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FCPA due diligence: Starting 2017 on the right note

» Identify the risks involved when using third parties or acquiring a business outside the U.S.
» Determine the risk levels and research needed for information gathering from the third party or merger and acquisition (M&A) target.
» Decide which due diligence measures to undertake in order to reduce these risks.
» Understand the basic requirements to be compliant with the two principal global laws: the Foreign Corrupt Practices Act (FCPA) and the UK Bribery Act.
» Identify gaps in your compliance activities to mitigate regulatory risks, reduce the likelihood of fraud, and minimize costs.

Effective Foreign Corrupt Practices Act (FCPA) due diligence processes require thought and consideration of risk. The stakes are much greater when you are orchestrating a major foreign acquisition or retaining third parties to represent your business. To be compliant with global anti-bribery laws, it is essential to identify and mitigate risk; failure to do so can result in criminal and civil penalties.


Nolan

Due diligence investigations whether as a necessary part of an acquisition process or retention of a third party, should primarily be based on complying with two principal global laws: the FCPA and the UK Bribery Act. Under these laws, conducting due diligence on these targets is not an option, it is required.

Incidentally, don't get too tied to the titles of third parties; they all must be reviewed. Third parties may include suppliers, independent sales agents, vendors, brokers, customs agents, logistic companies, consultants, attorneys, tax advisors, and others. A less technical definition of "third parties" is simply any person or entity that acts on your organization's behalf.

Identifying risk

The primary regulatory objectives for conducting due diligence on third parties are to determine if:

- The third party is qualified (i.e., suitable for the task at hand)
- The third party is reputable
- The party has ties to foreign officials (i.e., politically exposed)

To be compliant with global anti-bribery laws, it is essential to identify and mitigate risk; failure to do so can result in criminal and civil penalties.

In addition to third-party risk, when buying a business outside the

U.S. or UK, your concerns should be tied to, among other things, the size of the transaction, the nature of the deal (e.g., are you the primary stakeholder?), and certainly the risks associated with doing business in the geographies involved. For example, if you are buying a business headquartered in Germany (low risk) that makes goods in the Philippines (high risk) and China (moderate-to-high risk) and has sales agents in Russia (high risk), you have a lot of work to do in multiple places to assure compliance.

Unfortunately, there is no database available today that meets the needs of all these diligence requirements. In our experience, comprehensive databases are anything but. Global databases simply are not capturing critical information, despite claims of "real-time data" and "24-hour coverage."

Therefore, we have found that site visits are often an essential part of diligence in assessing a target, especially in less transparent markets. A site visit often reveals that a manufacturing company is a sales office in an apartment, or a vacant lot, for example. We also perform extensive media research in the local language to find out whether a party is politically-exposed or has been charged with corruption. And of course, identification and interviews of knowledgeable sources in the industry can be vital in assessing whether a vendor or other third party is reputable and suitable for your needs.

Defining risks

The level of due diligence should be elevated if one or more of the following risks apply:

- Government contracts are at stake;
- Government inspections and regulations are implicated;
- Former government employees are involved;
- Industry sectors are known to have a history of corruption or FCPA violations;
- Location is in less transparent countries under Transparency International rankings;
- Principals or shareholders of the third party are registered/incorporated in off-shore tax havens, such as Panama, British Virgin Islands, Belize, and others;
- Payments are made to off-shore accounts;
- No registered address, no physical location;
- Requests are made for up-front payments; or
- Businesses are unregistered.

Getting information from the third party or M&A target

We recommend that our clients use questionnaires that are executed by the target or third party. Ask for, in both English and the local language:

- Date of incorporation
- Proper full name of entity and also related entities
- Identities of all shareholders, key managers, and directors
- The third party's or target's code of conduct
- History of compliance violations
- Person responsible for compliance
- Bank and other commercial references
- Identification of employees with current or former government ties

A low-risk third party could be defined as one that does not touch any of the risks

listed above; a high-risk third party would be one that may touch one or more of the above listed risks. Examples of high-risk third parties are ones where the business operates in a country or region known for a lack of transparency, or the business owner was a high-ranking government official, or the entity being reviewed operates in an industry known for corruption.

Levels of due diligence

To effectively perform due diligence, research should be performed in English and the local language. Policies of countries differ when making certain information available. In many countries, the government does not provide access to criminal and/or civil litigation records. In other countries, the beneficial owners of the business are not required to be identified. (Actually, that is a problem in certain states in the United States as well.)

We recommend using the following three tiers for mitigating risk, and research methods can, of course, be changed (you can mix and match) to meet the needs of the project.

Level I research

- Corporate registration records
- Verification that principal individual is a shareholder/director/manager of entity
- Global watch and sanctions lists
- State-owned or state-controlled company
- Politically exposed persons (PEP)
- Adverse media

Level II research

Perform all Level I research, plus the following research:

- Criminal and civil litigation research (where available)
- Corporate affiliations (where available)
- Directorships and disqualified directorships (where available)
- Government regulatory searches (where applicable)
- Bankruptcies and insolvencies
- Liens, judgments, fines, and/or other financials (where available and applicable)
- Comprehensive media
- Social media
- Verification of credentials (when possible)

Level III research

Perform all Level I and II research, plus:

- Discreet site visits to verify operations and/or residence, may include interviews on site
- Reputational interviews
- Research of most recent financial records and credit data

Conclusion

Deciding which due diligence processes to perform for doing business outside the U.S. or UK, whether considering acquisition of a company or retention of a third party, should primarily be based on complying with two principal global laws: the FCPA and the UK Bribery Act. Under these laws, it is incumbent upon the businesses to identify and analyze the risks, perform appropriate research based upon the risks, and document due diligence planning and activities. This approach can help a business if you are ever faced with a time-consuming and potentially expensive government investigation. ✷

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