StrategicRISK

SPECIAL REPORT:

SUPPLY CHAINS: GETTING BENEATH THE SURFACE

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Who are you dealing with?

Supply chains may be complex and suppliers remote, but you must know their ESG strategies well. Because in the eyes of your stakeholders, the regulators and the world at large, their failings are yours, too.

When thinking about your organisation's supply chain, there's a plethora of different risks for a modern business to consider. Are your company's suppliers reliable, financially robust and operationally sound? Are they exposed to greater risks in developing and unregulated markets?

Global company supply chains are becoming increasingly complex as the business world moves across borders and boundaries. Multinationals can have tens of thousands of suppliers and may work with other outsourcers and contractors, making them even tougher to track.

And while financial and operational supply chain risks are important to any company, environmental, social and governance (ESG) risks with suppliers can also have a severe impact.

In recent years, food companies have been censured for using fraudulent suppliers, while some of the world's most glamorous fashion labels have been embroiled in ESG scandals over labour conditions and sweatshop safety. Such ESG risks in your supply chain can have a very immediate impact on your company. While your organisation may not be legally responsible for a supplier's ESG strategies, your company's reputation and future can be directly affected by their actions.

As such, it is crucial to oversee your suppliers and their ESG approach.

COMPLIANCE GAPS COST

ESG risks in the supply chain can include a third party's approach to fair trade, ethics, whistleblowers or treatment of workers. As ESG becomes a bigger topic for shareholders and the public, companies need to ensure suppliers' policies are consistent with their own.

Global regulations, including the US Foreign Corrupt Practices Act, UK Bribery Act and the US Patriot Act, require organisations to maintain a thorough understanding of their supplier and third-party networks. The consequences of failure can include significant fines, regulatory enforcement, bans and reputational damage.

Despite such penalties, Refinitiv's research reveals gaps in compliance exist; according to a 2019 survey, over half of customer, supplier and partner relationships did not have a formal due diligence check at the

onboarding stage. Suppliers' environmental policies must also be up to a high standard. According to statistics from the UN and Interpol, environmental crime is the world's fourth-most costly crime, behind only drug trafficking, counterfeiting and human trafficking. Organised crime groups have exacerbated the problem.

Environmental crime can include the trafficking of natural resources, such as waste, forestry products, gold or minerals. Illegal activity is often focused on developing and unregulated markets, where supply chain information is hard to access. Other crimes include the treatment of end products or waste. Companies must be mindful of these heightened environmental risks, and the direct impact they can have on your business if breaches emerge.

"PUBLIC AWARENESS OF SUPPLY CHAIN ISSUES CONTINUES TO GROW, WITH COMPANIES INCREASINGLY UNDER SCRUTINY TO TAKE ACTION ON MAJOR ESG ISSUES."

The United Nations' Principles for Responsible Investment

As a result of all this, investors are putting more pressure on companies to demonstrate their ESG credentials. Supply chains are becoming a more significant part of the conversation. And institutional investors and index funds have begun to screen out companies with ESG failings – a further reason to ensure your organisation has the best possible ESG practices across its supply chain.

The UN's Principles for Responsible Investment (UNPRI) underline what is expected of companies in 2020. "Businesses are increasingly expected to understand and manage their exposure to supply chain risks. Public awareness of supply chain issues continues to grow, with globally renowned companies increasingly under scrutiny to take action on major ESG issues among their suppliers."

"In many sectors, risks are often far greater in the supply chain than in the investee company's direct operations. For those with a good understanding of their supply chain, this is a great opportunity. For others, it is getting harder to hide."

Organisations must conduct a thorough review of their supply base in today's environment. Are suppliers' values aligned with your organisation's? Do they have robust ESG policies in place? Are they the type of firm you want to deal with?

Supply chains can play a key role in innovation and value creation. But as they lie outside of a company's core business, they can expose organisations to hidden risks. Human rights abuses, corruption, animal rights abuses and environmental crime in the supply chain can all lead back to your organisation.

Compliance with local regulation is unlikely to be enough to satisfy the expectations of stakeholders and the general public if things go wrong. As shareholders, consumers and customers expect more from global businesses, organisations need to ensure their supply base has strong ESG credentials.

THE FALLEN

In the past few decades, many high-profile multinational businesses have fallen foul of ESG issues in the supply chain, hitting profits, customer goodwill and production.

Toy company Mattel was forced to write down profits in 2007 due to charges and disruptions linked to the recall of potentially harmful toys. Mattel recalled roughly 21 million toys due to lead paint and other hazards posed by small magnets. The recalls resulted in a $40m loss and led to significant disruption to its supply chain.

In 2011, Japanese carmakers and other manufacturers were forced to delay production after severe flooding in Thailand. The floods underlined the significant environmental risks facing global businesses and their supply chains. Companies including Honda and Toyota were forced to shift production to the US.

At the same time, computer makers, including Lenovo, were hit by supply shortages and suffered a substantial hit to profits.

In 2013, frozen food company Findus was forced to recall beef lasagne products after an environmental agency found its products contained up to 100% horse meat. The scandal hit the Findus supply chain, exposed fraudulent practices of meat suppliers, and led to a significant fall in sales and profits.

Also in 2013, the collapse of a clothing factory in Dhaka, Bangladesh exposed some of the shocking supply chain conditions linked to some of Europe's most prominent retail brands. An eight-storey building used to produce luxury clothes for Versace, Gucci and Moncler, collapsed, killing 1,134 people.

The Dhaka factory collapse occurred after workers had raised concerns about conditions. The tragedy prompted mass outrage against fashion labels and supply chain ESG risk in unregulated countries.

In 2013, a group of retailers signed an accord on factory and building safety in Bangladesh. Still, according to ESG research company Vigeo Eiris, only 22% of footwear and clothing companies are signatories.

"SENDING A COMPLIANCE SURVEY TO A SUPPLIER IS NOT ENOUGH ANYMORE. YOU HAVE TO USE THE LATEST TOOLS TO SCRUTINISE YOUR SUPPLY CHAIN AND UNDERSTAND THE COMPLETE PICTURE."

Regional performance director, risk, APAC, Refinitiv
Phillip Malcolm

GOOD BEHAVIOUR REAPS REWARDS

In fact, according to a 2019 Vigeo Eiris report, the specialised retail sector's ESG risk mitigation scores remain weak, and supply chain issues persist. The sector's average performance in terms of social standards in the supply chain remains limited, at 42/100, and "relatively unchanged over the past three years".

While some sectors have a long way to go, forward-thinking businesses should engage with their supply chain on ESG matters. So what are the main benefits of good ESG risk management in the supply chain?

The UNPRI has issued guidance on the benefits of strong supply chain ESG risk management. It says companies must be able to respond more quickly to emerging regulation and legal obligations, such as the UK Modern Slavery Act, environmental laws in China, and EU Conflict Minerals Regulations.

The UNPRI also believes good ESG risk management in the supply chain can protect your organisation's social licence to operate, prevent the loss of governmental contracts, protect human rights, and avoid corruption and child labour.

In addition, the UNPRI says strong supply chain management will boost investor confidence. Clients, stakeholders, communities and regulators are likely to support measures to improve ESG supply chain management. The organisation adds that ESG supply chain management is a "significant opportunity" for companies to develop "long-term, trusting partnerships with their direct suppliers" and to "protect and enhance the relationship between their suppliers and customers".

It believes strong risk management can reduce costs, lead to better financial risk management, reduce disruption, and lessen exposure to fines, litigation, increased insurance premiums and enhance continuity.

With so much at stake, how can risk teams monitor ESG risk and potential reputational risks in their international supply chain? Companies must conduct a full review of their supply chain, drawing on as much information as possible to understand the potential ESG risks. Accurate and complete data is needed to conduct appropriately targeted due diligence.

In emerging markets, companies can draw on interviews with trusted sources to build a picture of ESG risk. This can help in jurisdictions where press freedom limits the availability of information.

Fortunately, new tools have emerged in recent years to help companies review their supply chains. Companies can use Refinitiv's World-Check risk intelligence database to screen hundreds of suppliers and customers. The tool allows users to identify potential criminal activity from reputable public domain sources, and access over 4 million records.

If the database comes up with a hit, companies can order an enhanced due diligence (EDD) report. EDD reports combine in-depth public domain research with on-the-ground interviews in key jurisdictions, for a full understanding of potential problems.

EDD reports are powered by Refinitiv's global research teams and can help risk teams gather up-to-date, accurate intelligence on supply chain activity. From social and governance concerns to environmental practices, EDD reports can prove a valuable tool across a multinational company's supply chain.

KNOWLEDGE IS POWER

Using this technology, companies can begin to tackle ESG supply chain issues, prevent costly mistakes and ensure their reputation remains intact.

Refinitiv's EDD reports deliver targeted insights into supply chain relationships and can be tailored and customised. The reports focus on companies, key individuals and decision-makers, scrutinising backgrounds, track records, potential conflicts of interest, and political or criminal links. They also include a company's conduct and reputational history, as well as hidden liabilities. When necessary, additional information can be gathered from industry sources.

Refinitiv has one of the largest in-house EDD analyst teams, and its global network offers on-the-ground intelligence in different environments and regional customs. The company only uses ethical and non-intrusive research methods.

Refinitiv's regional performance director, risk, APAC, Phillip Malcolm says: "In the past, firms didn't look at their supply chains from an ESG point of view – it was all about continuity of supply and that was it, as long as business went on. But the world has changed. There is scrutiny on supply chains, scrutiny on who you deal with, from government and NGOs as well as your customers and investors."

"Investors and stakeholders want to know you're dealing with the right people, whose values align with theirs. Sending a compliance survey to a supplier is not enough anymore. You have to use technology and the latest tools to scrutinise your supply chain and understand the complete picture, that your suppliers are on the right side of the law, have sound ESG values and practices and won't expose your firm to unexpected risks."

As global companies look to tackle ESG risk in their supply chains, due diligence is critical. A detailed understanding of a third party's risk profile is necessary to avoid falling foul of regulators and causing long-lasting reputational damage to your organisation. **SR**

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Don't get sunk by sanctions

As governments update sanction lists, and regulators are quick to hand out fines, how do you protect your organisation from non-compliance? You need the right intel, and for that you need an expert.

Sanctions can impact an organisation in many ways. Goods could be transported on a sanctioned vessel or through a sanctioned port, or payments may have been processed through or to a sanctioned entity. The repercussions of breaching sanctions are severe and can lead to supply chain disruption, falling sales and reputational damage.

US regulators, including the US Treasury's Office of Foreign Assets Control (OFAC), are notably aggressive in pursuit of those who breach sanctions. Last year alone, OFAC fined Standard Chartered $657m, Unicredit $611m and British Arab Commercial Bank $4m. Banks from Canada, Japan and the United Arab Emirates have all been hit with fines over the past decade.

Last year alone, 18 non-banking organisations were hit with civil penalties of $16.5m for breaching various sanction regimes. Organisations in travel, oil services, insurance and manufacturing, automotive, health and leisure sectors were all affected.

Meanwhile, the 50% rule from the OFAC has become more complex in the last few years. This states that any entity owned in the aggregate, directly or indirectly, at 50% or more by one or more blocked persons is also considered to be a blocked person. Ownership can be direct, indirect or in the aggregate.

CONFUSION FUELS FEAR

Developments concerning the US 50% rule have left businesses concerned about sanctions compliance. Many need watertight assurance they have not missed a risk related to transacting with any entity. Amid a difficult environment, companies and risk teams should screen for sanctioned entities using comprehensive, up-to-date software, and conduct enhanced due diligence (EDD) on entities flagged as high risk.

Amid turbulent political times and trade wars between superpowers, sanctions are changing quickly. And sanctions are becoming more prevalent, being used as tools to accomplish foreign policy or respond to political change. There are 65 bodies issuing sanctions across the globe, with 700 lists. It is a colossal task for risk managers to keep up with.

And this is against the backdrop of 'know your customer' (KYC) procedures within financial institutions. Financial Institutions have a regulatory obligation and responsibility to keep sanctioned individuals and financial crime out of their systems, and must perform stringent checks of new customers during the onboarding process. Organisations must conduct sanctions screening and PEP (politically exposed person) screening to adhere to KYC requirements.

FAILURE MEANS FINES

Failure to conduct sanctions and PEP screening can spell serious danger for an organisation. Non-compliance can lead to severe fines. In November 2018, French banking giant Société Générale was forced to pay $1.4bn to settle investigations into its handling of dollar transactions in violation of US sanctions against Cuba and other countries.

Last April, Standard Chartered was forced to pay $1.1bn over allegations of poor money laundering controls and breaching sanctions against countries including Iran. The US Treasury said Standard Chartered processed transactions worth $438m between 2009 and 2014. Most of the transactions involved Iran-linked accounts from its Dubai branch routing payments through, or to, its New York office or other Standard Chartered banks in the US.

Last year, the number of fines issued by US regulators for sanctions breaches reached a decade high. OFAC was previously viewed as a banking enforcement agency but has shown increasing willingness to enforce on non-banks, too.

And no enforcement is too small or obscure. One company, Cosmetic Inc, was fined $1m last January for allegedly importing false eyelash kits from China-based suppliers that had sourced materials from North Korea.

The volume of sanctions is becoming a serious challenge, and organisations are grappling with the issue daily. In a difficult environment, how can corporates keep up with the changes?

SCREENING SOLUTION

First, companies need a world-class sanctions screening solution. Companies and risk teams need access to up-to-date and comprehensive information. Yet tools on their own are not enough.

Organisations need to know where their risk lies. As governments become more willing to use sanctions, risk teams must stay abreast of sanctions developments in different jurisdictions. Regular dialogue with your government on the current landscape is recommended.

Sanctions can make it difficult for organisations to plan and maintain international relationships and supply chains. And this is not just a problem for multinationals – the complexity of the international sanctions landscape also affects smaller institutions. Organisations can benefit from having a sanctions compliance team in place. According to a recent poll conducted by Refinitiv, 71% of organisations have a sanctions compliance team.

Organisations should not assume that compliance with their local regulator is enough. They must review all cross-border payments to ensure they do not fall foul of international sanctions. Companies must use thorough screening tools to review partners, customers and third parties before they engage in business.

"FOR COMPANIES THAT HAVEN'T LOOKED AT THEIR SANCTIONS EXPOSURE, THEY NEED TO DO SO ASAP. THEY NEED TO ENGAGE PROFESSIONAL HELP. IT IS NOT SOMETHING THEY CAN DO ON THEIR OWN."

Regional performance director, risk, APAC, Refinitiv
Phillip Malcolm

GET TARGETED INTEL

EDD is a vital part of the solution. An EDD report can deliver detailed and targeted information on any entity or individual anywhere in the world. Risk teams can use this intelligence to make informed decisions about who to work with and where.

Third-party sanctions specialists can also help risk teams work through this challenging environment. Specialist advisers can help companies implement the right controls to ensure compliance and reduce risk through the customer onboarding, screening and monitoring phases.

Refinitiv's regional performance director, risk, APAC, Phillip Malcolm says: "Regulators have global reach and can impose substantial fines for sanctions breaches. It may be because you've transported your goods on a sanctioned vessel or aircraft, or transited through a sanctioned port, or the ultimate owners of one of the companies you deal with is a sanctioned individual. It's a very complex area. Companies need to place a lot more scrutiny on this than they have done in the past."

"For companies that haven't looked at their sanctions exposure, they need to do so ASAP," Malcolm adds. "They also may need to engage professional help. In many cases It is not something they can do on their own. Firms should seriously consider engaging a sanctions expert to come in and understand their business, look at the risk tolerance and design and implement a formal programme to minimise sanctions risk."

Risk teams can use information and data to their advantage as they attempt to monitor sanctions risk. Screening tools can help to ensure a nimble and immediate response to a changing sanctions landscape and empower organisations to avoid breaches.

Access to comprehensive and trusted data and thorough due diligence can be the difference between failure and success. **SR**

Financial crime: Are you being used?

72% of organisations have seen financial crime in their operations in the past year (Refinitiv survey, 2019)

With a mere 1% detection rate, all multinationals are at risk of being tarnished by illicit funds. Emerging tech could be the answer but learning how to harness it is half the battle.

Companies around the world are at risk of being used to launder money and the proceeds of financial crime, or being indirectly associated with corrupt business practices. Multinational organisations face significant risks if customer and partner relationships are not adequately screened.

According to UN estimates, only 1% of criminal funds in the global financial system every year are detected and dealt with by law enforcement agencies. With such a low rate, companies are left with a tough task to unearth financial crime and find its perpetrators.

Financial crime has a broad definition that includes cash from money laundering, bribery, tax evasion, fraud, modern slavery, drug trafficking and prostitution. Financial crime can also include the proceeds from terrorism flowing through the financial system. But it is difficult to detect and more difficult to eradicate.

In March 2019, Refinitiv conducted a survey of more than 3,000 managers with compliance-related roles at global organisations. The study found 72% of organisations had seen financial crime in their operations over the preceding 12 months. The surprising figure underlined the true scale of financial crime — and the helplessness of organisations trying to tackle it.

The prevalence of financial crime comes as regulatory demands increase around the world. Organisations are faced with the difficult job of conducting due diligence on each entity and individual they do business with. In the past, this may have been impossible, but new technology offers a glimmer of hope in the ongoing fight.

IN COMES THE TECH

Across Europe, America, Africa, the Middle East and the Asia-Pacific region, KYC and third-party risk screening has become more important as regulators look to eradicate financial crime. New technology is emerging to help banks, financial institutions and other organisations monitor and disclose risk and meet KYC, anti-money laundering and counter-terrorist financing legislation, among other jurisdictional regulatory demands.

AI, blockchain, machine learning, cloud computing, robotics and the Internet of Things can all be harnessed by organisations to fight financial crime. Emerging technology can help organisations navigate KYC and other onboarding processes, spot criminal activity, and prevent the flow of illicit funds at the source.

According to Refinitiv's recent survey, 73% of respondents said they struggled to harness the technology currently available to them. About 97% believed technology could help them get a grip on financial crime prevention. Furthermore, 94% said technology used to detect financial crime enhances customer engagement.

73% of organisations struggle to use new technology to fight financial crime (Refinitiv survey, 2019)

The findings come as organisations pledge to spend more on tackling financial crime. More than 51% of respondents to Refinitiv's survey said they would increase their budget over the next 12 months. Meanwhile, 82% said they were under pressure to be more innovative.

Data and information can be a valuable tool in the efforts against financial crime. Global due diligence tools offer a crucial source of relevant information to check customers, partners and relationships.

50,000 new records are added to the World-Check risk intelligence database every month

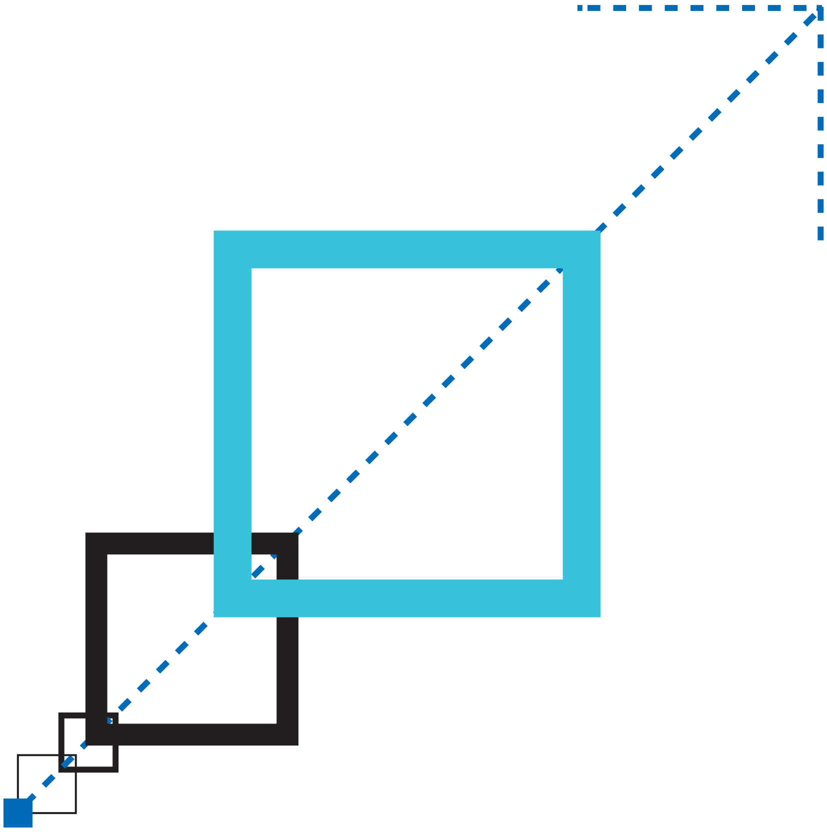
PARTNERS IN CRIME-FIGHTING

Refinitiv's World-Check risk intelligence database can help organisations meet regulatory obligations, make informed decisions and prevent the spread of financial crime. Using up-to-date information and data, the database simplifies customer onboarding, and provides the tools needed to fulfil diligence obligations.

World-Check allows users to search for key information, delivers reliable data and leans on hundreds of specialist global researchers. The tool adheres to strict research guidelines and collates information from reliable sources. The data is easily absorbed into organisations' workflow screening platforms, cloud-based or third-party solutions.

Through the marriage of tech and human expertise, organisations may have a better chance of fighting financial crime. Each day, hundreds of researchers gather information on individuals and entities deemed to warrant enhanced scrutiny. World-Check covers 240 countries, 65 languages, more than 100,000 sources, and adds 50,000 new records each month.

As financial crime continues to lurk in the shadows, risk teams will be able to use data, information, and emerging technology to shed some light. Using technology to your advantage could be the difference between detection and a financial crime disaster. **SR**



RELY ON OUR REPUTATION TO PROTECT YOURS

Refinitiv Enhanced Due Diligence reports provide detailed integrity and advanced background checks. With a global, on-the-ground footprint, we leverage local insights and the industry's most trusted financial crime risk screening database.

Our globally recognized experts deliver the trusted perspective to help you make informed business decisions.

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