Best Practices for Vendor Risk Profiling

Presented By

Michael Volkov | CEO & Founder, Volkov Law Group
Stephen Gooding | Director, Product Specialists, NAVEX Global
Agenda

• Review of 2018 FCPA Activity
• Best Practice Use Cases
  – Multinational Manufacturer
  – International Resellers
  – Individual Entities
• Three Key Takeaways
• The Right Approach
Presented By

Michael Volkov
CEO and Founder, The Volkov Law Group

Michael Volkov has over 35 years of experience in practicing law. A former federal prosecutor and veteran white collar defense attorney, he has expertise in areas of ethics and compliance, internal investigations and enforcement matters. Michael Volkov has extensive experience with best practices, government expectations, and industry standards for ethics and compliance programs.

Stephen Gooding
Director, Product Specialists, NAVEX Global

Stephen joined NAVEX Global in early 2015 and has since lead the sales efforts for the company’s third party risk management solution, RiskRate®. He has experience working with Customers in a wide variety of industries including manufacturing, retail, life sciences, technology, and financials. As Director of Product Specialists, he partners with Customers to help design ABAC programs and solve business challenges.
FCPA Enforcement in 2018

BEST PRACTICES FOR VENDOR RISK PROFILING
2018 FCPA Activity: Trending Upward

A Record Year for Enforcement

• 16 organizations paid $2.89 billion to resolve FCPA cases
  - Led by Petrobras ($1.78 billion)
  - Societe Generale ($585 million)
• 15 declinations
• 4 declinations with disgorgement
• 4 individual SEC enforcement actions
• 26 DOJ prosecutions
  - 6 plead guilty to FCPA criminal charges, 6 sentenced, two convicted, 9 indicted
A Steady Increase in FCPA Enforcement

- 2018 saw a resumption of increasing activity, up from a 2017 dip
- Declinations show impact of FCPA Corporate Enforcement Policy (e.g. United Technologies, Sanofi)
- Extension of FCPA Corporate Enforcement Policy to Mergers and Acquisitions, and to non-FCPA criminal cases
- Indications of more action in 2019
Total Corporate Fines: 2008-2018

Fines (millions)

- 2008
- 2009
- 2010
- 2011
- 2012
- 2013
- 2014
- 2015
- 2016
- 2017
- 2018

Fines (millions)

Linear (Fines (millions))
2018 Enforcement Trends

A Focus on Third Parties

• Due Diligence and Third-Party Risk Management
  – DOJ focus continues on third-party risk management
  – In-house attorneys under greater scrutiny with failures to follow controls and intervene (United Technologies, Sanofi)

• C-Suite Risks

• Internal Controls (SEC)
  – Invoice to Payment Process
  – Legal Reviews
  – Financial authorizations
  – Financial auditing
  – Circumvention of controls applicable to third parties
Best Practices

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Justice Department Guidance

• First, qualifications and associations of your third-party partners, including business reputation, and relationship, if any, with foreign officials

• Second, business rationale for using the third party:
  − Role of and need for the third party
  − Contract: Services to be performed and invoicing and payment methods.
  − Payment terms comparable to market
  − Document actual performance of work

• Third, ongoing monitoring: updating due diligence, exercising audit rights, providing training, and/or requesting annual compliance certifications.

• What incentives does third party have to ensure compliance?

• Train “responsible persons” on compliance risks and how to manage those risks with contracts.
Ten Elements of an Effective Vendor Risk Management System

- Written policies and procedures
- Business sponsor participation
- Pre-defined tier levels and requirements for due diligence (basic, enhanced)
- Risk ranking process with consistent risk rule application
- Red flag protocol to identify and resolve red flags
- Contractual certification
- Internal review and approval process (must be outside business)
- Advice of counsel and documentation
- Rational assessment of “representational” vendors and suppliers
- Monitoring and auditing program strategies to reflect risk
Important Tips/Reminders and Principles

• Does the process for third-party due diligence and risk management correspond to the enterprise risk associated with the activity?
• Has the process been integrated into procurement and vendor management?
• The **fact** of due diligence versus the **quality** of due diligence
  – How were red flags identified and resolved?
  – Did the company review third party’s beneficial ownership?
• Importance of invoice, verification and justification and segregation of duty conflicts
• Audits and monitoring of third parties is the new cutting edge
• Third party training is easy mark for government prosecutors
Sample Case: Multinational Manufacturer

Location Based Third-Party Risks

- Company ABC manufactures products for global distribution in three countries: China, India and Spain. Vendors/Third-Parties fall into four categories:
  - Representatives who interact with foreign government: Tax, Regulatory (Health, Safety & Labor) and Customs
  - Agents and Distributors in each country responsible for business development and sales to customers, including government-owned businesses
  - Suppliers of Raw Materials and other Inputs
  - Suppliers of Goods and Services used in and to maintain office locations

- Risk-Rank Vendor Universe:
  - Country of Operation
  - Interactions with foreign government officials
  - Amount of money/commerce
  - Non-representative vendors
Multinational Manufacturer: A Strategy

• Screen all vendors for potential sanctions, reputational and government ownership risks

• Focus on vendors that interact **on your behalf** with the foreign government

• Isolate beneficial owners (a must)

• Identify and resolve red flags (Examples)
  – Prior allegations/involvement in corruption, money laundering, fraud or other misconduct
  – Government official involvement, relationships and/or ownership
Common Red Flag Scenarios

- Suspicious or unusual compensation (high commission or fees)
- Transactions in high risk countries (CPI)
- Individuals or entities with questionable reputation
- Family connections to government officials
- Agents recommended by foreign officials
- Objection to anti-bribery contractual provisions
- Existing or former foreign official (or close ties)
- Shell companies
- No significant experience relevant to the business or organization
- Individuals who claim to have special relationship with a foreign official
- Requests for political or charitable contributions
- Vague scope of work or description of services
Enhanced Due Diligence

• Deeper investigation and red flag resolution

• Need for comfort in resolving red flag risks – rarely used for vendors who do not represent your company

• Common situations for enhanced due diligence:
  – Chinese state-owned company with questionable past activities
  – Questionable expertise in area
  – Government official ownership or involvement in business
  – Questionable business structure and ownership arrangements

• Document your enhanced due diligence investigation
4 Required Steps

1. Information Collection
2. Analysis and Investigation
3. Red Flag Resolution
4. Residual Risk Mitigation
Use Case: Using Relative Contract and Compensation Values

• Within categories of ABC third parties, relative contract values can be applied to rank

• Proposition: The more money a third party handles, the more “opportunity” for misuse
  – Representatives who interact with foreign government Tax, Regulatory (Health, Safety and Labor) and Customs
  – Agents and Distributors in each country responsible for business development and sales to customers, including government-owned businesses
  – Suppliers of Raw Materials and other Inputs
  – Suppliers of Goods and Services used in and to maintain office locations

• Agents and distributors relative risk follows such an analysis (more on this next)

• Risk for representatives who interact with foreign government may not follow value ranking (depending on risky nature of regulatory function)

• Suppliers can be divided using value to reflect extent of reputational risk
Use Case: International Resellers

High-Risk Third-Party Categories

• International agents and distributors pose significant risk

• Channel partners have to be divided based on country of operation and annual revenues
  – China third parties will pose greater risk than Spain
  – Depending on function, India may be riskier than China and definitely riskier than Spain

• Lack of privity between company ABC and downstream sub-agents and sub-distributors

• Ability to screen and review sub-agents and sub-distributors will depend on contractual rights

• Risks are compounded exponentially when company ABC has no visibility into sub-agents and sub-distributors

• Residual risk mitigation strategies are critical, along with monitoring and audit functions
Use Case: Individual Entities

Politically Exposed Third-Party Risks

- Government ownership of a third-party creates unique risks
- PEPs are not prohibited persons, just higher risks
- In Middle East and Asia, government ownership is common
- Questionnaire, screening and possible enhanced investigation will confirm nature and extent of government ownership
- Beneficial ownership is critical to this issue
- FCPA Guidance provides means to solve such issues depending on government owner, role in government and in third party
Residual Risk Mitigation

- Due diligence is not the end of the process
- Residual risk mitigation tools
- Contractual provisions to confirm representations
- Invoice scrutiny and service verification
- Internal training of “responsible” business official for monitoring
- Enhanced monitoring and oversight, including periodic audits
- Due diligence refresh
- Increased training
Three Key Takeaways

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One: Focus on Protecting Your Organization

Confidence in Your Program

- Identify goals. Deliberate programs with rules in place
- Internal controls. Tie it up tight. Tone from the top. Buy-in
- Centralization
- Organizational approach to 3P. Not reactionary. Proactive
- Holistic approach
- It’s NOT: A screening program. That’s not enough; it’s the baseline minimum and no longer defensible. And enforcement agencies expect more
Two: Stratify

Identify Actual Risks and Take Action on Them

- Risk based approach requires digging into vendor population
- Classify and analyze your vendors based on risks factors
- Apply consistent rules-based risk analysis and priorities
- Segregate vendors by risk and apply three-step process
  - Ranking
  - Analysis/Investigation
  - Risk Resolution and Mitigation
- Screening is just a tool to use in the process
Three: Automate

No Excuses

- Vendor risk management cannot be done manually
- Paper programs are by definition deficient and ineffective
- Government expectation is more than just screening
- Screening does not equal automation
- Vendor risk management means holistic approach to identification, risk-ranking, analysis and mitigation
- Vendor risk management has to be central to an effective ethics and compliance program
The Right Approach

BEST PRACTICES FOR VENDOR RISK PROFILING
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<th>Centralized</th>
<th>Automated</th>
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<td>The efficiency and visibility of a third-party due diligence program is dependent on the solution being centralized: one hub for all of your processes, records, and actions.</td>
<td>Good software should allow your team to work smarter, not harder. RiskRate users are engaged proactively and on the key tasks and approvals that require their attention.</td>
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<th>Consistent</th>
<th>Perpetual</th>
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<td>RiskRate offers the tools any organization needs to continually perform due diligence crafted to their carefully defined specifications for a risk-based approach. Run due diligence the right way, every time.</td>
<td>RiskRate keeps all history of due diligence activity where it can easily be found, and features such as monitoring and rules-based workflow maintain current compliance on a third-party for as long as needed.</td>
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Four Key Components of RiskRate®

Essential Options for Third Party Risk Management and Due Diligence

**Stratify**
With a weighted scoring system that’s customizable to your specifications, RiskRate’s Profile Risk calculator applies a risk-based approach to classify your third parties as Low, Medium, or High risk.

**Screen & Monitor**
Screen and monitor your third parties against the world’s largest risk intelligence database for real-time sanctions, PEP, and adverse media alerts.

**Communicate**
Create and distribute deeply customizable questionnaires from within RiskRate, so that you can gain disclosure, legal attestation and important documents from your third party points of contact. RiskRate scores third party responses automatically upon reporting receipt.

**Investigate**
Analyst-driven reporting is a key component to any mature due diligence program. Request, scope, order and store your deep-dive engagements directly within the platform.
Potential workflow with RiskRate

Example: Sales Agent in China, $1m spend, interacts with public officials

- Business Sponsor Form Completed
- Automated 3rd Party Facing Questionnaire
- 3rd Party completes questionnaire in RR
- Profile Risk scores “High” based on 3rd party responses
- Automated DD report task assignment
- DD report returned, Compliance notified via RR
- Relationship Denied

Data upload into RiskRate

Automated RiskRate process
Questions?