



BEST PRACTICES:
THIRD-PARTY RISK MANAGEMENT

Criteria Identifying When to Request Enhanced Due Diligence

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Enhanced due diligence (EDD) investigations come into play when ordinary due diligence techniques do not reveal the true depth or extent of information your company seeks prior to engaging with a third party. Despite the considerable volume of data available online, reliance on internet-based sources alone is not enough.

An EDD investigation utilizes local knowledge, extensive investigative resources, and honed skills by expert researchers to provide company executives with critical intelligence beyond what is publicly-accessible provides more accurate, valid, and reliable information. Having access to more dependable information allows companies to make better-informed decisions about engaging with third parties that present higher inherent compliance risks.

Get the Right Information to Make the Right Decisions

At minimum, your organization should always screen and monitor third parties using traditional due diligence methods from open source intelligence resources. These resources can deliver cursory information on risk indicators such as sanctions watchlists, adverse media reporting, financial background checks, and resources that reveal the political connections of key stakeholders.

Some third parties may be quickly cleared or rejected using open source intelligence, as standard screening techniques should capture most surface-level concerns. However, there will be occasions when deeper dives are warranted before commencing a business engagement. In scenarios where your company determines that a heightened level of risk is involved based on your unique risk profile, screening results or even a gut-feeling, EDD procedures have the potential to reveal more elusive data and satisfy business requirements or curiosity.

EDD reports may include beneficial ownership information, sources of funding, banking relationship information, supplier names and locations, customer names and locations, and litigation records, which provide high value to your organization as it determines the viability of its third-party relationships. These reports are the result of more robust, in-depth procedures, such as site visits and investigative interviews of the third party's regulators, business partners, and former associates.

When to Order Enhanced Due Diligence

Legal guidance promulgated under the Foreign Corrupt Practices Act (FCPA) makes clear that risk-based due diligence processes are integral to any effective compliance program. The question therefore arises as to which factors would necessitate going the extra mile to conduct an EDD inquiry, and an analysis of this issue always begins and ends with risk.

While there is no definitive list of factors that inherently trigger an EDD inquiry, the appropriate degree of due diligence scrutiny varies based on the overall risk indicators associated with a third party. In other words, the degree of due diligence should be commensurate with the level of risk. As additional red flags surface signaling a higher-risk third party, EDD helps define and mitigate the risks presented, as the enhanced level of scrutiny provides a more comprehensive understanding of the third party and confirms the factual information it has provided.

Common warning signs of heightened risk that may prompt your company to dig deeper into the potential third party by conducting EDD include:

- **Third party's industry:** Certain industries, such as natural resource extraction, pharmaceuticals, construction and infrastructure, transportation and logistics, defense contracting, and finance, inherently carry greater corruption risks simply due to the nature of the business. Third parties that operate within these industries often should undergo EDD.
- **Contract value:** The sheer size of a proposed third-party transaction could necessitate conducting EDD. It makes sense to mitigate risks to the greatest extent possible when there is much to lose.
- **Contract nature and complexity:** Your company should examine the type of work that the third party will perform. Scenarios become riskier, for instance, when the nature of the third party's services could cause government regulators to construe the third party as your company's legal agent. Moreover, third parties seeking to conduct an unusually complex transaction or pattern of transactions could warrant heightened scrutiny, particularly when those transactions have no readily apparent or visible economic or lawful purpose.
- **Geography:** The geographic location for the proposed work is often a helpful indicator of risk. Countries' inherent risk levels are ranked on the Corruption Perception Index (CPI) scale to identify which locales present heightened corruption risks. Third parties operating in countries with lower CPI scores tend to warrant deeper dives into their business practices through EDD inquiries.
- **Historical relationship with the third party:** Put simply, third parties with a history of corrupt behavior pose a greater risk of future illicit activities. If something suspicious has occurred in the past, EDD could help shield your company during future transactions.
- **Government interaction levels:** Third parties that interact with government officials more frequently naturally have increased opportunities for bribery and other forms of corruption. Such entities merit additional inquiries into the nature and extent of their government interactions to ensure a standard of integrity.
- **Suspected government ownership:** If government ownership of a third party is suspected but unconfirmed, then EDD procedures to uncover the entity's true ownership structure would be appropriate.

- **Political ties:** The term “politically exposed person” (PEP) describes someone who has been trusted with prominent public functions. When a third party’s key stakeholders include one or more PEPs, the third party’s risk of involvement in bribery and corruption increase simply by virtue of those stakeholders’ influential political positions. After identifying PEPs within the third party’s organizational structure, your organization should conduct EDD to clarify critical information about the PEPs and mitigate associated risks.
- **New and developing technologies:** Third parties seeking to use new and developing technologies or products that favor anonymity can present increased corruption vulnerabilities; additional EDD measures can help manage those risks.
- **Unique or inexplicable legal entity forms:** When the third party assumes a unique legal form, such as a trust or other vehicle for holding personal assets, there is a sound basis for conducting EDD. This recognizes the potential use of trusts as vehicles for disguising the criminal origin of funds or the true ownership and effective control of trust assets. This is especially true when the trust’s ownership and control arrangements are particularly sophisticated or complex.
- **Any other suspicious circumstances your company determines to be high-risk:** Based on your company’s risk profile, assessment and standard due diligence practices, EDD may be warranted in situations that simply feel riskier. There is no precise formula associated with this determination as these situations vary based on multiple factors, including the nature of your business, the suspicious behavior of the third party in question, the due diligence practices your company has conducted previously, the results of the monitoring process, and the broader corruption environment. Some examples of suspicious activities may include a lack of experience or expertise in the proposed services, requests for government approval by seemingly arbitrary deadlines, or requests for additional commission payments to reward successful outcomes. Your company must determine which measures are required according to the degree of risk involved.

EDD is an effective tool in the risk-mitigation arsenal, and knowing when to employ it can help your company avoid costly mistakes with high-risk third parties. The factors outlined above should demonstrate that EDD is a highly subjective process that should be tailored to the facts and circumstances that gave rise to the concerns detected through standard due diligence. Similarly, the type of EDD procedures vary based upon the risks identified.

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