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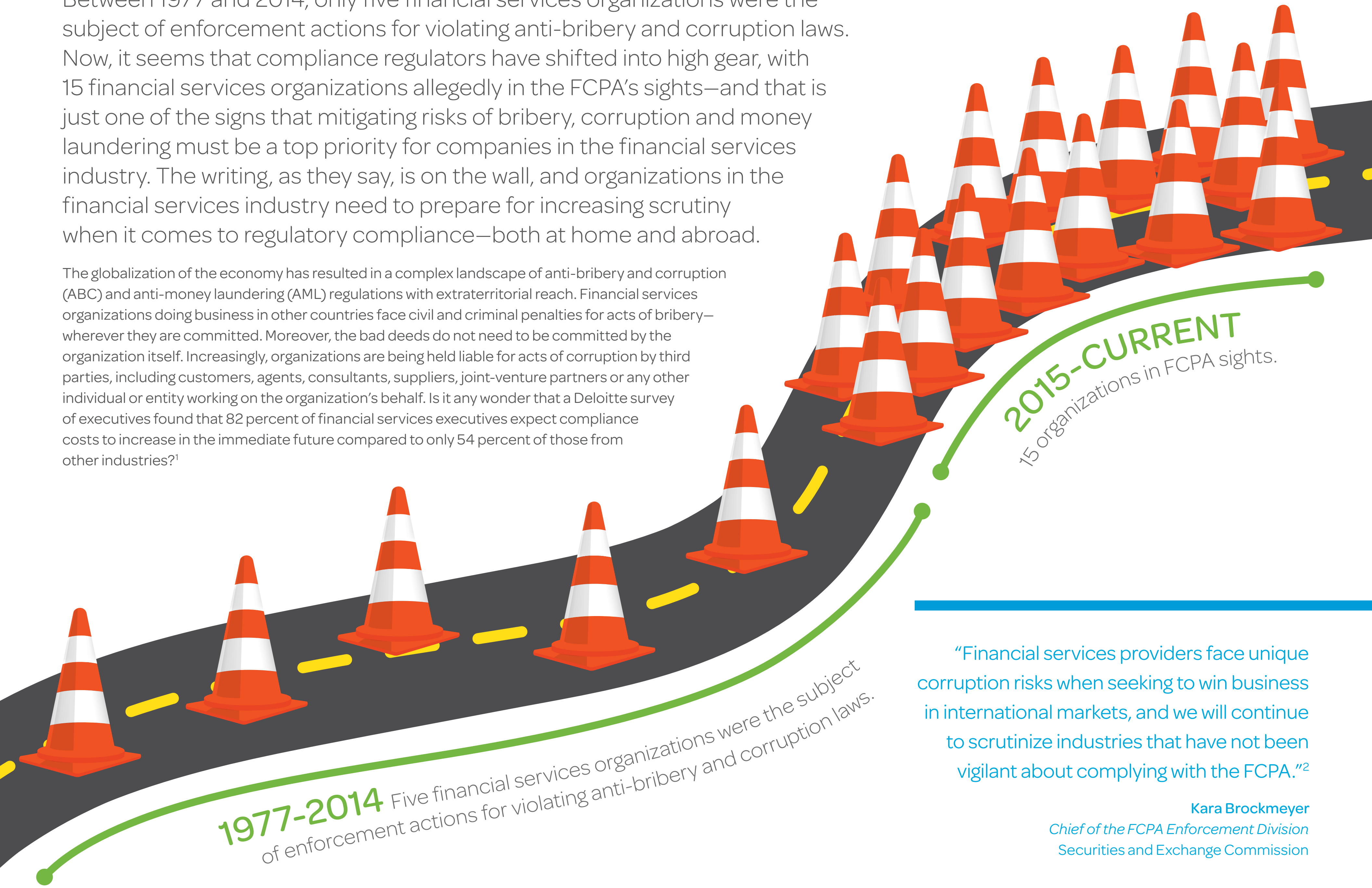
A Better Route to Mitigating Third-Party Risk

THIRD-PARTY DUE DILIGENCE FOR FINANCIAL SERVICES

Between 1977 and 2014, only five financial services organizations were the subject of enforcement actions for violating anti-bribery and corruption laws. Now, it seems that compliance regulators have shifted into high gear, with 15 financial services organizations allegedly in the FCPA's sights—and that is just one of the signs that mitigating risks of bribery, corruption and money laundering must be a top priority for companies in the financial services industry. The writing, as they say, is on the wall, and organizations in the financial services industry need to prepare for increasing scrutiny when it comes to regulatory compliance—both at home and abroad.

The globalization of the economy has resulted in a complex landscape of anti-bribery and corruption (ABC) and anti-money laundering (AML) regulations with extraterritorial reach. Financial services organizations doing business in other countries face civil and criminal penalties for acts of bribery—wherever they are committed. Moreover, the bad deeds do not need to be committed by the organization itself. Increasingly, organizations are being held liable for acts of corruption by third parties, including customers, agents, consultants, suppliers, joint-venture partners or any other individual or entity working on the organization's behalf. Is it any wonder that a Deloitte survey of executives found that 82 percent of financial services executives expect compliance costs to increase in the immediate future compared to only 54 percent of those from other industries?[1]


2015-CURRENT
15 organizations in FCPA sights.
1977-2014 Five financial services organizations were the subject
of enforcement actions for violating anti-bribery and corruption laws.

> "Financial services providers face unique corruption risks when seeking to win business in international markets, and we will continue to scrutinize industries that have not been vigilant about complying with the FCPA."[2]

Kara Brockmeyer
Chief of the FCPA Enforcement Division
Securities and Exchange Commission

Compliance Wrong Turns are Costly

The growth in counter-terrorism, anti-money laundering (AML) and anti-bribery and corruption (ABC) regulations has led to not only greater corporate liability for compliance failures but increased personal liability as well. In a press release accompanying EY's publication of top fraud and corruption trends for 2016, Brian Loughman, EY Americas Fraud Investigation and Dispute Services Leader, said, "The geopolitical risk facing companies is manifesting itself with increased exposure to bribery, fraud, cyber breaches, and terrorist financing. Companies will need to stay vigilant, work harder at providing the right training to their employees, and focus more on monitoring risks proactively."[3] Companies that fail to address compliance risk discover—too late—that anti-bribery and corruption enforcement agencies are committed to setting an example.

It's not just the organizations themselves that need to be concerned. In a DOJ (U.S. Department of Justice) memo, Deputy Attorney General Sally Quillian Yates wrote, "One of the most effective ways to combat corporate misconduct is by seeking accountability from the individuals who perpetrated the wrongdoing."[4] The Yates memo explicitly ties a company's identification of suspected individual violators with the possibility of cooperation credit. The SEC (Securities and Exchange Commission) has also indicated a sharpening focus on the individual perpetrators of fraud, bribery, corruption and money laundering.

> "The fine must be substantial enough to have a real economic impact which will bring home to both management and shareholders the need to operate within the law. Whether the fine will have the effect of putting the offender out of business will be relevant; in some bad cases, this may be an acceptable consequence."[5]
>
> UK Sentencing Council

$1.45 BILLION

Commerzbank

penalty in 2013

The German lender settled the case with a deferred prosecution agreement that included a formal admission that Commerzbank violated sanctions by removing identifying information so they could process transactions on behalf of Iran, Sudan, Cuba and Myanmar through U.S. financial institutions.[6]

$33 MILLION

ICBC Standard Bank

penalty and a deferred prosecution agreement in 2015

The bank settled with the UK Serious Fraud Office for failing to prevent overseas corruption and also resolved similar charges from the SEC with an additional $4.2 million payment.[7]

$14.8 MILLION

BNY Mellon

settlement in 2015

Charged by the SEC for FCPA violations related to offering student internships to family members of foreign government officials affiliated with a Middle Eastern sovereign wealth fund—without holding the recipients to the same rigorous standards used for awarding other internships.

$12.3 MILLION

Allianz SE

settlement in 2012

The insurer based in Germany faced the SEC penalty for FCPA violations for improper payments to government officials in Indonesia.

$7.7 MILLION

PayPal

settlement in 2015

The U.S. Treasury Department's Office of Foreign Assets Control (OFAC) charged PayPal with failing to properly screen transactions with OFAC-sanctioned entities and individuals, resulting in violations of trade sanctions against Iran, Sudan and Cuba.[8]

Following the Rules of the Road

Third-party due diligence is especially important for financial services organizations because clients can lead to increased risk just as easily as third-parties working on your behalf. In fact, *A Resource Guide to the U.S. Foreign Corrupt Practices Act* published by the U.S. Department of Justice (DOJ) and Securities and Exchange Commission (SEC) states that "Businesses may reduce the FCPA risks associated with third-party agents by implementing an effective compliance program, which includes **due diligence** of any prospective foreign agents."[9]

Meeting Regulator Expectations

Regulators expect financial services companies a robust due-diligence process in place as a means of preventing bribery and corruption risk.

You need to be alert to risk warning signs—and which sources of information offer the best view of what dangers lie on the road ahead. The World Economic Forum has developed "Good Practice Guidelines Conducting Third-Party Due Diligence" outlining a number of warning signs of which organizations need to be aware.[10] What should you watch for to pave the way for greater compliance and risk mitigation?

> "Financial institutions are encouraged to develop and maintain 'enhanced scrutiny' practices and procedures designed to detect and deter transactions that may involve the proceeds of official corruption by senior foreign political figures, their immediate family, or their close associates. These practices and procedures should be viewed as an application of institutions' due diligence and anti-money laundering policies."[11]
>
> **U.S. Department of Treasury**

BRIBERY
RISKS
AHEAD

Industry or Country Warning Signs

Are the countries where you are operating high on the Transparency International Corruption Perceptions index? Does the transaction involve an industry with a history of anti-bribery violations? If so, you need to put your due-diligence checks into high gear.

Political Warning Signs

If a third party is likely to engage with public officials on your organization's behalf, you need to be especially cautious. Over and over, we've seen companies fall on the wrong side of regulators because a third-party agent violated ABC laws in dealing with public officials or their family members and associates.

STAY ALERT
POLITICAL
RISK

Organizational Warning Signs

When conducting due diligence, you need to adjust your process based on organizational red flags, such as a third party who appears to lack experience, qualifications or adequate staffing to provide the services required. In addition, you need to be wary when your organization is asked to use a specific third party. Why is someone trying to influence your selection?

PROCEED
WITH
CAUTION

Transactional Warning Signs

When transactions appear unreasonably high, such as excessive payments for commissions, bonuses or typical goods and services, you should look deeper to ensure the reasons for these high dollar transactions aren't attempts to detour around ABC or AML laws. Pay special attention to payment or billing procedures that:

- Go through bank accounts in a foreign country outside of the one where the services are being provided
- Utilize anonymous, numbered bank accounts
- Go through shell companies, third-party intermediaries or individual accounts
- Demand cash payments or checks made out to 'bearer' or 'cash'

BEWARE
HIDDEN
RISKS

Identifying and Mitigating the Risks Ahead

The first step? Conduct a risk assessment to determine the extent of the due diligence required. Treating all cases the same can lead to problems: Shallow due diligence may increase your risk exposure, but deep due diligence may lead to wasted time and resources. Instead, the degree of due diligence should be matched to the level of risk and the complexity of the third-party relationship.

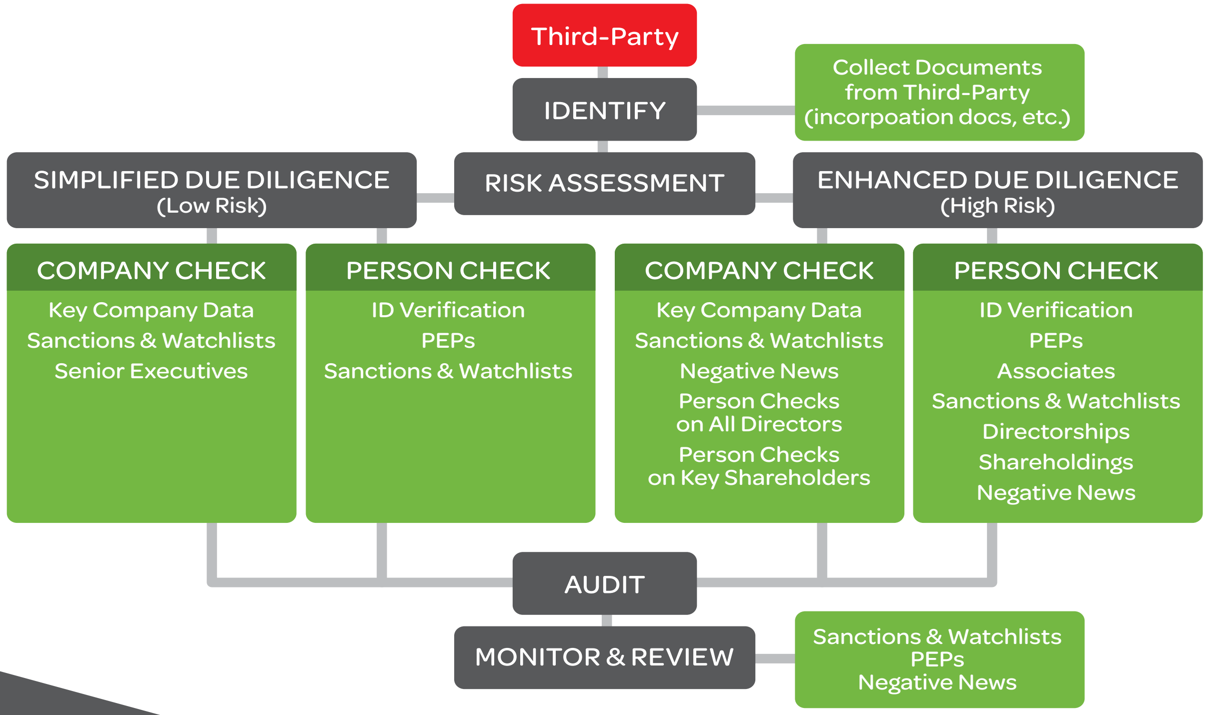
In this way, you can identify the best route and resources needed for effective, timely due diligence.

In recent years, a growing number of resolved cases involved payments made through third-party intermediaries, supporting a previous finding by the OECD that:

> More than 75 percent of 427 corruption cases since 1999 have involved third parties.[12]

To mitigate risk, financial services organizations need to develop robust risk-assessment, due-diligence and ongoing monitoring processes that look deeper at those necessary third-party relationships. While no program can eliminate all risk, compliance enforcement officials have indicated that having a robust compliance strategy and evidence of "a genuine commitment to uncovering and preventing FCPA violations" can go a long way towards reducing potential penalties for violations.[13] Such was the case in 2012 when the DOJ publically declined to bring an enforcement action against Morgan Stanley following an admission of FCPA violations by the company's former managing director, Garth Peterson. The DOJ cited Morgan Stanley's "system of internal controls, which provided reasonable assurances that its employees were not bribing government officials."[14] Otherwise, your reputation, your ability to conduct business in the future and your bottom line may take a serious hit.

Map Out a Third-Party Due-Diligence Process



Third-Party

IDENTIFY

Collect Documents from Third-Party (incorpoation docs, etc.)

RISK ASSESSMENT

SIMPLIFIED DUE DILIGENCE (Low Risk)

ENHANCED DUE DILIGENCE (High Risk)

COMPANY CHECK
- Key Company Data
- Sanctions & Watchlists
- Senior Executives

PERSON CHECK
- ID Verification
- PEPs
- Sanctions & Watchlists

COMPANY CHECK
- Key Company Data
- Sanctions & Watchlists
- Negative News
- Person Checks on All Directors
- Person Checks on Key Shareholders

PERSON CHECK
- ID Verification
- PEPs
- Associates
- Sanctions & Watchlists
- Directorships
- Shareholdings
- Negative News

AUDIT

MONITOR & REVIEW

Sanctions & Watchlists
PEPs
Negative News

Fuel Your Due-Diligence Process with Good Information Sources

Even for low-risk individuals and entities, questionnaires and open Web searches can fall short because of out-of-date or unreliable data. On the other hand, using outside services for every risk level can be cost-prohibitive and less timely than desired.

A solution like Lexis Diligence® brings together trusted, current content—all in one place—making it easier to integrate your due-diligence process into your workflow.

OPEN WEB LIMITATIONS

- EU 'Right to be forgotten' legislation means data gaps
- Paywalls mean multiple subscriptions to access news archives
- Content accuracy difficult to verify

OUTSOURCING LIMITATIONS

- High costs for basic due-diligence research reports
- Reports received require appraisal
- Time lag in receiving information

CURATED CONTENT PROVIDER ADVANTAGES

- Comprehensive, current and archival global content
- Fast, efficient single search and due-diligence report creation
- Consistent process and audit aligned to risk-based approach

✓ Politically exposed persons (PEPs)

✓ Full text Negative News

✓ Aggregated watchlists

✓ Global public & private company reports

✓ Legal cases

About LexisNexis®

We help our customers mitigate business risks, meet their strategic goals and accomplish greater return on investment. Using our efficient, flexible and cost-effective due-diligence and monitoring empowers our customers to find the information they need on people, companies and countries:

- PEP, watch list and negative news screening and monitoring
- Enhanced due diligence and reporting

LexisNexis solutions are backed by best-in-class global news, company, regulatory and legal content and supported by experienced industry specialists and thought leaders well versed in the evolving requirements our customers need to address.

For More Information

🖥 www.lexisnexis.de/diligence

☎ +49(0)211 417435-40

✉ kontakt@lexisnexis.de

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