

Third Parties: The Growing Challenge of Ethics and Compliance Responsibility

Moderator:

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Panelists:

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Corporate Responsibility, Solvay North America, LLC

Christine Chaney, Director Ethics & Compliance, Continental Airlines

Diana Lutz, Managing Director, CECO, The Steele Foundation



Topics for Discussion

- Panel Introductions
- Role of third parties in conducting business globally
- Risks encountered when doing business with third parties
- Opportunities and current practices for risk mitigation
- How we can address third party risk
- Due Diligence
- Your challenges and opportunities and experience
- Q&A

Our Panel

- Marjorie Doyle, Principal, Marjorie Doyle LLC, a Global Ethics and Compliance Consultancy , previously EVP & CECO Vetco International, CECO DuPont (Ret).
- Carolyn Egbert, Vice President, Global Human Resources , Solvay North America, LLC, Subsidiary of Solvay SA, a Belgium-based international chemicals/plastics company, employing >30,000 people in 50 countries. Solvay operates in four regions: Europe, NAFTA, Mercosur & Asia-Pacific.
- Christine Chaney Director Ethics & Compliance, Continental Airlines, Continental is based in Houston, Texas with over 42k employees worldwide, servicing 262 destinations. In 2009, Continental joined the Star Alliance (United, Lufthansa, Air Canada, etc.).
- Diana Lutz, Managing Director and CECO The Steele Foundation. STEELE is a global advisory and risk management company with offices in 16 strategic locations and engagements in over 110 countries. Steele provides investigative due diligence, FCPA risk assessments, and compliance program development for Fortune 500 companies, mid-sized businesses and nonprofit organizations.

Third Party Reliance

- Almost every business engages suppliers, contract employees, agents, lobbyists, etc.
- Businesses are increasingly entering new markets and expanding the global reach of their products and services.
- “Outsourcing” work has increased in popularity, allowing companies to access and leverage the global workforce.
- Initially, some companies may have assumed that outsourcing meant limiting their risks and responsibilities.
- Currently, use of third parties expands beyond outsourcing and includes contracting for specialized and local products, services and expertise, supporting faster growth and a greater impact in new markets.
- The reputation of your organization, for better or worse, is often placed in the hands of these third parties.

Who are Third Parties?

Third Party Types:

- Suppliers, Vendors
- Distributors, resellers
- Consultants - Expertise in: Legal, Accounting, Strategic Business, Local and Regional Issues, etc.
- Industry Experts, Advisory Services
- Contractors, Temporary Services
- Agents, Sales Representative, Marketing Intermediaries
- Joint Venture Partners

Tracking Third Parties:

- Record third parties and centrally track relevant information such as:
 - risk classification / category
 - Business need
 - due diligence file completion
 - compliance program implementation status
 - in person visits
 - relationship owner
 - contract terms
 - projects
 - payments
 - approvals, etc.

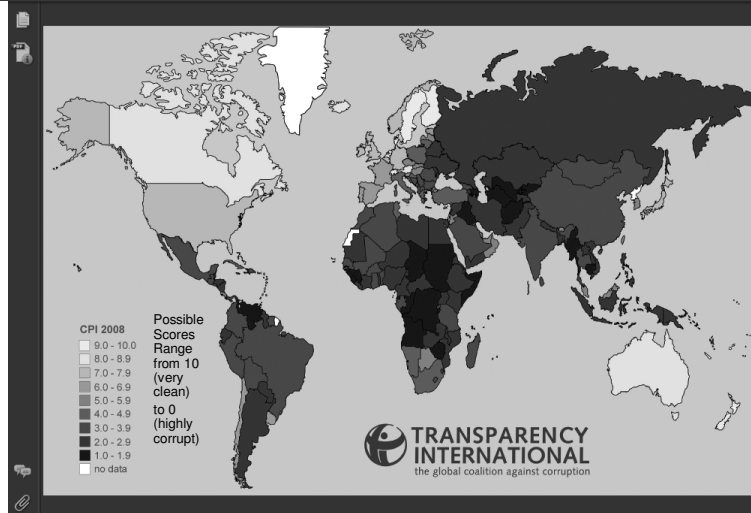
Third Party Risk Exposure

- Legal liability and consequences for actions of third party.
- Third party actions on your behalf affecting reputation.
- Third party investigated or under a cloud can affect your organization even if your organization is not implicated.
- **Specific examples of how a Third Party can create Risk:**
 - Supplier of your goods runs a sweat shop.
 - New manufacturer of your dog food brand has “quality issues” and substitutes cheap, toxic fillers for ingredients.
 - Your agent lavishly entertains government officials.
 - Distributor sells product to a legally prohibited market (i.e. sanctioned country).
 - Marketing consultant misuses customers’ private data.
 - Lobbyist bribes government official.

Managing third party relationships and conducting due diligence to mitigate ethics and compliance risks is a priority for leading companies.

Emerging Markets and Increased Risk

The Transparency International Corruption Perceptions Index ranks the degree to which corruption is perceived to exist among public officials and politicians by country.



Examples and Experience

CURRENT PRACTICES AND CHALLENGES

Managing Third Party Compliance Risk

- Identify third parties that present the highest risk.
- Consider corruption index of location for business to be conducted, interaction with government, contract size, when assigning risk ratings to third parties.
- Use due diligence process to mitigate risk and eliminate those third parties who present unmanageable levels of risk.
- Ensure third parties are educated and agree to company ethics & compliance program standards.
- Ensure own company staff is well trained and able to spot red flags and address them.
- Include terms in third party contracts that require compliance and audit rights and provide for contract termination if noncompliance situations arise.
- Ensure ongoing monitoring and requalification of third parties.
- Continuous oversight of third party activities and payments.
- Always stay alert for red flags.

Embedding E&C in Third Party Contracts

**All obligations related to “risk” with third party
Performance obligations should be in a written contract.**

Sample contract topics:

- Inclusion of an anti-corruption clause
- Identify all relevant laws related to their service
- Right to terminate for compliance violations
- Right to audit contract for compliance with terms
- Require proper record keeping
- Require adoption of parts of your Code of Conduct (or theirs if it meets standards) that relate to their service
- Make clear how questions or reports of violations are to be addressed, i.e. hot lines
- Require reporting on change in status relevant to reputation, business ownership, legal violations, etc.
- Make training and education requirements clear

Ongoing Requirement of Third Party Oversight

- Each third party must be actively managed by someone in the company.
- This person maintains the documentation on the third party and updates it when necessary.
- Degree of supervision depends on degree of risk with the third party their tasks, and their geography.
- Audit schedule needs to be created and implemented.
- Evaluations of adherence to the contract, and periodically analyzed for compliance.
- Stay current on changes in ownership and changes in the business model of third party.
- Company managers of third parties need to be monitored and evaluated on their performance of third party management.
- Third party's failure or success is an added responsibility of the company's manager for that entity.

Avoiding Issues with Third Parties and Corruption: Watch for Warning Signs or Red Flags

- Representative referred by a government official;
- Lack of experience and qualifications to perform the services;
- History of corruption in the region or country;
- Check the transparency international corruption perceptions (TI CPI index);
- Refusal to certify that it will comply with the FCPA and Company compliance program;
- Unusually high commissions;
- Lack of detail on work to be done;
- Unusual payments or financial arrangements;
- Lack of transparency in expenses and accounting records.

Examples and Experience

DUE DILIGENCE

Discussion Background

Common Conditions

- Decentralized/legacy culture (global growth by acquisition)
- Disparate companies and systems
- Disparate agreements
- Inconsistent segment business practices
- Lack or absence of quality data
- Third-parties undefined and unidentified
- No third-party risk analysis process in place
- No due diligence program in place
- Responsiveness from business segments

The Challenge

- Knowing your business – knowing your risks
- Defining a program & setting a standard
- Clearing your due diligence backlog
- Implementing a manageable process moving forward
- Executing on the process

Focusing in Areas of Greatest Liability

Risk-Based Compliance: How To Be Prepared

- Companies with clear, demonstrable commitment to consistent, intentional third-party due diligence program do best
 - Vetting is essential pillar of robust and “reasonable” FCPA compliance program
- What does a credible third-party due diligence program look like?
- Which intermediaries need to be vetted and at what levels?
 - Your company needs to evolve a specific and systematic methodology to calculate risk among third-party intermediaries, including vendors, customs agents, consultants, joint venture and teaming partners, distributors, and sub-contractors.
- A policy without teeth will not protect a company from prosecution, much less prevent misconduct

What Does a Written Due Diligence Program Look Like?

PROGRAM COMPONENTS

- Program Objective & Scope
- Roles and Responsibilities
- Definitions
- Exceptions
- Risk Based Due Diligence

PROCESS

- For Conducting Due Diligence
- When a Red Flag Is Discovered
- For New and Existing Third-Parties
- Repetition of Due Diligence Process
- Process at Renewal or Modification of Legal Agreement
- Filing and Retention of Documents Created under this Program
- Payment of Cost for Due Diligence Services

ROLES, RESPONSIBILITIES AND TRAINING

Focusing in Areas of Greatest Liability

Initial Third Party Inventory to Define Risk Basis

1. There is no off-the-shelf program or risk matrix that provides a roadmap of where to focus your efforts.
2. A program require financial investment – so be strategic with your resources when defining training, due diligence, and audit requirements.
3. Know which areas of your business (Geography, business units, relationship types) present the greatest exposure for your company.
You must know your business to know your risk.
4. Step One: Conduct a corruption risk inventory.
 - Based on risk inventory results, then you can tier your risk and focus your resources appropriately.

Identifying Your Third Parties, Rating Them and Creating a Database

- 1) **Identify categories of Third Parties:** How does your Company do business? -- Segment by Segment, Company by Company, Region by Region
 - Interview key stakeholder(s) (may include sales, legal, procurement, IA)
 - Collection of 3rd party definitions in broad terms (Specific data not req'd)
- 2) **Weight and assess risk**
 - Conduct risk analysis on the categories to determine the level of exposure for each discrete category
- 3) **Define risk tiers based on category risk scores** (i.e., risk thresholds) and the scope of due diligence (if any) to be applied to each tier.
- 4) **Data aggregation**
 - Data source identification, collecting, conforming, and cleansing
 - Assign category type (which has an associated risk and a predefined level of investigation)

Wrap up and Discussion

- Third parties are a necessity in today's business world.
- Business leaders must understand that they are not necessarily a cheaper alternative.
- The same rigor in ensuring an effective ethics and compliance program for the company, applies to its third parties.
- Third parties who have effective ethics and compliance programs have a competitive advantage with their customers - engenders trust.
- Risk assessments, due diligence processes, programs addressing and mitigating particular risks, strong contracts, and ongoing internal management and monitoring are essential.

Risk Mitigation Checklist

(for reference)

Managing Third Party Risk – Mitigation Checklist

(every principle in effect, mitigates risk)

- Third parties are under formal contractual agreement with company and management has contract on file.
- Regular audits are conducted by company to ensure third party contractual agreements are managed and enforced as agreed.
- Contractual agreements with third parties clearly set forth expectations regarding the relationship and adherence to specific company standards and policies.
- Third party contracts prohibiting third-parties from unilaterally sub-contracting its contractual responsibilities with other entities.
- Nature of relationship clearly identifies legal status of entity, place of incorporation.
- Third party conducts background checks on all employees, contractors, associates and others working on its behalf.
- Company has a Code of Conduct in place applicable to third parties or requirement that third party have own Code. Addresses how the Code is formally applied and enforced with third parties.

Checklist, con't

- Third parties certify that they have read and understand the company's Code of Conduct or their own substantially similar Code.
- Third parties receive regular training and communications regarding company standards, culture, compliance, and other legal requirements. Review how these communication and awareness efforts are delivered and with what level of frequency. Communications translated and delivered in local languages.
- Company has a widely publicized and readily available global reporting mechanism and process where employees, contractors, third parties, agents, etc, can seek guidance, report concerns and ask questions (anonymously if desired).
- Anti-bribery / anti-corruption standards and training is communicated and provided to everyone in the organization to include employees, third parties, contractors, etc. Review how these communications and training delivered and with what frequency.
- Third parties are required to certify that they have received, completed, understand and will comply with anti-corruption / anti-bribery policy and training.

Checklist, con't

- Third-party is NOT a current or former government official, employee or agent or a relative.
- Clearly defined and legitimate business purpose exists for engaging third parties.
- Third party is qualified and experienced to engage in the service or activity he or she was retained to undertake.
- Third parties paid via standard payment protocols established by company (ex. direct deposit).
- Employees working with third parties are knowledgeable of applicable anti-bribery, anti-corruption, and U.S. FCPA compliance standards.
- Third party activities are closely monitored by company management in all operating locations.
- Third parties are directly supervised and managed by company employees in high-risk operating locations.

Checklist, con't

- Supply chain, procurement, accounting, senior and local management, legal and compliance trained on third party compliance standards and can readily identify red flags.
- New third party relationships in high risk countries or where activities involve regulated or high risk operations are reviewed and approved by the company's CEO or other designated company official.
- Conflict of interest check completed.
- Third party subject to any past, current and/or pending legal issues, lawsuits, government investigations, inquiries, etc. If so, describe the nature and disposition of these actions.
- Company actively assists third parties in mitigating compliance risks.
- Regular and ongoing audits are conducted at third party sites and operating locations for all business activities. Includes risks assessment, site visits, management and employee interviews, document review.
- Company performs due diligence efforts on third parties prior to entering into business relationships.

Third Parties:

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Q&A