TT CLUB
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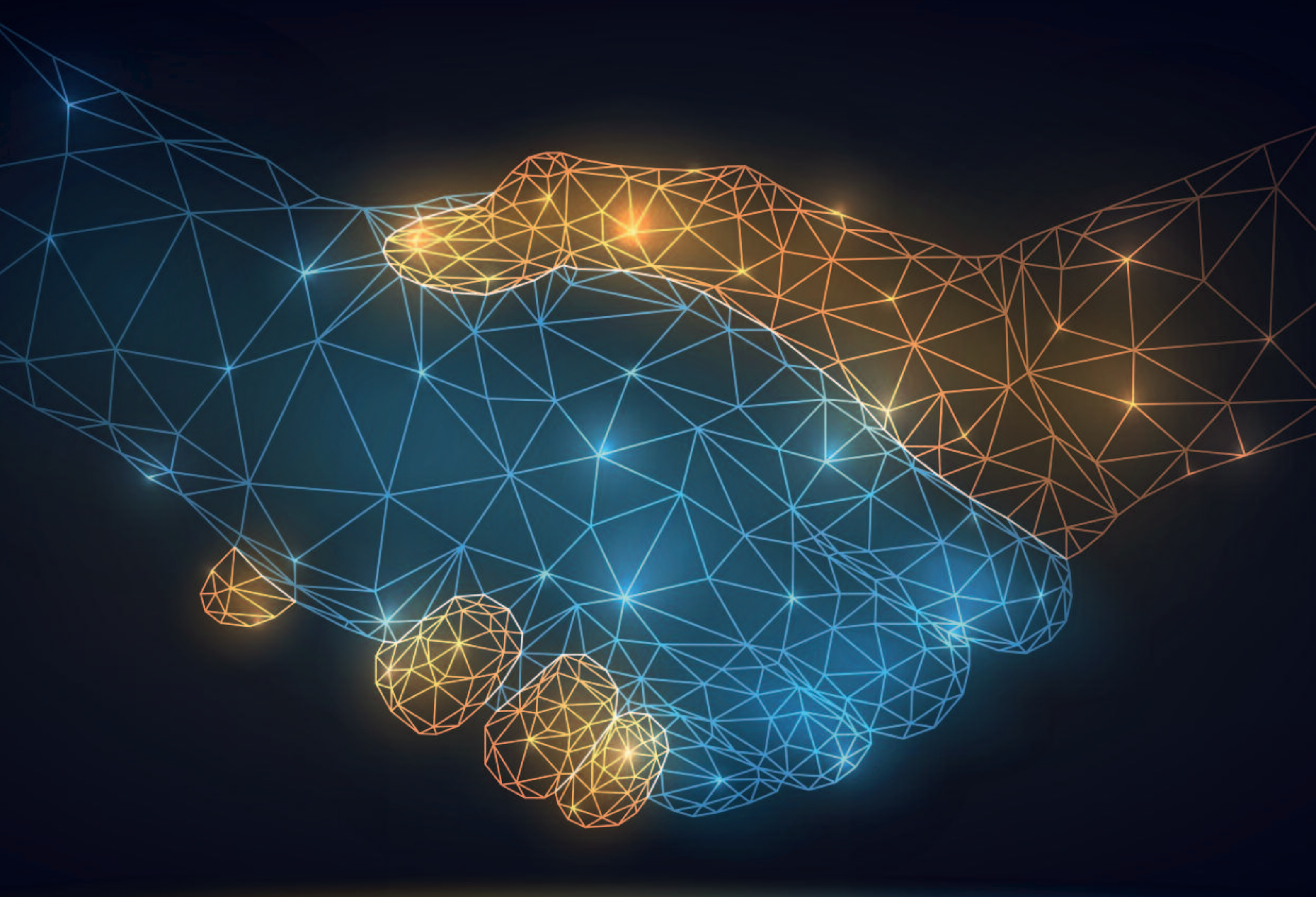
Due diligence

Increasing safety and security throughout the supply chain



TT CLUB
IS MANAGED
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Acknowledgements
The information contained in this StopLoss briefing has been formulated from the TT Club's experience. However, the Club would also like to thank BIFA for their assistance in the drafting of this briefing.

StopLoss series
StopLoss briefings are developed on a broad range of topics that give rise to recurring problems. They seek to provide a straightforward summary of an issue, essential good practice advice and, where applicable, sources of further information. The complete series and further information is available at www.ttclub.com/lossprevention and printed copies are available from the TT Club's Regional Centres.

The role of due diligence in mitigating risk throughout the supply chain

International trade and the global nature of the supply chain involve stakeholders frequently interacting with other parts of the world. Effective due diligence is increasingly important, whether providing a service or relying on another party to fulfil your obligations.

The world is becoming an ever smaller place, and demands on speed of service and response continue to increase. Electronic communications and trading portals, such as freight exchanges, may lead to informality in concluding contractual arrangements, potentially circumventing appropriate controls.

The range and complexity of services to fulfill a contract may include storage, haulage, consultancy or related functions, such as procurement or maintenance, through to local agency services where international movements are concerned.

Regardless of the services being tendered and whether contracting with a supplier on the other side of the world or in the same city, it is fundamental to know who you are contracting with, that they are a reputable company, that they are able to represent your interests appropriately, and importantly that they are a genuine, financially viable entity.

Performance of due diligence in the global supply chain is as important in relation to the individuals or entities for whom services are undertaken. It is a misconception that care only is required in relation to those on whom reliance is placed through the contractual chain.

Winning and retaining business present plenty of commercial challenges. New opportunities may be subject to prescriptive tender processes, while retention necessitates careful management of performance criteria and the broader commercial relationship.

There are a number of risk factors to be considered in relation to due diligence regardless of the actor in the supply chain. Steps need to be taken to be satisfied that any counter-party is competent to fulfil the necessary obligations, including those concerning safety and security. Commercially, it will be important to ensure timely payment, but also to understand the trading practices and applicable business culture. Equally, appreciate the nature and scope of incorporated contractual terms. It is also important to take account of international and national regulations relating to sanctions, financial crime, etc.

Take your time

The potential risks and exposures are generally heightened when actors are subjected to time restrictions and where one-off business transactions are in contemplation. Whether an urgent shipment for an unknown new customer or the need to sub-contract haulage to meet a tight delivery deadline, these are often the circumstances which may result in entities deviating from their standard operating procedures.

Where due diligence activities are concerned, the internet can be viewed as a great enabler, providing remote access to many key metrics under consideration here. However, care should be taken, recognising that internet pages may not be fully accurate (whether by omission or deliberately fraudulent); always think about what is presented and seek to cross-check information from trusted sources. Wherever possible, obtain original documents, conduct pre-contract negotiations over known landline phone numbers and verify email addresses. Thorough checks frequently pay dividends.

Whilst not exhaustive, this StopLoss focuses on processes to be considered by stakeholders to evaluate and manage counter-party relationships in ways that protect their business interests and mitigate the associated risk exposures.

SAFETY
Know your customer and the cargoes they tender, how they are packing them and that they are aware of and follow good practice, such as the CTU Code

REGULATORY
Protect your business by checking compliance of your counter-party in relation to safety and security

SECURITY
Verify the identity of your counter-party to combat theft and fraud, protecting your interests including reputation

COMMERCIAL
Take standard commercial steps to understand applicable conditions and law, and secure payment as required.

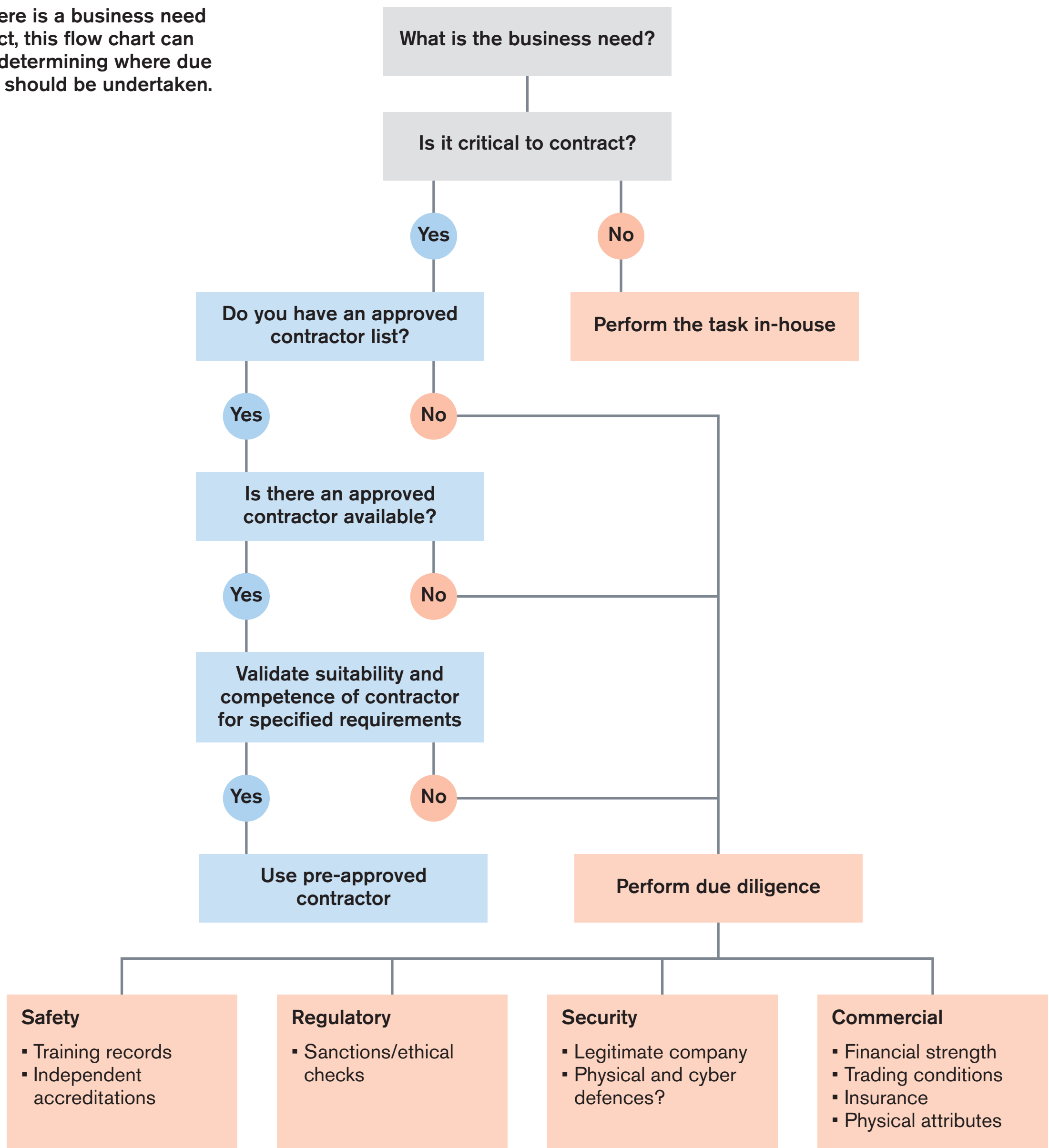
Due diligence when contracting

The starting point for any service tender process is to evaluate what services are required, identify the exact specification of all obligations and the requirements expected of the provider. Thereafter, accurately communicating with each counter-party is critical.

There are a number of key factors when considering contracting. Whilst it may appear excessive to document and implement formal procedures, even for relatively mundane tasks, the benefits are considerable. Such procedures underpin training and consistency, enable thorough review of accepted processes and empower defences in litigation.

- Identify the exact service to be provided
- Consider the competence of the counter-party to fulfill the obligations
- Consider the complexity of the task and whether any special requirements must be stipulated
- Consider both normal and peak volumes
- Consider the importance of the service to the customer's business
- What is the likely total spend by the customer?
- Review the market to identify alternative suppliers and ease/ability to change
- What would the impact be on your commercial relationship with your customer if the supplier was to fail?

Where there is a business need to contract, this flow chart can assist in determining where due diligence should be undertaken.



Key metrics for success

The due diligence process

Introduction
Once you have established exactly what services are required and in what volumes, and have undertaken the series of checks mentioned in the previous section, there is a need to search for a potential partner.

Once identified, due diligence checks should be undertaken in order to satisfy your business that the supplier is reputable, appropriately competent, has evidenced resources, has sufficient insurance in place and is capable of meeting your expectations. These due diligence checks are considered in greater detail later in this StopLoss.

Approval
The due diligence process should be designed in order that the results enable your business to approve or reject a potential supplier. Stakeholders use a variety of key criteria to qualify and approve suppliers, however it is prudent to adopt a standard, documented methodology which can be used in all cases. In the interests of constant improvement, such a procedure will provide consistency in approach and will in time allow your business to benchmark new suppliers against existing/past suppliers.

Audit
An adequate due diligence procedure includes, as a critical follow-through, the implementation of an audit system to monitor regularly the performance of the supplier to ensure that they continue to meet your expectations.

⚠ A change in ownership could be a signal that processes have changed and further due diligence is required.

The subject of due diligence necessarily encompasses the total scope of a relationship between different entities. Much attention is generally given to purely commercial matters; these are clearly important (and elements are included here) but the issues identified below are intended to initiate a more rigorous risk management assessment.

Safety

A prime concern for safety will be in relation to the assets and obligations that may be exposed to actions of other actors in the supply chain over which there may be lesser control. Where a direct contractual relationship is under consideration, there are certain checks that may assist in mitigating the risks.

Checking the approvals and accreditations in place for a counter-party are recommended and may provide additional verification of the identity and capability of the supplier; they may also provide an alternative route to trade referencing.

- Undertake checks (these may be done with applicable authorities) to ensure that the supplier meets regulatory requirements, such as:
  - Dangerous goods training (mobile and non-mobile personnel)
  - Driver licence qualifications
  - Operator's licence
- Does the supplier hold any governmental or industry recognised accreditations?
  - ISO certification
  - Authorised Economic Operator (AEO) / Customs Trade Partnership Against Terrorism (CTPAT)
- Is the supplier a member of any industry/trade associations?
  - National forwarding association
  - National warehousing association

The supplier should also be able to provide evidence of training records and describe operational procedures that demonstrate safe working practices and awareness of industry good practice.

⚠ Do you require your supplier to undertake activities which require specialist knowledge and qualifications? Movement/storage of dangerous goods – are the supplier's driving staff qualified or warehouse correctly accredited?

Regulatory

There needs to be a common understanding of the broad (and extensive) regulatory environment that will be applicable, not just in relation to the anticipated business relationship but also for general operations both nationally and internationally.

There is an overlap here with the *Safety* section above, for example in relation to UN dangerous goods regulations. Consideration is increasingly important in relation to sanctions, anti-money laundering, corruption, trafficking etc.

While specific checks will be required, general procedural controls are relevant.

- What documentary evidence can the supplier provide to demonstrate their operational business activities are cognisant of applicable regulations?

  These may include:
  - dangerous goods training records
  - ethical standards
  - general Health & Safety

Security

An initial stage of due diligence should be focused on verifying the supplier's identity. For most commercial transactions, there will be a series of already established formalities to be undertaken which will gather the information below as a matter of course.

Risk exposure increases where adhoc suppliers are appointed at short notice, thus challenging the ability to follow standard, documented procedures. Abbreviating checks is not recommended and, at the minimum, account should always be taken of international and national regulations relating to sanctions, financial crime etc.

Verify, as appropriate, what is in place for physical and cyber security.

Whilst not exhaustive, the following points should be considered:

- Full legal name and registered address of the supplier
- Details of other branches (nationally or internationally)
- Contact details (telephone and email)
- Web address
- The main activity of the supplier
- Verify ownership (taking account of regulations, such as sanctions, as appropriate)
- Legal form (limited company, sole trader, public limited company)
- Company registration number
- Tax (e.g. VAT) registration number
- Governmental or similar audit scheme (e.g. AEO) membership
- Key personnel and their roles
- Authority of the individual to sign on behalf of the supplier

⚠ Be wary if an unknown supplier only appears to use a mobile/cell number, a free email account and does not appear to have an established website.

Commercial

Various checks are relevant to verify the viability of entering a commercial relationship and to demonstrate the capability and competence of an entity to provide the required services.

Consider the following *general commercial* checks:

- Financial reports
- Copies of the latest annual accounts
- Use a credit rating agency to establish the credit worthiness of the supplier
- Consider trade references (are your competitors/peers also using this supplier?)
- Request evidence of insurance policies in place, including limits of liability, and validate with the insurer
- Where possible verify any warranties on the insurance policies
- Establish what terms and conditions are to be incorporated and ensure the liabilities and obligations are appropriate
- Ensure the terms of the supplier, where possible, do not leave you with an exposure (seek your own insurer's authority)

If the supplier is unwilling to discuss and provide information/evidence of insurance, beware. Question what their motivation is to hide this information.

Validation for the *services* to be provided may include:

- Define exactly what services are required and establish what will be provided
- Verify that the supplier is capable of meeting your expectations
  - Do they have sufficient physical resources?
  - Do they have a sufficient number of trained/competent personnel?
- Consider development of Key Performance Indicators (KPIs) and a Service Level Agreement (SLA) to monitor supplier performance
- Check the supplier's address through a web mapping tool to validate assertions, such as capacity or accessibility.

If you require large volumes of truck movements or provision of warehousing, can the supplier perform or will they simply sub-contract resulting in a reduction of control?

Due diligence for customers

At both initiation and on an on-going basis, due diligence checks in relation to your customers is important to protect the totality of the commercial relationship. While basics such as effective incorporation of your standard terms and conditions or simple credit-worthiness are important, more is at stake.

Your standard terms and conditions are a primary risk management tool and provides your business with protection and certainty in the event of a dispute.

Equally, all businesses should have a clear credit policy which is agreed at board level. Whilst the associated procedures will vary, for example dependant on the size and complexity of your business, it is good practice to establish a base procedure covering the essentials necessary for all customers.

Key metrics for success

Safety

Whatever services are to be provided, it should be recognised that a customer has the potential to compromise safety through the supply chain – and a contractor may face an exposure as a consequence.

While not exclusive, the supply chain most commonly involves the movement of goods internationally. As such, a supplier of transport services needs to be confident that the goods are correctly described in order for appropriate decisions to be made. Some relevant checks to be satisfied that your customer is acting safely could be:

- Ensure that the customer meets regulatory requirements (potentially with applicable authorities)
  – Dangerous goods training (mobile and non-mobile personnel)
  – Operational licence (e.g. product/producer authorisation)
- Does the customer hold governmental or industry recognised accreditations?
  – ISO accreditation
  – Authorised Economic Operator (AEO)
- Is the customer aware of and adopting the CTU Code?
- Is the customer a member of any industry/trade associations?
  – Commodity association (e.g. CEFIC)
- Can the customer evidence compliance with national health & safety regulations?

Regulatory

The key regulatory risk in relation to customers concerns identity (see below). There is also an overlap here with the *Safety* section above, for example, in relation to UN dangerous goods regulations.

In general, consideration may be given to:

- What documentary evidence can the customer provide to demonstrate their operational business activities are cognisant of applicable regulations?

  These may include
  – dangerous goods training records
  – ethical standards
  – general Health & Safety

Key due diligence should, however, be focused on verifying the customer's identity. Risk exposure increases where adhoc services are provided at short notice, thus challenging the ability to follow standard, documented procedures. Abbreviating checks is not recommended and, at the minimum, account should always be taken of international and national regulations relating to sanctions, anti-money laundering, corruption, trafficking etc.

Whilst not exhaustive, the following points should be considered:

- Full legal name and registered address of the customer
- Contact details (telephone and email)
- Website address
- The main (or registered) activity of the customer
- Verify ownership (taking account of regulations, such as sanctions, as appropriate)
- Legal form (limited company, sole trader, publically limited company)
- Company registration number
- Tax (e.g. VAT) registration number
- Governmental or similar audit scheme (e.g. AEO) membership
- Key personnel and their roles
- Authority of the individual to sign on behalf of the customer

⚠ Be wary if an unknown customer only appears to use a mobile/cell number, a free email account and does not appear to have a working website.

Security

While customers may not generally compromise security in relation to a supplier, it is worth recognising that activities for which the customer may take responsibility – such as tariff/customs declarations – may expose a supplier. Further, be alert to customers that may expose you in relation to narcotics, trafficking and counterfeit goods.

More generally, be alert to the potential that a customer may have inadequate cyber security in place.

Commercial

Various checks are relevant to verify the viability of entering a commercial relationship.

Consider the following *general commercial* checks:

- Financial reports
- Copies of the latest annual accounts
- Use a credit rating agency to establish the credit worthiness of the customer
- Request confirmation of any cargo insurance policies in place (where possible verify any warranties on the insurance policies)
- Verify acceptance of your standard terms and conditions

In relation to the *services* to be provided:

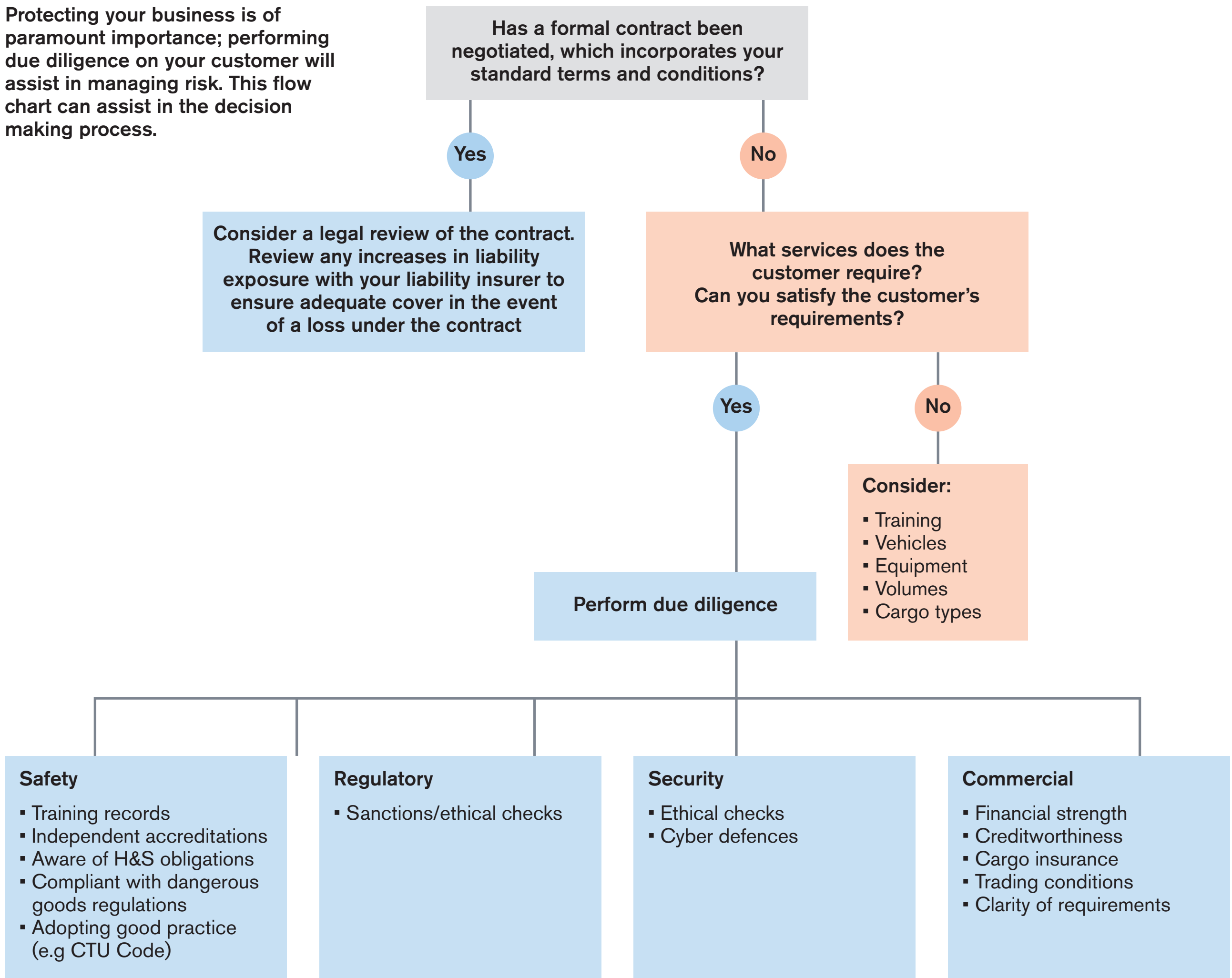
- Establish exactly what services are required and define what will be provided
- Verify that the services required realistically rest within any agreed credit limit
- Verify that you are capable of meeting your customer's expectations
  – Do you have sufficient physical resources?
  – Do you have sufficient number of trained/competent personnel?

Where *credit* is requested:

- Establish the reasons for credit to be required
- Verify how much credit is requested
- Confirm credit policies relating to Duty/Tax
- Detail credit policy timelines
- Obtain full banking account details, including IBAN and SWIFT codes where applicable
- Verify the identity and contact details of the person responsible for payments (mitigating the risk of mandate fraud)

⚠ Where cargo is to be transported, does your customer purchase cargo insurance? Does the customer fully appreciate the limits and exclusions in your STCs?

Protecting your business is of paramount importance; performing due diligence on your customer will assist in managing risk. This flow chart can assist in the decision making process.



If it seems too good to be true, then it probably is

All stakeholders inevitably take risks during the course of their business activities, this StopLoss seeks to provide a practical framework to empower those in positions of responsibility to minimise the associated risks.

In each business case the circumstances should be evaluated to assess the appropriate level of due diligence required, taking a risk-based approach.

The various strategies considered in this StopLoss generally rely upon a business having standard, documented procedures, underpinning effective internal control and escalation processes, together with a clearly defined line of authority for operational decision-making.

Contracting – Check, understand and evaluate

- Cargo theft – failure to follow your procedures/fraudulent hauliers stealing cargo
- Damage to cargo – inability to handle the subject cargo/lack of expertise
- Regulatory fines – non-compliance/lack of competence to undertake services (e.g. dangerous goods)
- Commercial penalties – inability to meet contractual obligations
- Reputational damage – negative impact on commercial relationship with your customer, e.g. through loss/damage of cargo

Customer – Check, understand and evaluate

- Non-payment for services
- Uncollected cargo exposures – low value cargoes/waste
- Reputational damage – anti-corruption and business ethics
- Liability exposures – complete and accurate understanding of commodities and service requirements

Other sources of information

- IMO Circular MSC.1/Circ.1531
- BIFA – A Guide to Minimising Supplier Risk
- BIFA – A Guide to Due Diligence Regarding Credit Application Procedures
- IMO/ILO/UNECE Code of Practice for Packing of Cargo Transport Units (CTU Code)
- United Nations Security Council Consolidated List
- Transparency International Corruption Perceptions Index

TT Club
TT Club is the international transport and logistics industry's leading provider of insurance and related risk management services. Established in 1968, the Club's membership comprises ship operators, ports and terminals, road, rail and airfreight operators, logistics companies and container lessors. As a mutual insurer, the Club exists to provide its policyholders with benefits, which include specialist underwriting expertise, a worldwide office network providing claims management services, and first class risk management and loss prevention advice.

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