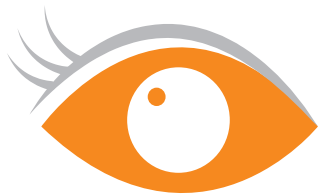
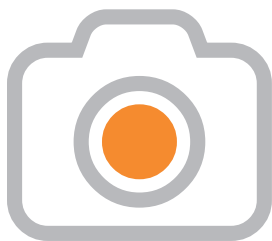
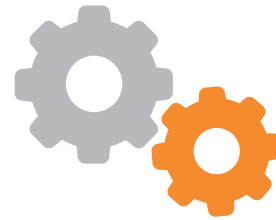


Third Party Risk: Exposing the Gaps from a U.S. Point of View



Foreword

By Shaun Sibley,

Managing Director, Customer and Supply Chain Risk,
Thomson Reuters

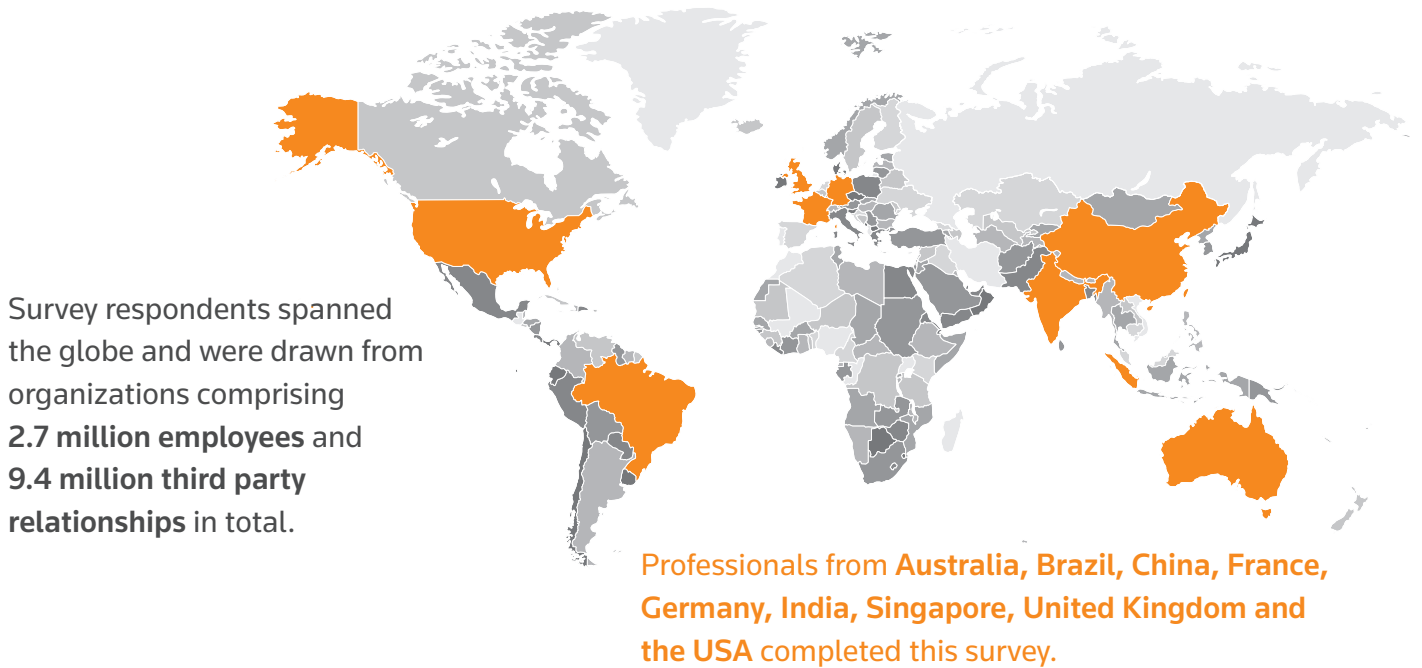


A crucial element in effective supply chain and third party risk management involves developing and maintaining a thorough understanding of the plethora of potential risks inherent in business relationships. The consequences of failure are significant, and can include enforcement action, often hefty fines, and – perhaps most devastating of all – lasting reputational damage. This, in turn, can potentially lead to a significant loss of market capitalization. For example last year the stock prices for a large pharmaceutical company fell dramatically after they were fined to resolve criminal charges and civil claims relating to a scheme to defraud the United States and pay kickbacks in exchange for patient referrals.

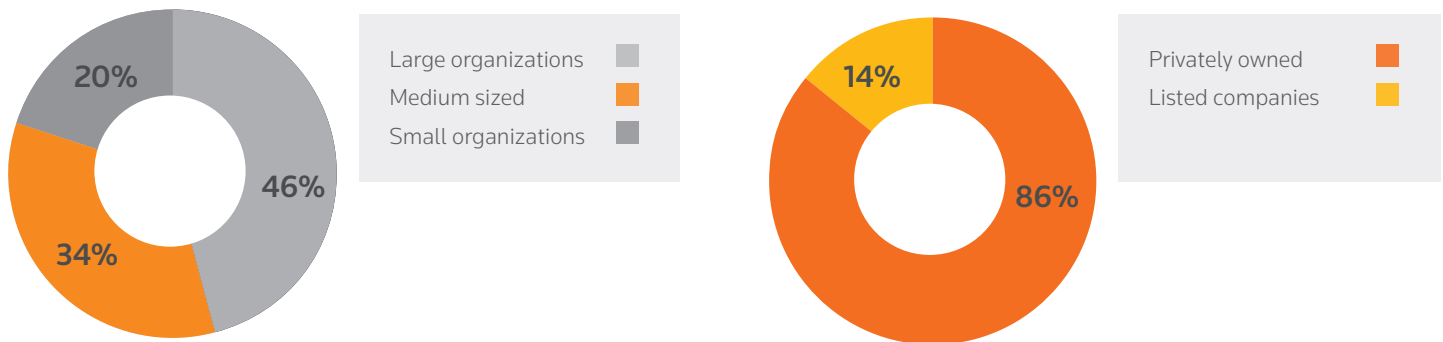
In a bid to understand how U.S. organizations are really managing third party risk and, further, to uncover any gaps in knowledge, Thomson Reuters commissioned a survey of professionals involved in global third party relationships and/or third party risk management. The results highlighted the potential real world risks linked to suppliers, distributors and partners across the globe. These risks are brought into sharp focus if one considers that U.S. survey respondents reported that they have on average 14,036 third party relationships.

About the survey

This report is based on research commissioned by Thomson Reuters and conducted by an independent agency between July and September 2016. A total of 1,132 professionals completed the survey and, of these, 149 (13.2%) were from the USA.*

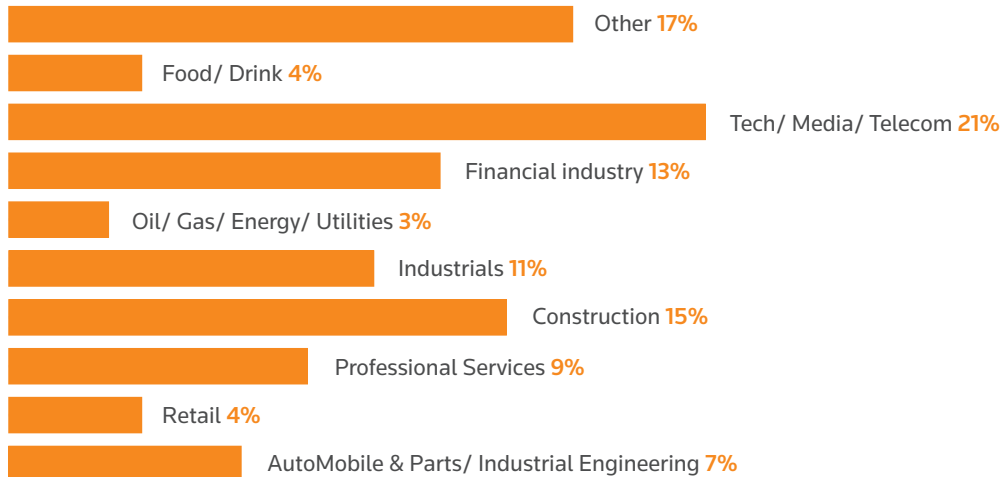


Organization type

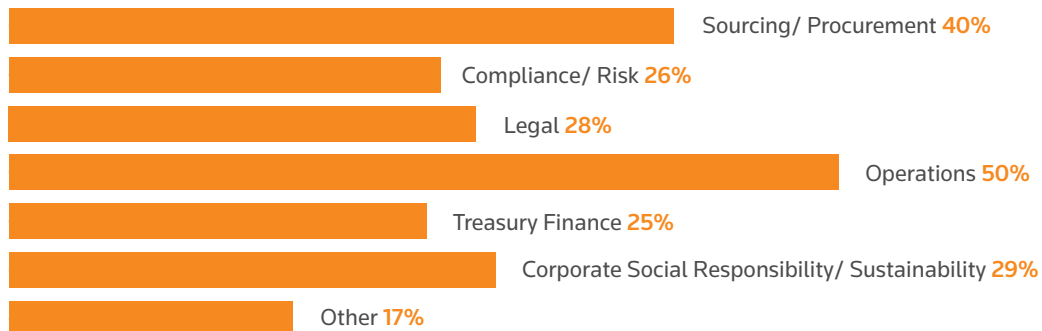


*The general convention for rounding percentages has been applied, so not all sums will add up to 100%.

Industry



Job functions*



*respondents selected all functions that applied

Definitions

For the purpose of this report we have defined a 'third party' as any person or organization that is connected to a supply chain or is executing business on an organization's behalf such as, a distributor, agent and/or partner.

The report has defined the term 'third party risk' to include anything that could expose a company to threats and risks through engagement with third parties, including bribery and corruption, modern slavery, environmental crime or conflict minerals.

The term third party due diligence refers to assessment of the third party at the onboarding and ongoing monitoring stage to determine the risk profile.

A snapshot: what did the survey reveal?



The survey revealed the following headline statistics for the USA:

Outsourcing benefits and risks

- 77% believe that third party relationships have enabled them to be more flexible and competitive
- 79% agree that winning new business is a priority and as a consequence they might breach regulations

The regulatory landscape and gaps in knowledge

- 9% are not aware of the Foreign Corrupt Practices Act (FCPA)
- When questioned about key specific risks, less than half feel they have sufficient knowledge in each category
- Only 7% feel that they have sufficient knowledge of ultimate beneficial ownership (UBO)

Due diligence and enforcement

- On average, U.S. organizations carry out due diligence on 74% of third parties
- 61% agree that 'there is a perception that we're unlikely to be prosecuted if we breach regulations'
- 96% increased the amount their organization spends on compliance after experiencing an enforcement action

Third party risk management

- The main drivers for due diligence are compliance with regulations and protecting the company from reputational damage
- Only 36% are fully monitoring for all ongoing risks

Real world challenges

The top three challenges reported by U.S. organizations are:

- Resource constraints, including budget and time
- Lack of data available
- Limited knowledge of the risk

Expectations

- 79% expect to increase the time and resources spent on conducting due diligence over the next 12 months
- 72% believe the personal liability of compliance professionals will rise over the next 12 months

Outsourcing benefits and risks



Increasingly competitive global markets have resulted in more and more organizations having to cut costs and scale back on internal resources in order to grow - or in some cases just preserve - their market share. Many choose the outsourcing of activities or working with third parties as an effective solution, but this can expose them to new risks, especially if the third parties they engage with operate in diverse geographies. Considering that regulatory action around the globe is becoming more and more onerous, these new risks must be given due attention.

Benefits

U.S. respondents resoundingly supported the view that outsourcing can help their organizations, with over three quarters (77%) of survey respondents saying that third party relationships had allowed their companies to be more flexible and competitive. This was slightly higher than the global average of 74% that supported this view, but not as high as some other countries, notably Brazil (87%) and China (86%).

Risks

Respondents are, however, aware that the risk landscape is changing. Overall, 65% of those surveyed agreed that the current economic climate is encouraging organizations to take risks (relating to regulations) in order to win new business and this view was even more widely held in the USA, where 68% of respondents were in agreement.

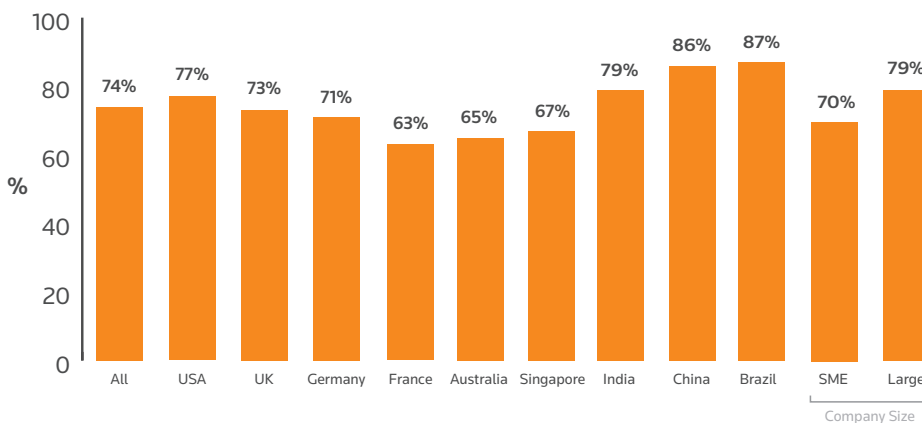
Geopolitical risk is an important factor to consider and the survey sought to identify which regions are perceived as 'high risk'. Sub-Saharan Africa topped the list, with 54% of all respondents describing it as high risk against a slightly lower 45% of U.S. respondents.

Respondents were also asked if third party relationship decisions often overlook key risks and 67% of U.S. respondents agreed against an average of 61% overall. A possible reason for this is that 79% of U.S. respondents - the highest percentage of all countries surveyed - agreed that winning new business is a priority and, as a consequence, they might breach regulations. The overall figure was 63%.

Top five regions perceived as 'high risk' by U.S. respondents

- Sub-Saharan Africa (45%)
- Middle East and North Africa (44%)
- Russia CIS (42%)
- South Asia (31%)
- North America (28%)

Third party relationships have allowed our company to be more flexible and competitive





The regulatory landscape and gaps in knowledge

At this stage it's not clear what President Trump's approach towards regulations will be as there is significant speculation that he will place a moratorium on any new financial regulation yet he supports more restrictive trade policies.

Yet, despite the uncertainty, any potential changes to financial and/or anti-bribery and corruption legislation will take time, so organizations need to ensure they are compliant, especially with regulations as they relate to third party risk, in order to avoid enforcement action.

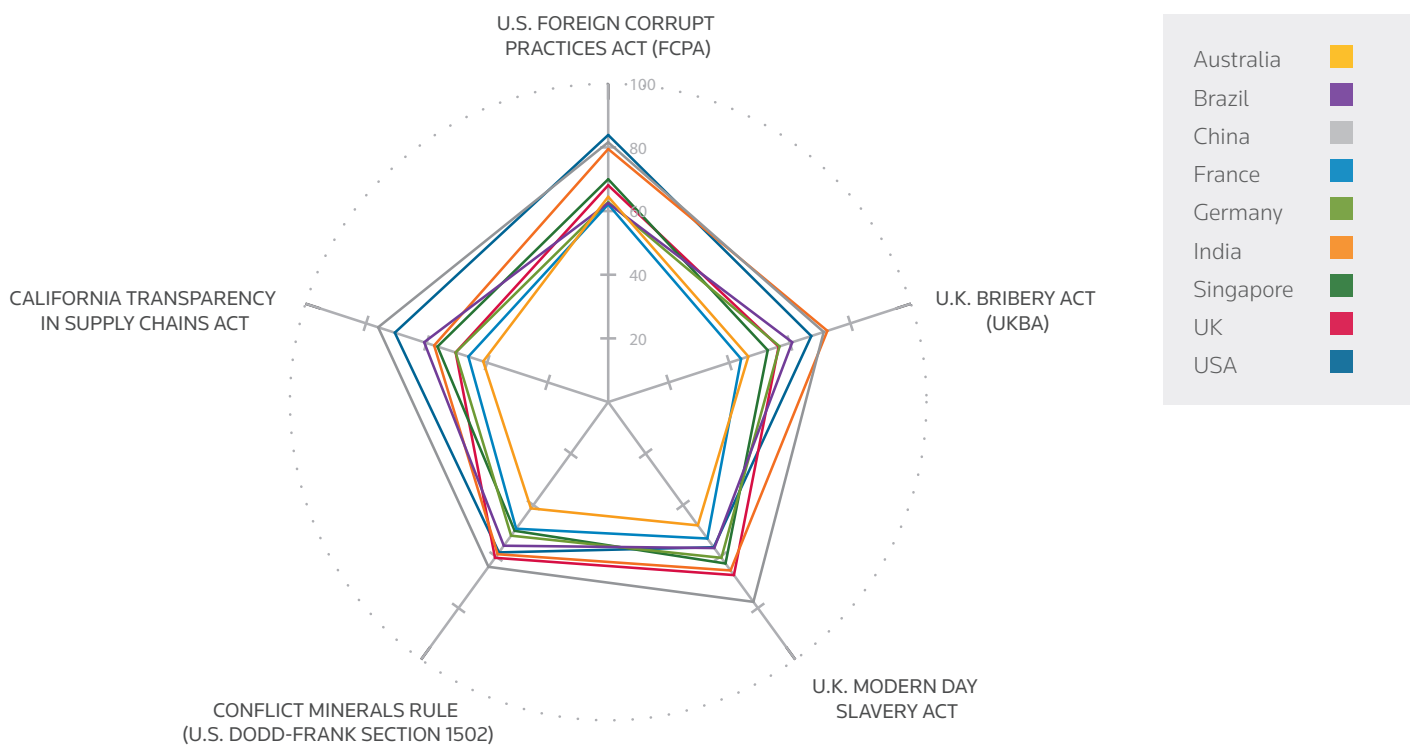
Specific legislation

Respondents were questioned about the legislation they use to inform their decisions about third party risk management, specifically referring to, inter alia, the Foreign Corrupt Practices Act (FCPA), the UK Bribery Act, the Modern Day Slavery Act in the UK and the Conflict Minerals Rule (Dodd-Frank Act Section 1502) in the USA.

In the USA, 49% claimed that the FCPA informs all their decisions against just 30% of overall respondents. Whilst this figure is significantly higher than the average, it still means that over half of U.S. companies are not fully complying with important legislation relevant to them. More worryingly, 9% said that they are not even aware of the FCPA (although this was lower than the overall figure of 15%).

When questioned about the Conflict Minerals Rule 28% of U.S. respondents (as opposed to just 20% of all respondents) confirmed that this legislation informs all their decisions. Once again, it is clear from the survey results that there are large percentages of respondents who are not fully complying with important - and relevant - legislation.

Which of the following legislations do organizations use to inform decisions on third party risk management?



Gaps in knowledge

The survey uncovered some quite alarming gaps in respondents' knowledge relating to the potential risks they face. When asked about specific third party risks, just 41% of U.S. respondents felt that they had sufficient knowledge about bribery and corruption; 38% felt knowledgeable about anti-competitive practices; and 34% were happy with their knowledge of data breaches and IT security. The point to note is that these were the three highest percentages where respondents felt knowledgeable, indicating that, in every area, more than 50% do not feel that they have adequate knowledge. Moreover, percentages continued to fall for other serious third party risks, including slavery and forced labor, and conflict minerals, revealing even greater gaps in knowledge.

Of particular concern across the board was the general lack of knowledge around ultimate beneficial ownership, especially as to comply with legislations around money laundering and countering the financing of terrorism, organizations have to ensure they understand who owns and controls the companies that they do business with. In the USA, only 7% of respondents feel that they have sufficient knowledge in this important area, against 11% overall. The USA was, in fact, one of the worst performers in this area, along with Singapore. At the other end of the spectrum, China reported the highest levels of knowledge at 19%, which is still excessively low.

Landmarks on the landscape

Six pressures shaping the risk environment:

- Increased supply chain and third party risk regulation, aimed at improving sustainability
- More and higher fines for non-compliance
- Proof required to demonstrate due diligence
- Consumer ethics driving the agenda
- Shareholder value and investor satisfaction
- Civil society and NGO pressure

Due diligence and enforcement



Insufficient due diligence

It would be difficult to over-emphasize the importance of thorough and rigorous due diligence, because the more companies know about who they are doing business with, the better they can manage risks, ensure compliance and avoid reputational damage.

It is therefore alarming to note that U.S. survey respondents reported, on average, that their organizations had carried out due diligence on just under three quarters (74%) of their third parties. This was the highest figure reported across all regions, with a global average of 62% and Germany reporting the lowest percentage at 53%. Even in the USA - the best performer overall - due diligence is **not performed on over a quarter of third parties.**

Another significant issue worth highlighting is the extent to which third parties are outsourcing to other suppliers. This practice can significantly raise risk levels, but 61% of U.S. respondents do not know the extent to which this is happening (the same percentage as all respondents).

A sizeable majority (62%) of all respondents say they only carry out due diligence on tier 1 third party relationships and in the USA, the figure jumps to 69%. Australia was the best performer in this area, with only 48% agreeing. Sharon Zealey, former U.S. Attorney and Chief Compliance Officer with The Coca-Cola Company says, "Ideally, companies should be able to confirm that all their high risk third parties undergo thorough due diligence, they are knowledgeable about the company's compliance program requirements, and that they will hold subcontractors to the same high standards. They should further be able to produce training records and contracts to substantiate this."

How far do organizations go in their due diligence? In the USA, 69% of respondents confirmed that they conduct due diligence on third parties at company level, somewhat higher than the overall average of 60%. When it comes to parent companies, however, this figure drops to 46% overall and just 36% for U.S. companies - and the figures are even lower for ultimate beneficial owners (38% overall and 26% in the USA).

A lack of enforcement?

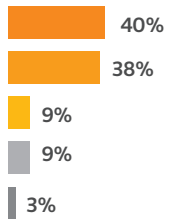
Could a lack of enforcement be the reason? This is certainly something to consider in light of the fact that 61% of U.S. respondents (56% overall) agreed that 'there is a perception that we're unlikely to be prosecuted if we did breach regulations'.

And what do respondents say their likely actions would be if they discovered that a third party had breached regulations? U.S. respondents said that they are most likely to report the breach internally (51%). Across the board this was the most likely action. Interestingly, in the USA, 20% said their most likely action would be to record the breach, but not report it. The USA had the lowest overall percentage of respondents that would 'report' the breach (just 64% against 77% overall). Zealey offers some possible insight into why, "Most companies would not report a small breach, for example, an improper payment of \$200. This is because in FCPA conferences, the DOJ lawyers have implied they don't want to hear about the 'cats and dogs' but rather they are big game hunting. Regulators expect companies to correct problems, however small, but don't want their investigative teams burdened with these."

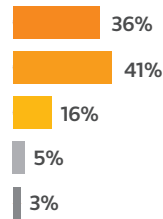
Unsurprisingly, many organizations pay far more attention to compliance once they have been the subject of an enforcement action. In the USA 96% (against 92% overall) said that they had increased the amount their organization spends on compliance after experiencing an enforcement action. The percentage of respondents who said this was very high across the board, including 99% in China.

How strongly do U.S. organizations agree or disagree with the following statements

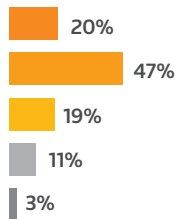
Winning new business is a priority and as a consequence we might breach regulations



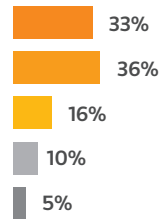
Third party relationships have allowed our company to be more flexible and competitive



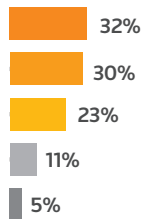
Third party relationship decisions often overlook key risks



We only conduct due diligence on our tier 1 third party relationships



We do not know the extent to which third parties are outsourcing our work



Strongly agree ■ Slightly agree ■ Slightly disagree ■
 Strongly disagree ■ Don't know ■



Third party risk management

Key reasons to conduct due diligence

What are the most important reasons for conducting due diligence on third parties? According to survey respondents, compliance with regulations is the most crucial, with 55% overall selecting this option, against a higher figure of 64% for U.S. respondents. This was the highest percentage of all countries surveyed, with those in Australia at the other end of the scale (46%).

The second most important consideration for U.S. respondents was protecting the company from reputational damage (54%), followed by ensuring that third parties are being compliant with regulations (44%). These were also the second and third most important considerations globally.

Key drivers for additional due diligence

When U.S. respondents were asked what determines if further due diligence needs to be conducted on a third party, the key drivers selected were: 'if it's a high value supplier to the organization' (46%); a 'traffic light system based on jurisdiction or country' (also 46%); and a 'traffic light system based on types of industries or products' (30%).

Globally these were also the top three reasons cited.

Who manages third party risk?

In the USA, 73% reported that their company's third party risk compliance program is managed by their organization's headquarters (against 68% globally). Additionally, 42% said that the function is managed by a local jurisdiction (the same as the global figure), implying that many companies have input from both headquarters and local jurisdictions. This appeared to be the case across all countries surveyed.

Onboarding

Turning to onboarding, what compliance risks do organizations screen for at the initial third party onboarding stage?

In the USA, 'financial crimes' was the top risk selected, with 46% of respondents saying that they screen for this during onboarding. Bribery and corruption was second at 40% and country risk was third, at 39%. These responses matched the overall global responses, where financial crime and bribery and corruption also topped the list at 47% and 42% respectively. Overall, country risk was third at 37%.

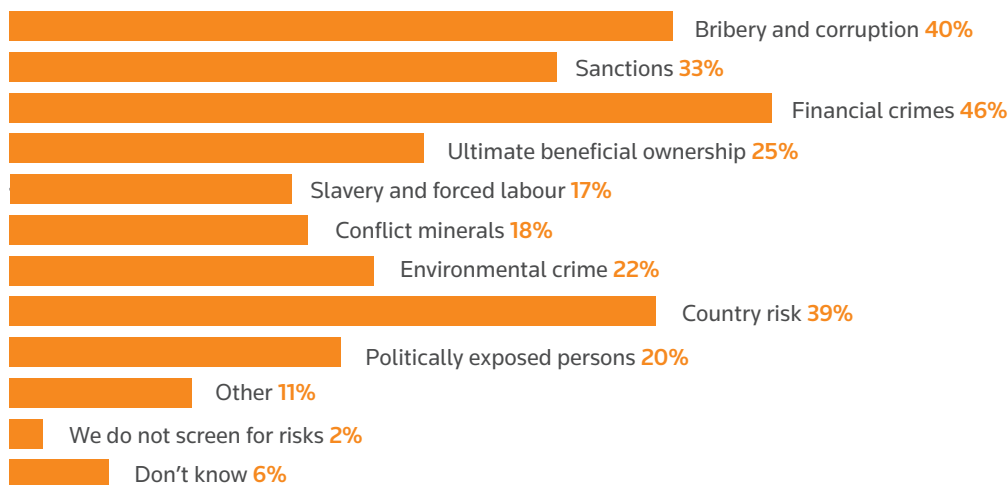
Ongoing monitoring

Turning to the important area of ongoing monitoring, only 36% of U.S. respondents confirmed that they are fully monitoring for all ongoing risks associated with third parties. This matched the global average. This means that 64% - both globally and in the USA - are not fully monitoring for ongoing risks.

Training

Training is an important tool for managing third party risk in supply chains and, when questioned about this, 49% of U.S. respondents (slightly higher than the overall figure of 45%) confirmed that they fully train and educate their staff. When it comes to fully training and educating third parties, this percentage falls to just 30% overall, with the USA faring somewhat better at 36% (second only to Brazil at 42%).

What compliance risks do organizations screen for at the initial third party onboarding stage?



Real world challenges



Challenges faced

Three quarters (75%) of U.S. respondents admitted that they know where risks may materialize, but struggle to employ processes to detect them. This was a fair bit higher than the 66% of overall respondents and, in fact, the highest percentage overall.

Respondents were further asked to be specific about the challenges they face in implementing the right approach to identifying risk within their supply chains. For U.S. respondents, 'resource constraints including budget and time' topped the list, with 44% selecting this option (38% overall). Second was 'lack of data available' at 36% (41% overall) and then 'limited knowledge of the risk' at 32% (also 32% overall).

Weaknesses

The survey asked respondents what areas relating to third party risk management they are confident their companies are executing well and there was evidence of weaknesses in some key areas:

Nearly a third (30%) of U.S. respondents are either 'not at all confident' or only 'slightly confident' in their ability to train and educate third parties.

Moreover, 27% lacked confidence in two areas – conducting further due diligence on third parties and managing the third party onboarding process. Almost as many (26%) reported little or no confidence when it comes to screening third parties against risks during onboarding and ongoing reporting on third party risks/sustainability efforts.

These are important areas where over a quarter of U.S. respondents lack confidence in their ability.

Expectations

What do professionals expect in the year ahead? Looking at the growing issue of personal responsibility, 72% of U.S. respondents (against 70% overall) believe that the personal liability of compliance professionals will rise over the next 12 months. Personal liability is an area that should be given due consideration, given recent enforcement actions. In one example, a leading camera and medical equipment maker and three of its former executives pleaded guilty to inflating the company's net worth by more than \$1.7 billion in one of Japan's biggest corporate financial scandals. On top of massive corporate fines, the courts also issued 10-year jail sentences and fines of up to \$128,000 to the former executives.

Furthermore, nearly a quarter (73%) of USA respondents expect the volume of regulatory information to increase over the next 12 months (against 71% overall).

Respondents, both in the U.S. and globally, do seem to be aware that they need to take action sooner rather than later. In the USA, 79% expect to increase the time and resources they spend on conducting due diligence over the next 12 months (globally 77%).

Looking ahead

Our survey shines the spotlight on some significant challenges that remain in the third party arena. If not adequately - and immediately - addressed, these issues look set to become even more challenging as regulatory scrutiny and uncertainty continues to increase. Forward-thinking organizations therefore need to take urgent action and employ the right expertise. For many, partnering with external experts and having access to global in-depth information may be the preferred route to enable them to remain ahead of the regulatory curve.

How to harness the power of data to address third party risk challenges



“Global supply chains are complex and the most critical issues usually appear deeper within the supply chain – further from customer reach and influence. This is why it’s critical that organizations have access to data and solutions that can enable them to detect and assess such risks.

Oversight of third parties is still one of the greatest challenges in managing compliance programs, yet our survey reveals that 62% of respondents only screen tier 1 suppliers, resulting in a lack of data on all business relationships for effective risk management.

This is why it’s critical that organizations have access to up-to-date and in-depth data such as Thomson Reuters World-Check risk intelligence. Using more than 230+ research analysts to search for hard-to-reach information, World-Check risk intelligence provides structured profiles on individuals and entities to enable organizations to identify who they are really doing business with and to understand how the various risks intersect.

For heightened risk individuals and entities, Thomson Reuters Enhanced Due Diligence provides organizations with customizable detailed background reports that include information on adverse media, connections and relationships and ultimate beneficial ownership.

Companies that have a holistic and systematic approach to third party due diligence and work with key solution partners will be well prepared for future challenges and empowered to build more sustainable supply chains.”

Howard Presland,

Global Head of Third Party Risk, Thomson Reuters

How Thomson Reuters can help

At Thomson Reuters, our Third Party Risk solutions help you detect, assess and minimize potential risks associated with your suppliers, distributors and agents, and regularly monitor them for any change in status.

We enable clients to:

- Evaluate the level of risk when working with third parties in a given country using Thomson Reuters Country Risk Ranking
- Screen and monitor third parties against millions of profiles using Thomson Reuters World-Check risk intelligence to raise red flags around potential risks, such as sanctioned entities, politically exposed persons (PEPs), bribery and corruption, environmental crime, slavery and human rights abuse
- Research deeper into heightened risk entities and individuals with Thomson Reuters Enhanced Due Diligence
- Provide online training for staff and third parties to help prevent risks from entering your business with Thomson Reuters Compliance Learning

Our solutions combine intelligence, technology and human expertise to help your organization identify the different risks you might face in a complex global environment.

With Thomson Reuters you get answers you can trust to increase efficiency and growth in your business and supply chain.

For more information, visit risk.tr.com/thirdpartyrisk

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