

Reputational and Integrity Due Diligence on Investors

HOW TO GUIDE



Columbia Center
on Sustainable Investment

A JOINT CENTER OF COLUMBIA LAW SCHOOL
AND THE EARTH INSTITUTE, COLUMBIA UNIVERSITY

INTRODUCTION

Reputational and Integrity Due Diligence

Reputational and Integrity Due Diligence (RIDD) is used by commercial entities to identify and mitigate the reputational and commercial risk associated with potential business partners, suppliers, customers and investors.

RIDD often forms part of the wider due diligence process encompassing financial, commercial and legal due diligence. Financial due diligence is the evaluation of the investor's financial stability, commercial due diligence is where the proposed project's commercial potential is evaluated, and legal due diligence typically requires the help of a qualified lawyer to assess that there are no legal risks, such as poorly drafted contracts.

This how-to-guide is designed to help governments engage with investors. It provides general advice for governments wishing to assess the commercial and reputational impact of a proposed investment, to evaluate any potential risks, and to get comfortable with investors as credible and reliable partners.*

Why should you conduct RIDD?

While RIDD is commonplace in the commercial world, it can also be used by host governments who are the recipients of Foreign Direct Investment (FDI) to assess the potential reputational and integrity risks posed by investors. Just like corporations, governments need to understand who the investors are, what impact the investment might have on their economy, environmental management, community and labor relationships and, importantly, any issues associated with the investors which raise concerns or require more information prior to the investment taking place. An RIDD process will touch on the investor's track record of environmental, social and governance (ESG) issues, but should not be confused with a project-specific environmental impact assessment (EIA) or a comprehensive ESG review.

Governments across the world are regularly approached by investors seeking to fund and develop major projects in strategic sectors which may contribute to economic development prospects. The potential socioeconomic and financial returns of FDI are often easier to quantify and understand than the potential downside risks.

Potential risks associated with the "wrong" FDI partners are significant. They include fraud and misuse of public funds; adverse impact on or displacement of other investors and participants in the economy; a breakdown in relations with lenders and development finance partners; non-completion and mismanagement of the project; negative public opinion both domestically and internationally; negative socio-economic externalities; macro-economic risk; tax abuse and lost tax revenues; and even costly legal action. While not a guarantee against such events, conducting basic RIDD checks prior to engaging with investors is a relatively easy and cost-effective step that a government can take to identify "red flags" at an early stage.

**This guide should not be interpreted as a definitive or comprehensive manual for conducting due diligence. Rather, it outlines suggested steps for governments prior to engaging with investors. This guide does not cover legal, commercial or financial advice which should be sought from appropriately qualified advisers. Elements of RIDD can – depending on specific circumstances – help with identifying legal, commercial, or financial risks.*

CCSI has long advocated in its training and advisory work for governments to perform due diligence on prospective investors. However, little guidance exists for governments on how to decide what level of due diligence is necessary, how to perform basic checks, and when to engage with third parties. CCSI has teamed up with Kroll to help fill this information gap with this guide.

Reputation

is the opinion that people have of someone or something, based on past behaviour or character.

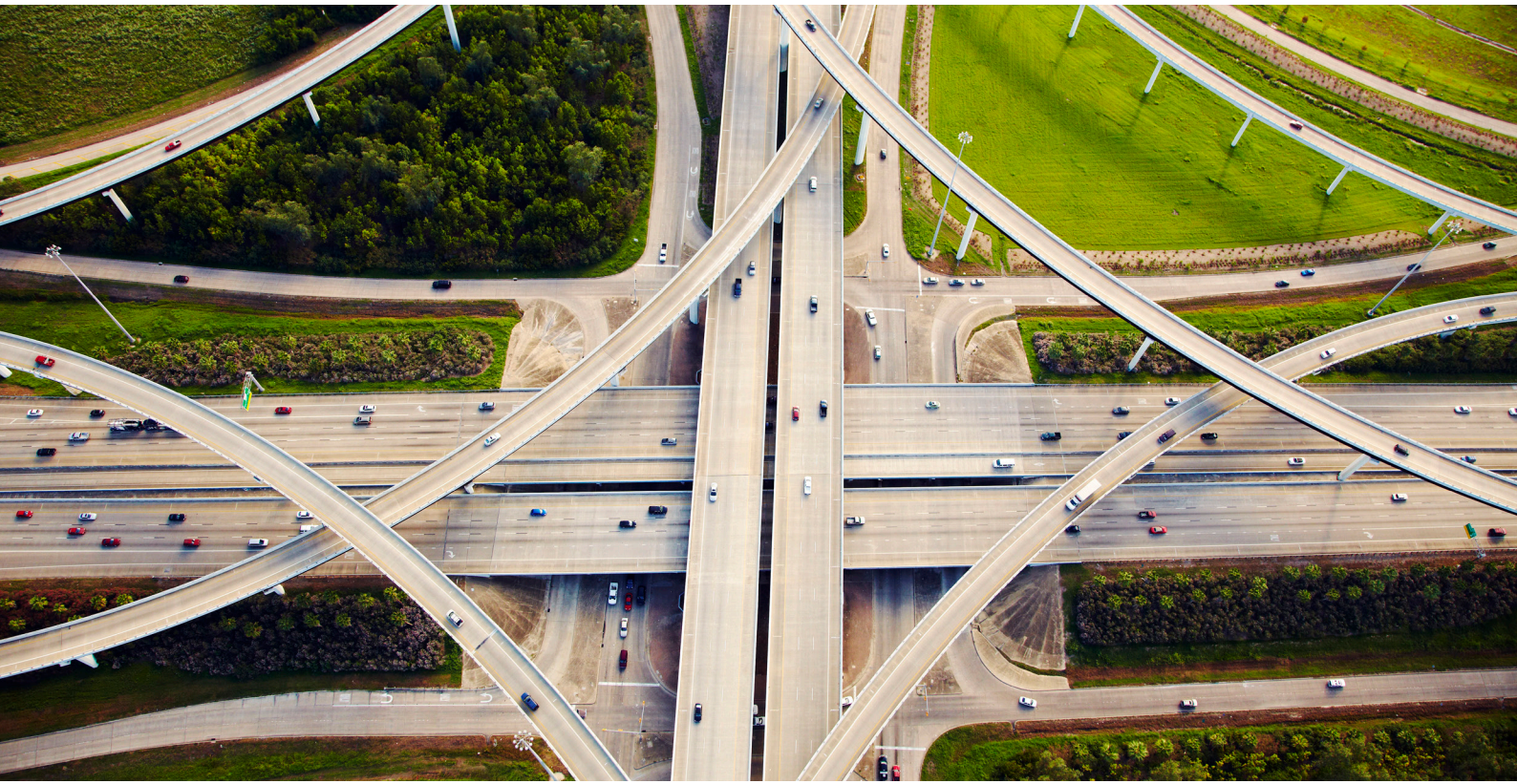
Integrity

is the quality of being honest and having strong moral principles that you refuse to change.

Due Diligence

is the action that is considered reasonable for people to take in order to keep themselves or others and their property safe.





How to decide when to conduct RIDD?

Each proposed investment and host country has its own set of specific circumstances. A process of prioritizing and triaging investment proposals will help to decide when to conduct RIDD.

Questions to consider include:

- Was the investor introduced through informal channels or an invitation by a politician or public official?
- Is the investor an individual, as opposed to an established commercial entity?
- Does the investor represent a sector or jurisdiction that has high levels of transparency and corruption issues and/or links to illicit and non-transparent activity more generally?
- Is the investor's home jurisdiction subject to international sanctions and/or is a relationship with the investor or investor's home country likely to cause tension with existing economic and political partners?
- Is the intended investment in a strategic sector for the national economy or related to areas such as national security, defence and critical infrastructure?
- Does the proposed investment require a significant and/or ongoing capital commitment from the host country at the local, regional or central level?
- Will the investment require a significant share of scarce resources and access to infrastructure grids?
- Is the investment likely to have a significant impact on the host country's Gross Domestic Product (GDP) and will it create subsequent vulnerabilities to exogenous economic shocks?
- Will the investment have a significant impact on the natural environment, areas of historical and biodiversity interest or the livelihoods of vulnerable members of society?
- Is the labour market requirement of the investment significant and will current market capacity be stretched to accommodate the needs of the investment?

If the answer to any of the above questions is YES, conducting RIDD is recommended, as detailed in the next section.

How to conduct 'basic checks'

In this section, we suggest a three-step process for identifying potential risks relating to investors without the need to engage third parties or have access to specialist resources. Depending on the results of this process, further RIDD measures may be appropriate, as detailed in the next section.

A defined process will allow each investment proposal to be evaluated methodically and consistently. This means that several proposals can be reviewed and compared in a selection process involving multiple propositions or bidders. An auditable process also allows for retrospective reviews.

1

Requesting Information

Your first step is to request information and documentation from the investor to better understand them.

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PURPOSE	EXAMPLE DOCUMENTS	ACTION	METHODOLOGY
Identifying key individuals behind the investor company: directors, shareholders and Ultimate Beneficial Owners (UBOs). ¹	Company documents (e.g. certified annual return) Share register	Verification of all available information in company documents, including registration number, incorporation date, contact details and information on directors, shareholders and UBOs. Individual investors may also provide personal information such as passport copies, date of birth, residence and other details.	In some countries such as the United Kingdom, it is possible to check company registration information for free through the official corporate registry online. ² Where this is not available, it may be possible to contact the local company registry and request documentation (for a fee). There are also free-of-charge online databases and directories which include basic details. Offshore jurisdictions typically do not disclose directors or shareholders.
Assessing the investor's background, including a track record in the market, ability to deploy capital, and investment history.	Investor presentation Recent annual report	Aspects to be considered include whether the investor/company has a website, whether the investor has an online presence indicating operations and activities as described by the investor, whether there are past projects discernible online which correspond to the investor's disclosed track-record. The investor may also have a presentation or information tailored to the proposed investment, including details of track-record, past comparable projects, credentials, financial and other details. These are often designed as "sales pitches"; the information should be viewed accordingly and verified.	For established companies and investors, much of this information should be visible through a basic internet search on the investor's name in the form of a company website, online news reports, company directories and other online resources. It may also be possible to call or email local business and trade associations or chambers of commerce, or even any proposed partners or funders.

1. The Extractive Industries Transparency Initiative ("EITI") Standard Requirements (2016) states that implementing countries should "maintain a publicly available register of the beneficial owners of the corporate entity(ies) that bid for, operate or invest in extractive assets", <https://eiti.org/document/eiti-standard-requirements-2016#r2-5>

2. Even in the UK, the enforcement of beneficial ownership registers is often limited, and those trying to obfuscate their ownership may file incorrectly despite the legal requirement.

PURPOSE	EXAMPLE DOCUMENTS	ACTION	METHODOLOGY
<p>Understanding the origin of the investor's funds.</p>	<p>Letter of credit Bank statement Letter of intent</p>	<p>Established national and international financial institutions, corporates, investment firms or other funders would be expected to provide information in the form of official, signed and/or authenticated documents. They may include financial statements (preferably audited), tax returns, bank statements and investment/securities account statements. Investors should be forthcoming with details of any lenders, financial backers or other funders if applicable. It may also be appropriate to request information on compensation and contractual arrangements for any individuals who act as introducers or facilitators on the proposed investment.</p>	<p>Details included in official documents such as the existence of a bank providing account statements or an auditor signing off on financial statements should be visible in the public domain, such as corporate websites or lists of certified auditors maintained by national professional associations/regulatory bodies.</p>
<p>Identifying any past legal or regulatory action taken against the investor.</p>	<p>Court documents Regulatory notices</p>	<p>Investors should be willing to disclose their involvement in any significant current/past legal proceedings, or if they have been subject to any regulatory action.</p>	<p>Legal proceedings are public in some countries, to varying degrees. International regulatory actions from authorities in countries such as the U.S. are often publicly available and readily searchable on the internet.</p>



2

Searching on the internet

Conducting internet research on the investor is highly recommended as a second step.

Information to look for includes: newspaper reports on failed projects, legal or business disputes with partners and allegations or rumours of wrong-doing such as corruption, bribery, money-laundering or other financial crime. Your review should take into account the reliability and credibility of any source of negative reporting. An allegation of wrong-doing made in a mainstream newspaper, for instance, should be taken more seriously than an anonymous post on an online forum.

This research can be done through search engines and by checking the websites of major national newspapers in the investor’s home jurisdiction. If there are many results, and you wish to focus on identifying negative information, you can combine the investor’s name with specific keywords (e.g. “dispute”, “corruption” or “scandal”).

You can also utilise other publicly accessible online resources which will vary by country and sector. They may include searchable databases of legal and bankruptcy proceedings, or official government gazettes and public bodies’ “blacklists.” International organisations such as the United Nations and the European Union also maintain websites with lists of sanctioned individuals and entities.

Some examples of commonly used free and paid tools include:

TYPE	EXAMPLES OF FREE RESOURCES	EXAMPLES OF PAID RESOURCES
Regulatory	Websites maintained by regulatory agencies are often free and searchable. For example: Financial Conduct Authority (UK) or Securities and Exchange Commission (U.S.); UN and EU sanctions lists	Databases which collate regulatory filings and notices by official bodies across the globe. For example: World-Check.
Litigation	The World Legal Information Institute maintains free online litigation filings for a variety of countries worldwide.	Litigation databases maintained by commercial entities. For example: Thomson Reuters.
News and journalism	News and journalism. Google and other search engines. Major newspaper websites (some paid-for newspapers also offer free trials). Social media platforms.	Commercial news aggregator databases. For example: Lexis-Nexis; Factiva Paid subscriptions to major international newspapers. For example: Financial Times (UK) or The Wall Street Journal (U.S.) Industry/sector-specific publications. For example: Mining Weekly
Corporate	Official national corporate registries are sometimes free and searchable. There are also free online aggregators. For example: Offshore Leaks; OpenCorporates	Commercial corporate record aggregators. For example: Bureau van Dijk (BvD)

You may have sector-specific requirements to fulfill and to check, for instance, mining code requirements which need to be satisfied before the granting of mining licences. RIDD does not replace these requirements but serves a complementary role in assessing reputational and integrity risk. There may also be requirements (or restrictions) specific to foreign investors, such as permitted ownership thresholds and local content obligations.

3

Reviewing information

Following the request for information and internet research, you should have enough information to begin your third step: reviewing all information gathered to decide whether further RIDD work is required.

Example questions that you could consider when deciding whether to do any further RIDD assessments include:

- Was the investor reluctant to provide requested information/ documents or was the request only partially fulfilled without a reasonable explanation?
- Was the identity of UBOs disclosed?
- Is the investor's ownership structure complex involving multiple corporate entities and/or companies incorporated in offshore jurisdictions without UBO disclosure?
- Were discrepancies found when verifying information/ documents (e.g. local corporate registry information indicates different owners and managers)?
- Is there a lack of information in the public domain (e.g. no evidence of claims made with regard to track-record or past projects or no identifiable corporate website)?
- Were inconsistencies identified when public domain information was compared with provided documents/ information (e.g. company appears to operate in a different sector or is registered in another country)?
- Was there any potentially adverse information found during internet searches (e.g. legal/business disputes with partners/ host governments, environmental damage, waste or misuse of public resources)?
- Is the investor identified as a Politically Exposed Person (PEP) but not acting on behalf of a government entity corresponding to his/her role or public function?

If the answer to any of the questions above is YES, it may be appropriate to consider engaging a third-party RIDD expert, as detailed in the next section.

It is also recommended to further engage with the potential investor to discuss any concerns or discrepancies identified and to request clarification and/or further documentation. For example, it may be that the omission of information was inadvertent and that further documentation clarifies an apparent discrepancy.

It is advisable to recheck the information provided by the investor periodically. This continued monitoring, which could be a Google News alert or requesting the investor for updated documents, could help uncover significant developments. For example, it could be that proposed funders have changed their financing conditions, withdrawn their backing or that new investors previously undisclosed to the host government have entered the project.

Example scenarios



Targeted internet research scenario

A mining company has approached you to bid for an exploration licence. You have never heard of the company and it has provided minimal information on its track-record and operations.

However, you notice during your detailed review of the company's documentation that it is registered in a neighbouring country and previously operated under a different name. You decide to check local newspaper websites and discover that, under its previous guise, the company was accused of obtaining a mining licence through corruption and selling it on for significant profits.



Request for information scenario

An international oil company is interested in drilling for oil in your country. The investor has disclosed to you a minor tax-related lawsuit in the U.S.

You decide to check this online and find references to the case on websites collating information on U.S. legal proceedings. In your review of these references, you discover many more legal proceedings relating to the same oil company.

You read further and find out that a class action suit is ongoing against the company following an oil spill. Industry publications are concerned about the company's ability to meet financial commitments due to anticipated significant compensation payments and have questioned the company's environmental policies and governance.

REPUTATIONAL AND INTEGRITY DUE DILIGENCE PROVIDERS

How to engage experts

In some cases, it may be appropriate to engage an expert RIDD provider. Providers can be identified on the internet, and established companies will have information on their websites detailing services, expertise and contact details. Some specialize in certain jurisdictions, regions and/or industries.

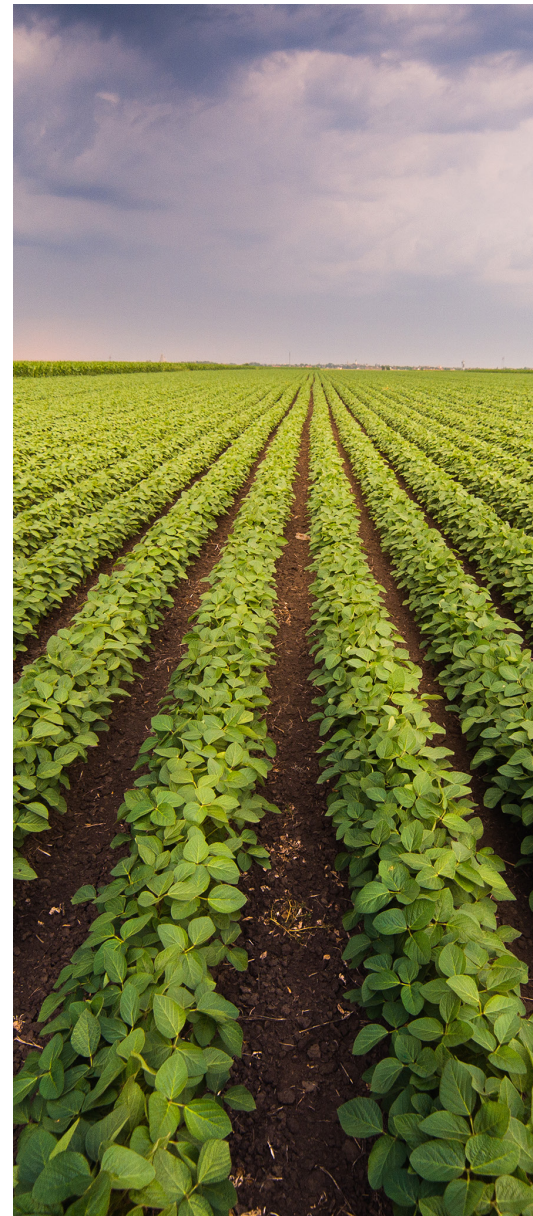
It is recommended that you request quotes for RIDD from at least three providers and compare information relating to the proposed scope of work, cost and methodology. You may also ask the providers for references and examples of similar assignments in the past. Providers should be willing to discuss such details and to offer tailored scopes of work to service the needs of the proposed investment. For example, in some cases, you may only need to engage a provider to address a specific question, as opposed to conducting a comprehensive RIDD.

The fees of third-party RIDD providers can be prohibitive, typically equating to a small percentage of the overall value of the proposed investment. It may be possible for the investor to cover the cost of RIDD or to incorporate such costs into any planned project expenditure, if appropriate.

While ad hoc requests for RIDDs on investors may be more cost-effective, larger volumes could attract economies of scale. A third-party provider may offer cost savings when requesting multiple RIDDs at the same time or through concluding a contractual arrangement, such as a master services agreement. If such approach is chosen, it is crucial that a diligent procurement process is followed. This could include asking for quotes from more than three service providers, reviewing the terms carefully to ensure that the proposals are comparable in terms of time spent on the due diligence reports by level of seniority, and putting in place clear deliverables and mechanisms to control costs once engaged.

Advantages of engaging a third-party RIDD provider include:

- Independent and at arm's length from the proposed investment
- Access to information, resources and specialist software tools
- Experience in interpreting results and findings
- Specialist industry, market and country knowledge
- Risk management and compliance expertise (e.g. anti-corruption and bribery)
- Advisory and consultation in risk/impact mitigation beyond RIDD



Engaging a third party



Scenario 1

You have found press reports saying that one of the directors of the investing company is close to the royal family of a Middle Eastern country. The financial documents provided by the investor show that it is owned by a complex structure involving companies located in Belize, Panama and the British Virgin Islands. When pressed, the company executives were reluctant to disclose the identity of the company's owner.

This investing company is looking to build a power plant which is strategic to your country's energy supply, and you worry about the implications of a foreign state having a hidden stake in this key industry. You decide that you should engage a third-party provider to do further research into this director and the ownership structure of the investing company.



Scenario 2

Your in-house research has identified negative information about a potential investor who wishes to develop a deep-water industrial harbour in a major port city. The investor's activities have historically been concentrated in Europe, and their only other comparable infrastructure project in your region attracted considerable criticism after the tender was allegedly awarded in a non-transparent manner and the project suffered from spiraling costs and construction delays.

You wish to find out more about this investor, but do not have the internal capacity to answer complex questions relating to the investor's market reputation and track record. You therefore choose to engage a third-party external provider who also has the capacity to collect information and commentary in the investor's home jurisdiction.



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CONTACT

Kroll, a division of Duff & Phelps
The Shard
Floor 14, 32 London Bridge Street
London SE1 9SG
krolluk@kroll.com

Columbia Center on Sustainable Investment
Jerome Greene Hall
435 West 116th Street
New York, NY 10027
ccsi@law.columbia.edu

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