



WHAT COMPANIES NEED TO KNOW ABOUT THIRD PARTY RISK MANAGEMENT AND DUE DILIGENCE IN ASIA PACIFIC

Countries such as China and India are some of the most high-risk jurisdictions for bribery and corruption risk.

Written by Mini vandePol, Angela Ang and Andrea Kan,
Baker McKenzie

The Importance of Risk Management and Due Diligence. Companies increasingly rely on the support of third party intermediaries - such as agents, dealers, distributors, and consultants - in their global supply chains. The engagement of such intermediaries can reduce costs, and create new opportunities and greater efficiencies. Third parties, however, particularly those in high-risk countries, may also bring higher risks to the companies that engage with them.

Most anti-bribery and anti-corruption (ABC) laws, including the US Foreign Corrupt Practices Act (FCPA) and the UK Bribery Act (UKBA) prohibit making corrupt payments directly and indirectly through third parties. The FCPA's far-reaching accounting provisions for companies holding US securities also requires books and records to accurately and fairly reflect all business transactions and effective internal controls to be maintained. Where third party intermediaries are concerned, it is difficult to closely monitor the work they carry out and track how the money paid for this work is used. For example, payments such as unsubstantiated fees or unusually large commissions to intermediaries such as shell entities or government-affiliated entities may be used as a means to hide corrupt payments. As such, companies must (i) conduct thorough due diligence before the engagement of a new third party intermediary as well as (ii) ensure that comprehensive risk management controls are in place to detect and prevent misconduct on an ongoing basis.

The Asia Pacific Context

Asia Pacific's largest markets - such as China and India - are some of the most high-risk jurisdictions for bribery and corruption risk. Of the 604 FCPA enforcement actions involving third party intermediaries between 1978 and 2019, 217 actions (36%) involved misconduct that took place in Asia Pacific, nearly half of which involved China alone. In China, interaction with government officials, normally through external agents or consultants, is common because

regulatory approvals and licenses are frequently required and many potential business partners, customers and suppliers are state-owned enterprises. Also, dubious gift and entertainment practices - stemming from the tradition of guanxi, a system of social networks where strong relationships are built on reciprocity and exchanging favours - are still rampant. Therefore, companies operating in this region cannot simply expect their employees and third-party intermediaries to "do the right thing"-strict procedures and controls are necessary to mitigate and manage risks.

Best Practices - What Companies Need to Know and Do

Pre-engagement Due Diligence

All companies should conduct comprehensive pre-engagement due diligence on prospective third-party intermediaries before the commencement of any business relationship. This can be done in-house, or, as we increasingly see, by externally hired local expert investigators. While it may be cost and time prohibitive to run background checks on all third-party intermediaries, it is highly advisable to screen major third party intermediaries in high-risk jurisdictions or industries, in particular those where the third party is frequently required to interact with government officials on behalf of the company. Even if a company did not have knowledge of or participated in its third-party intermediary's misconduct, failing to conduct proper due diligence may lead to regulators to believe that the company "wilfully" committed or facilitated the misconduct - as shown in the recent Telefonaktiebolaget LM Ericsson (Ericsson) enforcement action, discussed below.

The third party intermediary should be required to:

- Complete written questionnaires detailing, among other things, experience and qualifications for the work it has been contracted to perform; and
- Declare all government ties and affiliations, financial and accounting practices, and compliance program and history.

It is good practice to benchmark costs through competitive bids and provide ABC training to high risk third parties. Most importantly all such measures, and the red flags identified and resolved should be recorded in a formal due diligence report. The engagement should be formally set out in a signed agreement and include the scope of services, agreed remuneration, as well as basic compliance

covenants (i.e. adherence to all relevant ABC laws, audit rights, and termination rights).

Post-engagement Monitoring and Training

A standard "check-the-box"-type approach to post-engagement third party monitoring and training is no longer sufficient to meet the US and UK regulators' standards - companies must have in place a robust compliance program with tailored standards and controls that are consistently and effectively applied and periodically audited.

What this means, at the most basic level, is that companies should have a set of protocols that can detect compliance problems on a continuing basis, to ensure that policies and procedures are actually carried out in practice. In December 2019, Ericsson agreed to pay a total penalty of more than US\$1 billion - making this the second largest FCPA enforcement action of all time - for various alleged FCPA violations, including paying bribes and managing off-the-books slush funds through third party intermediaries in China, Indonesia and Vietnam, among other countries. The allegations against Ericsson included:

- Failing to implement and maintain sufficient controls to ensure effective enforcement of its third party compliance procedures; and
- Engaging third parties through sham contracts while payments were made pursuant to false invoices and then improperly recorded in its books and records. The Securities and Exchange Commission (SEC) characterised this as a "wilful failure".

Companies should also regularly exercise their audit rights over high-risk third party intermediaries and reconcile bank accounts with outgoing and incoming payments to/from all third party intermediaries on a monthly basis. Companies should verify compliance by conducting a formal risk assessment annually (or more frequently where warranted) and obtaining a renewed signed compliance certification form.

Moreover, simply gathering information and identifying compliance problems is not enough - where any red flags are uncovered, companies should swiftly and proactively investigate and remediate. In June 2019, Walmart Inc. was fined US\$ 282.65 million in relation to allegations of making payments at the subsidiary level in a number of countries including China and India, to third party intermediaries without assurances that the payments

were consistent with their stated purpose or in accordance with ABC laws. Walmart learned of various internal control risks and weaknesses from its internal audit team on multiple occasions and even received a whistle-blower complaint, but did not sufficiently investigate the allegations or implement the suggested remedial actions. The SEC treated this as evidence of Walmart's internal controls failures, in breach of the FCPA's accounting provisions.

Ultimately, companies cannot blindly assume that their global compliance programs will be operationalised where they conduct business - rather, they should drill down to understand the specific risks faced by their employees on the ground including those associated with the engagement of third parties; conduct training in the local language and implement practical policies and procedures customised to ameliorate the risks faced. To ensure that the compliance program is properly communicated to and understood by third party intermediaries, companies should closely monitor attendance at training sessions and follow-up on missing attendees. Lessons can be learned from Walmart - despite having a worldwide anti-corruption compliance and training program, the SEC considered that Walmart's failure to adapt and implement this for its China subsidiary or offer formal compliance training to be evidence of Walmart's internal controls failures.

Expert Biography



Mini vandePol is the Chair of Baker McKenzie's Asia Pacific Compliance & Investigations Group.

She focuses on risk management and mitigation, transactional compliance risk due diligence and cross border investigations across multiple countries and industries. She is the trusted advisor to significant global clients — establishing and enhancing their risk management programs and promoting a strong commitment to a compliance culture.

Angela Ang has extensive experience in cross-border investigations. She regularly assists clients with designing practical compliance policies, training programs and advising on Hong Kong anti-bribery issues.

Andrea Kan has assisted in a range of cross-border anti-bribery and corruption investigations including in China. She also advises on regulatory compliance matters involving clients from various industries.