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EXPANDING EXISTING DUE DILIGENCE PROGRAMS TO COVER MODERN DAY SLAVERY IN THE SUPPLY CHAIN

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Statement of intent

This White Paper aims to demonstrate that corporations can expand existing supplier vetting activities under anti-bribery and corruption compliance programs (UK Bribery Act or US Foreign Corrupt Practices Act) to identify risks associated with forced and bonded labor in their supply chains. Once these risks are identified, corporations can apply heightened due diligence and monitoring to ensure ethical labor practices are followed by their suppliers. These efforts will not only allow corporations to comply with modern-day slavery and transparency legislation, but also support ethical trading, sustainability, and corporate social responsibility programs. Failure to prevent forced and bonded labor in the supply chain can affect brand integrity and consumer confidence, as recent examples have shown.

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INTRODUCTION

On 26 March 2015, the UK's Modern Slavery Act received Royal Assent becoming Europe's first legislation aimed at tackling modern-day labor issues such as child, forced, and bonded labor. The Act introduces measures compelling UK companies to specifically disclose their efforts to combat modern-day slavery in their supply chains. The California Transparency in Supply Chains Act was passed in 2010 and federal-level measures are being considered in the United States. In the past several years, governments, non-governmental organizations, and the media have increasingly highlighted the role global commerce and the expanding international supply chain have played in proliferating forced and bonded labor worldwide. Real-life examples of modern-day slavery exist in the food we eat, the clothes we wear, and the consumer products we purchase. The demand for cheaper goods, faster production, and raw materials have expended supplier networks and made it more challenging for corporations to trace the origin of many materials sourced through the supply chain.

A GLOBAL ISSUE AFFECTING GLOBAL BUSINESS

According to the International Labor Organization (ILO), which runs several initiatives aimed at increasing awareness of modern-day slavery in the supply chain, more than 21 million people are victims of forced and bonded labor worldwide. The vast majority of these victims work in the private sector, generating more than USD 150 billion in illegal profits annually. Forced labor is most prevalent at the commodity level, where migrant workers are often recruited by brokers to work in labor-intensive industries such as agriculture, fishing, construction, food processing, and garment manufacturing. Multinational organizations run the risk of sourcing commodities from suppliers with irregular labor practices, which can jeopardise brand integrity while posing compliance and reputational risks. While many multinational corporations practice due diligence and audit-focused social responsibility modelling when selecting suppliers, few programs specifically focus on forced and bonded labor.

Unscrupulous labor practices can take many forms, including deceiving workers over conditions of employment, charging employees unreasonable recruitment fees, and confiscating or otherwise denying access to identity documents such as passports and travel passes. Internationally accepted definitions of forced labor, also known as modern-day slavery, are generally derived from the Protocol to Prevent, Suppress, and Punish Trafficking in Persons maintained by the United Nations (UN). The UN defines the practice as, "the recruitment, transportation, transfer, harbouring or receipt of persons, by means of threat or use of force or other forms of coercion, of abduction, of fraud, of deception, of the abuse of power or of a position of vulnerability or of the giving or receiving of payments or benefits to achieve the consent of a person having control over another person, for the purpose of exploitation."

Most recently, instances of forced and bonded labor have been found in the seafood industry in Thailand, the electronics sector in Malaysia, and the recruitment of construction workers in Qatar. While the instances of slavery were found deep in the supplier web (often the supplier's supplier), the reputational damage often affects the sourcing organization. In the Thai example, journalists traced instances of forced and bonded labor from supermarket shelves in the U.S. and Europe to the trawlers and vessels providing feed products to a local Thai distributor. In Malaysia, non-governmental organizations found recruitment agencies in Nepal were charging excessive recruitment fees to workers migrating to Malaysia, effectively locking them into conditions of indentured servitude. The workers were recruited into Malaysia's growing electronics sector and were associated to popular smart phones and other consumer goods. In both examples, the instances of modern-day slavery were found in the wider supply web, not the direct contractor.

MANAGING YOUR SUPPLY CHAIN EFFECTIVELY

Effective supply chain management is progressively becoming a constructive way for organizations to improve their financial and operational performance, while remaining competitive in the global business environment. Suppliers are selected against a wide range of criteria, including price, product or service offering, and delivery terms.

Organizations with international supply chains rely on on-boarding processes to ensure effective supplier selection. The on-boarding process aims to determine a potential supplier's credit worthiness and financial stability, compliance with domestic and international regulations such as economic and trade sanctions, and increasingly, a risk-based assessment of a potential supplier's reputation centred on environmental, social, and ethical business practices.

There are several approaches to conducting risk assessments prior to on-boarding new suppliers and monitoring existing third party relationships to ensure on-going compliance. Multinational corporations can utilise publicly-available data to construct risk assessments to identify suppliers who represent a heightened risk of forced and bonded labor. Once the risk is identified, companies should apply levels of due diligence proportionate to the risks involved. This risk-based approach is similar to the methodologies used by financial services institutions for anti-money laundering (AML) and counter-terrorism financing (CFT) due diligence. Similarly, multinational corporations are adopting a similar approach to comply with anti-bribery and corruption legislation in both the U.S. (Foreign Corrupt Practices Act) and the UK (Bribery Act). The guidance notes for both Acts recommend companies employ a risk-based approach to identify instances of heightened risk when selecting third parties (suppliers, distributors, partners, etc.) and to apply appropriate mitigation measures.

Multinational organizations have regulatory obligations to conduct due diligence on associated third parties under anti-bribery and corruption legislation. Moreover, newly-implemented legislation in the United States under the Dodd–Frank Wall Street Reform and Consumer Protection Act requires corporations to implement due diligence program to ensure supply chain transparency with regards to minerals sourced from regions of armed conflict. As corporations are already incorporating risk assessments and due diligence to comply with existing compliance requirements, these existing third party vetting programs can be expanded to include forced and bonded labor risks.

COUNTRY RISK RATING AWARENESS

The U.S. State Department offers a country risk rating based on efforts to combat human trafficking and forced labor, assessing governments' efforts to comply with minimum standards related to trafficking and modern-day slavery. Countries, including the United States, are placed into three tiers; Tier 1 representing the highest level of compliance, while Tier 3 represents the lowest level. The rankings do not necessarily correspond to the prevalence of bonded or forced labor in that country, but rather address a country's compliance to international standards. Countries in the Tier 3 ranking may not have serious issues associated with forced or bonded labor, but have weak regulatory environments which could potentially lead to increased risk. Table 1 maps the Tier 3 countries to their most common exports.

Table 1: Tier 3 Countries and their Most Common Exports

COUNTRY	TIER	COMMON EXPORTS
Algeria	3	Petroleum, Natural Gas
Central African Republic	3	Diamonds
Democratic Rep. of Congo	3	Conflict Minerals*, Copper, Diamonds
Cuba	3	Raw Sugar
Equatorial Guinea	3	Petroleum
Eritrea	3	Gold, Minerals
Guinea-Bissau	3	Coconuts, Cashews
Iran	3	Carpets
North Korea	3	Bricks, Cement, Coal, Gold, Iron, Textiles, Timber
Kuwait	3	Petroleum
Libya	3	Petroleum
Malaysia	3	Petroleum, Electronics, Palm Oil
Mauritania	3	Iron, Copper
Papua New Guinea	3	Gold
Russia	3	Petroleum
Saudi Arabia	3	Petroleum
Syria	3	Calcium Phosphates
Thailand	3	Fish, Seafood
The Gambia	3	Wood
Uzbekistan	3	Cotton
Venezuela	3	Petroleum
Yemen	3	Petroleum, Fish
Zimbabwe	3	Diamonds, Gold

Sources:
US State Department TIP Report 2014, Bureau of International Labor Affairs, Observatory of Economic Complexity (MIT).
** Conflict minerals include Cassiterite (tin ore), Coltan (tantalum ore), Heterogenite (cobalt ore), wolframite (tungsten ore).*

INFORMATION GATHERING

Gathering information regarding a supplier's policies and procedures to eradicate forced and bonded labor is common in the risk assessment process. Multinational corporations commonly use questionnaires to gather initial data, however, utilizing questionnaires or attestations from suppliers may present additional risks as the responses are largely self-reported. Additional measures to validate the information should be employed, particularly in jurisdictions or industries identified as high risk during an initial supplier on-boarding assessment.

In addition to the questionnaire results, multinational companies may evaluate additional risks based on individual characteristics of the suppliers such as annual spend, nature of the goods and services rendered, risks inherent to the geography of the supplier, and the level of political exposure. Understanding a supplier's affiliation and exposure to government officials may present a heightened risk as organizations and individuals with political connections may be more prone to engaging in bribery and corruption to circumvent labor codes. Due diligence efforts should therefore include the identification of companies and individuals who are considered to be Politically Exposed Persons (PEPs). More in-depth due diligence should be performed when the shareholders or principals behind a potential supplier are found to be politically exposed. The same methodology is used by financial services organizations complying with AML and CFT risk assessments.

WHERE THE VULNERABILITIES LIE

Certain industries and products are more vulnerable to forced and bonded labor and multinational corporations should identify how widespread their goods and services are dependent on these materials. The U.S. Bureau of International Labor Affairs (ILAB) publishes an annual list of goods and services prone to both child and forced labor per jurisdiction. In 2014, the report identified 138 products in 74 countries prone to modern-day slavery. Coffee, sugarcane and tobacco were identified as the most prominent products affected by both child and forced labor in terms of the number of countries where these issues were prevalent. The countries with the most industries affected include India, Bangladesh, the Philippines, Mexico, and Brazil.

Table 2: Top Five Products Associated with Child and Forced Labor

PRODUCT	EVIDENCE OF CHILD AND FORCED LABOR
Cotton	Argentina, Azerbaijan, Benin, Brazil, Burkina Faso, China, Egypt, India, Kazakhstan, Kyrgyz Republic, Mali, Pakistan, Paraguay, Tajikistan, Turkey, Turkmenistan, Uzbekistan, and Zambia.
Sugarcane	Belize, Bolivia, Brazil, Burma, Colombia, Dominican Republic, El Salvador, Guatemala, India, Kenya, Mexico, Pakistan, Panama, Paraguay, Philippines, Thailand, and Uganda.
Tobacco	Argentina, Brazil, Cambodia, Indonesia, Kenya, Kyrgyz Republic, Lebanon, Malawi, Mozambique, Nicaragua, Philippines, Tanzania, Uganda, and Zambia.
Coffee	Colombia, Cote d'Ivoire, Dominican Republic, El Salvador, Guatemala, Guinea, Honduras, Kenya, Mexico, Nicaragua, Panama, Sierra Leone, Tanzania, and Uganda.
Cattle	Bolivia, Brazil, Chad, Ethiopia, Lesotho, Mauritania, Namibia, Niger, Paraguay, South Sudan, Uganda, and Zambia.

Source: Bureau of International Labor Affairs, USA

THE NEXT STEPS

Once a risk assessment is completed based on country risk, product risk and internal supply chain considerations (commercial value of relationship with supplier, dependency on supplier, etc.), corporations can initiate the due diligence process. Multinational organizations and financial services companies utilize due diligence levels commensurate with the level of risk and complexity of the third-party relationship; applying lower levels of due diligence to low risk relationships and more in-depth reviews in higher risk scenarios. Standard reputational due diligence includes:

- Verification of the legal standing of the supplier, including review of registration documents from the company registry or tax office, which may provide incorporation details, audited financial statements, disclosure of shareholders/directors, and any former or trading names.
- Search for adverse media in international and local press to conduct a reputational assessment of the counter-party's track record. This element may include a review of established press outlets and social media forums where employees comment on a company's labor practices.
- Review of regulatory, litigation and bankruptcy databases in the jurisdictions where the supplier is registered and operates. These databases may include civil and criminal litigation, regulatory breaches and indications of insolvency or financial difficulties.
- Due diligence research should include a reputational review of the principals and shareholders of the company which may include a review of the reputation and legal standing of the individuals. In addition, due diligence research methodologies should attempt to identify any PEPs or individuals with significant political influence and/or government ties.
- Counter-parties should be screened against international sanctions, watch-lists, and prohibited parties' databases published by governments, international organizations and development banks. These lists, such as the U.S. Office of Foreign Assets Control Specially Designated Nationals, HM Treasury's Financial Sanctions, and the European Union's Restrictive Measures, stipulate certain economic and trading restrictions with countries, companies and individuals.

THE DUE DILIGENCE PROCESS

Due diligence researchers can access a wide variety of publicly-available information to conduct enhanced due diligence. When researching corporate entities, regulatory bodies recommend confirming corporate entities are duly registered and if applicable, are licensed to conduct business. For public companies, the verification and identification element can be performed through a stock exchange or regulator. Obtaining information on private companies can be more challenging depending on the company type and jurisdiction. Enquiries with local company registries and tax offices should be made to verify entities are properly registered. Information obtained directly from the suppliers through questionnaires during the on-boarding stage can also be verified through registry checks. The breadth and type of information publicly available through a registry office will vary from jurisdiction to jurisdiction but will generally include a company's registration number, registration date, registered address, current full and former names of registered shareholders, and directors. Information in emerging markets and offshore jurisdictions is generally more limited.

Identifying the principals and shareholders behind a corporate entity is a critical component to any due diligence exercise. It is equally important to understand the reputation associated with the managers behind a corporate entity and therefore, due diligence should be conducted on these individuals as well as the corporate entity. When researching individuals, available public records will vary across jurisdictions. Ideally, public records and company registration filings will provide enough detail to understand an individual's corporate affiliations, shareholding and directorships. This is a key component in supply chain due diligence as individuals may be associated with numerous companies all competing for the same contract or tender. By understanding where an individual's corporate affiliations lie, a multinational can avoid the risk of collusion.

Adverse media searches include scanning available and searchable media archives for risk information on the corporate entity and the associated individuals. Multinational organizations incorporating adverse media into their due diligence efforts may take different approaches to conducting research. Commercial due diligence providers, such as Thomson Reuters, provide managed services where corporations can outsource the media searches to ensure local language sources are covered. Electronic tools are also available to automate adverse media searches by utilizing negative search strings with key words of interest such as "bonded labor," "forced labor," "slavery," etc. Conducting media searches allows multinational companies to survey press coverage on potential suppliers to understand any previous risk issues or areas of concern.

CONCLUSION

This whitepaper hopes to highlight the prominence of forced and bonded labor in the international supply chain and attempts to demonstrate that multinational corporations can employ existing screening practices to mitigate against exposure to modern-day slavery. While no risk management program will be capable of completely eliminating unethical labor from the international supply chain, there are measures that can be employed to reduce these risks. Corporations should be mindful of modern-day slavery risks due to increasing regulatory pressure following the Modern Day Slavery Act in the UK and forthcoming federal legislation in the United States. Aside from the legislative environment, forced and bonded labor can have adverse effects on brand integrity and consumer perception.

ABOUT THE AUTHOR

James Swenson is the Head of Operations and Delivery for Thomson Reuters Enhanced Due Diligence services. He is a Certified Anti-Money Laundering Specialist (CAMS) and has substantial experience designing due diligence programs complying with FCPA, UK Bribery Act, AML, and supply chain risk management.

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