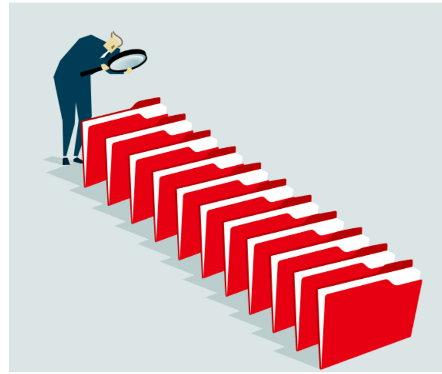
TRACE Anti-Bribery Compliance Solutions

Red Flags for Bribery Risk: *What They Are and What They Mean*

Introduction

You're conducting business in a foreign market. You've found an agent to serve as an intermediary for your company in interactions with the local government, whether those involve applying for permits, marketing your company's services, or responding to contract tenders. You also know about bribery risk—the catastrophic harm that can follow from an intermediary's use of corrupt means to pursue a company's goals. After an initial assessment of the general risk factors (including country, industry, and market conditions), you decide it's appropriate to take a closer look at your prospective intermediary prior to engagement.



Your primary aim in conducting this due diligence is to identify "red flags"—certain facts that can signal a heightened risk of public official bribery. A red flag doesn't mean you shouldn't hire the subject, but it does warrant consideration as part of your company's decision-making process. The proper evaluation of such red flags requires an understanding of what they mean and the risks they signal.

This whitepaper will review and discuss several classes of red flags that are commonly encountered in the performance of due diligence on third party intermediaries. The aim is to help company executives and compliance personnel interpret the information provided in due diligence reports, informing their decisions about what safeguards might be appropriate in a given case or whether the third party is simply too risky to engage.

Relevant Information

The precursor to identifying and interpreting red flags is collecting the relevant information. Such information can be obtained from a variety of sources, such as public records, media searches, and the third party itself. Your collection should include the following (with appropriate modification where the intermediary is an individual rather than a company):

- **Business information, registration and literature.** Along with the basics like name, address, point of contact, and any trade or marketing aliases, you'll need documentation regarding the nature of the intermediary's work, its qualifications and experience, the regions and markets in which it provides services, and how—and where—it expects payments and other financial transactions to be processed. Copies should be obtained of any corporate registration or licensing documents. It can also be helpful to review the intermediary's marketing literature: how does it present and distinguish itself? What does it say it can accomplish for its clients?
- **Owners and directors.** You need to know who owns the company, and you need to know who controls the company. Directors should be identified, as should those who have power to appoint them. Complete ownership percentages should be ascertained for privately-held companies. If any owners are themselves corporate entities, their ownership needs to be determined as well, all the way back to individual beneficial ownership. For publicly-traded companies, individuals or entities that own a significant quantity of outstanding shares (e.g., more than 5%) should be identified, along with the individual owners of any such entities.

> **Personnel information.** Bribes are ultimately paid by people, and people can hold positions and interests that facilitate or incentivize illicit payments. To assess those risks, you'll want information about the intermediary's owners, directors, and key personnel: citizenship, work history, any political or governmental affiliations, and any other currently-held positions or ownership interests. The same sort of information should be obtained about close relatives, given the overlapping nature of family interests.

> **Government engagements.** Having connections to the government, whether directly or through family, may or may not signal heightened bribery risk. To get the full picture, you should know which government agencies (including military and state-owned enterprises) the intermediary will interact with in performing its services, and whether the intermediary (or anyone associated with it) itself performs any services for or has contracts with any government agency.

> **Compliance information.** Does the intermediary have a written anti-bribery policy or code of conduct? Does it maintain a well-functioning compliance program? Does it periodically assess its own bribery risk? While the presence of such measures doesn't guarantee that an intermediary will avoid bribery, their absence is something you would want to know about.

> **Reputational screening.** It should go without saying that past behavior is a key predictor for future behavior. Information about an intermediary's past dealings—and the past dealings of its key personnel—can be obtained in two ways: directly from the intermediary via a detailed questionnaire; and indirectly through a media search on all relevant people and entities, as well as a review of court records in applicable jurisdictions.

> **Business references.** You should obtain independent confirmation of a potential intermediary's practices and ethics from other companies with which it has done business, either as a provider of services or as an agent or representative. To maintain independence, the references should not be entities that are affiliated with the intermediary, entities owned or controlled by individuals associated with the intermediary, or entities that themselves act as third party agents for the intermediary.

> **Company financials.** An audited financial statement or an independent financial reference (e.g., from an external accountant) provides important information about the intermediary, including the soundness of its accounting practices and its overall financial health and stability. You'll want to be sure that all of the intermediary's outlays are properly tracked, and that it demonstrates an ability to carry out its work by legitimate means.

Red Flags

As with any potential hazard, it is difficult to comprehensively list all possible indicators of bribery risk. Context matters, and not every situation can be anticipated.

At the same time, there are certain identifiable facts that usually warrant closer investigation. The appearance of the following types of red flag can signal a need to pause and take note of the possible danger.

Government Links

The overriding question for any intermediary is whether it will pursue your company's aims solely by legitimate means, or whether it shows any motive, inclination, or distinct opportunity to make use of bribery. Opportunity arises when the intermediary has ties to the government and its agencies, either directly or through the individuals associated with it.

Direct ties include being owned or funded by a government entity, or having members of the Board of Directors subject to government appointment or approval. At a minimum, government ownership would raise the question of whether your company's payment to the intermediary could itself be considered a bribe. Extra care should be taken to ensure and document that any payments to the government-owned intermediary are commensurate with the legitimate services it provides. One should also be attentive to any connections between the controlling government body and any agencies with whom the intermediary will be interacting on your behalf. Even informal connections among personnel can signal an opportunity for collusive behavior.

A similar concern arises where an owner, board member, or key employee of the intermediary holds a government, military, or political position, or where such a position is held by a close relative of the same. You need to understand how that position could be leveraged—directly or indirectly—to improperly influence a government decision in your company's favor. The same can be said of individuals who have recently retired from government service and may still have connections within the agency, particularly if that agency is one to which the intermediary will be marketing your goods or services.

These sorts of connections do not necessarily signify anything untoward. Intermediaries are hired precisely because they are able to get things done, which often means knowing the right people to communicate with. But familiarity can also be an opportunity for corruption. Where an intermediary's connections with the government go beyond what can legitimately be expected within industry practice, that's a red flag calling for closer scrutiny.

History and Reputation

An experienced intermediary will be known within the local industrial and regulatory community. It will have a track record and a reputation, and you should familiarize yourself with both.

While some of the relevant facts, such as criminal convictions or debarments, will be matters of public record, it can be more efficient to request all such information from the intermediary itself, with appropriate confirmation against court records.[1]

A criminal conviction against the intermediary or any of its owners, directors, or key personnel is, of course, cause for concern. How much concern may depend on the nature of the conviction, along with how recently it occurred and whether there is any evidence of remediation. Offenses involving unlawful payments to government officials or procurement fraud, for example, may be considered more relevant than, say, income tax evasion. But any conviction (other than routine traffic infringements) should be considered a red flag to the extent that it raises questions about the subject's character.

Even without a conviction, any involvement in criminal proceedings (or comparable civil or administrative proceedings) is something you should be aware of. Being investigated, charged, interviewed, deposed, or subpoenaed in connection with such a matter is by no means itself a sign of wrongdoing, but you will want a thorough understanding of the matter's nature and the subject's role therein as part of your due diligence evaluation.

Reputation, of course, goes beyond court records. The intermediary's business references will be an initial source of information in this regard, but you will want your inquiry to extend further. The local embassy may be able to tell you if the company or any associated individuals have been the subject of negative reports. And a review of media databases can help you ascertain whether there has been any relevant adverse coverage. Opinion and news may not always get at the truth, but they can help identify issues that will inform your engagement decision.

Inadequate Controls

Bribery as a company policy is (we hope) more the exception than the norm. The more typical scenario involves an employee or other representative choosing to cut corners to win a contract or otherwise obtain favorable governmental treatment. Whether such actions are driven by internal pressure to meet sales goals or simply by greed, an effective compliance program can go a long way toward altering the incentives and the disincentives for employees to engage in them.

The same is true for third party intermediaries. Those with an explicit anti-bribery policy, comprehensive anti-bribery training, and a system to address questions and solicit concerns will be better-positioned to prevent rogue activity by their employees—activity for which your company could end up liable. Insisting on such measures by your third parties is critical; even better is to find an intermediary that has already implemented them of its own accord.

[1]As of the writing of this paper, there is a live controversy regarding the propriety of obtaining information about the criminal history of individuals residing in the European Union. According to Article 10 the EU's General Data Protection Regulation (GDPR), "[p]rocessing of personal data relating to criminal convictions and offences . . . shall be carried out only under the control of official authority or when the processing is authorised by Union or Member State law providing for appropriate safeguards for the rights and freedoms of data subjects." There is not currently any Union-wide uniformity in the enactment of such authorization for purposes of anti-bribery due diligence. See generally A. Wrage & I. Antonenko, "Anti-corruption and GDPR: A collision of galactic proportions", Ethical Boardroom (March 2018), available at www.ethicalboardroom.com/anti-corruption-and-gdpr-a-collision-of-galactic-proportions/.

Compliance controls require time to take full effect, and you may need to exercise greater oversight where an intermediary is having to start from scratch.

Your third party may have any number of related entities—subsidiaries, affiliates, joint-venture partners, suppliers, subcontractors, and so on. One should expect the intermediary to require all such affiliates to adhere to its ethics and compliance policies, just as your company requires of its third parties. The absence of such a requirement may not be suspicious as such, but it may be considered a red flag with respect to the intermediary's overall commitment to compliance.

Finally, a third party cannot be considered to have adequate controls if its accounting is awry. If you cannot assure yourself—whether through a financial reference or through an audited financial statement—that the intermediary's books and records are maintained in accordance with generally accepted accounting practices, you should consider that to be a serious red flag for bribery risk.

Suspicious Circumstances

Suspicion might be justified, for example, if the intermediary doesn't have any apparent expertise or experience in your industry. Marketing a product or navigating a bureaucracy requires a certain familiarity with the field. Knowing the right people is important, but so is the capacity to understand and clearly communicate both the strength of your offering and the needs of the customer. If an intermediary demonstrates no particular ability in this regard, one has to ask whether it intends to use other, illicit means to advance your interests.

Performing this work also requires resources, both human and financial. The intermediary should be adequately staffed to meet the demands, not just of your project, but of all the projects to which it is committed. For an intermediary who will be working on commission, you will want to be sure that it is financially strong enough to absorb the ongoing costs, and that it will not be in a position where it must make the deal go through by any means.

A qualified intermediary will be justified in promoting itself as able to get the job done. But making extraordinary promises can be cause for suspicion, as can a documented success rate substantially in excess of industry norms. Suspicion can also be triggered by an unusually high compensation demand, as some of that compensation may be intended for redirection to corrupt government officials. Likewise when an intermediary asks to receive payment in a separate jurisdiction or in an otherwise unusual fashion.

All of these suspicions can be amplified by the way in which the intermediary was brought to your attention. Was it by recommendation of a government official? Of someone close to a government official? Of someone within your company who has little or no connection to the industry or the product? Any of these sources standing alone can be a red flag, calling for rigorous inquiry into the intermediary's credentials and capabilities. Where either of those appears askew, the danger is severely compounded.

Missing Information

Obtaining relevant information directly from the intermediary can significantly increase the efficiency of your due diligence research. At the same time, such information must be subjected to careful review to ensure completeness and coherence.

Ownership information is critical to a bribery-risk assessment—knowing who you're paying, and knowing what government connections they might have. Any gaps in ownership information should be considered a red flag until resolved. Also of concern are structures that serve to obscure true beneficial ownership, such as the involvement of estates or family trusts, circular ownership (the entity holding an indirect stake in itself), ownership by non-transparent corporate entities, or complex arrangements of derivative and indirect ownership.

Other omissions can be easier to spot, as when the intermediary does not provide requested documents, does not identify the complete board of directors, or leaves out the names, titles, or citizenship of key personnel. Or you may find gaps in the work histories of key personnel. These omissions may well be inadvertent or innocuous, and a follow-up request may be sufficient to resolve the issue. But as long as this sort of information remains unavailable, you are justified in asking yourself why.

A more problematic situation arises when the intermediary is unable to provide you with an acceptable business reference. The intermediary may at first identify references that are inappropriate, such as affiliated companies or companies with common ownership; as with other missing information, this problem might be easily communicated and rectified. But if it can't be resolved, and the intermediary cannot find an independent entity able to vouch for its business integrity, that's a signal either of inexperience or of ethical problems—a red flag either way.

Misleading Information

Missing information is one thing; misleading information is another. Any falsification or forgery of business registration documents is a red flag of the highest order, and should be considered immediately disqualifying. Likewise any deceit or collusion in connection with business or financial references. These deceptions are not always easy to identify, but you should remain attentive to the possibility and approach your review, not with undue suspicion, but with a critical eye.

Information can be misleading even though it may not be blatantly fraudulent. Omissions regarding past illicit behavior are more troubling than an incomplete identification of ownership, and failing to identify current or past government affiliations is more problematic than neglecting to account for time spent out of the workforce. These kinds of red flag, if openly acknowledged and addressed, shouldn't automatically remove a potential intermediary from your consideration. But if the intermediary is not forthcoming about them, that becomes a red flag of its own.

Uncooperativeness

Due diligence almost always involves a certain amount of back-and-forth. Additional information is needed, circumstances prompt follow-up questions, and certain safeguards may need to be implemented. It is a difficult and sometimes lengthy process, and not one that anybody is likely to enjoy.

One can expect to encounter a degree of frustration in this process. But there's a difference between mere frustration and outright uncooperativeness. When an intermediary fails to provide relevant information even after multiple follow-ups; when its communications are evasive or belligerent; or when it pressures you to go forward with the engagement before the process is completed—these can be red flags not only for compliance, but for the ongoing health of your business relationship. Under such circumstances, you would be well within reason to reconsider the engagement.

Conclusion

While the process of identifying red flags in the course of due diligence can be somewhat mechanical, deciding what to do about them is anything but. Some flags, as a matter of company policy, may on their own be flatly disqualifying, but for the most part it won't be so clear-cut. Any attempt to apply a simple quantitative rule ("three flags and you're out") would be misguided and counterproductive, given the variety of risks and the range of severity such flags represent.

In many instances, a red flag will serve primarily as a caution—identifying a potential risk that requires some form of constraint or oversight. Other flags may, upon further investigation, turn out not to be of serious concern at all. Often, though, you will be presented with a dilemma: a significant risk of corrupt behavior that, while it may be mitigated, cannot be eliminated. At that point, you will need to balance that risk against your company's needs and goals, assess any alternative options for the engagement, and decide whether to proceed.

The appearance of a red flag doesn't mean that your intermediary will definitely engage in bribery, just as the absence of red flags isn't a guarantee that it won't. But, in the event that you do proceed with the engagement, having identified those flags will help you understand the nature of the risks you're dealing with and find appropriate administrative measures to mitigate them. You will also have a better idea of how best to monitor the engagement so that, if something improper does happen, you can catch it early and respond appropriately.

TRACE due diligence solutions are heavily benchmarked, innovative and cost-effective. With in-house research capabilities in over 35 languages, a worldwide network of partner firms that can be called on for local law expertise, and nearly two decades of anti-bribery experience, TRACE offers superior quality and competitive pricing.

Visit **www.TRACEinternational.org/due-diligence**, email **info@TRACEinternational.org** or call (+1) 410 990 0076 for more information.

About TRACE

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