BEYOND COMPLIANCE: THE GROWING IMPORTANCE OF THIRD PARTY RISK MANAGEMENT

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As corporations of all sizes expand internationally, their supply chains are becoming increasingly complex and geographically diverse. At the same time, the regulatory environment becomes more challenging. This combination of factors creates a major, new set of risks that many corporations have only limited ability to monitor and manage. Organisations today are being held responsible not only for their own activities but also for the actions of customers, suppliers, vendors and partners.

Treasurers are caught in the middle of this risk and regulatory dilemma, with two sides to their compliance and monitoring requirements. Firstly, the onus is typically on treasury to provide the information that allow their banks to fulfil their own regulatory obligations, such as increasingly stringent know your customer (KYC) requirements. Secondly, corporations need to conduct the appropriate level of due diligence on their own third party relationships to help them manage the risks that these relationships present. Treasurers’ expertise in both due diligence and risk management equips them to take a role in this process, but what is becoming clear, is not only the importance of supporting compliance and third party risk requirements from both perspectives, but also the need to achieve this without adding significantly to the administrative burden, or interrupting business operations.

**THE REGULATORY BURDEN**

For companies working with a single bank, in a single jurisdiction, supporting the bank’s KYC process by providing the necessary company, shareholder and officer information is relatively straightforward. For multi-banked corporations operating internationally, however, the documentation and resource implications for treasury can be very significant. Not only do KYC regulations differ across countries, but banks also adopt their own risk management procedures, which may also vary across jurisdictions. Furthermore, compliance challenges are not restricted to supporting banks’ regulatory requirements. With a raft of new and emerging regulations having a direct impact such as the Foreign Corrupt Practices Act, Conflict Minerals Rule (US Dodd Frank Section 1502) in the United States, and the Bribery Act and Modern Day Slavery Act in the United Kingdom, the regulatory burden is becoming heavier for a large number of organisations resulting in higher compliance costs.

Companies with long, complex, and global supply chains in particular face challenges associated with large numbers of diverse suppliers, distributors and partners. Conducting due diligence on these third parties to satisfy anti-bribery and corruption (ABC) regulations, for example, can be lengthy and labour-intensive, particularly given the lack of transparency and inaccessibility of information in many jurisdictions. As officers and shareholders become more keenly aware of the potential financial and reputational damage caused by environmental, financial or ethical failure or malpractice by third parties in their supply chain, there is growing pressure to conduct adequate due diligence.

**ORGANISATIONAL IMPLICATIONS**

Treasurers’ involvement in supplier risk management will vary across organisations, depending on the degree of treasury centralisation and the scope of its activities. The nature of third party risk will also vary across businesses, which will determine whether it is best managed at a business unit or country level, or on a more centralised basis. For lower risk suppliers, due diligence may be part of the procurement process, or managed by contract owners; however, for higher risk businesses, senior managers may demand greater oversight which is typically easier to achieve centrally. While procurement and contract negotiators are likely to play an important role, treasury’s expertise in identifying and monitoring counterparty risk globally is a compelling factor in engaging treasury in this process, whether at an operational or oversight level.

As the compliance and third party risk burden increases, financial and non-financial organisations alike require a systems infrastructure that streamlines compliance and due diligence processes to provide regulators, investors and stakeholders with the information and transparency they need, without compromising business efficiency.

Looking at KYC, for example, many treasurers have expressed their concerns that banks are asking for different information in different formats and at various frequencies throughout the year to comply with the same regulations. This is heavily impacting their workload and only looks set to continue as regulations change, and new ones are introduced, such as new tax rules, MiFID II etc. As a result, there is growing pressure to standardise the KYC process across banks, and across markets wherever possible, to reduce the administrative burden and avoid the costs of doing business spiralling upwards.
LEVERAGING TECHNOLOGY AND DATA ASSETS

As KYC checks and on-boarding requests for information proliferate, it is taking longer to open new bank or trade accounts, while routine data requests are also becoming more frequent and onerous. This is leading to demands amongst corporations for banks to standardise the timing and nature of data requests. The largest multinational corporations with considerable influence on their primary partner banks are inevitably more persuasive in encouraging their banks to support greater standardisation; even so, many will also have accounts with a far wider pool of banks where they might lack the same level of influence. Inevitably, smaller organisations that may also hold a large number of accounts across multiple banks might find it more difficult to be persuasive as their larger peers.

To support these growing demands, banks are increasingly turning to financial utilities and shared service processing platforms in non-competitive areas such as compliance to cut their operational costs and to improve customer service. For example, financial utilities such as Thomson Reuters Org ID KYC managed service are being introduced to meet the needs and demands of a large body of corporate customers in discussion with banks. The Org ID solution offers a platform to simplify counterparty due diligence and the distribution of KYC documents, thereby supporting the development of a common standard that meet the needs of both the corporate and banking community, reducing the administrative burden on treasurers. Org ID acts as a custodian and conduit with the ability to collect, classify and verify a customer’s identity efficiently and accurately. Org ID also enables banks to obtain much of the routine data they require for KYC purposes from external sources in an automated way, such as corporate actions and changes to shareholdings, limiting the amount of information and frequency of information requested from customers.

In October 2015, Thomson Reuters announced a milestone of 10,000 KYC records from financial institutions, funds and corporations within Org ID, reflecting the considerable demand and market confidence in the service. In addition, Org ID is the only service to provide integrated screening and ongoing monitoring to detect changes in legal entity identity information and status.

Similar challenges, and indeed opportunities, also exist for third party risk management. At present, although most large organisations will already have processes in place for ABC, a growing number are now seeking to expand these into a more unified approach to broader third party risk management as the regulatory and risk drivers become more compelling. Consequently, as companies seek to implement efficient due diligence processes to maximise transparency and stakeholder confidence on one hand, whilst minimising the impact on efficient business practices on the other, standardisation, automation and outsourcing of routine information sharing are becoming important priorities. This is more challenging given the wide spectrum of third parties with which a company typically engages and the diversity of risks, not only financial but also reputational, that need to be covered.

At Thomson Reuters, we offer a full end-to-end Third Party Risk solution that includes, for example, checking suppliers, distributors and partners against the World-Check risk intelligence database that comprises millions of profiles on individuals, entities and vessels to identify risk in business relationships and networks, evaluating geopolitical, social and economic risks associated with the country in which third parties are headquartered or operate. The service also provides detailed enhanced due diligence reports on any third party to protect against regulatory and reputational damage. This is part of an ongoing initiative to evaluate how data assets can be used as part of the risk assessment and monitoring process in order to reduce the burden on clients as far as possible. Furthermore, we are looking at emerging risks that are now becoming more important, such as labour practices, environmental track records and cyberfraud attacks, to provide mechanisms to help our customers monitor these risks.

Drivers for the rise of KYC Utilities

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Source: Thomson Reuters
A STRATEGY FOR 2016

As the business and compliance risks of international expansion continue to grow, corporations need to be proactive in determining how they will identify and mitigate their exposure. Some treasurers, and other senior finance professionals engaged in the compliance and due diligence process, prefer to be ahead of the curve through earlier adoption of technology and people with specialist skills, while others take a more reactive approach to new regulatory requirements. However, non-compliance is not an option, and 2016 is the year in which all treasurers should focus on their compliance obligations and third party risk strategies. KYC, AML and ABC requirements cannot be dismissed as the unique domain of banks, and with a constantly evolving regulatory environment, corporate treasurers need the tools and processes to support compliance without adding cost.

As regulators and the wider stakeholder community, including customers, increase their expectations and demand transparency over corporate behaviour, businesses need to devise and implement robust, efficient and transparent processes for meeting regulatory requirements to protect the reputational, compliance and financial interests of the company. Thomson Reuters is playing a highly significant and growing role in supporting clients in their KYC and third party risk endeavours, from the provision of technology through to leveraging data assets, facilitating industry collaboration and standardisation, and encouraging the development of best practices.

For more information, please visit financial.tr.com/corporate-treasury