One of the key considerations for any anti-bribery/anti-corruption (ABC) compliance program is how to think about the risk of third parties that may enter into a contractual relationship with your company via the SC. In many companies the SC function is a stand-alone discipline, which is siloed from other functions. Typically the greatest divide found in companies is between the sales side and supply sides of the business. However this divide also comes into play with a company’s compliance function and the SC.

Even if SC performs extensive due diligence or other background checks on a potential vendor, it does not do so in conjunction with the company’s compliance function or even integrate an ABC compliance program approach into its calculus. If any ABC compliance analysis is involved, it is usually a ‘check-the-box’ approach. Such an approach has potentially disastrous consequences for any ABC compliance program.

The reason is that if you employ a “check-the-box” approach it may not only be inefficient but, more importantly, ineffective. This is because each ABC compliance program should be tailored to an organization’s specific needs, risks and challenges. This means that a company should assess its needs and based on that assessment design the third party component of its ABC compliance program to be appropriate for its particular business. In the end, if designed carefully, implemented earnestly and enforced fairly, a company’s compliance program - no matter how large or small the organization - will allow the company, generally, to prevent violations, detect those that do occur, and remediate them promptly and appropriately.

I. RISK RANKING

This determination of the level of due diligence and categorization of a supplier should depend on a variety of factors, including, but not limited to, whether the supplier is (1) located, or will operate, in a high risk country; (2) associated with, recommended, or required by a government official or his or her representative; (3) currently under investigation, the subject of criminal charges, or was recently convicted of criminal violations, including any form of corruption; (4) a multinational publicly traded corporation with a recognized exemplary system of compliance and internal controls, that has not been recently investigated or

convicted of any corruption offense or that has taken appropriate corrective action to remedy such conduct; or (5) a provider of widely available services and products that are not industry specific, are offered to the public at large and do not fall under the definition of Minimal-Risk Supplier detailed below.

A High-Risk Supplier is an individual or an entity that is engaged to provide non-project specific goods or services to a company. It presents a higher level of compliance risk because of the presence of one or more of the following factors: (a) It is based or operates in a country (including the supply of goods or services to a company) that poses a high risk for corruption, money laundering, or commercial bribery; (b) It supplies goods or services to a company from a high-risk country; (c) It has a reputation in the business community for questionable business practices or ethics; or (d) It has been convicted of, or is alleged to have been involved in, illegal conduct and has failed to undertake effective remedial actions. Finally, it presents one or more of the following factors: (1) it is located in a country that has inadequate regulatory oversight of its activities; (2) it is in an unregulated business; (3) its ultimate or beneficial ownership is difficult to determine; (4) the company has an annual spend of more than \$100,000 with the supplier; (5) it was established or registered in a jurisdiction where ownership is not transparent or that permits ownership in the form of bearer shares; (6) it is registered or conducts business in a jurisdiction that does not have anti-corruption, anti-money laundering and anti-terrorism laws comparable to those of the United States and the United Kingdom; or (7) it lacks a discernable and substantial business history.

A Low-Risk Supplier is an individual or a non-publicly held entity that conducts business

such as a sole proprietorship, partnership or privately held corporation, located in a Low-Risk Country. Some indicia include that it (1) supplies goods, equipment or services directly to a company in a Low-Risk Country; (2) a company has an annual spend of less than \$100,000 with the supplier; and (3) the supplier has no involvement with any foreign government, government entity, or Government Official. However, if the supplier has other indicia of lower risk such that it is a publicly-held company, it may be considered a Low-Risk Supplier because it is subject to the highest disclosure and auditing and reporting standards such as those under the US Securities Exchange Act 1934, including those publicly traded on a reputable and highly regulated stock exchange, such as the New York or London exchanges, and are, therefore, subject to oversight by highly regarded regulatory agencies.

Below the high and low risk categories I would add the category of 'Minimal-Risk Suppliers' who generally provide to a company goods and services that are non-specific to a particular project and the value of the transaction is \$25,000 or less. Some examples might be for the routine purchase of fungible items and services, including, among others: Office supplies, such as paper, furniture, computers, copiers, and printers; Industrial or factory supplies, including cleaning materials, solvents, safety clothing and off-the-shelf equipment and parts; Crating and other standard materials for packing products for shipping; Leasing and rental of company cars and other equipment; and Airline or other travel tickets or services. This category would also include those third parties that provide widely available services and products that are not industry specific, are offered to the public at large. Here you might think of periodicals, florists, daily

limousine and taxi, airline and food delivery (including coffee shops, pizza parlors and take out) services.

Last, but certainly not least, is the category of 'Government Service Providers', which includes entities that generally come into a company through the SC, who interact with a foreign government on behalf of your company. Examples might be customs brokers, providers who obtain and process business permits, licenses, visas, work permits and necessary clearances or waivers from government agencies; perform lobbying services; obtain regulatory approvals; negotiate with government agencies regarding the payment of taxes, tax claims, and tax audits. These third parties present some of your highest risks so they need to have not only the highest level of scrutiny but post contract-signing management as well.

The risk ranking of third parties is one of the areas that seems to continue to cause confusion, if not outright bewilderment. The FCPA Guidance states, "An effective compliance program promotes "an organizational culture that encourages ethical conduct and a commitment to compliance with the law."... A well-constructed, thought-fully implemented, and consistently enforced compliance and ethics program helps prevent, detect, remediate, and report misconduct, including FCPA violations." If you think through your risk rankings and can articulate a reasonable basis for doing so followed by documentation, I think your own risk ranking system will survive regulatory scrutiny.

II. MANAGING THE RELATIONSHIP

As with any third party relationship, the most difficult part of the process is managing the relationship. This is equally important when considering companies in your SC. Putting incentives in place and then managing those

incentives is important for vendors. One of the key elements for any third party contract under the FCPA or UKBA is the compensation issue. If the commission rate is too high, it could create a very large pool of money that could be used to pay bribes. It is mandatory that your company link any commission or payment to the performance of the third party. If you have a long-term stable relationship with a third party, you can tie compensation into long-term performance, specifically including long-term compliance performance. This requires the third party to put skin into the compliance game so that they have a vested, financial interest in getting things done in compliance with the FCPA or other anti-corruption compliance regime.

Mark Trowbridge, in a Supply Chain Management Review article, entitled "Put it in Writing: Sharpening Contracts Management to Reduce Risk and Boost Supply Chain Performance", said, "The fact is, linking contractual compensation to performance does make a significant difference in supplier performance. This is especially valuable when agreed upon key performance indicator (KPI) metrics can be accurately tracked." This would seem to be low hanging for the compliance practitioner. If you cannot come up with some type of metric from the compliance perspective, you can work with your business relationship team to develop such compliance KPIs.

Auditing is another important tool in managing the risk from SC. One company that handles this issue with the highest profile is Apple who annually publicizes vendors through its Supplier Responsibility Report. Apple looks at a variety of issues that affect its business relationships with its suppliers, these areas included training, protecting of workers, use of underage labor, compliance and social responsibility.

In this Supplier Responsibility Report Apple set forth its audit protocols. Apple selects suppliers based on risk factors, such as conditions in the country where a facility is located and their past audit performance, enabling Apple to focus its efforts where it believes it can have the greatest impact. An Apple supplier responsibility auditor leads every audit, supported by local third-party auditors trained to use Apple's detailed audit protocol and to assess the requirements as specified in Apple's compliance program.

Apple conducts interviews with employees, contract workers and senior management in relevant functional areas. Apple also conducts a physical inspection of manufacturing facilities and factory-managed dormitories and dining areas, as well as a review of records and relevant policies and procedures. Apple also believes that there may be cases where its audit reveals compliance in actual practice, but the underlying management system may not be strong enough to prevent violations. For this reason, the Apple audits include examination of the management systems, such as policies and procedures, roles and responsibilities and training programs, underlying every category in its compliance program.

III. TERMINATION OF A THIRD PARTY

In the article entitled "Breaking Up Is Hard To Do", Carol Switzer relates how to avoid pain by planning for the end of a third party relationship. She begins by noting that it all should begin with "an exit strategy, a transition plan or a pre-nup—whatever the title, it's best to begin by planning for the end which, in the case of business at least, will always eventually come. Whether due to contract completion or material breach, turning over responsibility to another party, or abandonment of the contracted activity altogether, contract termination is an inevitable phase in the third-party relationship lifecycle." Planning for the end is important because, "The

more long term and layered the relationship, the more difficult it will be to disentangle. The deeper the third party is embedded in and uses the confidential information of the company and its customers, the greater the risks presented by failing to design a smooth transition process."

1. Plan and Organize. Develop a plan to evaluate the level and complexity of risk. Some of the things you should consider are the volume of business engaged in by the third party representative, the nature of the risks involved, the extent to which the third party representative will use sub-contractors and any required legal or regulatory approvals required for the geographic areas which the third party representative will conduct business with or for you.
2. Perform Due Diligence. Assess each third party's compliance controls relative to the level of risk you have determined is present. Here the standard inquiries are such items as ultimate beneficial owners, anti-corruption compliance and risk management controls currently in place, incident management and reporting and conflicts of interest.
3. Manage Contracts. Ongoing review and assessment of the contractual relationship. If new or greater risks arise and they have not been previously addressed, you may need to add new contract terms to address them going forward. In addition to your standard anti-corruption compliance terms and conditions, you should have KPIs, confidentiality terms and conditions and sub-contractor requirements.
4. Conduct Ongoing Monitoring. Oversee and pro-actively monitor and review each third party relationship at a level commensurate with risk and ensure that issues are identified and appropriately escalated for remediation.

5. Manage Terminations. Follow your established plan for transition to ending the relationship and transitioning to another third party representative. You should also consider the need to “protect information, maintain smooth operations and protect reputation during the transition.”

One of the key risks that companies face in the area of anti-bribery and anti-corruption is through the SC. The overall management of vendors who enter a contractual relationship with your company through SC is something that requires several corporate disciplines. The integration of the management of that risk into the overall process of your organization is key to properly managing this risk going forward. Compliance planning and integration with and visibility into SC is an important step in any best practices anti-bribery/anti-corruption compliance program.

IV. WHERE IT CAN GO WRONG

A. Reputational Damage from Down the Supply Chain

The damage which your business can suffer for the actions of its third party suppliers is not limited to fines and penalties under such laws as the FCPA. The danger of reputational damage has become much greater as companies farm out their SC farther and farther afield. In 2013 there was the tragedy in Bangladesh involving the collapse of Rana Plaza. In this tragedy almost 600 clothing factory workers died in the worst disaster for Bangladesh’s \$20 billion-a-year garment industry. The collapsed building was not built and owned by the owner of the factories that operated in Rana Plaza; as such, the building owner and landlord was legally required to provide a safe structure.

This reputational problem has become much more public for clothing companies who purchase finished goods from countries like Bangladesh. This is because, even if you know

who you are directly contracting with, your company may not know the subcontractors or your direct counter-party and you probably have no chance to know who the building owner or landlord might be. Finally, how can you determine if the building where your products are being produced meets minimum building code standards or is even safe to work in at all?

B. Human Trafficking and Slavery

Many state and national governments now require a business response to the tragedy of human trafficking and slavery. In a White Paper, entitled, “Human Trafficking & Global Supply Chains: A Background Paper” authored by Joy Ngozi Exeilo and prepared for the UN Special Rapporteur meeting held in 2012, it challenged businesses to engage in both prevention of such conduct and to implement corrective action where such instances are uncovered. The paper stated, “companies can act at the enterprise level, across their industries, nationally, in their communities of operation and internationally. Each ‘level’ has its own opportunities, benefits and challenges, but in most cases companies will prioritise engagement where they face the greatest risk or have the greatest leverage or potential for impact, for example in their own operations or among their first tier suppliers.

The US government provided numerous speeches and other public displays of support in this area in the month of January 2015, which was notated “National Slavery and Human Trafficking Prevention Month.” At that time a Press Spokesman for the White House announced that there were updates made to the Federal Acquisition Regulation (FAR) as required by the President’s Executive Order “Strengthening Protections Against Trafficking in Persons in Federal Contracts” and related requirements in the Ending Trafficking in Government Contracting Act (set forth in the National Defense Authorization Act for 2013).

Both of these updates required contractors doing business with the US government to have implemented policies and procedures to stop human trafficking in the business community.

Further and similar to its strong stand against bribery and corruption in the enactment of the UK Bribery Act in 2011, in 2015 the UK government enacted the UK Modern Slavery Act into law. This new law is potentially the strongest in the western world. According to a White Paper released by the UK Home Office, entitled, "Landmark Bill to Help Eradicate Modern Slavery Passes into Law" the legislation provides "support and protection for victims, gives law enforcement the tools they need to target today's slave drivers, ensures perpetrators can be severely punished, and includes a world leading provision to encourage business to take action to ensure their end-to-end supply chains are slavery free. However as with the UK's lack of prosecution of cases under the Bribery Act, it remains to be seen if the UK will actually use the law.

C. Whistleblowers and the Supply Chain

Companies must also be aware of whistleblowers in today's interconnected world of suppliers. The smart phone is ubiquitous across the globe. Even where workers, employees and people do not have enough money, training or skills to use a computer; they know how to use a smart phone. Digital pictures and videos can have a similar effect for reputational damage. More importantly

these common day tools can be used to facilitate a worldwide base of whistleblowing. Moreover there are financial incentives for workers, employees or anyone else to blow the whistle on US or other western companies which may be breaking the law.

In the US, the Dodd-Frank Act has a Whistleblower's Provision which can pay a bounty of up to 30% of fines and penalties of companies, which break laws such as the US FCPA. The US agency which administers this law, the Securities and Exchange Commission (SEC), has announced that even though Dodd-Frank is a US law, it will pay whistleblowers if they are citizens of countries outside the US. This means there is no territorial limit to the Whistleblower Provisions and any company subject to the Dodd-Frank law can be subject to paying whistleblowers who provide information from outside the US.

All of these legislative and executive initiatives make clear that the Supply Chain is becoming one of the highest risks in any business organization. The management of the Supply Chain will be a critical element for businesses going forward. With the continued march of world governments to fight the issues of human trafficking and human slavery, business organizations will be called to provide more protection and prevention through business processes which may have been design for other risks. International businesses will ignore these requirements at their own peril.

ABOUT THE AUTHOR

Thomas Fox has practiced law in Houston for 30 years. He is now an Independent Consultant, assisting companies with anti-corruption and anti-bribery compliance. He was most recently the General Counsel at Drilling Controls, Inc., a worldwide oilfield manufacturing and service company. He was previously division counsel with Halliburton Energy Services, Inc. where he supported Halliburton's software division and its downhole division.

Tom is the author of the award winning FCPA Compliance and Ethics Blog and the international best-selling books "Lessons Learned on Compliance and Ethics" and "Best Practices Under the FCPA and Bribery Act". His latest book is Doing Compliance, was published by Compliance Week and released in October 2015. He writes and lectures across the globe on anti-corruption and anti-bribery compliance programs.



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