***International Due Diligence Investigations-Finding the Needle in the Corporate Haystack***

This white paper will consider investigative due diligence investigations in a variety of context. It is based upon a series of interviews I did with Candice Tal who will help us through that maelstrom to find useful and actionable information for your compliance program. We consider when basic due diligence is not enough, recent Foreign Corrupt Practices Act (FCPA) enforcement actions where the lack of or failure of due diligence was a key takeaway, the investigative due diligence function in the mergers and acquisition context, innovation in investigative due diligence and who data privacy laws and Artificial Intelligence (AI) will impact investigative due diligence in the future.

***Part 1 - When Basic Due Diligence Is No Longer Enough***

We began with an understanding of the differences between basic and deep dive due diligence. Tal explained there are typically three levels of due diligence. The three levels are typically Level I, the basic level which typically looks only at a global watch lists for sanctions, politically exposed persons (PEPs), anti-terrorist lists, anti-money laundering (AML) and similar government produced lists. Level I generally provides a summary of the beneficial owners of a company, its corporate structure, perhaps some financial information and the Global Watch lists. Many companies use that as their primary tool for risk ranking. A Level II due diligence investigation is an intermediate between Level I and Level III. Level II takes a deeper dive looking at every aspect of public records information in addition to areas that are not necessarily in the public record. It encompasses items like a deeper dive of executive backgrounds.

The final level, Level III, is also called a deep dive due diligence investigation. This level works to not only identify bad people or bad actors but also patterns of behavior which might tend to indicate a propensity for circumvention of internal controls or stepping over or even getting too close to the ethical line that indicates behavior that may turn criminal or turn in a direction that would hurt your business reputation going forward. Tal said there are behavioral issues that can be discovered through Level III due diligence. It can be through the online searching of media including newspapers, publications and digital media. A wide variety of information can come up in behavioral assessments in terms of what is the background of the executive or how they may have behaved in the past. Additionally there may be information available in a country that may not reach the rest of the press. So you may find that there are local issues that are well documented. Sometimes you can only find that information through local language searches online, other times Tal indicates you need to do in-country research.

It is a process that is labor intensive; whether that is shoe leather getting out and walking around talking to people, conducting face-to-face interviews or taking a very deep Internet dive. It is the spade work of digging into many different sources of information to come up with a much fuller picture of whoever you are looking at, whether it be an individual or through a third party. Tal encapsulated it in what she called the “80-20 rule”. In investigations, you do find about 80 percent of information online about companies and individuals. Therefore, if you conduct a Level II search that incorporates a deep media search and switch, you can find 80% of the information fairly readily.

However, there is another 20% out there that is generally not available on the Internet. Level I searches never get to that information. One reason is because many companies do not disclose all their information and you may not find that information readily in those basic types of searches, Tal emphasized that it does, however, exist and investigators can find about 20% of that information. It is this final 20% of information or rather not finding out about it that often trips companies up in terms of corporate compliance programs.

Tal further explained that a great deal of hidden and undisclosed information is found through deep internet searches. Unfortunately, a Level I, or even Level II search may be only looking at adverse keywords; which usually consists of only 20 or 30 keywords. If a person or company has a history of bribery, corruption or perceived types of bribing of local officials, that information could be uncovered but it may well not be found unless you look in the right places for it.

### *Part 2 - Recent Enforcement Actions*

We next consider some recent FCPA enforcement actions wherein insufficient due diligence was a key takeaway. The vast majority of FCPA enforcement actions over the past 10 years have involved some form of inadequate, insufficient or even a total lack of due diligence. We began by exploring how a company can perform sufficient due diligence without breaking the bank. Tal noted that most companies perform Level I due diligence, which of course provides limited information. Typically in Level I, companies find less than 1% of the issues that are out there. When you couple that with the realization that 90% of FCPA enforcement actions are against companies who engaged third parties and third-party vendors, it leads Tal to opine, “I would say that you’re not finding the needle in the haystack most of the time you should be concerned.” Now if you add due diligence in the Supply Chain component where there can be 5,000 or even 10,000 companies, you can begin to see the daunting nature of getting your arms around these risks.

Another key feature of almost all FCPA enforcement actions is that companies that sustained enforcement actions most usually had ‘check-the-box’ compliance programs. We considered this implication in the context of due diligence. To increase the percent of information about the troubling 1% figure Tal noted above, she said companies need to “start looking at incorporating deep media searches, into their due diligence.” Deep





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media typically looks at aggregated data from companies that amass millions and millions of digitized records, journals, newspapers, articles, periodicals or other similar information. Now overlay global watch lists, with some basic corporate financial information, and you might be able to move from finding only 1% to up to 5% of the corruption and bribery related issues that exist amongst the parties. However, when you further expand that and do a deeper level search on online, beyond simply adverse keyword searches, it can move your discovery rate up to as much as 35% of the corruption and bribery related information.

We next turned to key executive searches for senior management and even Board members. Tal notes that most information suggests that between 10 to 20% of all such persons have adverse information in their backgrounds, which is often not reported and not uncovered. This means that if you have 100 senior managers and Board members, you can reliably estimate that 10 to 20% of that group has a red flag in their background which should be cleared before hiring or even promotion. If you have 1,000 such people in your organization, simply do the math. You may well have hundreds of senior executives with bribery related issues or issues in their backgrounds that you would not want to be responsible for causing nightmares for an organization down the road.

Another issue which Chief Compliance Officers (CCOs) and compliance officers struggle with is the number of red flags. Tal said that a key element is to consider a deep dive of internet searches different from a deep dive due diligence. This is because the deep dive due diligence provides a much fuller and richer picture of a candidate's background; whether that candidate be an entity or individual. When you couple this with risk ranking it can lead to a more cost-effective approach to due diligence.

The regulators have made clear a check-the-box approach to due diligence is insufficient because it will not provide sufficient information as required by them. A company must rank its third parties based on a variety of factors such as where they are doing business, who they are doing business with, how they are doing business, financial strength and even political risks. The recent Vantage Drilling Co. FCPA enforcement actions drove home this need. The company's largest supplier was a drilling ship supplier who was so important to the organization that he was not only put on the Board of Directors but was also granted so much stock he became the largest single shareholder in the organization.

The problem was this supplier, Board of Director and shareholder, had lied to the company about his ability to deliver as he had no assets. A deep dive due diligence investigation was certainly in order for any of the roles he held during his relationship with the company. It would have revealed that he actually had no assets to provide to Vantage Drilling. Further, it would have also indicated a propensity to skirt ethical niceties such as not paying bribes in violation of the FCPA. The company paid a very high price for its due diligence failures.

***Part 3 - What Works and What Doesn't***

We next take up what works and what does not work in due diligence investigations today. Unfortunately most CCOs are working with limited information from their due diligence programs or due diligence providers. This means they do not have enough information to input into their risk assessment. As we previously explored, if a company is performing or having performed for them only a Level I due diligence, they may well only be uncovering up to 1% of the adverse information or raising the appropriate red flags. In a high-risk jurisdiction, Tal believes that if a company is not receiving up to 35% of the required information, they are really operating behind the 8-ball.

Moreover, relying on computer searches raises an amount of concern for other reasons. These include both shell companies and front offices. There are still situations that without a physical drive by of the third parties facilitates, the address may simply be a local postal box. The problem of shell companies still exists far beyond the initial dump of information past the Panama Papers and Paradise Papers. Even with a real physical address, if your third-party shares an address of a flat in London that also houses some 1,500 additional corporations, this is a serious red flag that you are dealing with a shell company. That in and of itself is a red flag which, if not cleared, could lead to a serious legal violation and a significant reputational hit to your organization.

Tal pointed to another area which is often missed which is the extended relationships between people in Latin America, where you can see a lot of family run enterprises. Tal stated, "A Level I due diligence will not pick up on this where one company is a family which may run multiple businesses. Some other business may be corrupt and the question becomes how does that impact the primary relationship? This can be a very important red flag that is being missed as the US Company may not even know who the real owners are going forward."

She added that if you do not have good information to begin with on the basics, such as a company name, you cannot research a matter correctly. A wrong company name can lead to a false negative. Due diligence might come back with no information about the company or it could come back with information on a different company, "so that's another type of issue for some Chief Compliance Officers to be concerned about." Of course the physical issue of whether a company actually exists or actually have employees working there can still be a problem as well.





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We next turned to a strategy which a CCO could employ to allow for a sufficient level of due diligence but with an eye towards doing so in a cost-effective manner. In other words, what should be your investment in due diligence? Tal said, "a very good strategy would be to do the Level I due diligence but consider adding to it by building in deep dives on media and the Internet." With such deeper dives a compliance professional can increase their due diligence yield to up to 35% more information than Level I can provide. This approach also allows for a quicker and more expeditious uncovering of red flags that might warrant more focused investigations. It can then allow a quicker clearing of red flags to move forward.

With a more long-term focus a CCO needs to perform due diligence on an ongoing basis. Even if a company has done a basic due diligence investigation, feel they have a solid compliance program around their third parties, internal controls and accounting provisions, recent enforcement actions mandate more due diligence and a review of your third parties more than every two to three years. The Panasonic Avionics enforcement action made clear that due diligence should be viewed as an ongoing process. Additionally, there has been and will continue to be political instability in various areas of the world. This political upheaval can mean you find yourself in a country now having to do business in a completely different manner. Both South Africa and Malaysia have had peaceful regime changes impacting whom you may have done business with and with whom you are doing business, therefore ongoing monitoring is really vital to a solid compliance program.

***Part 4 - M&A***

How can compliance related investigative due diligence in M&A protect companies from both financial loss and reputational damage? The disastrous Hewlett-Packard (HP) merger with the UK Company Autonomy Corporation PLC was back in the news recently when the former Autonomy CEO was indicted by a US grand jury for making false representations in the sale of his company to HP back in 2010 for $11.1 billion. Some 18 months later, HP threw in the towel and wrote off $8.8 billion from the failed merger of the two companies. HP has claimed that Autonomy, with the knowledge and participation of its senior management, actively misrepresented its financial statements. Former Autonomy executives claim that there was no misrepresentation, only the differences in US and UK accounting standards and that HP could have performed full due diligence on Autonomy but either did so negligently or failed to do so.

Tal noted that compliance due diligence in M&A is different than looking at numbers; it is a much deeper dive. Compliance due diligence investigations are an overriding term for a number of different aspects or applications of due diligence. There could be agent and distributor due diligence, vendor due diligence together with looking at the





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company and its operations, its financial information, its executives, its Board of Directors and senior management. She cautioned that in the past, many companies really do not look at the executives of a target, which can lead to multiple problems later on, in terms of FCPA violations and also shareholder losses, market losses and volatility at all levels.

She said that rarely do the purchasers look closely at the target's Board of Directors but that it can be an important inquiry from the compliance perspective. For instance, if the Board has any issues that the acquirer should be aware of which would impact or even dictate tone at the top; this could be critical information. It might not even be untoward information which could be uncovered in the deep dive due diligence on the Board. It could uncover potential conflicts of interest which are currently in place or could occur should the merger occur. Finally, such a due diligence on the target's Board could give the acquirer information on both the target's culture and what needs to be in the remediation plan after closing.

Certainly a deep dive due diligence should be performed on the target's CEO and senior management to see if there is anything in their past which could turn around and bite the acquirer after closing and integration. As Tal has previously noted, from her 30+ years of experience in performing deep dive investigations on senior executives, approximately 20% have significant issues in their background that were not known. Obviously, this can present serious problems to an acquirer if the risks manifest after the closing.

Tal turned to another topic she has developed through her years of work in this field, which she called "the investigative hunch." She said, "you expect to find certain pieces of information and you don't find it anywhere. The question is: what does that mean? Does it mean anything or is it something that's being covered up and potentially serious?" This example shines a light that there are many different aspects to investigative due diligence, particularly in M&A. Transactional due diligence is one part of compliance due diligence in the M&A context but it is only one part. Through a more robust, deeper dive due diligence you can begin to uncover both hidden and undisclosed information that can be found through both deep media and historical Internet searches. She concluded with "it's a much, much greater type of investigative analysis than simply Level I due diligence."

### *Part 5 - Global Investigations and Innovation*

In this final section, we consider how the changing nature of international anti-corruption compliance programs, through data privacy laws such as General Data Protection Regulation (GDPR), and technical innovations, such as Artificial Intelligence (AI), are prompting innovation in investigative due diligence. The rules around data privacy outside the US changed significantly when GDPR went live in May 2018.



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Now the state of California has passed data privacy legislation and many are lobbying the US government to enact a national standard. Issues in this arena are playing out literally in real-time. It is changing the manner in which information is obtained and transmitted.

Tal said the most significant aspect for investigative due diligence is "how we will investigate criminal activity". This is because of GDPR's right to be forgotten which is most often used by the criminal element to attempt to rescind data online. She noted that if there is a criminal conviction, such information may be prevented from being "forgotten" but if there is only a guilty plea or other resolution or simply a civil allegation, a fraudster or other nefarious actor may be able to hide the information by having it removed online.

We next turned to AI in investigative due diligence. She believes that AI will be a "game changer" in compliance. Massive data sets require some type of AI to sort through and analyze the information. She said this is particularly important for internal controls and accounting books and records provisions to identify massive fraud. This is yet another area which is still developing. Tal stated, "I'll frame that by saying at least in the next few years, there will still be a need for the traditional investigative approach that the boots on the ground, one where an investigator goes out and physically checks on facilities. Artificial intelligence is going to have limited ability to do that." While drones may become part of an investigators tool kit, Tal believes that AI will be used "in a similar way to most data aggregators today. They find about 80% of the information. Yet there will always be the remaining 20% which they cannot find and you will need human intervention on the investigative side."

Looking down the road to the veiled land of the future, Tal sees continued innovation facilitating investigative due diligence. While AI is more than simply on the horizon, she said it "is a tried and tested methodology that has existed for many years, in terms of how do you look for and locate shell companies." It is also true about finding information about people who are trying to deliberately hide information. The bottom line is some of these investigative techniques involve old-fashioned shoe leather or simply hard diligent investigative work and "that's not new". Yet AI and other technological tools can make investigations more efficient and more cost effective, while giving better results. At the end of the day, AI can be used to sharpen and hone the due diligence process.

Yet with all of this information, many compliance professionals become somewhat bewildered with data overload. They often receive a substantial amount of information but are not certain of what it might mean or even how to use the data. Tal responded that one of the things Infortal provides is both a summary of the factual findings and recommendations based on Infortal's investigative experience. It consistently helps a CCO to shape the data into their compliance program for continuous improvement. Further, one area of ongoing concern is conflicts of interest, in terms of both third parties and senior executives and even Board members.

We end by returning to where we began. A Level 1 due diligence investigation simply does not provide you enough actionable information, in many circumstances. Even if a CCO is cost-constrained, there are ways to move forward to a more rigorous due diligence investigation without breaking the bank. Infortal is well-positioned to help you in this process.

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