KPMG
cutting through complexity

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Third-Party Integrity Risks

TODAY'S REALITY

- Working with third-parties, especially internationally, carries risk.
- Third-parties can expose your organization to reputational damage, operational risk and regulatory and other investigations, as well as monetary penalties and potential criminal liability.
- It is the people behind the third-party organization that truly matter – how much do you really know about who you are doing business with?

Global transactions and increasing scrutiny mean that firms should examine their business relationships to understand the potential risks, undertake informed negotiations, and comply with regulatory requirements. Failure to do so exposes organizations to potential operational, monetary, and reputational damage.

Organizations will commission integrity due diligence reports to ensure compliance with anti-bribery and corruption laws and anti-money laundering regulations. In addition, independent assessments assist with supplier risk assessments, transaction reviews and due diligence on senior executives.

KPMG has analyzed the findings of approximately 8,000 integrity due diligence reports that KPMG's global firms have conducted in order to understand the nature of risks facing organizations through third-party business associations.[1] The results of our analysis challenge some widely held assumptions about due diligence practices and the nature of third-party risk.

Key findings

Key findings include:

- Over 20 percent of reports were associated with significant risks (such as allegations or incidences of corruption, fraud, money laundering or other unethical or illegal practices).
- For 66 percent of reports, risk issues were identified, but these were not necessarily serious (such as opaque ownership structures; association of the subjects with politically exposed persons; significant involvement of the subject in civil litigation).
- Only 12 percent of reports were "all-clear" from an integrity risk perspective.

Analysis of risk by sector

Our analysis shows that the Financial Services sector presents by far the highest third-party integrity risks. This sector is further discussed below.

Three other sectors – Technology, Media and Telecommunications; Energy, Natural Resources and Chemicals; and Miscellaneous (general trading companies, for example) – present particularly high risks, with over 20 percent of reports rated high risk.

Analysis of risk by geography

Central and Eastern Europe (incorporating Russia), Central Asia and Middle East/North Africa stand out as the three regions posing the highest third party risks. More than half of the reports in each of these regions were rated as high risk.

Western Europe, Oceania, South America and Sub-Saharan Africa, but interestingly not North America, had the best results in terms of low risk reports.[2]

What's missing from an internet search?

If your third-party due diligence policy is based on sanctions and press searches alone, you are missing an estimated 84 percent of potential integrity risks.

Organizations often start their third-party due diligence with a basic sanctions check. Even combining press searches with sanctions checks may not identify key risks. Technology and automation play an increasingly important role in the third-party due diligence process, but ultimately a degree of manual and iterative research is required in many jurisdictions to accurately capture risks. Organizations need to go beyond a standard screening solution, which typically just incorporates sanctions and press checks.

1 The full results of our analysis can be found in Astrus Insights: KPMG's Analysis of Third-Party Integrity Risk.

2 The results for sub-Saharan Africa are slightly skewed by the fact that 50 percent of reports in that region were on subjects in South Africa.

People, not organizations, pose the highest risks

Our findings clearly demonstrate that third-party due diligence that focuses solely on the subject organization, and not its principals and shareholders, miss the majority of risks: it is the people behind the organization that matter and this is the single largest risk factor.

Fighting fraud

Key drivers for third-party integrity due diligence include anti-money laundering and anti-bribery and corruption risks. However, our analysis shows that the most prevalent third party risk is fraud. This exceeds all other risks, including regulatory violations, bribery, corruption, money laundering and business disputes.

Fraud impact

Fraud risk associated with third-parties needs to be identified early in a relationship. Due diligence enables organizations to avoid reputation damage and to better assess impacts of contemplated transactions. For example, good due diligence in respect of the proposed agent should address controls and appropriate remuneration for the services provided. Our findings show that fraud risk is not affected by geographical location, industry or third-party activity: it is prevalent across all situations. Early due diligence help organizations fulfill their regulatory requirements, but may also highlight real commercial risks.

What organizations need to do

There is clear evidence that integrity due diligence should focus on the individuals behind an organization. Various global anti-bribery and corruption statutes can hold individuals accountable for corrupt practices. Individuals can face significant fines and imprisonment if found guilty of bribery and corruption.

More specifically, companies need to:

1. Understand the universe of their third-party relationships and perform risk analysis to determine relationships requiring further review;
2. Have a risk assessment process to determine appropriate review levels on third-party where further information is required; and
3. When required, perform appropriate risk-based due diligence to obtain critical information to help manage business and other risks.

The financial services sector stands out as the sector with the most third-party risk

Over 40 percent of reports on subjects in the financial services industry are rated high risk, more than any other sector. Our analysis of the most alarming reports revealed that 90 percent had been completed for banks. Without extra care with due diligence, financial services companies could be exposed to significant risks.

In the financial services sector, there are three geographical regions that stand out: 71 percent of reports covering Central and Eastern Europe (including Russia), 70 percent of Central Asian reports and 72 percent of Middle East/North Africa reports were rated as high risk.

What do banks need to do?

A number of regulators have criticized banks for inadequate due diligence measures to tackle risks around their third-parties, including customers, correspondent banks, agents and intermediaries.

For example, in the UK, the Financial Services Authority (FSA) identified that most firms rely heavily on an informal "market view" of the integrity of third-parties and very basic checks, such as printing the third party websites. Further, three quarters of banks were found to have failed to take adequate measures to establish the legitimacy of the source of wealth of customers who are politically exposed and over half the banks failed to carry out robust due diligence in high risk situations.

How KPMG can help – Astrus

KPMG's secure on-line due diligence portal, ***Astrus***, provides a robust and cost-efficient way to obtain information and assess risks associated with customers, agents and counterparties. Astrus uses advanced search technology to cover an extensive range of on-line public data sources, including global sanctions and regulatory enforcement lists, corporate records, court filings, and press and media archives. Important integrity and reputational information on subjects is identified and interpreted by dedicated KPMG analysts. Astrus leverages the collective knowledge of KPMG's Corporate Intelligence teams globally to help clients assess reputational, regulatory and jurisdictional risk.

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